MERCOSUR Report

2008 (Second Semester) - 2009 (First Semester)

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

Inter-American Development Bank
MERCOSUR Report N° 14, February 2010

Institute for the Integration
of Latin America and the Caribbean

REPORT

MERCOSUR

NUMBER 14
2008 (SECOND SEMESTER) - 2009 (FIRST SEMESTER)

Inter-American Development Bank
Integration and Trade Sector

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Published in Argentina

Institute for the Integration of Latin America and the Caribbean - IDB-INTAL
MERCOSUR Report N° 14
1ª ed. - Buenos Aires: IDB-INTAL. February, 2010.
150 p.; 28 x 21 cm.

ISBN: 978-950-738-287-1

1. Desarrollo Económico
CDD 338.9

Coordination and Editing: Susana Filippa

PRESENTATION

Since 1996, the annual MERCOSUR Report has accompanied the most salient developments in the economies and trade of this regional entity founded by the 1991 Treaty of Asunción. The work presented here belongs to a broader framework of activities carried out by the Inter-American Development Bank (IDB), and is intended to examine and strengthen the regional and multilateral integration processes of Latin America and the Caribbean.

IDB/INTAL's objective in publishing this annual series is to observe and analyze the economic evolution of MERCOSUR over the months covered by the Report. The selection of issues and approaches takes into account a wide and varied audience -academia, the public and private sectors, and civil society at large- which has, over all these years, kept interest in this publication.

Report 14 covers the period between the second half of 2008 and the first half of 2009. Chapters I and II were produced at IDB/INTAL by Alejandro Ramos and Rosario Campos, and coordinated by INTAL Director, Ricardo Carciofi. The first draft of Chapters III, IV, and V was produced by a team of consultants led by Ricardo Rozenberg and made up of Osvaldo Nusshold, Marcelo Onesto, and Alejo Espora. The Integration and Trade Sector (INT), headed by Antoni Estevadeordal, also helped with the design and content of the work. Ricardo Carciofi undertook the general coordination and edition of the Report in collaboration with Alejandro Ramos and Rosario Campos.

In line with previous issues valuable comments and suggestions are most welcome. Readers are once again kindly invited to send in their views to *pubintal@iadb.org* in order to improve the scope and content of the Report.

ABBREVIATIONS & ACRONYMS

$	Argentine *peso*
1st H	first half
1st Q	first quarter
2nd H	second half
a.a.	cumulative annual
AFJP	Retirement and Pension Fund Administrator *(Administradora de Fondos de Jubilaciones y Pensiones)*
AIG	American International Group, Inc.
AL	automatic licensing *(licencias automáticas)*
ALICE-Web	Internet-Based Foreign Trade Information Analysis System *(Sistema de Análise das Informações de Comércio Exterior via Internet)*
ANCAP	National Administration of Fuels, Alcohol, and Portland *(Administración Nacional de Combustibles, Alcohol y Portland)*
Art.	Article
ASEAN	Association of Southeast Asian Nations
ATPDEA	Andean Trade Promotion and Drug Eradication Act
BCB	Central Bank of Brazil *(Banco Central do Brasil)*
BCP	Central Bank of Paraguay *(Banco Central de Paraguay)*
BCRA	Central Bank of the Argentine Republic *(Banco Central de la República Argentina)*
BCU	Central Bank of Uruguay *(Banco Central de Uruguay)*
BCV	Central Bank of Venezuela *(Banco Central de Venezuela)*
BIUNILA	Federal University of Latin-American Integration Library *(Biblioteca Universidad Federal de la Integración Latinoamericana)*
BNDES	National Economic and Social Development Bank *(Banco Nacional de Desenvolvimento Econômico e Social)*
BOE	Bank of England
BoJ	Bank of Japan
BRIC	Brazil, Russia, India, and China
BsF	Venezuelan bolivars
CADIVI	Commission of Foreign Exchange Administration *(Comisión de Administración de Divisas)*
CARICOM	Caribbean Community and Common Market
CCM	MERCOSUR Trade Commission *(Comisión de Comercio del MERCOSUR)*

CCMASM	MERCOSUR Coordination Commission for Social Affairs Ministers *(Comisión de Coordinación de Ministros de Asuntos Sociales del MERCOSUR)*
CCR	Agreement on Reciprocal Payments and Credits *(Convenio de Pagos y Créditos Recíprocos)*
CET	Common External Tariff
CIF	Cost Insurance and Freight
CMC	Common Market Council *(Consejo del Mercado Común)*
CNCE	National Foreign Trade Commission *(Comisión Nacional de Comercio Exterior)*
CPB	CPB Netherlands Bureau for Economic Policy Analysis
CPI	Consumer Price Index
CRPM	Commission of Permanent Representatives of MERCOSUR *(Comisión de Representantes Permanentes del MERCOSUR)*
Dec.	Decision
DeTIEC	Technology development, Innovation and Conformance Assessment *(Desarrollo Tecnológico, Innovación y Evaluación de la Conformidad)*
DGEEC	General Directorate of Statistics, Surveys, and Censuses *(Dirección General de Estadísticas, Encuestas y Censos)*
DLSP	Public Sector Liquid Debt *(Dívida Líquida do Setor Público)*
ECA	Economic Complementation Agreement
ECB	European Central Bank
ECLAC	Economic Commission for Latin America and the Caribbean
ECPI	Extended Consumer Price Index
EU	European Union
EUROSTAT	Statistical Office of the European Communities
FAF	MERCOSUR Family Farming Fund *(Fondo de Agricultura Familiar del MERCOSUR)*
FDI	Foreign Direct Investment
FED	Federal Reserve
FOB	Free On Board
FOCEM	MERCOSUR Structural Convergence Fund *(Fondo para la Convergencia Estructural del MERCOSUR)*
FONDEN	National Development Fund *(Fondo de Desarrollo Nacional)*
FSB	Financial Stability Board
FSF	Financial Stability Forum
FUNCEX	Foreign Trade Study Center Foundation *(Fundação Centro de Estudos do Comércio Exterior)*
G-20	Group of Twenty
G8	Group of 8

GAHCAM	*Ad Hoc* Group for Drafting the MERCOSUR Customs Code *(Grupo Ad Hoc para la redacción del Código Aduanero del MERCOSUR)*
GANREL	High-Level Group on Institutional Relations between the CMC and the MERCOSUR Parliament *(Grupo de Alto Nivel sobre la Relación Institucional entre el CMC y el Parlamento del MERCOSUR)*
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GIP	Productive Integration Group *(Grupo de Integración Productiva)*
GMC	Common Market Group *(Grupo del Mercado Común)*
IBGE	Brazilian Institute of Geography and Statistics *(Instituto Brasileiro de Geografia e Estatística)*
ICTSD	International Center for Trade and Sustainable Development
IDB	Inter-American Development Bank
IDB/INTAL	Institute for the Integration of Latin America and the Caribbean
IFI	International Financial Institutions *(Instituciones Financieras Internacionales)*
IMEA	MERCOSUR Institute of Advanced Studies *(Instituto MERCOSUR de Estudios Avanzados)*
IMF	International Monetary Fund
INDEC	National Institute of Statistics and Censuses *(Instituto Nacional de Estadísticas y Censos)*
INE	National Statistics Institute *(Instituto Nacional de Estadística)*
IPEA	Institute of Applied Economic Research *(Instituto de Pesquisa Econômica Aplicada)*
IPI	Industrial Product Tax *(Imposto sobre Produtos Industrializados)*
IPI	Implicit Price Index
ISM	MERCOSUR Social Institute *(Instituto Social de MERCOSUR)*
kg	kilogramo
LAIA	Latin American Integration Association
LEBAC	Central Bank accounts *(Letras del Banco Central)*
LPG	Liquefied Petroleum Gas
MAC	Competitive Adaptation Mechanism *(Mecanismo de Adaptación Competitiva)*
MAPEO	Structural Convergence Needs Identification in MERCOSUR *(Identificación de Necesidades de Convergencia Estructural en el MERCOSUR)*

MDIC	Ministry of Development, Industry, and Foreign Trade *(Ministério de Desenvolvimento, Indústria e Comércio Exterior)*
MECON	Ministry of Economy and Production *(Ministerio de Economía y Producción)*
MERCOSUR	Southern Common Market *(Mercado Común del Sur)*
n.a.	not available
NAFTA	North American Free Trade Agreement
NAL	non-automatic licensing *(licencias no automáticas)*
NCM	MERCOSUR Common Nomenclature
NGO	Non-Governmental Organization
NOBAC	Central Bank Notes *(Notas del Banco Central)*
NTB	Non-tariff barriers
OECD	Organisation for Economic Cooperation and Development
p.	page
PAC	Common Automotive Policy *(Política Automotriz Común)*
PAC	Common Tariff Policy *(Política Arancelaria Común)*
PAC	Growth Acceleration Program *(Programa de Aceleração do Crescimento)*
PAMA	MERCOSUR Foot-and-Mouth Disease-Free Action Program *(Programa de Acción MERCOSUR Libre de Fiebre Aftosa)*
PDVSA	Venezuela Petroleums Inc. *(Petróleos de Venezuela Sociedad Anónima)*
pp.	pages
PPT	*Pro Tempore* Presidency
R$	Brazilian *real*
RMADS	Meeting of MERCOSUR Social Development Ministers and Authorities *(Reunión de Ministros y Autoridades de Desarrollo Social del MERCOSUR)*
RTIN	Technical Meeting for the Incorporation of the MERCOSUR Regulatory Framework *(Restricciones no Arancelarias Reunión Técnica de Incorporación de la Normativa MERCOSUR)*
SACU	South African Customs Union
SADC	South American Defense Council *(Consejo de Defensa Sudamericano)*
SCA	Special Customs Areas
SDR	Special Drawing Rights
SEBRAE	Brazilian Service of Support for Micro and Small Enterprises *(Serviço Brasileiro de Apoio às Micro e Pequenas Empresas)*

SECEX-MDIC	Secretariat of Foreign Trade-Ministry of Development, Industry, and Foreign Trade *(Secretaria de Comércio Exterior-Ministério do Desenvolvimento, Indústria e Comércio Exterior)*
SELIC	Special System for Settlement and Custody *(Sistema Especial de Liquidação e Custodia)*
SICA	Central American Integration System *(Sistema de Integración Centroamericana)*
SM	MERCOSUR Secretariat *(Secretaría del MERCOSUR)*
SMEs	Small and Medium Enterprises
SML	Local Currency Payment System *(Sistema de Pagos en Moneda Local)*
SNB	Swiss National Bank *(Banque Nationale Suisse)*
TIC	Trade and Investment Council
TIFA	Trade and Investment Framework Agreement
TM	Treaty of Montevideo
TPR	MERCOSUR Permanent Review Tribunal *(Tribunal Permanente de Revisión del MERCOSUR)*
UN	United Nations
UNASUR	Union of South American Nations
UNILA	Federal University of Latin American Integration *(Universidad Federal de la Integración Latinoamericana)*
US$	US dollar
USA	United States of America
UTE	National Administration for the Generation and Transmission of Electricity *(Administración Nacional de Usinas y Transmisiones Eléctricas)*
UT-FOCEM/SM	FOCEM Technical Unit/MERCOSUR Secretariat *(Unidad Técnica FOCEM/Secretaría del MERCOSUR)*
var.	variation
VAT	Value Added Tax
WTO	World Trade Organization

MERCOSUR'S INSTITUTIONAL FRAMEWORK

COMMON MARKET COUNCIL (CMC)

MINISTERIAL MEETINGS

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

GROUPS

- *Ad Hoc* High Level Group for Institutional Reform (GANRI)
- High Level Group for MERCOSUR Employment Growth Strategy (GANEMPLE)
- High Level Group to Examine the Consistency and Dispersion of the Current Structure of the CET (GANAEC)
- High Level Group for the Elaboration of the Strategic Plan to Overcome Asymmetries in MERCOSUR (GANASIM)
- High Level Group for the Elaboration of a South-South Cooperation Program (GANASUR)
- High Level Group on Intitutional Relations between the CMC and the MERCOSUR Parliament (GANREL)
- *Ad Hoc* Working Group for the Incorporation of the Republic of Bolivia as a MERCOSUR State Party (GTBO)
- Working Group for the Negotiation of the Membership Process of the Bolivarian Republic of Venezuela (GTVENE)

COMMISSION OF PERMANENT REPRESENTATIVES OF MERCOSUR (CRPM)

COORDINATION COMMISSION FOR MERCOSUR SOCIAL AFFAIRS MINISTERS (CCMASM)

POLICY CONSULTATION AND CONSENSUS-BUILDING FORUM (FCCP)

- Working Group on Firearms and Munitions
- Working Group on Legal and Consular Affairs
- Working Group on the Prevention Weapons of Mass Destruction Proliferations
- *Ad Hoc* Working Group on the Common Regsitration of Motor Vehicles and Drivers

MEETING OF HIGH AUTHORITIES IN THE AREA OF HUMAN RIGHTS (RADDHH)

- Institute for Public Human Rights Policies (IPPDDHH)

COMMON MARKET GROUP (GMC)

WORKING SUBGROUPS

- Communications (SGT N° 1)
- Institutional Aspects (SGT N° 2)
- Technical Regulations and Conformance Assessment (SGT N° 3)
- Financial Affairs (SGT N° 4)
- Transport (SGT N° 5)
- Environment (SGT N° 6)
- Industry (SGT N° 7)
- Agriculture (SGT N° 8)
- Energy (SGT N° 9)
- Labor Affairs, Employment, and Social Security (SGT N° 10)
- Health (SGT N° 11)
- Investments (SGT N° 12)
- E-Business (SGT N° 13)
- Mining (SGT N° 15)

SPECIAL MEETINGS

- Family Farming (REAF)
- MERCOSUR Film and Audiovisual Authorities (RECAM)
- Application Authorities in Drugs, Prevention of Drugs Abuse, and Drug Renovation (RED)
- Science and Technology (RECyT)
- Social Communication (RECS)
- MERCOSUR Cooperatives (REC)
- Official MERCOSUR Ombudsmen (REDPO)
- Integration Infrastructure (REII)
- Youth (REJ)
- Women (REM)
- MERCOSUR Public Ministries (REMPM)
- Internally Controlled Government Organizations (REOGCI)
- MERCOSUR Joint Trade Promotion (REPCCM)
- Tourism (RET)
- Government Entities for Nationals Resident Overseas (REEG)
- Specialist Meeting on Socionatural Disaster Risk Reduction, Civil Defense, Civil Protection and Humanitarian Aid (REHU)

AD HOC GROUPS

- "MERCOSUR Structural Convergence Fund' Experts (GAHE-FOCEM)
- MERCOSUR Customs Code (GAHCAM)
- Concessions (GAHCON)
- Consultation and Coordination for WTO and SGPC Negotiations (GAH OMC-SGPC)
- External Networking (GAHRE)
- Sanitary and Phytosanitary (GAHSF)
- Sugar Sector (GAHAZ)
- Agricultural Biotechnology (GAHBA)
- Cigarette Trade in MERCOSUR (GAHCC)
- Border Integration (GAHIF)
- Toward a Regional Policy on Tires, including Retreaded and Used (GAHN)
- Biofuels (GAHB)
- MERCOSUR Support Fund for Small and Medium Enterprises (GAHFPME)
- Capital Goods, and Information Technology and Telecommunications Goods Sectors (GAH BK/BIT)
- MERCOSUR Domain (GAHDM)

MERCOSUR TRAINING INSTITUTE (IMEF)

MERCOSUR OBSERVATORY FOR DEMOCRACY (ODM)

MERCOSUR LABOR MARKET OBSERVATORY (OMTM)

CONSULTATIVE FORUM OF MERCOSUR MUNICIPALITIES, FEDERATED STATES, PROVINCES, AND DEPARTMENTS (FCCR)

GROUPS

- MERCOSUR Public Contracting Group(GCPM)
- MERCOSUR Production Integration Group (GIP)
- Services (GS)
- SAM Budgetary Affairs Group (GAP)

MERCOSUR SOCIAL LABOR COMMISSION (CSLM)

COMMITTEE

- Automotive Committee (CA)
- MERCOSUR Technical Cooperation (CCT)

TECHNICAL MEETING FOR THE INCORPORATION OF THE MERCOSUR REGULATORY FRAMEWORK (RTIN)

MERCOSUR TRADE COMMISSION (CCM)

TECHNICAL COMMITTEES

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

MERCOSUR PARLIAMENT (PM)

SOCIAL AND ECONOMIC CONSULTATIVE FORUM (FCES)

MERCOSUR SECRETARIAT (SM)

MERCOSUR PERMANENT REVIEW TRIBUNAL (TPR)

MERCOSUR ADMINISTRATIVE AND LABOR TRIBUNAL (TAL)

MERCOSUR CENTER FOR THE PROMOTION OF DEMOCRACY (CMPED)

MERCOSUR Observatory for Democracy (ODM)

Source: Official MERCOSUR Portal *http://www.mercosur.int* (own translation).

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EXECUTIVE SUMMARY

The period covered by *MERCOSUR Report 14* (July 2008-June 2009) was marked by the international crisis. The inflationary phase of the crisis (August 2007-June 2008) fuelled certain expansionary trends in MERCOSUR countries. Once this phase had run its course, MERCOSUR's performance began to feel the negative effects of the world economy. As of the fourth quarter of 2008, the collapse of activity levels and global trade, falling commodity prices, and financing difficulties were reflected in recessionary trends within the bloc. However, as of March 2009, there were clear signs of stabilization in the world economy, if not of outright recovery. This marks a shift in the international scenario compared to the previous period.

Macroeconomic overview: The deepening of the international crisis in the last quarter of 2008 had a significant impact on the economies of MERCOSUR, especially in the private sector: activity and employment levels fell, bringing to a close the expansionary phase that began in 2002-2003. The adjustment in activity levels was due to falling exports and private investment, while imports also contracted significantly. The fall in imports avoided a balance of payments crisis, marking a significant difference with recent episodes. Although most countries saw significant capital outflow, this was in fact the result of a flight-to-quality in investment portfolios caused by the international context and not of a sudden stop in external creditor financing. The accumulation of reserves was crucial in stabilizing the exchange market and reducing uncertainty. The public sector, which had been seeing primary surpluses, had in several cases some initial capability of responding to the crisis. Again in contrast to other episodes in the past, the role of international financial cooperation was outstanding, helping MERCOSUR not just indirectly by shoring up the global economy, but also by benefiting the largest economies in the bloc through currency swaps that strengthened liquidity, thus reducing uncertainty in the local markets. It is estimated that the average activity levels of the bloc's economies in 2009 may be 0.4% up on 2008, a not insignificant detail keeping in mind the unprecedented degree of adversity displayed at times by the external situation. In the future, however, the problem lies in the potency of the forces driving the recovery of private investment in a world context likely to remain challenging.

The evolution of trade and foreign direct investment (FDI): Until the deepening of the crisis, MERCOSUR's global trade balance had been eroded by the acceleration of imports. In the last quarter of 2008, exports from MERCOSUR countries slowed sharply and contracted during the first half of 2009, though they did perform better than the world average. This is partly explained by the growing importance of Asia (particularly China, where the government implemented a huge stimulus package) as a destination of MERCOSUR sales: demand in these markets continued to expand or declined less than those at the epicenter of the financial crisis. The significant shortfall in external purchases in Argentina and Brazil during the first half of 2009 is explained by a steeper drop in quantities than prices, the shortfall in prices being more significant in the case of Uruguay. Since 2003, it should be remembered, the MERCOSUR countries have steadily increased their share in world exports, uninterrupted by the crisis. This process has involved both an increase in extrabloc sales and those to other MERCOSUR partners. It is worth nothing that, measured at constant prices, exports from Argentina and Brazil to the bloc in 2008 were almost 60% higher than a decade ago. The bloc's trade with Venezuela continued to rise in 2008, reaching US$8.6 billion. FDI flows to MERCOSUR that year hit a record US$56 billion. In the first part of 2009, however, they slowed amid the complicated world financial situation.

The internal agenda: Consonant with the deepening of the international crisis, Argentina and Brazil launched the Local Currency Payment System (SML) and their governments promoted an initiative to implement a currency swap pending approval by the Central Banks. Other measures from the bloc in response to the crisis include the formation of a Technical Support Group to monitor extrazone trade flows and the exchange of proposals to generate flexible amendment mechanisms for the Common External Tariff (CET). In parallel to this, the internal agenda during the Brazilian and Paraguayan *Pro Tempore* Presidencies included the institutional and operational strengthening of the MERCOSUR Structural Convergence Fund (FOCEM), notable in which was its use in productive integration projects (FOCEM II). A timetable for liberalizing trade in services was set, progress was made in the discussions over the MERCOSUR Secretariat's institutional reform, in the Parliament's citizen representation, and in the structure of the MERCOSUR Social Institute. The problems involved in the elimination of double levying of the CET, the distribution of customs revenue, and the definition of a MERCOSUR Customs Code were not resolved. The process of Venezuela's membership of the bloc is not yet complete.

Sectoral tensions and disputes: The contraction of intra and extrabloc trade flows revived old trade tensions in sectors considered sensitive, reversing the trend toward fewer tensions and disputes seen up to mid-2007. Implemented trade defense measures included the use of non-automatic licensing (NAL) on imports of any origin (including MERCOSUR), the spread of the use of "criterion values" by customs, and the application of antidumping duties. However, the impact on trade through various types of administrative barriers did not differ significantly from other historic periods. Certainly, the difficulty was demonstrated of channelling trade tensions at MERCOSUR level through formal instruments like the Competitive Adaptation Mechanism (CAM), which did not come into force, despite having been agreed in 2006. Nevertheless the growing competition from China as a potential common threat helped bring stances in certain sectors of Argentina and Brazil closer. Brazilian exporters agreed to self-regulate their sales to the partner country through voluntary bilateral agreements between private sector individuals to ensure a given market share. The new agreements on Itaipú between Brazil and Paraguay meant a breakthrough in the settlement of a historic dispute between the two partners.

The external agenda: The change in the international scene shifted the focus of the issues on the external agenda to those necessitated by the crisis. Brazil and Argentina participated in the G-20 meetings as members and were also involved in the innovative international liquidity provision schemes via swaps agreed with the US Federal Reserve and the People's Bank of China respectively. The main developments in the traditional external agenda centered on initiatives already under way, especially with other developing economies. This tended to deepen the South-South profile of the external agenda, which included the entry into force of the Fixed Preference Agreement with India -modest in scope, but of strategic significance- and the signing of another such instrument with the South African Customs Union (SACU). Uruguay and the US signed additional protocols under the Trade and Investment Framework Agreement.

Contents

CHAPTER I. MACROECONOMIC OVERVIEW

A. The international scene

Signs of stabilization and uncertainty in the world economy

Toward mid-2009, there were signs of stabilization in the world economy after the serious deterioration the previous year, tentatively described by several analysts as "the Great Recession". The name points to similarities and differences with the 1930s: while the contraction of global indicators of industrial production, trade, and stock exchanges after the deepening of the crisis in late 2008 was more serious than the Great Depression (Eichengreen O'Rourke [2009]), the prolonged depressionary and deflationary spiral of those years seems to have been avoided. Different conceptions of economic policy and the consequent rapid implementation of extraordinary fiscal and monetary stimulus packages in developed and developing countries alike mark the difference between present and past. The effective functioning of international financial cooperation mechanisms and the coordination of the major economies -including the emerging ones- designed to avoid financial collapse are an outstanding feature of this change. The evidence for a strong recovery and the start of an expansionary phase is, however, less clear. In the second quarter of 2009, annualized quarterly GDP variation rates in the major developed countries were positive or close to zero, after consecutive and increasingly steep declines over the three or four previous quarters. US GDP in this period contracted by 0.7%, the Euro Zone's by 0.4%, and Japan's grew by 3.7%; preliminary estimates for the US forecast 3.5% growth in the third quarter. At the same time, the slowdown in the Chinese economy since 2007 was interrupted during the first half of 2009 (see Graph 1).[1] In contrast, the situations of Eastern European countries -whose GDP may drop 5% in 2009 (International Monetary Fund [2009c])- and some Latin American and Caribbean countries show less clear prospects of recovery.

World trade volumes and prices also began to show signs of stabilizing after the historic contraction of a few months ago. In July, the quarterly moving averages for the monthly rates of variation of these variables were both 1.2% (see Graph 2). As is well-known, the global financial system had been experiencing unusual tension and uncertainty since mid-2007, marked by several waves of panic culminating in the paralysis of key markets and the bankruptcy or rescue of symbolic institutions between September and October 2008.[2] The freefall of the prices of assets such as shares and commodities was interrupted in March 2009 after massive monetary and fiscal intervention by the US authorities and the world's leading economies. In May 2009, the quarterly moving average of the home price index in 20 metropolitan areas in the United States showed zero growth, rising 0.7% in June.[3] This was significant because the deflationary pressures in this market were the trigger for the financial crisis. At the same time, the high tensions in the short-term money markets cooled to some extent. In the second quarter, the gap between the rate of three-month financial papers and the federal funds rate in the United States stood at 23 basic points, markedly down on the 157 in the fourth quarter of

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1 The National Bureau of Statistics of China provides no seasonally adjusted series for GDP. The series in Graph 1 is an estimate by the authors. According to the World Bank Office in China, the slowdown in the fourth quarter of 2008 was sharper than the graph, with annualized growth of just 2.5%. China Quarterly Update, March 2009, p. 2.

2 There have been several episodes of stock market panic since the outbreak of the financial crisis in mid-2007: August 2007, March and September/October 2008. In this case, the panic eventually spread to the financial system in the shape of a run by creditors leading to the collapse of the Lehman Brothers investment bank on September 15 and to extremely difficult situations in systemically important entities like the insurance company, AIG. The increasing difficulty for certain large intermediaries to obtain short-term financing was caused by the devaluation of the assets underlying their operations, particularly in real estate. This situation began to force sales of their assets in illiquid and opaque markets, with the consequent collapse of prices and the discrediting of the entities involved. In February 2009, there was also a sharp drop in share values. For the sequence of events of the crisis, see IDB-INTAL [2007], p. 3; IDB-INTAL [2008], pp. 2-4; Bernanke (2009) and BCRA [2009a], pp. 9-22.

3 Standard & Poor's/Case-Shiller Home Price Index.

2008, but still way above the 10 points in 2006. A restoration of pre-crisis conditions should not be deduced from this improvement. The disappearance of entire institutions issuing debts in this market to finance mortgage loans and other assets with real support and, furthermore, a global cooling of demand for credit mark a major difference. Although stock market indices saw a recovery, they did not reach the earlier high. At the end of October, the Dow Jones Industrial Average was 49.5% up on the minimum for March 2009, but still 31% below the maximum for October 2007. The case of commodity prices -of prime importance to MERCOSUR countries- is similar (see Graph 3). These prices had risen steadily in the first phase of the crisis (August 2007-June 2008), giving this stage a markedly inflationary climate that spread at the global level. Certain structural factors aside, rising commodity prices were due to the persistent depreciation of the dollar (the currency in which they are valued), driven by the US authorities' expansionary monetary policy. This measure was intended unsuccessfully as it turned out- to contain the early effects of the crisis against a background of growing uncertainty, but one where the pace of activity was still predominantly positive, particularly in developing countries. This enhanced the role of commodities as value reserves. However, in mid-2008, the widespread signs of weakness in the real economy finally triggered a sharp fall in commodity prices that lasted until the first quarter of 2009. This was in line with a massive reallocation of investment portfolios to minimum-risk assets like US Treasury bonds, whose yields plummeted.[4] The movement involved dropping a wide range of assets, including financial investments in emerging countries, and paradoxically resulted in a rapid appreciation of the dollar that lasted until March 2009. These processes gave the second stage of the crisis a deflationary climate. However, the drop in commodity prices slowed as the first half of 2009 progressed. The prices of energy products and oilseeds recovered compared to the low levels of late 2008, while metal prices remained at historic highs. It is worth noting that the dollar began a sharp slide as of the second quarter of 2009, related to the extremely lax conditions in the US money markets and uncertainty over the future growth of the world economy.[5]

Strictly speaking, the signs of stabilization in the world economy ought to be tempered with clearly visible signs of stagnation in the labor market and in investment by the developed economies in mid-2009. Unemployment in the United States, Japan, and the Euro Zone in June reached 9.5%, 5.7%, and 9.4% respectively, markedly up on the previous year.[6] One trend measurement shows that, in the second quarter of 2009, the contraction of non-residential investment in the United States and Japan deepened, down 7.8% and 6.2% respectively, while in the Euro Zone it was down 3.2%. Residential investment in the United States, which began to weaken in 2006, showed no signs of having reached a turning point (see Graph 4). As of 2007, investment clearly began to weaken in the developed countries, contributing to sluggishness in the rate of activity. In reality, this was the catalyst for progressive deterioration and crisis in the financial sector. The size and scope of the crisis between September and October fed back negatively into private sector expectations, resulting in the acute shrinkage in investment seen in the first half of 2009. The exception is China, where it is estimated that fixed capital formation will expand 12% in 2009. This is the result of a highly expansionary monetary and credit policy, and a massive fiscal stimulus package[7] aimed at offsetting the collapse of private investment and exports, to date the main drivers of growth Chinese. The abrupt collapse of exports, whose fall in 2009 is estimated at 10.1% at constant prices, turned the Chinese economy's strong orientation toward exports into a factor of vulnerability. Imports would contract 4.7% in 2009, an indication of the weakening of the stimulus of Chinese demand for activity in the rest of the world. This variable had already slowed in 2008, with growth of 3.9% as against the 13.9% of 2007.

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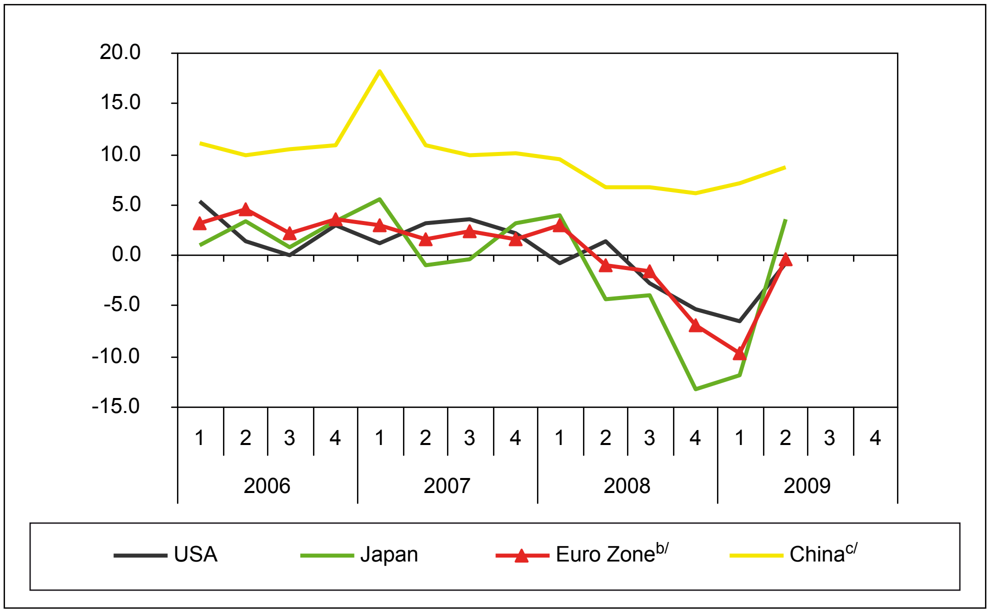
4 In the case of the 3-month bonds, the yield was 0% in December 2008 and just 0.2% in June 2009. The floor of the yield on the 10-year instrument (2.4%) was reached in December 2008, rising to 3.7% in June 2009, some 200 basic points below the pre-crisis average for 2006.

5 A sharp rise in the gold price was not immune to the depreciation of the dollar: in September 2009, it again reached the US$1,000 mark. See Blas [2009] and The Financial Times [2009].

6 The 2008 average for this indicator in the United States, Japan, and the Euro Zone was 5.8%, 4.0% and 7.5%, respectively.

7 In November 2008, a 2-year stimulus plan was announced, equivalent to 12% of estimated GDP for 2009 and involving different state entities, including banks. From the central government's share, an outlay equivalent to 0.4% of GDP was implemented in the last quarter of 2008 and it is estimated that, in 2009, this direct stimulus will be 1.5% of GDP. World Bank [2009].

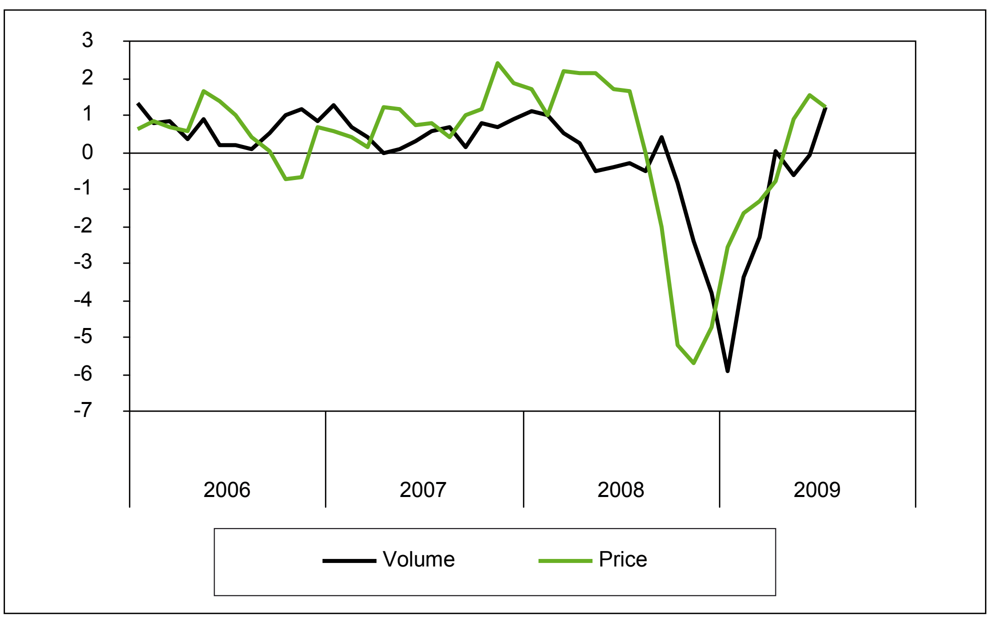
Graph 1
DYNAMICS OF REAL GDP OF THE MAIN ECONOMIES[a/] 2006-2009
(Annualized rates of variation against the previous quarter - As %)



Notes: [a/] Seasonally adjusted series.
[b/] 2000 prices; aggregation in US$ with that year's purchasing power parities.
[c/] Authors' own seasonal adjustment using Tramo/Seats method.

Source: Authors' own based on the seasonally adjusted series of the US Bureau of Economic Analysis, the Organisation for Economic Cooperation and Development (OECD), the Economic and Social Research Institute of Japan, and the National Bureau of Statistics of China.

Graph 2
DYNAMICS OF WORLD TRADE VOLUMES AND PRICES[a/] 2006-2009
(Quarterly moving average of rates of variation from the previous month - As %)



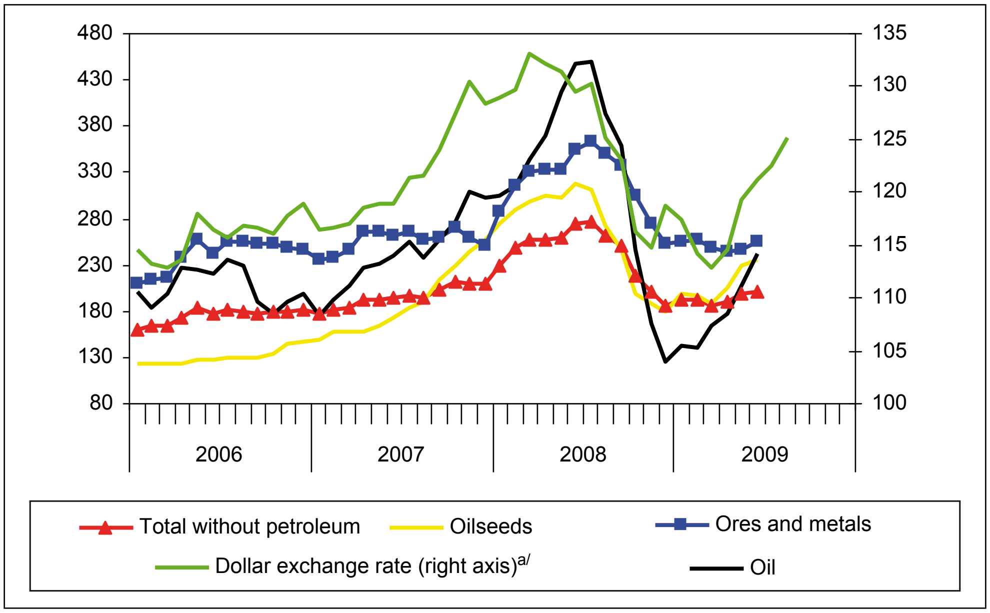
Note: [a/] Seasonally adjusted series; rates of logarithmic variation.

Source: Authors' own based on data from CPB Netherlands Bureau for Economic Policy Analysis.

Graph 3

SELECTED MONTHLY COMMODITY PRICES, 2006-2009

(2000=100 base indices)



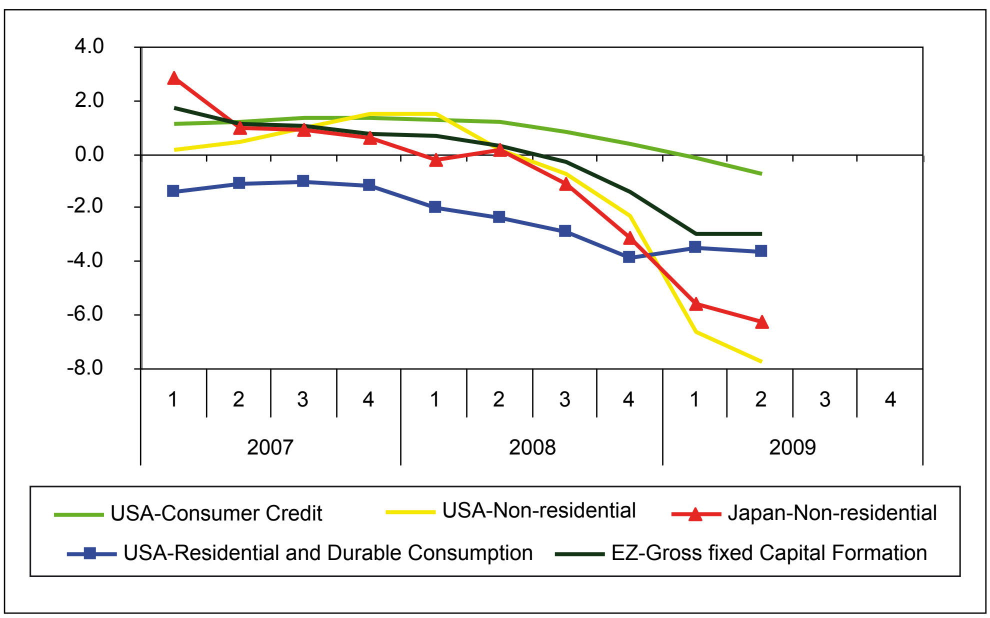
Note: [a/] Real effective exchange rate of US$ against leading currencies; depreciation = positive slope.

Source: Authors' own based on data from ECLAC and the Federal Reserve.

Graph 4

CREDIT AND INVESTMENT DYNAMIC INDICATORS[a/] 2006-2009

(Annual moving average of rates of variation against the previous quarter - As %)



Note: [a/] Seasonally adjusted series. Consumer credit in USA is for nominal balances to the end of the quarter. Investment series are quarterly averages of figures at constant national account prices.

Source: Authors' own based on the seasonally adjusted series of the US Bureau of Economic Analysis, the Organisation for Economic Cooperation and Development (OECD), and the Economic and Social Research Institute of Japan.

To this mixed picture of the global economy, with both signs of stabilization and stagnation, should be added the potential medium-term consequences of the measures taken to contain the crisis, in particular in the United States, in monetary and fiscal terms. In the first of these areas, the development of the crisis led to unusual forms of intervention intended to modify monetary conditions through injections of liquidity and interest rates cut to the 0-0.25% range. This was supplemented with unconventional operations (quantitative easing and credit easing) aimed at modifying the financial structure of institutions whose net worth had been severely eroded by the depreciation of assets. The Federal Reserve established procedures to trade these assets for no-risk instruments, preventing the decapitalization of these institutions from driving up the spiraling credit contraction even further. Other operations, like currency swaps with several countries, including Brazil, aimed to directly facilitate the provision of domestic credit or international liquidity.[8] The impact of these operations on the Federal Reserve's balance sheet has been enormous. In July 2007, the Reserve's assets stood at 6.5% of US GDP, the Treasury's instruments representing 89% of the total portfolio. In August 2009, assets represented 14.7% of GDP, 49% of which was linked to the restructuring of financial institutions or other measures such as the ones mentioned above. In the same month, 30% of Federal Reserve assets was made up of mortgage-backed securities generated in private institutions, while Treasury securities had fallen to 41.5%. The counterpart of the expansion of Federal Reserve assets was the increase in the monetary base centered on bank reserves. In other words, quantitative easing did not actually contribute to credit expansion; instead, once their balance structure had picked up, the banks opted for "hoarding" in the form of reserves in the central bank. To put it another way, they were still unwilling to lend, as reflected in the fall of the bank multiplier. So for example, in mid-2009, there was a prevailing negative trend in consumer credit (see Graph 4). The problem with its balance sheet expansion policy is that it has exposed to the Federal Reserve to unusual credit risk and therefore puts additional pressure on the value of the dollar, visible in the depreciation beginning in March.

It is believed that the various fiscal policies aimed at stimulating the economy and supporting specific sectors[9] may push public spending up by 23.6% in 2009, while tax revenues may fall by 16.8%. The result would, according to the Congressional Budget Office, be a deficit equivalent to 11.2% of GDP -the highest since World War II- with impacts over subsequent years that may raise the proportion of public debt from 40.8% of GDP in 2008 to 67% in 2018 (The Congress of the United States [2009]). It is possible, then, that the trajectory of US borrowing will put new pressures on the interest rate and that these would affect the long-term behavior of the world economy as a whole. Other developed countries are experiencing similar monetary and fiscal tension, creating a scenario of uncertainty about the possibility of a return to an expansionary dynamic similar to the one experienced up to 2007.

Finally, although the crisis has led to an increase in protectionist measures, there has certainly been no explosion of restrictions or trade retaliation, but an incremental increase in trade limitations and distortions.[10] This is, to an extent, due to the gap existing when applying restrictions "within the rules", arising from the difference between applied and consolidated tariffs at the multilateral level. (IDB-INTAL [2009a]). According to WTO reports, during the most acute phase of the crisis, government actions designed to restrict trade outweighed those intended to facilitate it. The number of tariff measures, import licenses, safeguards, and antidumping investigations rose. Although difficult to discern, several fiscal stimulus

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8 On these transactions, see Meier [2009] for example.

9 It is worth mentioning the Trouble Asset Relief Program (TARP), the American Recovery and Reinvestment Act (ARRA), and the cost of cleaning up the mortgage lenders, Fannie Mae and Freddie Mac. The total cost of these initiatives in 2009 is estimated at US$539 billion, or 76.5% of the total expansion in spending for the year, equivalent to 3.8% of GDP.

10 See WTO [2009]; ICTSD [2009]; Global Trade Alert [2009], and Estrades [2009].

policies entail trade-distorting effects, among which are provisions favoring local purchases or propping up specific sectors. Export subsidies on dairy products from the developed countries are also up.

Transmission mechanisms to MERCOSUR: The erosion of external buoyancy factors

Unlike previous externally driven crises, which revealed the vulnerabilities of the financial account of the balance of payments in MERCOSUR countries, the transmission of the disruption on this occasion affected all the variables of the current account, in particular foreign trade. In other words, there was a predominance of the "real channel" of propagation, while the financial repercussions of the crisis had limited impacts.[11] The collapse of world trade between the fourth quarter of 2008 and the first of 2009 (see Graph 2) finds a counterpart in the external demand indicators specific to MERCOSUR countries, which also show a high degree of synchronization of the phenomenon (see Graph 5). The start of 2009 saw the most critical point of the contraction, with falling quarterly moving averages for these variables of between 10% and 15%. It should be noted that the contraction in US non-oil imports from MERCOSUR was greater than the total, due to the influence of the evolution of commodity prices in MERCOSUR countries' export baskets. Both the European Union (EU) demand for MERCOSUR products and total imports from China plummeted. However, as 2009 progressed, these indicators recovered their positive values. Several factors had a bearing on the depth of the contraction in the MERCOSUR economies' external demand. First, the sharp fall in commodity prices contributed to the reduction of nominal export flows. Second, it has already been seen that the crisis caused an acute shrinkage in investment by developed countries, which hit activity levels and therefore reduced overall import volumes. These countries account for a large proportion of world trade. Third, the liquidity problems associated with the crisis directly affected the financing of exports anchored in the international market. In turn, the flight-to-quality and the abandoning of portfolio and securities investment positions in emerging countries put pressure on the depreciation of local currencies. This phenomenon was particularly marked in Brazil, where the depreciation of the *real* pushed up imports, while demand for exports contracted sharply. The rapid depreciation of the *real* also caused complications for some companies and banks with high exposure in the futures market based on a supposed trend toward appreciation of the currency. The episode, however, had no systemic consequences.

The abrupt weakening of external demand in late 2008 made clear the fragility of the dynamic model on which economic growth and world trade had relied since 2003, and which had been benefiting the MERCOSUR countries. In recent years, the expansion of the Asian economies -in particular, China- found its mainstay in demand from the United States. The continued widening of the deficit in the US current account (which reached 6% of GDP in 2006) stimulated activity and world liquidity. In particular, the relocation of industrial investments in China, attracted by cost differentials, has made this country a generator of large export, import, and investment flows. Even the growth of the mature economies, such as Japan and Germany, began to depend on the expansionary circuit originating in the United States and retransmitted by China. In the case of MERCOSUR, the indirect effects of the process had been felt in the excellent conditions created by Chinese demand in the commodity markets. However, the breakdown of the stability of the financial system in the United States and the adjustment under way there (in the second quarter of 2009, the current account deficit reached just 2.8% of GDP) will make it difficult in years to come to recover the intensity of the external stimulus MERCOSUR countries could count on up to 2007.

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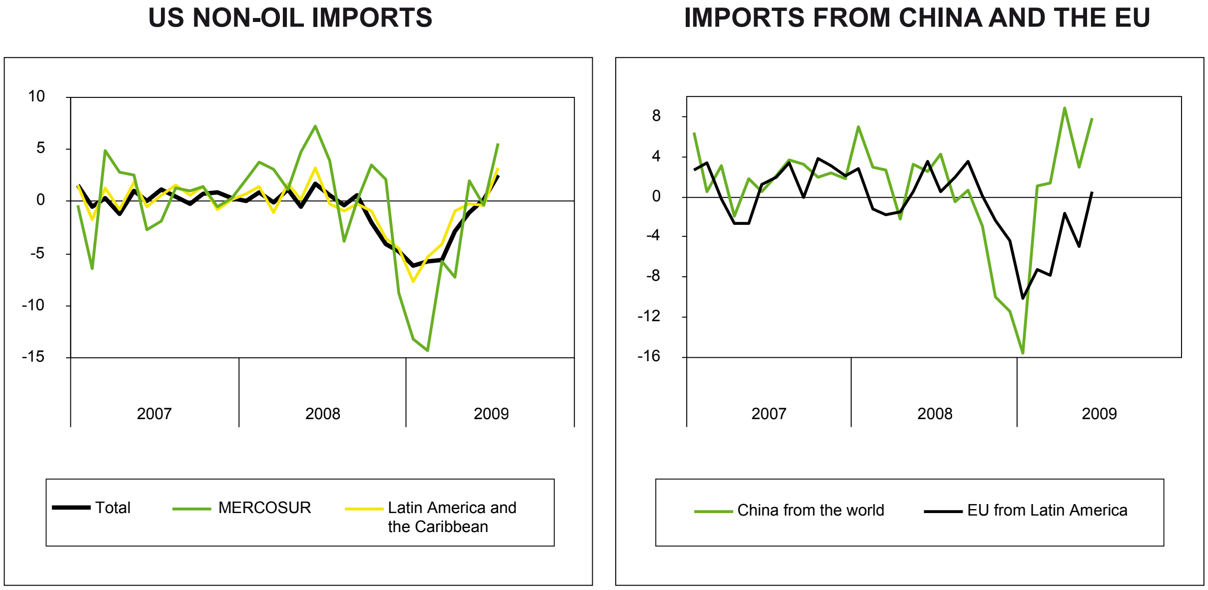
11 A distinguishing feature of this crisis is the transmission channels via which it has affected the economies of Latin America and the Caribbean. Unlike similar episodes, they have been harder hit via the real channel. ECLAC [2009], p. 6.

GRAPH 5
MONTHLY EVOLUTION OF IMPORTS 2007-2009
(At current prices; quarterly moving average of rates of variation
of the seasonally adjusted series compared to the previous month - As %)



Source: United States International Trade Commission (USITC), Customs of the People's Republic of China, and EUROSTAT.

B. The evolution of balances of payments

In keeping with the serious disruption suffered by the world economy between late 2008 and early 2009, the MERCOSUR countries' balances of payments underwent significant changes, although triggering no serious crises. This contrasts with previous episodes such as the Asian and Russian crises of 1997 and 1998, in which the destabilization of the external sector generated violent foreign exchange and financial crises in several of the bloc's countries. Although what stands out is the heterogeneity in the behavior of the balance of payments variables between MERCOSUR countries, a common feature is the essential solidity of financial and macroeconomic variables during the disruption.

The evolution of the crisis can be divided into two distinct stages: a *first stage*, dominated by global inflationary trends driven especially by rising commodity prices and the depreciation of the dollar, stretching from the third quarter of 2007 to the third quarter of 2008; and a *second stage* covering the fourth quarter of 2008 and the first of 2009, dominated by acute instability and deflationary trends, with an appreciation of the dollar. As mentioned above, there is, in the second quarter of 2009, a stabilization of the main financial and real variables (see Graph 6).

- Argentina -

During the first stage of the global financial crisis, Argentina's goods balance remained solid, with an average quarterly level of US$3.9 billion, or, in annualized terms, 4.7% of GDP in 2008. This was due to the fact that, in spite of the growth of imports, inflationary pressure favored Argentine export levels and terms of trade. Once other items are discounted from the surplus in goods, the average quarterly current account balance reached US$1.96 billion in this period, or 2.4% of GDP on the above scale. At the same time, the net formation of private assets abroad grew significantly to an average of US$1.4 billion in the period, 1.7% of GDP expressed annually. This phenomenon slowed the accumulation of international reserves beginning in 2003: neither the current account credit balance, nor the net financing flows (which are negative) is reflected in the increased domestic money supply, because of which the monetary authority was unable to continue acquiring external assets through this channel. In fact, as a whole the process involved an erosion of international reserves, which, however, remained at a historic high: US$47 billion at the end of the third quarter of 2008 (14.3% of GDP this year). At the start of the second stage of the international financial crisis in the fourth quarter of 2008, there was an initial collapse of Argentine exports, associated mainly with the collapse of commodity prices. Although this impacted the positive balance of the goods balance, there was, at the same time, an even more intense reduction in imports. The overall balance of the goods balance thus reached a quarterly average of US$3.5 billion and that of the current account US$1.3 billion (4.2% and 1.6% of GDP respectively in the measurement used). In the second quarter of 2009, there was a large surplus in the current account as a result of the more moderate year-on-year fall in exports and lower revenue payments. Throughout the period, the net outflow of private capital intensified, impacting the level of reserves in the margin.

- Brazil -

Until the unfolding of the mortgage crisis in the United States, the distinguishing feature of Brazil's balance of payments was the strong net income of private financial capital, which reached US$59.2 billion in the first half of 2007 (an annualized 9.1% of GDP that year). In the first phase of the crisis, this income suffered a drastic reduction, but remained positive and significant, with a quarterly average level of US$14.7 billion (an annualized 3.7% of GDP in 2008). The influx of financial capital was coupled with an appreciation of the currency, and an acceleration of imports and general activity levels, to which must be added an increase in revenue payments from capital income. Although these factors ended up generating a current account deficit, the overall balance of the goods balance remained in positive territory. During this phase, the average level of the current account deficit was equivalent to 1.2% of GDP in 2008, while the surplus in the goods balance was 2% of GDP that year. In the fourth quarter of 2008, there was an abrupt break when Brazil saw a sharp outflow of financial capital to the tune of US$15.7 billion (4% of GDP expressed in annual terms). This continued with much less force in the first quarter of 2009. This reversion of capital flows was part of the flight-to-quality that characterized the financial scene world in this period. On the other hand, although the surplus in the account in goods declined during this second stage of the crisis, the deficit in the current account tended to stabilize thanks to lower revenue payment. The intense outflow of financial capital was reflected in a reduction in the levels of reserves, which again recovered, however, in the second quarter of 2009 due to the increase in the overall balance of the goods balance and new net financial capital income.

- Paraguay -

The development of the crisis meant a steady worsening of the goods balance, which, in the first stage, is explained by a rise in the price of Paraguayan imports as the economy went on expanding. But this deficit was offset by other positive balance items in the current account (the balance of payments and transfers) and was comfortably financed by positive capital flows. Paraguay went on accumulating reserves like this up to the second quarter of 2008. But, in the second half of that year, there was a shortfall of US$1 billion in the goods balance (an annualized 12.6% of GDP) to do with the sharp contraction in exports due to the falling prices of the commodities Paraguay sells. There was no net capital outflow in the first quarter of 2009, as there was in Argentina and Brazil. But this was in parallel to a sharp adjustment of imports that reduced the deficit in the goods balance and prompted a surplus in the current account of US$380 million in the first half of 2009. This, coupled with low income from financial capital helped the levels of international reserves recover.

- Uruguay -

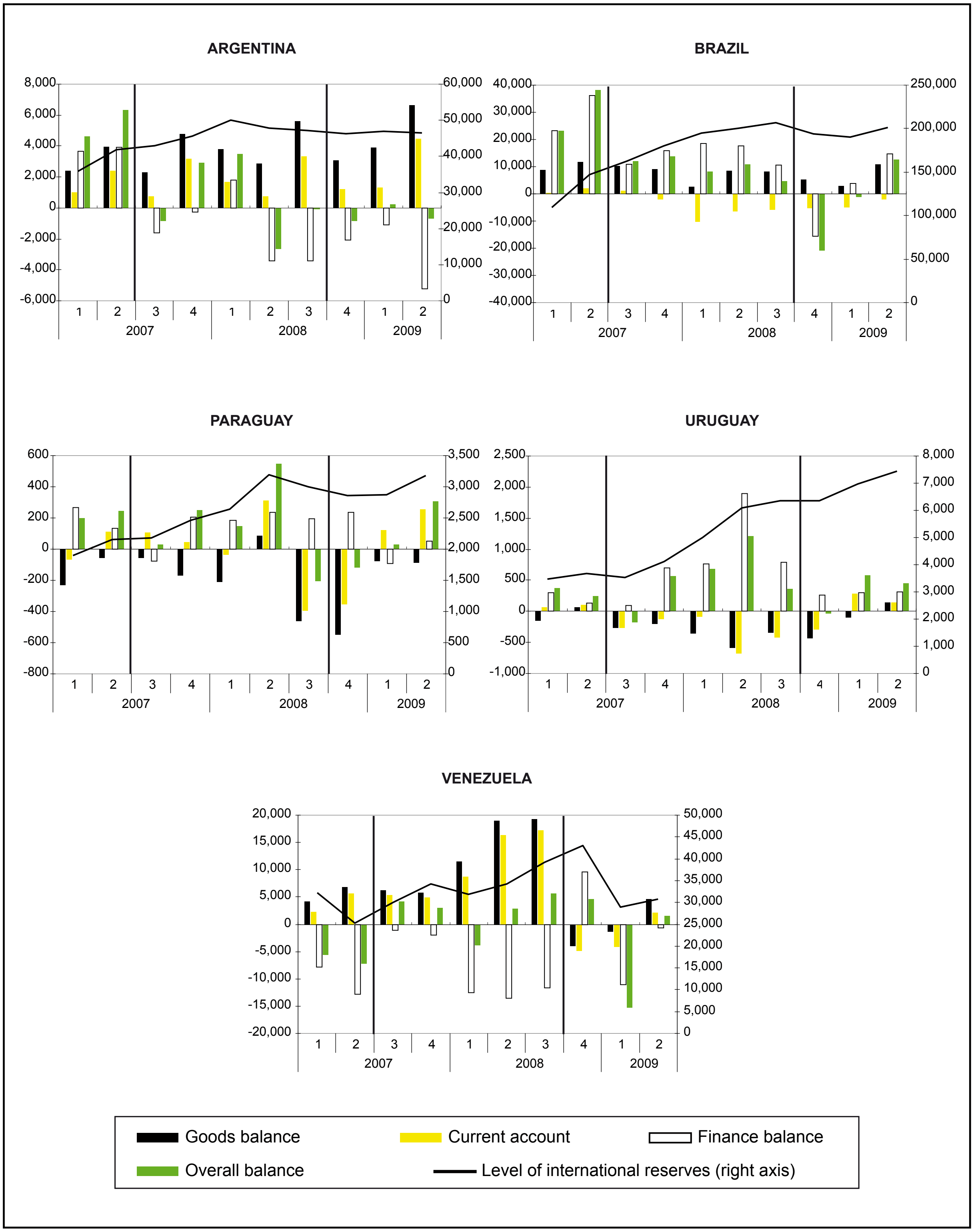
The international crisis initially affected Uruguay's balance of payments through a growing deficit in the goods balance due to the fact that the escalation in the prices of raw materials expanded the value of imports far more than it did exports. However, Uruguay at the same time became a major recipient of financial capital. The first stage of the crisis thus saw a quarterly average income of US$850 million, or an annualized 10.6% of GDP in 2008. The maximum in these trends occurred in the second quarter of 2008. By the start of the second stage of the crisis, Uruguay had not experienced an outflow of financial capital, but only a significant reduction. Between the fourth quarter of 2008 and the first of 2009, the average income was US$275 million, a third what it was in the previous stage. A sharper contraction in imports than exports in the first half of 2009 adjusted the goods balance, allowing a surplus in the current account. Overall, the trajectory of Uruguay's external sector during the crisis paradoxically involved sustained growth in the levels of international reserves.

- Venezuela -

During the international crisis, the results of Venezuela's balance of payments were determined by the evolution of the oil price. In the first stage, increases in the cost of hydrocarbons were reflected in growing surpluses both in the goods balance and the current account balance. The quarterly average level of the two balances was US$12.3 billion and US$10.5 billion respectively, the annual equivalent of 15.7% and 13.4% of GDP in 2008. In general, the counterpart of the credit balance in the current account was an outflow of private capital, but despite this, the result of the overall balance for the period was positive, with a quarterly average of US$2.4 billion (an annualized 3% of GDP). This allowed Venezuela to maintain a strong accumulation of reserves in this stage. The collapse in the oil price in the fourth quarter of 2008 and the first of 2009 was reflected in deficits in the goods balance and the current account in parallel with a net outflow of capital. The level of reserves dropped considerably from US$43.1 billion at the end of 2008 to US$28.9 billion at the end of March 2009, but almost 90% of this reduction is explained by their reassignment to the National Development Fund (FONDEN) (ECLAC [2009], p. 177).[12] The second quarter of the year saw a new positive overall balance in the goods balance due to the recovery of the oil price, which helped increased the stock of external assets.

[12] On the FONDEN, see IDB-INTAL [2007], p. 8.

GRAPH 6
MERCOSUR: QUARTERLY EVOLUTION OF THE BALANCE OF PAYMENTS
(In millions of US$)



Source: INDEC, BCB, BCP, BCU, and Central Bank of Venezuela.

C. The macroeconomic evolution of MERCOSUR[13]

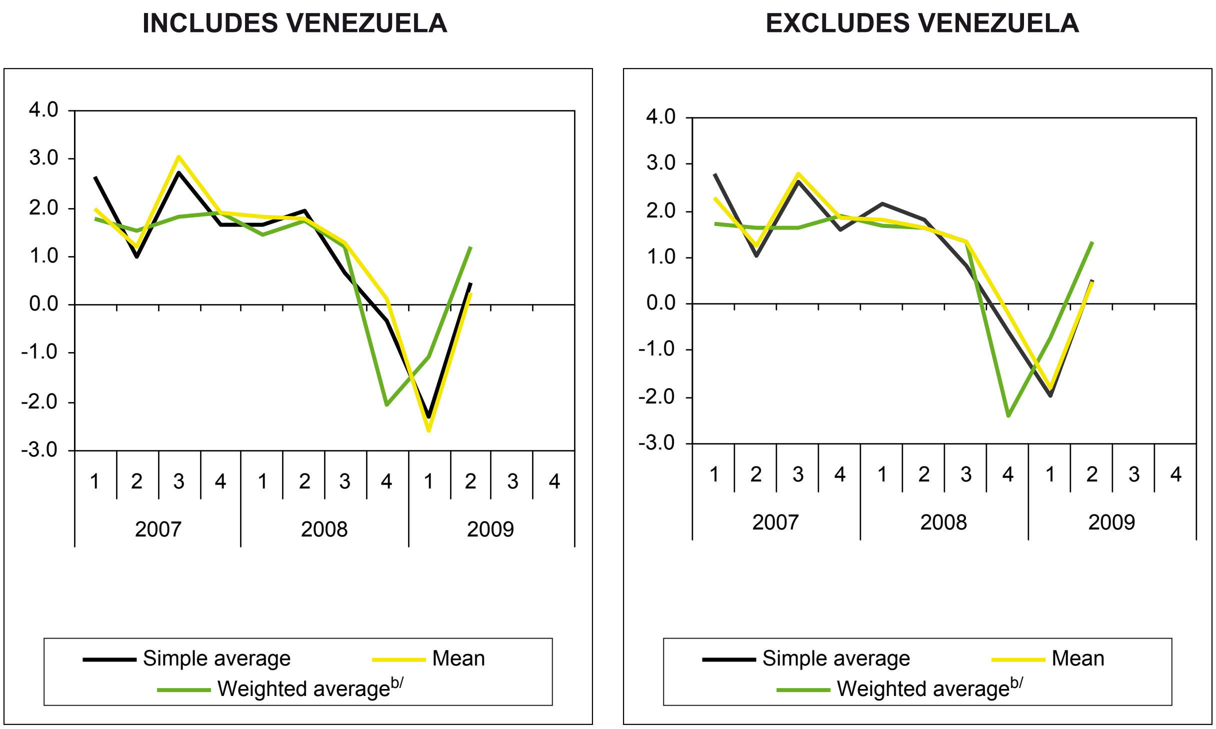
Adjustment and sources of growth

In the fourth quarter of 2008 and the first of 2009, the expansionary phase for all the MERCOSUR economies that had begun in 2002-2003 was interrupted. The mean growth of the bloc (including Venezuela) over these two periods was, -0.5% and -1% respectively (see Graph 7). In a stylized view of the process (see Graph 8),[14] the still robust growth in the first three quarters of 2008 was seen to be slanted toward domestic demand, with a low contribution of the variation in exports, whereas the contraction of the fourth quarter of 2008 and the first of 2009 is explained mainly by falling external demand and investment. Net exports acted as a factor in offsetting the recession due to a greater reduction of imports than exports. Since the second quarter of 2009, there have been clear signs of the stabilization of economic activity, mean MERCOSUR growth being 0.3%, although stagnation is forecast for the year for all economies.

Graph 7

MERCOSUR: QUARTERLY EVOLUTION OF GDP[a/] 2007-2009

(Average rates of variation compared to the previous quarter for the periods indicated)



Notes: [a/] At constant prices; Seasonally adjusted series.
[b/] Through the level of GDP at constant prices (2000=100); average 2007-2008.

Source: Authors' own based on data from national statistical offices and ECLAC.

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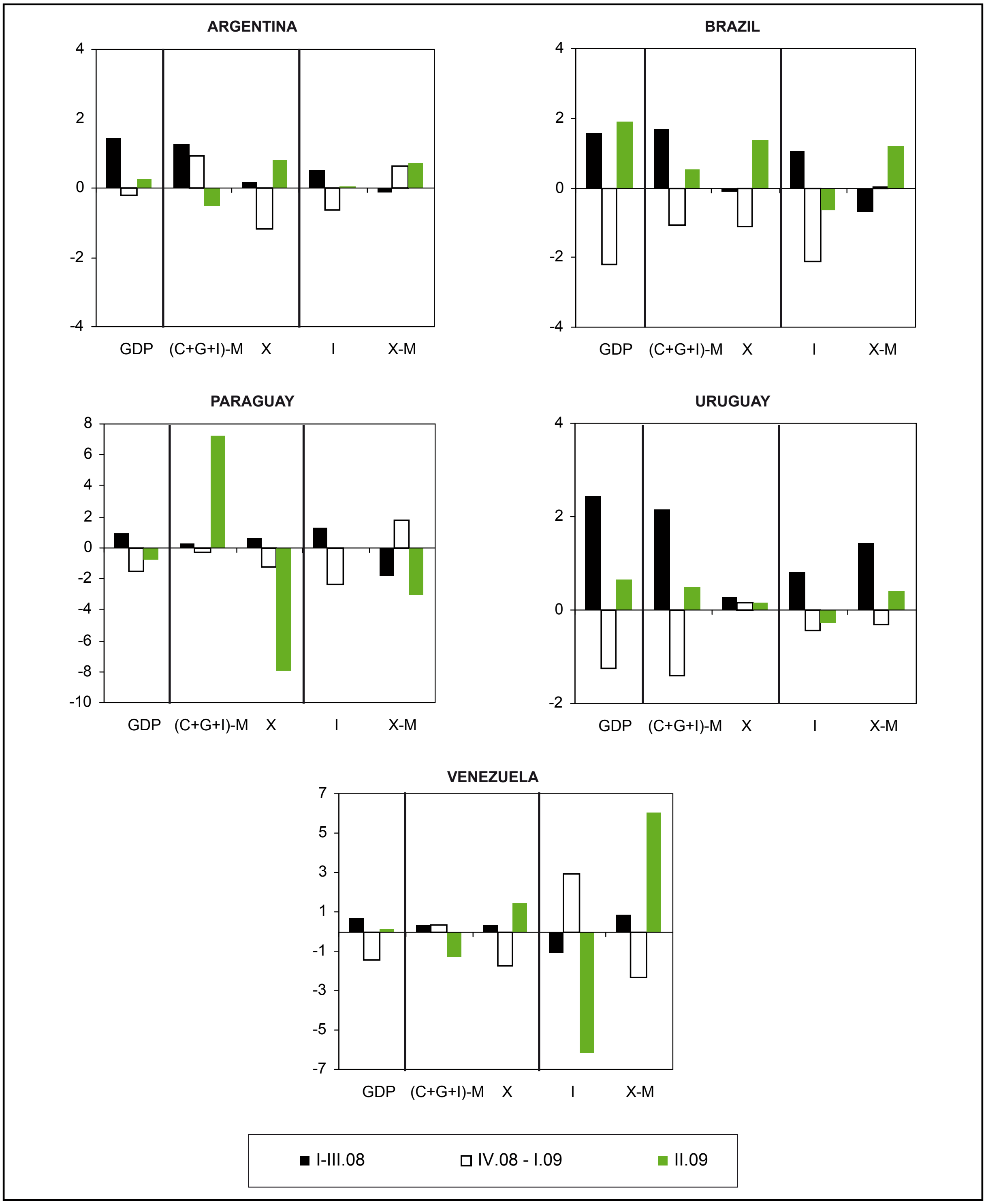
[13] Unless otherwise indicated, the forecasts and estimates contained in this chapter are based on the mean of the survey on private expectations conducted by the Central Banks (Argentina in September 2009, Brazil in October 2009, Paraguay in August 2009, and Uruguay in September 2009) and the calculations of ECLAC (Venezuela).

[14] Graph 8 shows the factors that explain the shift in GDP over three periods: the one prior to the crisis (I.08-III.08), the crisis itself (IV.08-I. 09), and stabilization (II.09). The first panel shows the scale of variation in GDP, the second the breakdown of this variation depending on the impetus arising from domestic demand (C+G+I-M) or external demand (X) and, the third plots the variation in investment and net exports (I and X-M).

Graph 8

MERCOSUR: DECOMPOSITION OF THE DYNAMICS OF GDP 2008-2009

(Average rates of variation in seasonally adjusted GDP compared
to the previous quarter for the periods indicated - As %)



Note: The seasonally adjusted GDP series are official for Argentina and Brazil. For Paraguay, Uruguay, and Venezuela seasonal adjustment was carried out using the X-12 ARIMA methodology. C=Consumption, S=Public Spending, I=Internal gross capital formation (gross domestic fixed capital + variation in stocks). X: Exports. M: Imports.

Source: Authors' own based on the Ministry of Economics and Public Finances, IBGE, BCP, BCU, and BCV.

In **Argentina**, GDP grew 6.8% in 2008, slower than the previous year, and growth of 0.7% is predicted in 2009. Investment and exports invigorated the evolution of GDP up to the third quarter of 2008, but in the last part of the year external sales dropped significantly and investment slowed, contracting in the first quarter of 2009. While public consumption kept up its positive contribution to growth, private consumption fell in late 2008 and the first half of 2009 due to waning consumer confidence, the lower growth of real income, and rising unemployment. Imports grew fast up to the third quarter of 2008, but fell significantly in the last quarter of the year, to such an extent that net exports eased the contraction of GDP during the crisis period. In the second quarter of 2009, the recovery of GDP is explained by the positive contribution of exports, while investment remained stagnant. On the supply side, lower activity levels were seen in the goods-producing sectors, mainly in primary activity, construction, and manufacturing, while services continued to show positive rates of variation.

In **Brazil**, GDP grew 5.1% in 2008 and a zero variation is estimated for 2009. The level of activity tailed off sharply in the fourth quarter of 2008, and to a lesser degree, in the first quarter of 2009. The international crisis hit hard with lower external demand and capital outflow, factors that led to a sharp fall in investment. With the exception of public consumption, the average variation in all the seasonally adjusted spending aggregates was negative in these two quarters. The rising cost of credit particularly affected private consumption. Although to a lesser degree than in Argentina, the contraction in imports translated into a positive contribution of net exports to GDP variation. In the second quarter of 2009, GDP growth was based on the buoyancy of exports and private consumption. On the supply side, industry and the agricultural sector saw major shrinkages in the first half of 2009, while services continued to grow, albeit at lower rates than in the previous period. Sales of automobiles, which had suffered a sharp fall in the last quarter of 2008, recovered significantly as of the first quarter of 2009 due to the temporary cut in Industrial Product Tax (IPI) and some improvement in credit access.

In **Paraguay**, GDP expanded by 5.8% in 2008, but no movement is expected in 2009. GDP, which had shown significant buoyancy during the first half of 2008, slowed in the second half of the year, mainly due to the performance of private consumption and investment. In the first quarter of 2009, all seasonally adjusted aggregates of the national accounts contracted, with a particularly significant tail-off in investment, imports, and private consumption. In the second quarter of 2009, exports fell significantly due above all to supply factors. This was partially offset by expanding private consumption. From the sectoral point of view, agricultural activity, which had sustained the expansion of the previous year, slowed during 2008 and fell as of the first half of 2009, affected by the regional drought and lower external demand for meat. Although slowing, growth in the service sector offset recessionary trends in other activities to some extent.

In **Uruguay**, GDP grew at the high rate of 8.9% in 2008, although it showed a progressive deceleration, culminating in a contraction in the first quarter of 2009, the year for which a positive variation of just 0.7% is predicted. In the first quarter of 2009, the level of all the aggregates of domestic demand was lower than the previous quarter. Exports grew, driven by services, which offset the fall in external goods sales. In the second quarter of 2009, there was a recovery of internal and external demand, while investments and imports continued to fall. On the supply side, there was a very significant reduction in activity in industry, the agriculture sector, and construction, partially offset by growth in service headings.

In **Venezuela**, GDP grew 4.8% in 2008 and zero growth is predicted for 2009. Seasonally adjusted GDP fell in the first quarter of 2009, mainly due to the shrinkage in private consumption and exports, partially offset by falling imports and rising public consumption. In the second quarter of 2009, GDP came to a standstill, highlighting the collapse of investment and imports. Sectorally speaking, 2008 showed a significant change to previous years: oil-driven GDP, which had been falling, made a positive contribution to total GDP, while seeing fresh shrinkage in the first half of 2009 against a background of falling international prices. For its part, non-oil GDP, which had grown significantly in the previous expansionary phase, slowed during 2008, a trend that continued in the first half of 2009.

In short, the adjustment in activity levels in MERCOSUR countries due to the international crisis came about via the reduction in exports and private investment, and led to a sharp decline in imports. 2009 will see stagnation in activity levels, pointing to less serious repercussions of the international crisis than on previous occasions, although the problem in the future will be how to boost private investment in an international framework where uncertainty is still the order of the day.

D. Economic policies and the crisis

Fiscal policy

The public sector of the MERCOSUR economies had been recording fiscal surpluses up until 2008 and had some capability for reaction in order to stimulate aggregate demand. Lower tax revenues due to lower activity levels and, in Argentina and Venezuela, lower export prices resulted in lower fiscal surpluses or outright fiscal deficits.

- Argentina -

Argentina's primary surplus during 2008 stood at 3.1% of GDP, similar to the previous year, while the overall surplus reached 1.4% of GDP. Total revenues rose 35.8% in nominal terms, slightly slower than primary spending (37.1%). A reform of the social security regime in December 2008 eliminated the capitalization regime, creating a single allocation system and transferring the asset stock (estimated at 7.8% of GDP) and flows from AFJPs to the State. The reform enabled a significant rise in spending, partially offset by increased revenue flows due to social security. Between January and June 2009, these rose almost 45% to 24.5% of total tax revenue (18.1% in the same period last year). Overall, total revenue grew at a markedly lower rate (13.8%) in the first half of 2009 than primary spending (28.9%). The primary surplus accordingly was almost 65% down on the same period last year, at 0.7% of GDP in the first half, hampering the achievement of the primary result provided for in the budget (3.27% of GDP). The slowing of total revenue was due to lower revenue from foreign trade and the decelerations linked to activity levels: VAT and financial transaction tax, among others. The higher growth in spending was concentrated in public works, capital transfers, and public sector salaries, while private sector transfers (energy and transport) slowed.

The social security reform transferred to the State an asset stock that was used to finance the public sector in the contractionary context brought about by the crisis and the attendant difficulties of accessing credit. Measures were announced to prop up internal spending and contain the falling employment levels. These included the strengthening of public works plans and the targeting of consumer credit, working capital, and export prefinancing. A tax and social security moratorium was also implemented for unpaid obligations, the temporary reduction of employer contributions for companies creating employment, an externalization regime for locally-based undeclared capital and goods, and for those held abroad by residents ("undeclared assets"), an extension of incentives to purchase capital goods, cosharing with the provinces of a fraction of the income from soy export duties against a background of weakening public finances in the provinces. The income tax aliquot was also cut to boost workers' disposable income.

Table 1
MERCOSUR: MAJOR FISCAL INDICATORS 2008-2009
(As % of GDP)

Country	Period	Primary Result[a/]	Interest[a/]	Overall Result[a/]	Public Debt[b/]
Argentina	2008	3.1	1.7	1.4	48.8
	2008 1st H	2.0	0.7	1.3	48.7
	2009 1st H	0.7	0.8	-0.2	49.4
Brazil	2008	3.7	5.7	-2.0	38.8
	2008 1st H	5.9	6.4	-0.5	41.8
	2009 1st H	2.4	5.5	-3.0	43.2
Paraguay	2008	3.1	0.6	2.5	18.0
	2008 1st H	2.5	0.4	2.1	19.4
	2009 1st H	2.8	1.1	1.7	19.0
Uruguay	2008	1.4	2.8	-1.4	51.4
	2008 1st H	3.0	2.8	0.2	52.1
	2009 1st H	1.6	2.8	-1.3	55.3
Venezuela	2008	-1.2	-1.5	-2.6	14.0
	2008 1st H	n.a.	n.a.	n.a.	n.a.
	2009 1st Q	-0.7	-0.3	-0.9	n.a.

Notes: n.a.: not available. The results of the first half are presented for all cases except Venezuela, where the results of the first quarter are shown.

[a/] Argentina: Central Government. Brazil and Uruguay: Consolidated Public Sector. Paraguay: Central Administration. Venezuela: Restricted Public Sector.

[b/] Argentina: Total Gross National Public Sector Debt. Not including US$29,127 billion for debt from holdouts. To calculate GDP the average of the last four quarters was taken. Brazil: Public Sector Net Debt (PSND). Paraguay: Non-Financial Public Sector Debt. Uruguay: Gross Global Public Sector Debt, including BCU debt. Venezuela: Gross public debt.

Source: Authors' own based on data from the Treasury and Finance Secretariat (Argentina); IPEA, Finance Ministry (Brazil); BCP, Finance Ministry, and IMF (Paraguay), Economy and Finance Ministry (Uruguay), and the Ministry of People's Power for Economy and Finance (Venezuela).

In June 2009, the public debt represented 49.4% of GDP, 48.8% up on the end of 2008. At the start of 2009, there was a debt swap (Guaranteed National Loans) that eased the financing needs for public debt interest payments. There was no progress in the initiative announced in 2008 for the regularization of the Paris Club debt, but the reopening of the debt swap for bondholders who did not accept the 2005 restructuring was announced in October 2009.[15]

[15] The fiscal difficulties foreseen for 2010 were reflected in October 2009 when, during treatment of the National Budget, a proposal was made to implement a two-year relaxation of the provinces' spending and borrowing limits established by the Fiscal Responsibility Regime, a shift in the accounting of spending on public investments, such as financial assets and the extension of certain taxes such as Income, Personal Property, and Assumed Minimum Income tax.

- Brazil -

In 2008, the consolidated public sector primary surplus reached 3.7% of GDP, slightly down on the previous year, and the overall deficit was 2% of GDP. Total central government income was up 15.8%, while primary spending grew 9.3% in line with the previous year's growth. To contain the effects of the crisis, it was decided in April 2008 to reduce the primary surplus target for 2009 from 3.8% to 2.5% of GDP and, in the first half of that year, it stood at 2.4% of GDP. The reductions in the Special System for Settlement and Custody (SELIC) rate eased the interest burden of the public debt in absolute terms, with fewer fiscal resources being allocated to it as a result. Total central government income fell 1% in the first half of 2009, while primary spending rose 17.1%. The evolution of fiscal revenue is a consequence, on the one hand, of the impact of the contraction in tax -based activity levels-mainly corporate profits and invoicing- and, on the other, of the reduced tax pressure intended to stimulate disposable income and aggregate demand. Among other measures, there were cuts in household income tax, credit, and consumer durables like cars and household items. In terms of primary spending, the highest increases were in current expenditure, mainly public officials' salaries and social security, while investment continued under the Growth Acceleration Program (PAC).

The public debt stood at 38.8% of GDP in December 2008 and 43.2% in June 2009. The combination of lower tax revenue and higher spending against a background of lower growth could subsequently push up the debt-GDP ratio by late 2009.

- Paraguay -

The Central Administration's primary surplus was 3.1% of GDP in 2008, significantly up on the previous year, when it reached 1.8% of GDP. Total revenues rose by 17.6%, due mainly to growth in tax collection linked to levels of activity and trade, like VAT, foreign trade, and income. Total spending grew just 6.6% as a result of a significant reduction in capital expenditures (-13.9%) due to underspending on physical investment partially offset by increases in current expenditure, mainly on personnel (18.1%).

To tackle the effects of the international crisis, the government began to implement an economic recovery plan in October 2008. This includes a significant increase in capital expenditures and the use of additional resources for conditioned money transfers. In the first half of 2009, the primary surplus stood at 2.8% of GDP. Central Administration spending rose 19%, while expenditures grew 29.3%, explained mainly by higher capital expenditures.

The non-financial public sector debt had reached 18% of GDP by the end of 2008 and 19% of GDP by mid-2009.

- Uruguay -

The consolidated public sector primary surplus represented 1.4% of GDP in 2008, significantly down on the previous year due to income growth (8.8% year-on-year variation), markedly lower than primary spending (17.8%). This was why, despite the interest burden falling to 2.8% of GDP, the overall deficit widened to 1.4% of GDP. The deceleration in income is explained by the reduction in the operating result of public enterprises, affected as it was by the anti-inflation policy implemented in 2008: the rising costs of the National Administration for the Generation and Transmission of Electricity (UTE) and the National Administration of Fuels, Alcohol, and Portland (ANCAP) due to high oil prices and the water shortage, which affected power generation, were not fully transferred to tariffs. The growth in primary spending is explained by private sector transfers, wages, and social benefits.

From the end of 2008, fiscal measures were implemented to address the crisis, including greater public investment in infrastructure (investments in the first half of 2009 rose 54%) and income tax exemption for economic activities to private investment during 2009, as well as sectoral support such as mortgage subsidies for housing, credit access facilitation for SMEs and the dairy sector. Also exempt from VAT was the manufacture of energy equipment, agricultural machinery, and fuel purchases, among others. In year-on-year terms, income during the first half of 2009 rose 15.8%, less than primary spending (22.5%). This gave a lower primary result, equivalent to 1.6% of GDP. Given the stability in the interest burden, the public deficit was 1.3% of GDP.

Public debt continued to fall in relation to GDP due to the latter's sound performance, reaching 51.4% in 2008. In the first half of 2009, the ratio stood at 55.3% due to the lower buoyancy of GDP and an increase in Central Government debt.

- Venezuela -

Fiscal policy remained expansionary in 2008 and the primary deficit reached 1.2% of GDP. There was an overall deficit of 2.6% of GDP. While total income grew 30.6% in nominal terms, it slowed during the year and fell in the last quarter in parallel with the falling oil price, the effects of the reduction of the VAT aliquot implemented in 2007, and the elimination of the bank debit tax in June 2008. Total spending was up 29%, driven by current spending, mainly public sector transfers, while capital expenditures slowed.

Comparing the first quarter of 2009 against the same period a year earlier, the primary result shifted from surplus to deficit. The impact of the reduction in the oil price on the surplus of Venezuela Petroleums Inc. (PDVSA) was extremely intense, causing a 37.6% fall in total restricted public sector income. Total expenditures fell 6%, mainly due to the reduction of capital expenditures. To contain the worsening fiscal situation resulting from the unfavorable economic oil circumstances the VAT aliquot rose from 9% to 12% and certain expenditures were cut, while the minimum wage was raised.

Public debt reached 14% of GDP in 2008, 9.5% of GDP corresponding to the external debt and the rest to the internal debt. In the first half of 2009, the debt was up US$13.5 billion on the end of 2008, due mainly to the issuing of internal public debt securities.

Monetary and exchange policy

From the third quarter of 2008, once the inflationary phase of the international crisis had run its course, the focus of monetary and exchange policy in MERCOSUR countries shifted. While, in the first half of 2008, the monetary authorities focused on inflationary pressures driven by rising commodity and food prices, after the deepening of the crisis in September 2009, they turned to easing the monetary and financial tensions by providing liquidity and containing the volatile nominal exchange rate. The impact on international reserves was moderate: while, in the most critical period of the global crisis, these plunged in all countries, in September 2009 they were up on October 2008 levels (with the exception of Venezuela).

Box A
THE INTERNATIONAL CRISIS IMPACT ON MERCOSUR FOREIGN EXCHANGE VARIABLES

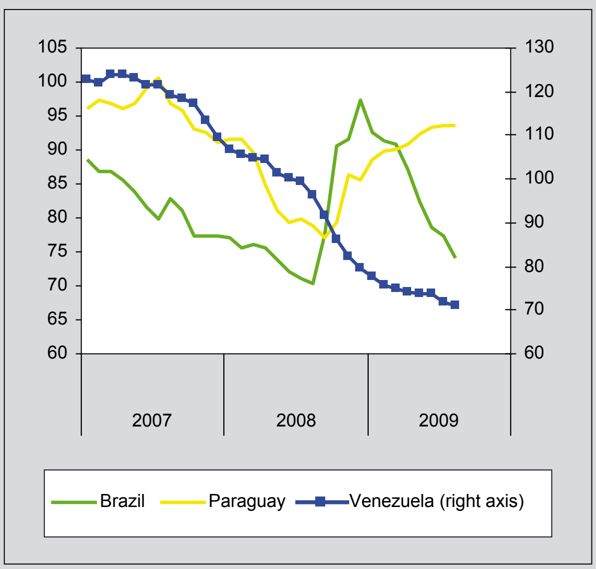
Since the international economic crisis began in mid-2007, MERCOSUR countries' foreign exchange variables reflected various pressures that become evident on analyzing the evolution of the types of real effective exchange (see Graph A). In the cases of Brazil, Paraguay, and Uruguay, this indicator followed a fairly similar pattern: persistent appreciation of currencies up to August-September 2008, driven both by nominal valuations of local currencies and by the inflationary acceleration of the first phase of the crisis. The acute financial instability that led to the bankruptcy of Lehman Brothers led to nominal depreciations in these countries -very pronounced in Brazil's case- and to a slowing of the inflation indices. As 2009 progressed, however, a reversion of the trend toward depreciation occurred at different speeds, particularly noticeable in Brazil, whose currency in this measurement reached a level in September 2009 very close to pre-crisis levels.

Argentina and Venezuela's situation differs from this pattern. The Argentine *peso* saw a gradual nominal depreciation up to April 2008 which, coupled with lower inflation as recorded by the CPI, resulted in a real effective depreciation. This contrasts with the other three countries. However, between May and November 2008, the *peso* appreciated due to a fall in the nominal exchange rate -sustained by the monetary authority- and inflationary acceleration. With some time-lag compared to the countries mentioned above, a tendency to real depreciation established in Argentina toward the end of 2008, leading the *peso* to a historic high in 2009. In Venezuela's case, the fixed nominal exchange rate and high inflation translated into a persistent appreciation of the strong bolívar throughout the period.

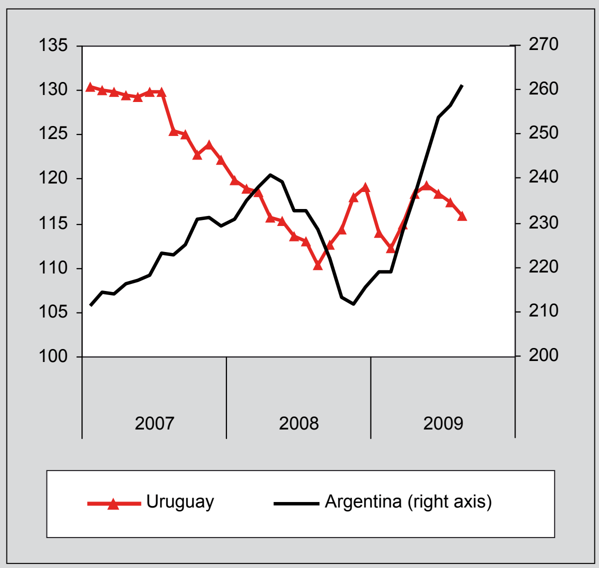
It should be noted how the flexible exchange rate regimes prevailing in all countries (except Venezuela) created a framework to channel the wide fluctuations in financial and commercial variables arising from the deepening of the international crisis. Of course, the advantages of exchange rate flexibility could be enjoyed because of the highly favorable initial context, characterized by widespread availability of international reserves and several years of reduction of the historic vulnerability of MERCOSUR countries' balances of payments, either through the availability of financial resources, improvements in terms of trade, or in the countries' export capacities. However, it must also be stressed that the highly volatile nominal exchange rate -especially of the Brazilian *real*- introduced trade tensions among MERCOSUR partners in a context of falling trade flows.

Graph A
MONTHLY EVOLUTION OF THE REAL EFFECTIVE EXCHANGE RATE
(Index 2000=100 - Appreciation=negative slope)

BRAZIL, PARAGUAY AND VENEZUELA



ARGENTINA AND URUGUAY



Source: Authors' own based on data from ECLAC.

- Argentina -

Against the background of global uncertainty, the Argentine economy experienced several episodes of monetary and financial tension during 2008 and the first half of 2009. These did not, however, result in instability. The period is characterized by a significant credit deceleration, accompanying the deterioration of investment. Between October and November 2008, short-term interest rates rose significantly and the level of deposits fell. The BCRA used various different instruments to provide banks with liquidity, like the sale of Central Bank Accounts (LEBAC) and Central Bank Notes (NOBAC), and open market transactions with National Treasury Securities. From the end of 2008 through the first half of 2009, interest rates stabilized, but at higher levels than the first half of 2008. Private sector loans were up just 4.4% between January and June 2009, slowing compared to the previous year, when they had risen 21%. In the first half of 2009, the Central Bank made efforts to revitalize credit through tenders for fixed interest rate swaps per variable and for access options to repurchase agreements in *pesos*, looking to the banks to grant fixed rate loans with longer terms than the markets'. The slight credit expansion is explained by placements associated with document advances and discounts, while secured and personal loans were down, and mortgage and card loans held fairly steady.

The monetary authority's exchange rate administration policy brought no significant changes in international reserves except in the critical period of October 2008, when substantial foreign exchange sales were made. However, in December 2008, they stood at US$46.4 billion, US$1.13 billion below that seen six months before. In June 2009, there had been a slight drop in reserves to US$46 billion. As explained in Chapter V, the Central Bank's quota agreement or currency swap with China's monetary authority (US$10 billion) and the possibility of another in Brazil (US$1.5 billion) eased the climate of foreign exchange and financial uncertainty.

While the acute inflationary tensions in the first part of 2008 eased over the rest of the year, they remained an important factor in the Argentine economy. The deceleration was a consequence of the reduction in commodity prices between July and December 2008, and the weakening of internal demand from the last quarter of the year. In 2008, the Consumer Price Index (CPI) showed a 7.2% variation but the Implicit Price Index (IPI) for GDP grew by a significant 19.2%. In the first half of 2009, the IPI recorded average growth of 9.2%.

- Brazil -

To contain inflationary pressures arising from external and internal factors, the Central Bank maintained a restrictive policy on interest rates between April and October 2008, pushing the SELIC up to an annual 13.75%. However, the deepening of the international financial crisis as of October 2008, as shown in the reduction of external credit lines, capital outflow, and the depreciation of the *real*, led to a change of focus in monetary policy. Initially, the monetary authority implemented measures to provide liquidity in foreign and local currency, and subsequently acted through credit lines with longer maturities and lower rates designed to shore up exports, while intervening in the foreign exchange market, convulsed by the deterioration of exports and the outflow of capital. In October 2008, Brazil agreed a US$30 billion currency swap with the Federal Reserve up to April 2009. This was not used. Between September and February 2009, international reserves were down nearly US$20 billion, but stood at US$201 billion in June this year, similar to the previous June. When it became clear that the impact of the crisis was worse than initially expected, the Central Bank opted, in January 2009, to cut its benchmark interest rate, setting it at a historic low of 8.75% in July 2009. The aliquots of the reserves maintained by the financial institutions in the Central Bank also fell. There was also a targeting of public credit to certain sectors (agriculture, civil construction, production, and trade) via the BNDES, La Caixa, and the Central Bank of Brazil.

Brazil also experienced inflationary tensions in 2008, with the ECPI exceeding the central value of the annual target (5.9% *vs.* 4.5%), although these receded by the end of year and 4.3% growth in consumer prices was forecast for 2009 in line with the year's inflation target.

- Paraguay -

After recording a 13.4% maximum in June 2008, the year-on-year variation in the CPI was gradually reduced to 1.9% in June 2009. The effects of the crisis from the third quarter of 2008 forced the Central Bank to provide the banking system with liquidity, while cutting its benchmark interest rate for monetary regulation instruments and the reserve for deposits in local and foreign currency. The growth in private sector bank deposits in guaranis, which had been significant in 2007 and the first part of 2008, slowed as of October this year, the counterpart of which was an increase in foreign currency deposits. Similarly, credit to the private sector in national and foreign currency, which had grown at high rates in the first half of 2008, driven by the entry of foreign currency, saw a deceleration from October 2008. These symptoms of uncertainty, however, seemed to have eased by around mid-2009 when placements saw annual rates of variation of over 30%.

The high volatility in the exchange rate in this period was linked to the evolution of commodity prices and the deepening of the international financial crisis.

- Uruguay -

To contain inflationary pressures during 2008, the Central Bank of Uruguay raised the interbank (call) interest rate, a policy that was upheld even after the fourth quarter of this year. The rate rose from 7.25% in January 2008 to 10% in January 2009. Despite this restrictive stance, year-on-year variation in the CPI reached 9.2% in 2008, above the annual target of 7%. The deepening of the international crisis in September-October 2008 was reflected in major increases in the average market interest rate in a context where expectations of the depreciation of the Uruguayan *peso* prevailed. The Central Bank concentrated on providing liquidity, relaxed the interest rate target, and sought to reduce exchange rate volatility, selling significant amounts of foreign currency. The contractionary monetary policy continued during the first half of 2009 to confront the pressure in the foreign exchange market and the inflationary indicators.

- Venezuela -

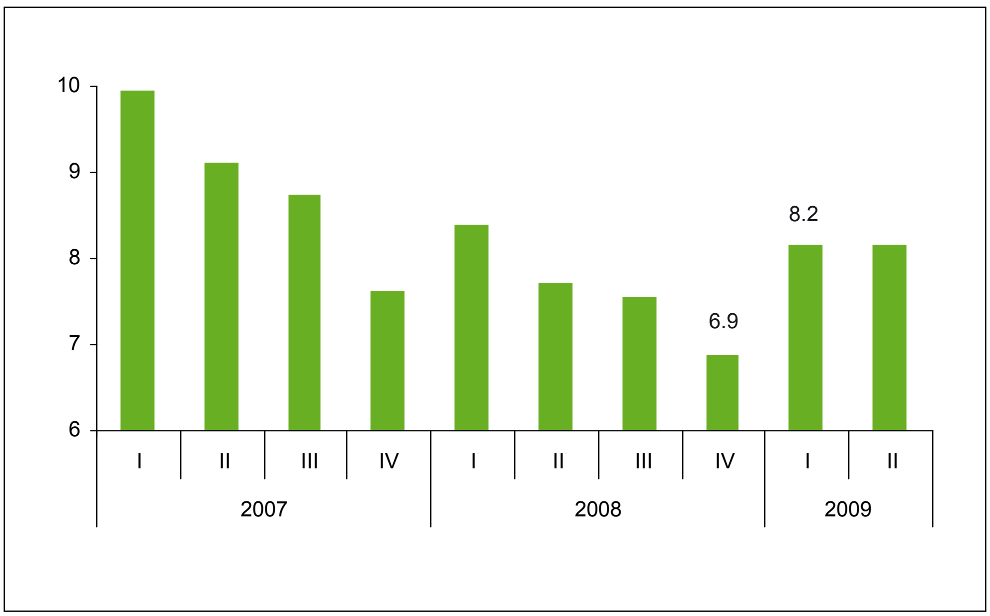
After recording a high of 34.5% in September 2008, the year-on-year variation in the ECPI slowed, reaching 27.3% in September 2009. During the period of rising inflationary pressure, the Central Bank implemented restrictive policies but, as in other countries, confronted the effects of the global crisis by providing liquidity and stimulating bank credit. To this end, the monetary authority, as of January 2009, reduced the legal reserve rate applied to the balance of financial institutions and, in March and June, capped interest rates for active bank transactions, including credit cards, and lowered the rates of its monetary policy instruments. As a result, during the first half of 2009, the number of banknotes and coins in circulation saw average real growth of 13%.

The transfer of reserves to the National Development Fund (FONDEN) explains much of their significant reduction from US$42.3 billion in December 2008 to US$29.4 billion in January 2009. In September 2009, international reserves stood at US$32.3 billion. The exchange rate remained fixed at 2.15 strong bolivars per dollar, and the operation of the Commission of Foreign Exchange Administration (CADIVI) and the restrictions on capital outflows were maintained.

E. Income and employment

The average unemployment rate in MERCOSUR countries was 7.3% during 2008, down on the 8.2% of 2007. The effects of the international crisis and economic deceleration were visible in the labor market as of 2009. In a measure that excludes Paraguay (due to lack of information) and includes Venezuela, there was a leap in the unemployment rate (simple average), rising from 6.9% in the fourth quarter of 2008 to 8.2% in the first half of 2009 (see Graph 9). In absolute terms (again excluding Paraguay and including Venezuela) the number of unemployed in MERCOSUR rose from 3.3 million at the end of 2008 to 4.1 million at the end of the first quarter of 2009. In the second quarter, the number of unemployed fell to about 4 million, with 215,000 people in Brazil finding jobs and 125,000 in Argentina and Venezuela losing them. In net terms, during the first part of 2009, in all countries where information was available, there was a deterioration in the labor market, less intense in the case of Uruguay.

Graph 9
MERCOSUR: QUARTERLY UNEMPLOYMENT 2007-2009
(Average unemployment, excluding Paraguay[a/] - As %)



Note: [a/] Paraguay has not submitted any quarterly unemployment data and there is no information for 2009. In 2008, the average rate of unemployment stood at 5.7%.

Source: INDEC, BCB, DGEEC, INE (Uruguay), and INE (Venezuela).

During 2008, real income (deflated by consumer price indices) rose in Brazil and Uruguay; and worsened in Paraguay and Venezuela. Despite the decline in the labor market during the first half of 2009, the improvement in real wages was up the previous year in Brazil and Uruguay due to the slowing of inflation. Venezuela saw a decline in real wages in the first half of 2009 due to the continued increase in the level of prices at a rate higher than nominal wages. In Argentina's case, although CPI-deflated wages saw significant increases in 2008 and the first half of 2009, when deflated by the IPI growth is recorded in line with Brazil and Uruguay's.

F. Conclusions

The deepening of the international crisis in the last quarter of 2008 had a significant impact on the economies of MERCOSUR, especially affecting the private sector, with falling activity and employment levels, bringing to an end the expansionary phase beginning in 2002-2003. The marked difference with recent episodes should be kept in mind, however, because, on this occasion, it did not spark a significant financial crisis in MERCOSUR countries. The episodes of tension were contained by the monetary authorities thanks to the accumulation of international reserves and spaces to implement several measures that shored up the stability of the financial system. In most cases, the outflow of capital was more the result of a flight-to-quality due to the external context than a sudden-stop response to internal policies. The public sector, which had recorded fiscal surpluses, was, to some extent, able to respond to the crisis and stimulate aggregate demand. It is not clear, however, how much room for maneuver there is, especially from a fiscal standpoint. It should be noted how -again unlike other past episodes- financial cooperation helped MERCOSUR not only indirectly, bolstering the global economy, but also benefiting the largest economies in the bloc through innovative currency swaps that strengthened liquidity and therefore eased uncertainty in local markets. It is estimated that in 2009 the activity levels of the bloc's economies stagnated but did not collapse. Given the unprecedented adverse external scene, this can be interpreted positively: the MERCOSUR economies avoided a collapse similar to those still present in the memory of their agents. Henceforth, however, the problem lies in just how strong the forces driving the recovery in private investment are in a world context that is likely to remain difficult for a long time to come.

ANNEX I

Table AI.1
MERCOSUR: GROSS DOMESTIC PRODUCT
(Real YOY percentage variation)

Year	Argentina	Brazil[a]	Paraguay	Uruguay	Venezuela[a]	MERCOSUR[b]
1998	3.9	0.0	0.6	4.5	0.3	1.9
1999	-3.4	0.3	-1.5	-2.8	-6.0	-2.7
2000	-0.8	4.3	-3.3	-1.4	3.7	0.5
2001	-4.4	1.3	2.1	-3.4	3.4	-0.2
2002	-10.9	2.7	0.0	-11.0	-8.9	-5.6
2003	8.8	1.1	3.8	2.2	-7.8	1.6
2004	9.0	5.7	4.1	11.8	18.3	9.8
2005	9.2	3.2	2.9	6.6	10.3	6.4
2006	8.5	4.0	4.3	7.0	9.9	6.7
2007	8.7	5.7	6.8	7.4	8.9	7.5
2008	6.8	5.1	5.8	8.9	4.8	6.3
2009[p]	0.7	0.0	0.1	1.0	0.0	0.4

Notes: [a] The figures for 2006-2008 differ from the previous report due to a change of source.
[b] Simple average for all five countries.
[p] Forecasts for Argentina, Brazil, Paraguay, and Uruguay are taken from the market expectations survey conducted by the Central Banks, while the forecast for Venezuela was produced by ECLAC.

Source: Ministry of Economics and Public Finances, IBGE, BCP, BCU, BCV, and ECLAC.

Table AI.2
MERCOSUR: DECOMPOSITION OF THE DYNAMICS OF GDP (2008-2009)[a]
(Average rates of variation in seasonally adjusted GDP
compared to the previous quarter for the periods indicated - As %)

Country / Aggregate demand component	Quarters		
	I-III.08	IV.08 - I.09	II.09
Argentina			
GDP	1.4	-0.2	0.3
(C+G+I)-M	1.3	0.9	-0.5
X	0.2	-1.2	0.8
I	0.5	-0.6	0.0
X-M	-0.1	0.6	0.7
Brazil			
GDP	1.6	-2.2	1.9
(C+G+I)-M	1.7	-1.1	0.5
X	-0.1	-1.1	1.4
I	1.1	-2.1	-0.6
X-M	-0.7	0.0	1.2

Table AI.2 (Continued)

Country / Aggregate demand component	Quarters		
	I-III.08	IV.08 - I.09	II.09
Paraguay			
GDP	0.9	-1.5	-0.7
(C+G+I)-M	0.3	-0.3	7.2
X	0.6	-1.2	-8.0
I	1.3	-2.3	-0.0
X-M	-1.8	1.8	-3.1
Uruguay			
GDP	2.4	-1.2	0.7
(C+G+I)-M	2.2	-1.4	0.5
X	0.3	0.2	0.2
I	0.8	-0.4	-0.3
X-M	1.4	-0.3	0.4
Venezuela			
GDP	0.7	-1.4	0.1
(C+G+I)-M	0.4	0.3	-1.3
X	0.4	-1.7	1.4
I	-1.1	2.9	-6.2
X-M	0.9	-2.4	6.0

Note: [a/] The seasonally adjusted GDP series are official for Argentina and Brazil. For Paraguay, Uruguay, and Venezuela seasonal adjustment was carried out using the X-12 ARIMA methodology. C=Consumption, S=Public Spending, I=Internal gross capital formation (gross domestic fixed capital + variation in stocks). X: Exports. M: Imports.

Source: Authors' own based on the Ministry of Economics and Public Finances, IBGE, BCP, BCU, and BCV.

Table AI.3
MERCOSUR: CONSUMER PRICE INDEX
(YOY percentage change)

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	0.7	1.7	14.6	8.6	29.9	11.1
1999	-1.8	8.9	5.4	4.2	20.0	7.3
2000	-0.7	6.0	8.6	5.1	13.4	6.5
2001	-1.5	7.7	8.4	3.6	12.3	6.1
2002	41.0	12.5	14.6	25.9	31.2	25.1
2003	3.7	9.3	9.3	10.2	27.1	11.9
2004	6.1	7.6	2.8	7.6	19.2	8.7
2005	12.3	5.7	9.9	4.9	14.4	9.4
2006	9.8	3.1	12.5	6.4	17.0	9.8
2007	8.5	4.5	6.0	8.5	22.5	10.0
2008	7.2	5.9	7.5	9.2	30.9	12.1
2009[b/]	6.8	4.3	4.4	6.5	27.3	9.8

Notes: [a/] Simple average for all five countries.
[p/] Forecasts for Argentina, Brazil, Paraguay, and Uruguay are taken from the market expectations survey conducted by the Central Banks, while the forecast for Venezuela was produced by ECLAC.

Source: INDEC, BCRA, IBGE, BCB, BCP, BCU, and INE.

Table AI.4
MERCOSUR: REAL EFFECTIVE EXCHANGE RATE
(2000=100 Indices - End of each period)

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a/]
1998	110.2	76.9	101.5	107.0	109.0	100.9
1999	100.4	105.4	101.0	98.7	100.9	101.3
2000	99.2	103.8	97.1	99.8	97.5	99.5
2001	97.1	116.1	113.1	106.0	94.0	105.3
2002	227.8	156.8	114.9	134.9	127.4	152.4
2003	215.9	126.2	107.1	158.0	130.6	147.6
2004	221.2	115.5	115.1	145.7	135.9	146.7
2005	215.0	92.0	115.8	128.8	137.9	137.9
2006	214.2	89.1	96.3	132.2	123.2	131.0
2007	231.0	77.1	90.8	121.9	108.1	125.8
2008	217.6	96.5	85.6	119.0	80.5	119.8
2009[b/]	253.3	78.7	92.8	118.4	74.7	123.6

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

Source: ECLAC.

Table AI.5
MERCOSUR: NET INTERNATIONAL RESERVES
(In millions of US$ - Yearly average for December)

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela
2005	28,077	53,799	1,297	3,078	29,636
2006	32,037	85,839	1,658	3,091	36,672
2007	46,176	180,334	2,462	4,121	33,477
2008	46,386	193,783	2,864	6,360	42,299
2009[a/]	46,026	201,467	3,183	7,438	29,921

Note: [a/] June average.

Source: BCRA, BCB, BCP, BCU, and BCV.

TABLE AI.6
MERCOSUR: RATE OF UNEMPLOYMENT
(As % of the economically active population - Annual average)

Year	Argentina		Brazil[b]	Paraguay[c]	Uruguay[d]	Venezuela[e]	MERCOSUR[f]
	a1/	a2/					
2003	17.3	22.7	12.3	8.1	16.9	18.0	14.5
2004	13.6	18.1	11.5	7.3	13.1	15.3	12.2
2005	11.6	14.8	9.8	5.8	12.2	12.4	10.4
2006	10.2	12.3	10.0	6.7	10.9	10.0	9.6
2007	8.5	9.4	9.3	5.6	9.2	8.5	8.2
2008	7.9	8.2	7.9	5.7	7.6	7.4	7.3
2009[g]	8.4	8.8	8.6	n.a.	7.8	7.9	8.2

Notes: n.a.: not available.
[a1] Urban areas. The beneficiaries of social plans performing labor considerations are considered employed.
[a2] Urban areas. People whose main occupation comes from a social plan are considered unemployed.
[b] Six metropolitan areas.
[c] Total population (urban and rural).
[d] In 2006, the National Survey of Households was expanded to include rural areas. The figures from this year are therefore not comparable with previous years (urban total).
[e] National total.
[f] Simple average for all five countries. In Argentina's case the rate in note [a1] is taken.
[g] First half.

Source: INDEC, IBGE, INE, and DGEEC.

TABLE AI.7
MERCOSUR: REAL EARNINGS
(YOY percentage change - Nominal wage index deflated by consumer price indices)

Period / Country	Argentina	Brazil	Paraguay	Uruguay	Venezuela	MERCOSUR[a]
2006	6.3	4.0	1.3	4.4	5.1	4.2
2007	10.8	3.2	0.7	4.8	1.5	4.2
2008	15.3	3.4	-0.6	3.5	-4.0	3.5
2009[b]	15.4	4.1	n.a.	7.3	-6.5	5.1

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

Source: INDEC, IBGE, BCU, INE, and BCV.

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CHAPTER II. THE EVOLUTION OF TRADE AND FOREIGN DIRECT INVESTMENT

In the last quarter of 2008, the deepening of the international financial crisis brought about a dramatic shift in the favorable external conditions driving trade in MERCOSUR countries. MERCOSUR trade slowed sharply and contracted during the first half of 2009. However, it can be argued that the effect of the global disturbance on the bloc's trade was relatively subdued, especially in light of its unusual scale and depth, and compared to previous external crises. Before the deepening of the crisis, the bloc's global trade balance had been suffering erosion owing to the acceleration of imports. This trend was reversed in the first half of 2009 due to the adjustment in the pace of activity on account of the unprecedented context of global instability.

Since 2003, MERCOSUR countries have steadily expanded their share in world exports and this growth was not interrupted by the crisis, despite falling external trade flows. The process has involved an increase in both extrabloc and intrabloc sales. In this case, it is worth noting that, as measured at constant prices, exports from Argentina and Brazil to the bloc in 2008 were almost 60% up on a decade ago. The improved performance of MERCOSUR trade in terms of the world average is linked to the growing importance of Asia as a destination for the bloc's external sales, as the demand of these markets went on expanding or deteriorated to a lesser degree than the countries at the epicenter of the financial crisis. In 2008, the bloc's trade with Venezuela reached US$8.6 billion and continued to rise, as it has been doing since 2004. That year, FDI flows to MERCOSUR were a record US$56 billion, whereas in the first part of 2009, they slowed amid the complicated world financial situation.

A. Total MERCOSUR trade and international insertion[16]

In 2008, MERCOSUR's exports[17] totaled US$278.3 billion, 24.1% up on the previous year (see Graph 10). While the bloc's external sales in the last quarter of 2008 grew at an annual rate of just 3.5%, this was well above world exports, which in that period of deepening world crisis contracted 11.6%. MERCOSUR's external sales in the first half of 2009 were down 21.7%, again, a less negative result than world exports, which fell at an unprecedented 31.6% (Table 2). When making this comparison, it should be remembered that, in exports, an extremely significant component was falling international prices after their historic highs in the first half of 2008.

MERCOSUR imports totaled US$248 billion in 2008, up 40.5% on the previous year, but also slowed over the last quarter of the year to a rate of 15.5%. In the first six months of 2009, the bloc's external purchases were down 31.5% in line with the world indicator.

The main effect of the international crisis was the abrupt reversion of the trend toward the reduction in the bloc's trade surplus over the previous two years. This balance plunged to US$30.258 billion in 2008 (US$55.5 billion in 2006) due to higher growth in imports than exports. However, in the first half of 2009, the surplus widened significantly, 61.7% up on the same period a year earlier. This phenomenon is explained by a sharp contraction in imports, dominated by the effect of falling quantities. Exports fell at lower rates and the effect of falling prices prevailed.

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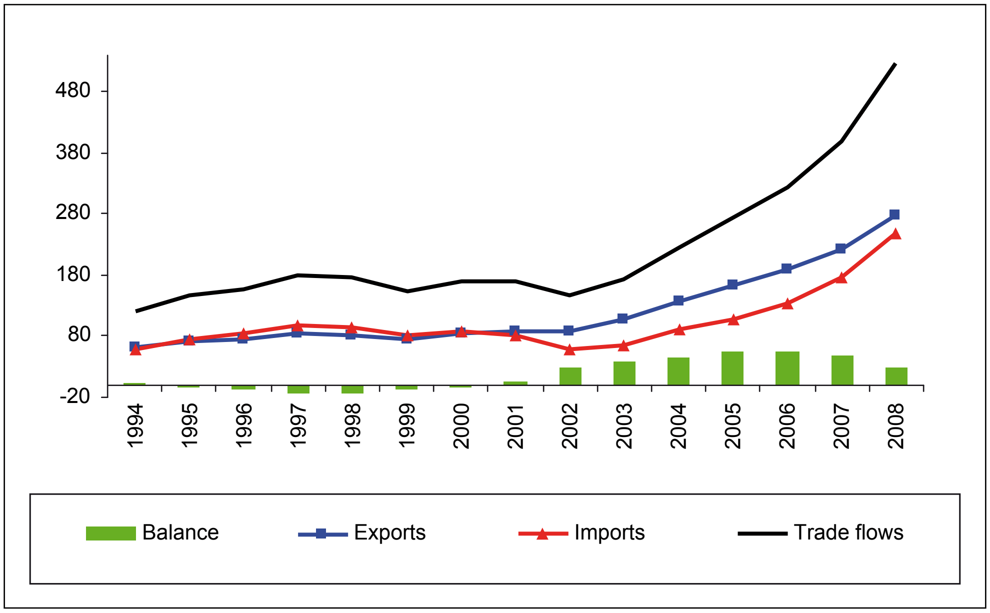
[16] Methodological note: as the process of Venezuela joining MERCOSUR is not yet complete, any references made in this chapter to the bloc's trade flows cover only the four original partners. Specific observations are, however, made about Venezuela.

[17] Includes intrabloc trade.

GRAPH 10
TOTAL MERCOSUR FOREIGN TRADE 1990-2008[a/]
(In billions of US$)



Note: [a/] Including intrabloc trade.

Source: INDEC, SECEX-MDIC, BCP, and BCU.

Trade flows by country

The distribution of trade flows between MERCOSUR partners in 2008 was similar to previous years. Brazil sold US$197.9 billion, or 71.1% of total exports, followed by Argentina (25.2%), Uruguay (2.1%), and Paraguay (1.6%). These market shares are explained mainly by the countries' differences in scale, given their populations and the values of their production. It should be noted that 79.8% of MERCOSUR's population and 80.6% of its GDP was accounted for by Brazil. It should, then, be stressed that the smaller partners, Paraguay and Uruguay, exhibited the greatest buoyancy in external sales, with significant increases of 57.6% and 32.2% respectively in 2008 (Table 2).

In MERCOSUR's foreign purchases, Brazil totaled US$173.2 billion, or 69.8% of the total, followed by Argentina (23.2%), Uruguay (3.6%) and Paraguay (3.4%). While, during 2008, the smaller partners recorded the highest buoyancy in total imports (Uruguay 59.3% and Paraguay 52.3%), Brazil also grew very significantly, with 43.6%. In Argentina, imports grew 28.2% in 2008, the smallest relative increase in the bloc's purchases, although, in itself, very significant.

As mentioned above, the bloc's trade balance continued to worsen in 2008, as it had the previous year, a fact explained mainly by the decline in the Brazilian surplus, down 38.2% to US$24.7 billion, similar to that seen in 2003. Uruguay and Paraguay recorded historic highs in the widening of their trade deficits. Only Argentina expanded its surplus, by 9.9%.

TABLE 2

TOTAL TRADE FLOWS IN MERCOSUR COUNTRIES[a/]

(In millions of US$ and %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
MERCOSUR Exports	**81,336**	**88,901**	**190,268**	**224,178**	**278,302**	**24.1**	**129,510**	**148,792**	**101,468**	**-21.7**
Argentina	26,434	25,651	46,569	56,246	70,021	24.5	33,504	36,517	27,250	-18.7
Brazil	51,120	60,439	137,808	160,649	197,942	23.2	90,645	107,298	69,952	-22.8
Paraguay	1,014	951	1,906	2,785	4,390	57.6	2,398	1,992	1,700	-29.1
Uruguay	2,769	1,861	3,985	4,498	5,949	32.2	2,964	2,985	2,566	-13.4
MERCOSUR Imports	**95,375**	**59,705**	**134,757**	**176,586**	**248,044**	**40.5**	**115,796**	**132,248**	**79,296**	**-31.5**
Argentina	31,379	8,988	34,150	44,781	57,423	28.2	28,114	29,309	17,389	-38.1
Brazil	57,714	47,243	91,343	120,621	173,197	43.6	79,351	93,845	55,963	-29.5
Paraguay	2,471	1,510	4,489	5,577	8,491	52.3	3,865	4,627	2,803	-27.5
Uruguay	3,811	1,964	4,775	5,608	8,933	59.3	4,466	4,467	3,141	-29.7
Trade Balance	**-14,039**	**29,195**	**55,511**	**47,592**	**30,258**	**-36.4**	**13,715**	**16,544**	**22,172**	**61.7**
						Absolute				Absolute
Argentina	-4,946	16,662	12,419	11,465	12,598	1,133	5,390	7,208	9,861	4,471
Brazil	-6,595	13,196	46,465	40,028	24,746	-15,282	11,293	13,453	13,989	2,696
Paraguay	-1,457	-560	-2,583	-2,792	-4,101	-1,309	-1,467	-2,634	-1,103	364
Uruguay	-1,042	-103	-790	-1,109	-2,984	-1,875	-1,502	-1,482	-575	926

Note: [a/] Includes intrabloc trade.

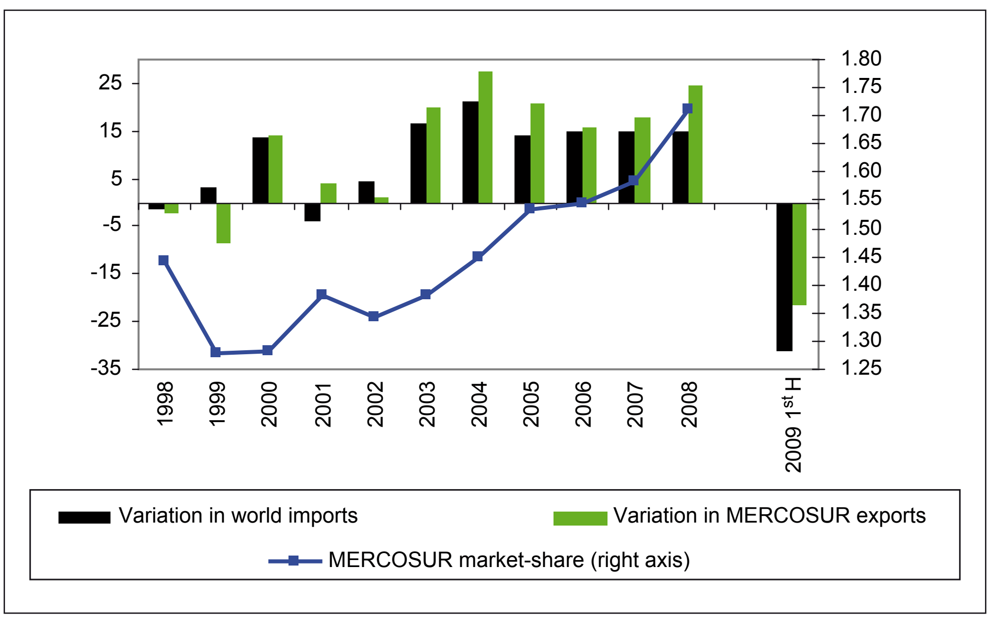
Source: INDEC, SECEX-MDIC, BCP, and BCU.

During the first half of 2009, all MERCOSUR members saw significant year-on-year decreases in their exports, although these were lower than the shrinkages recorded in imports, with the exception of Paraguay. Paraguay (-29.1%) and Brazil (-22.8%) experienced the steepest declines in MERCOSUR's external sales. Argentina and Uruguay saw their exports fall by 18.7% and 13.4% respectively. The decline in imports also occurred in all MERCOSUR countries, particularly significant in Argentina, which saw its external purchases fall by 38.1%. The other partners' fall was close to 30%: Uruguay, Brazil, and Paraguay saw their purchases fall by 29.7% 29.5%, and 27.5% respectively. This sharp reduction in imports enabled the larger MERCOSUR partners to significantly expand their trade surpluses, while the smaller partners reduced their deficits. The adjustment in Argentina was the most pronounced: its trade surplus rose from US$5.390 billion in the first half of 2008 to US$9.861 billion in the same period in 2009.

MERCOSUR trade and world market share

In 2008, the buoyancy of MERCOSUR's external sales translated into a record share in world imports, which reached 1.71%, as a result of higher growth in the bloc's sales in terms of world imports since 1999 (with the exception of 2002), when this share was 1.28%. The expansion is no mean feat considering that it occurred during a phase of strong growth in world trade (see Graph 11). It must be stressed that the international crisis had a very significant effect on world imports, which fell 31.3% in the first half of 2009, while MERCOSUR's external sales saw a less significant reduction, contracting 21.7%.

GRAPH 11
EVOLUTION OF MERCOSUR'S EXPORTS AND WORLD IMPORTS. DEVELOPMENTS IN THE BLOC'S MARKET-SHARE
(1998-first half of 2009 - As %)



Source: CPB, INDEC, SECEX-MDIC, BCP, and BCU.

Table 3
MERCOSUR'S EXTRAZONE TRADE BY ECONOMIC BLOC
(In millions of US$ - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				**Percentage**
Extrazone Exports	**60,982**	**78,712**	**164,483**	**191,777**	**236,715**	**23.4**	**109,576**	**127,139**	**87,487**	**-20.2**
Extrazone/total (%)	*75.0*	*88.5*	*86.4*	*85.5*	*85.1*		*84.6*	*85.4*	*86.2*	
NAFTA	14,383	22,713	38,233	38,593	41,639	7.9	19,312	22,327	11,845	-38.7
European Union	20,627	21,251	39,829	51,388	61,028	18.8	29,584	31,444	21,421	-27.6
LAIA[a/]	7,195	8,727	20,789	23,303	27,828	19.4	12,674	15,153	9,568	-24.5
Asia	9,933	13,598	30,014	37,509	60,376	61.0	26,630	33,746	28,758	8.0
Other Countries	8,844	12,423	35,618	40,984	45,844	11.9	21,376	24,468	18,670	-12.7
Extrazone Imports	**74,982**	**49,406**	**109,362**	**143,878**	**205,273**	**42.7**	**94,950**	**110,323**	**65,110**	**-31.4**
Extrazone/total (%)	*78.6*	*82.7*	*81.2*	*81.5*	*82.8*		*82.0*	*83.4*	*82.1*	
NAFTA	23,980	14,064	23,686	30,327	32,802	8.2	18,994	13,808	15,178	-20.1
European Union	27,140	16,017	26,734	35,080	46,415	32.3	21,668	24,747	16,260	-25.0
LAIA[a/]	3,297	2,424	8,087	9,224	12,112	31.3	5,946	6,166	3,706	-37.7
Asia	13,576	9,565	31,736	42,842	69,880	63.1	32,146	37,735	22,193	-31.0
Other Countries	6,990	7,336	19,119	26,405	44,063	66.9	16,196	27,868	7,773	-52.0
Extrazone Trade Balance	**-14,001**	**29,306**	**55,120**	**47,899**	**31,442**	**-34.4**	**14,627**	**16,816**	**22,378**	**53.0**
						Absolute				**Absolute**
NAFTA	-9,597	8,649	14,547	8,266	8,837	571	318	8,519	-3,332	-3,650
European Union	-6,513	5,234	13,095	16,308	14,614	-1,695	7,916	6,697	5,161	-2,756
LAIA[a/]	3,898	6,304	12,701	14,079	15,715	1,637	6,728	8,987	5,862	-866
Asia	-3,643	4,033	-1,722	-5,333	-9,504	-4,172	-5,515	-3,989	6,565	12,081
Other Countries	1,854	5,087	16,499	14,579	1,781	-12,798	5,180	-3,399	10,897	5,717

Note: [a/] With the exception of MERCOSUR and Mexico. Mexico is included in NAFTA.

Source: INDEC, SECEX-MDIC, BCP, and BCU.

Extra-MERCOSUR trade

In spite of the international crisis, MERCOSUR's extrabloc export and import flows were up in 2008 on rates seen in 2007. The crisis only affected trade in the first half of 2009, when significant reductions year-on-year were recorded (Table 3).

Sales to countries outside MERCOSUR totaled US$236.7 billion in 2008, 23.4% up on the previous year. In the same year, the share of extrabloc destinations in MERCOSUR's total exports was 85.1%. While the main destination for exports remained the European Union (21.9%), the high growth in sales to Asia made the geographic area climb from fourth to second place in terms of the share of MERCOSUR sales with 21.7% of total shipments, very close to the EU. It should be noted that sales to NAFTA recorded the lowest growth of all markets in 2008 (7.9%).

Extrabloc imports rose at the high rate of 42.7% in 2008. The main origin remained Asia, with 28.2% of total purchases, followed by the EU and other countries. As with external sales, imports from NAFTA recorded the lowest rate of growth, at 8.2%.

As a result, the balance of trade between MERCOSUR and the extrazone blocs remained in surplus in 2008, with the exception of Asia, where the trade deficit grew 78.2%. However, this became a surplus in the first half of 2009 as a result of its being the only destination to which exports grew during that period (8%), while there was a significant contraction in imports from that area (-31%). Sales in Asia helped to shore up the positive surplus achieved by the bloc countries in the first half of 2009.

During the first half of 2009, total sales outside the bloc fell by 20.2%. Reductions were recorded to all destinations -again, with the exception of Asia- and were particularly acute in NAFTA, with a drop of 38.7%. Imports from extra-MERCOSUR blocs were down 31.4% during the first half of 2009, with the greatest reductions in the Other Countries group and LAIA. The trade surplus expanded 53% during the first half of 2009, with a prominent trade deficit with NAFTA and a surplus with Asia for the first time. It widening where other countries were concerned.

B. Intra-MERCOSUR trade

Recent developments in intrazone trade

In 2008, intra-MERCOSUR trade (the sum of exports from each country to the other three partners) reached US$41.6 billion, up 28.4% on the previous year in nominal terms, higher than extrazone export growth (23.4%). The average annual rate of variation in intrabloc trade in 2003-2008 was 26.4% a year, also higher than the 20.1% for extrazone exports (Table 4). This dynamic raised the share of sales to the bloc from 11.5% in 2002 to 14.9% in 2008, still below the 25% high of 1998. The causes are discussed in Box B.

The effects of the international financial crisis were evident in the first half of 2009, which saw a 29.9% contraction in intrabloc trade. This fall was somewhat more intense than the fall in aggregate extrazone exports and imports (-25.4%), reflecting the usual sensitivity of the bloc's trade to cyclical fluctuations. However, unlike other crises in the past (1997-1999 and 2001-2002), the *similarity* between the contractions in intra and extrabloc trade should be noted, a result not only of the predominance of clearly external factors, but of the global and extremely acute nature of the most recent phenomenon (see Graph 12). Whereas, in the first part of 2009, both exports to MERCOSUR and those to the rest of the world contracted sharply, during the 2001-2002 crisis these exports merely decelerated.

Table 4
MERCOSUR INTRAZONE AND EXTRAZONE TRADE FLOWS IN SELECTED PERIODS
(In millions of US$ - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
Intrazone										
Exports[a/]	20,355	10,189	25,785	32,401	41,587	28.4	19,934	21,653	13,981	-29.9
Extrazone										
Exports	60,982	78,712	164,483	191,777	236,715	23.4	109,576	127,139	87,487	-20.2
Imports	74,982	49,406	109,362	143,878	205,273	42.7	94,950	110,323	65,110	-31.4
Total										
Exports	81,336	88,901	190,268	224,178	278,302	24.1	129,510	148,792	101,468	-21.7
Imports	95,375	59,705	134,757	176,586	248,044	40.5	115,796	132,248	79,296	-31.5
Trade Balance	-14,039	29,195	55,511	47,592	30,258	-36.4	13,715	16,544	22,172	61.7
Relations (%)										
Exports	25.0	11.5	13.6	14.5	14.9		15.4	14.6	13.8	
Imports	21.3	17.1	19.1	18.3	16.8		17.2	16.4	17.6	

Note: [a/] By definition, intrazone exports are the same as intrazone imports.

Source: INDEC, SECEX-MDIC, BCP, and BCU.

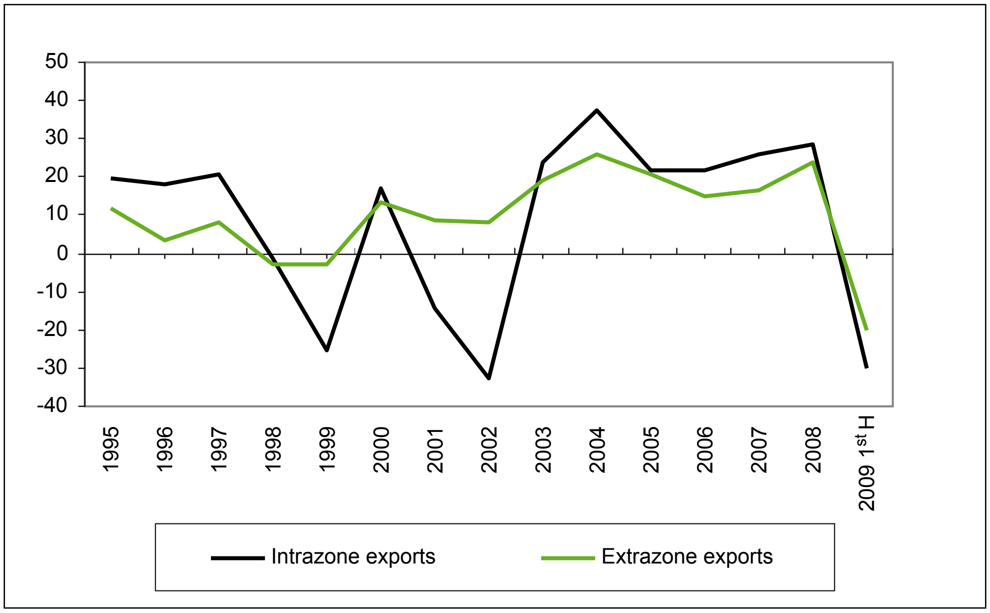
Table 5 sets out the composition of intrabloc trade flows by country. In 2008, Brazilian exports to MERCOSUR totaled US$21.7 billion, or 52.3% of the total, while imports from the bloc were noticeably lower, at US$14.9 billion, or 34.9% of the total. This imbalance between purchases and sales made Brazil the bloc's only economy in surplus, by US$6.8 billion. On the one hand, the lesser relevance of trade flows with the bloc for the Brazilian economy should be noted, its share of exports and imports being lower than its GDP in the bloc as a whole (80.6% in 2008). On the other, the surplus result of Brazilian trade means that, for the third year running, the demand originating in the other partners in net terms boosted activity levels in Brazil. In 2008, the other three partners' deficits with Brazil widened in relation to the previous year.

The crisis had a marked effect on the MERCOSUR partners' trade balances. The shrinkage in the levels of trade in the first half of 2009 also entailed a significant correction of deficit positions in Argentina, Paraguay, and Uruguay, with Argentina even seeing a small surplus in intrazone trade. Brazil's surplus fell to just US$400 million in the period, in sharp contrast with the US$3.4 billion of the first half of 2008. Argentina's balance variation over the two periods was practically equivalent to the reduction in the Brazilian surplus. The adjustment operating in the other smaller partners is a result of the intense reduction in their activity levels (see Chapter I) and, in Argentina's case, they also impacted the trade administration measures driven by the uncertainty created by the crisis (Chapter IV).

Graph 12

MERCOSUR: EVOLUTION OF INTRA AND EXTRAZONE EXPORTS

(1995-first half of 2009 - Annual rates of variation - As %)



Source: Authors' own based on data from INDEC, SECEX-MDIC, BCP, and BCU.

Table 5

INTRAZONE TRADE FLOWS IN MERCOSUR BY COUNTRY

(In millions of US$)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
Exports Intrabloc[a/]	**20,355**	**10,189**	**25,785**	**32,401**	**41,587**	**28.4**	**19,934**	**21,653**	**13,981**	**-29.9**
Argentina	9,415	5,718	9,940	12,426	16,145	29.9	7,547	8,598	6,205	-17.8
Brazil	8,877	3,311	13,986	17,354	21,737	25.3	10,459	11,278	6,196	-40.8
Paraguay	531	553	917	1,374	2,104	53.1	1,159	945	871	-24.8
Uruguay	1,532	607	942	1,247	1,601	28.4	769	831	709	-7.9
Imports Intrabloc[a/]	**20,393**	**10,300**	**25,394**	**32,708**	**42,771**	**30.8**	**20,846**	**21,925**	**14,186**	**-31.9**
Argentina	7,930	2,895	12,555	16,037	20,300	26.6	10,143	10,157	5,821	-42.6
Brazil	9,428	5,615	8,968	11,630	14,934	28.4	7,037	7,897	5,758	-18.2
Paraguay	1,383	845	1,689	2,461	3,618	47.0	1,611	2,007	1,098	-31.8
Uruguay	1,652	944	2,182	2,580	3,919	51.9	2,055	1,864	1,508	-26.6
Trade Balance										
						Absolute				Absolute
Argentina	1,485	2,823	-2,615	-3,611	-4,155	-544	-2,596	-1,559	384	2,979
Brazil	-551	-2,304	5,018	5,723	6,804	1,080	3,422	3,382	438	-2984
Paraguay	-853	-293	-772	-1,087	-1,514	-427	-452	-1,062	-227	225
Uruguay	-119	-337	-1,240	-1,333	-2,319	-986	-1,286	-1,033	-800	486

Note: [a/] Intrabloc exports and imports do not coincide due to differences in each country's records.

Source: INDEC, SECEX-MDIC, BCP, and BCU.

Box B
THE ECONOMIC CYCLE AND INTRABLOC TRADE IN MERCOSUR

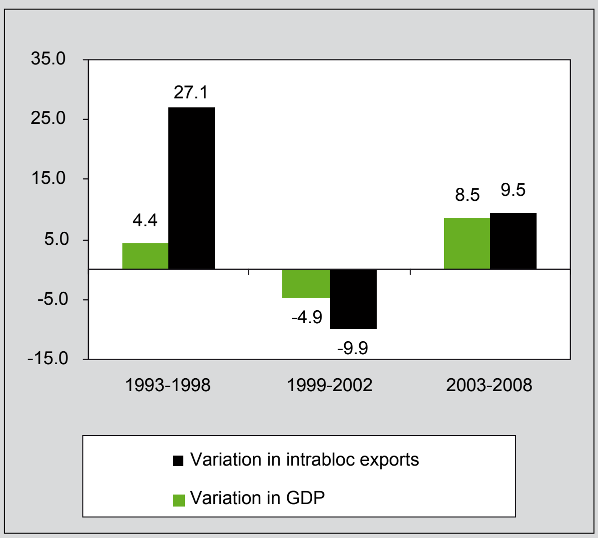
The share of intrabloc trade in current terms (the quotient of exports to MERCOSUR and total exports) peaked at 25% in 1998. Thereafter, intrabloc sales began to lose importance, reaching just 11.5% in 2002 and then experiencing a recovery of sorts, with the ratio reaching 14.9% in 2008. This decline in the importance of intrabloc trade is closely linked to the fluctuations the partners have been subject to in the economic cycle. The estimate at constant prices for Argentine and Brazilian exports to MERCOSUR -countries that produce disaggregated export price indices by type of good- gives a clearer idea of this phenomenon.

1993-2008 can be divided into three stages: the first (1993-1998) is a phase of economic growth in both countries; the second (1999-2002) a deep crisis, in which there is a deceleration in Brazilian growth and a depreciation of the *real*, while Argentina undergoes the collapse of the convertibility regime and economic activity; and the third phase (2003-2008), one of significant expansion across the bloc.

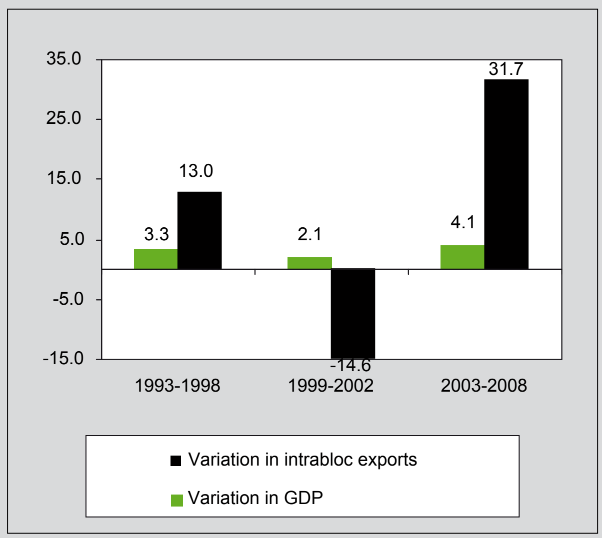
The differentiated behavior of GDP over the three stages clearly has a corollary in the dynamics of intrabloc shipments measured at constant prices (see Graph A). Overall, exports to MERCOSUR display greater product elasticity than extrabloc sales, as pointed out in other works (Heymann [1999], [2001]). In other words, when economies grow, intrabloc exports grow faster than shipments to the rest of the world, whereas, in recessionary periods, intrabloc sales suffer steep falls, steeper than the variation in extrazone sales. During 1993-2008, the product elasticity (in absolute values) of Argentine and Brazilian intrabloc exports was 1.6 times higher than extrabloc sales.

Graph A
ARGENTINA AND BRAZIL: ECONOMIC GROWTH AND INTRABLOC TRADE
(Average annual variations in GDP and exports to MERCOSUR at constant prices - As %)

ARGENTINA



BRAZIL



Source: Authors' own based on data from INDEC, SECEX-MDIC, and FUNCEX.

The economic cycle's effect on intra-MERCOSUR trade

The cyclical nature of shipments to the bloc -more pronounced in the case of extrazone sales- helps to explain MERCOSUR's loss of share as a destination in its total external sales (see Graph B). GDP growth in 1993-1998 resulted in increased exports to the bloc at rates far higher than those of sales to the rest of the world. In particular, while Argentina's annual average sales to the rest of the world rose 9.6% in that period, its exports to the bloc grew by 27.1%. In Brazil, average extrabloc sales grew just 3.1% per year, while those to MERCOSUR grew at 13%. This buoyancy meant that the two countries' share in total intraregional exports reached a 23.3% high at constant prices in 1998. However, the 1999-2002 crisis saw a virtual collapse of exports to MERCOSUR (with an average annual decline of 14.6% in Brazil and 9.9% in Argentina), while sales to the rest of the world grew at high rates, similar to those recorded during the subsequent recovery. In other words, while these countries were undergoing a situation of internal crisis, they managed to place significant volumes of exports in the rest of the world, driven not only by the exploitation of their comparative advantages, but also by the buoyancy of new export markets, particularly in Asia. Currency depreciations and the weakness of internal markets also acted as levers in this process of deepening of extrabloc exports. Given the share of intrabloc trade in the total, the recovery of exports to MERCOSUR, although very significant in 2003-2008, has clearly not been sufficient to offset the results of the accumulated buoyancy in extraregional markets since the period of internal crisis. As a result, although, during the recent upswing in both countries, intra-MERCOSUR exports grew faster than sales to the rest of the world, this was not enough to regain MERCOSUR's importance as a destination in 1998.

Gráph B
ARGENTINA AND BRAZIL: EVOLUTION OF EXPORTS BY DESTINATION AT CONSTANT PRICES
(Annual percentage variation 1993-2008)

ARGENTINA | **BRAZIL**

Source: Authors' own based on data from INDEC, SECEX-MDIC, and FUNCEX.

It should be stressed that, not only is the share of intrabloc exports in the total significant, but the evolution of the absolute level of real exports to MERCOSUR is equally so. Keeping this measurement in mind, in 2008, Argentina and Brazil's total sales to MERCOSUR were 57.1% up on 1998 levels. Although this increase is overshadowed when compared with shipments to the rest of the world, whose volume in 2008 was 1.9 times that of 1998, it nevertheless points to significant buoyancy in intrabloc exports, especially given the grave internal crises experienced by these countries for several years. This fact might be overlooked if attention is paid exclusively to the relative measurement.

Source: IDB-INTAL [2009c].

C. Terms and composition of trade by country

MERCOSUR countries' terms of trade[18]

The evolution of trade flows described above is largely explained by export prices. While, in the first half of 2008, commodity prices climbed significantly, they nosedived in the second half of the year. Even when these prices began to recover toward the second quarter of 2009, the first-half year-on-year variations were significantly down on 2008, when they stood at historic highs.

[18] Terms of trade are the average price of exports in relation to the average price of imports. For MERCOSUR countries' terms of trade indices, see Annex II.

The significant increase in export commodity prices during the first part of 2008 improved the terms of trade throughout MERCOSUR (Table 6). The fall of these prices since mid-2008 was reflected in the first half of 2009 in a deterioration of this relationship in the case of Argentina and Brazil, while Uruguay benefited from the low oil prices. Although there is no data for Paraguay and Venezuela, considering the great importance of these products in their respective export baskets, the terms of trade are likely to have fallen in the first half of 2009, due to lower soy and oil prices.

Table 6
MERCOSUR: TERMS OF TRADE
(YOY variation - As %)

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela
2007	3.7	2.1	4.8	0.2	9.6
2008	13.3	3.6	7.3	6.0	23.4
2009 1st H	-6.5	-3.5	n.a.	16.1	n.a.

Source: ECLAC, INDEC, FUNCEX, and BCU.

Trade composition by country

- Argentina -

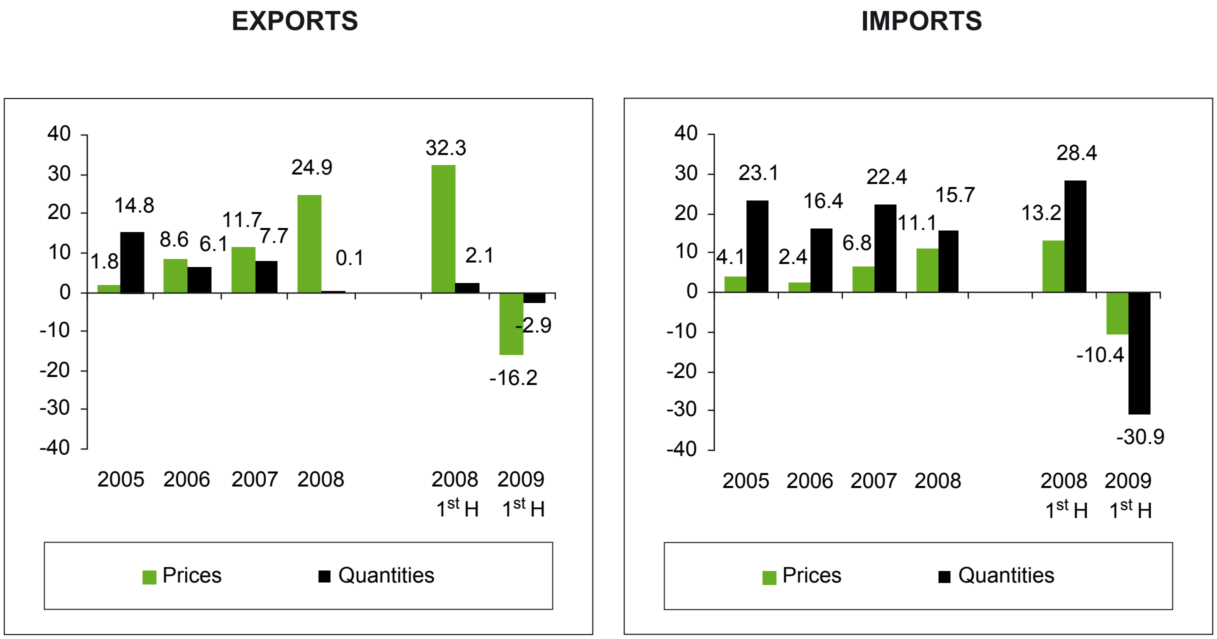
Looking at the composition of Argentine exports, agricultural and industrial manufactures remained the most important group in 2008, with a respective 34.1% and 31.5% of the total. Commodities represented 23% of the total, while fuels and energy accounted for 11.4%. In the first half of 2009, all export headings saw reductions, especially commodities (-39.7%), and fuels and energy (-25.3%). While industrial manufacturing was down 15.5%, agricultural manufacturing fell just 3%, explained by the sound performance of waste and waste products from the food industry, composed mainly of soy complex byproducts and strong demand from Asia.

In terms of composition, during 2008, imports continued to be headed by intermediate goods (35.2%) and capital goods, and their parts and accessories (22% and 17.3% respectively). Consumer goods represented 11% of the total, fuels and lubricants 7.5%, and motor vehicles 6.7%. Like exports, all economic uses of external purchases were down in the first half of 2009, in particular motor vehicles (-46.4%). The other categories fell by around 40%, while consumer goods were down 20.9%.

The evolution of Argentina's export and import prices was key in the above evolution of trade flows (see Graph 13). During 2008, growth of total exports was due exclusively to the variation in export prices, as the quantities remained stagnant. During the first half of 2009, the decline in prices, coupled with a slight decline in quantities, explain falling total sales.

The growth in the value of imports during 2008 was due to a significant rise in imported quantities and their prices. During the first half of 2009, the ongoing macroeconomic adjustment resulted in a steep fall in imported quantities, steeper than import prices.

GRAPH 13
ARGENTINA: PRICES AND QUANTITIES OF EXTERNAL TRADE FLOWS
(2005-2008 and first half of 2008 & 2009 - YOY variation - As %)



Source: INDEC.

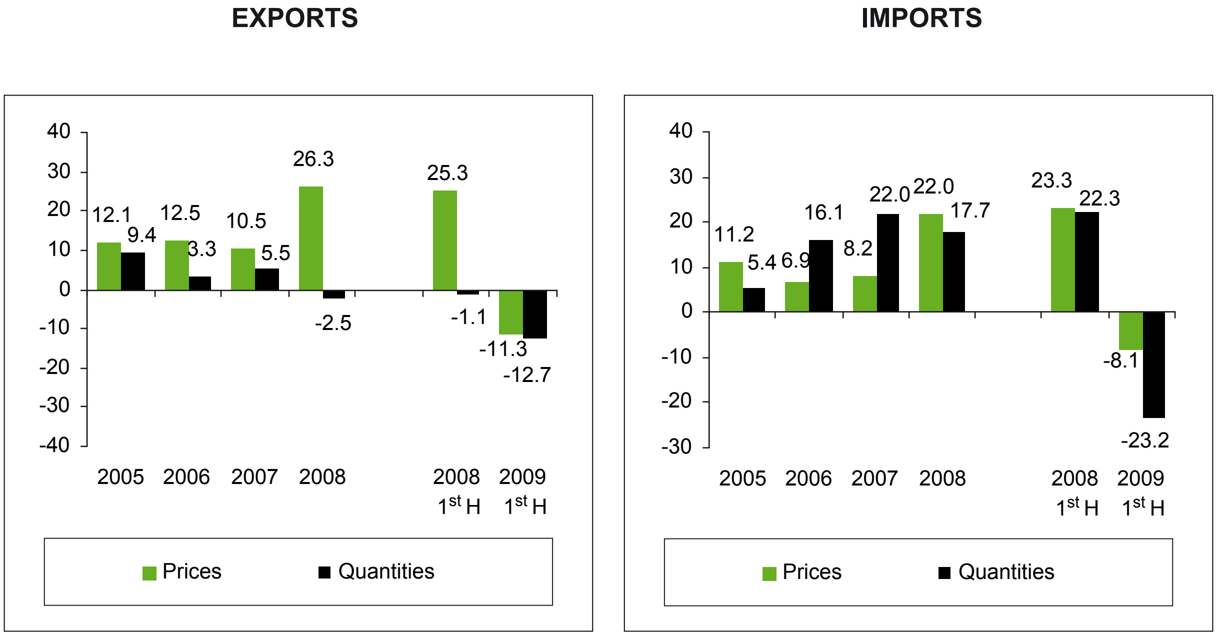
- Brazil -

Manufacturing represented 46.8% of external sales in 2008, followed by commodities with 36.9%, and semi-manufactured goods with 13.7%. The momentum in external sales was headed by commodities, which grew 41.5% in 2008. All three categories were down in the first half of 2009, more significantly in manufactured products (-31.1%) and semi-manufactured products (-27.5%), while commodities experienced the lowest fall (-8.2%)

In 2008, the composition of imports continued to be headed by intermediate goods, at 57.7% of the total. Fuels and capital goods accounted for 17.6% and 14.4% respectively, while consumer durables and non-durables totalled 10.3% of shipments. In the period's recessionary context, all use categories saw significant declines over the first half of 2009, with the exception of consumer non-durables, which grew 2.6%. Fuels recorded the largest reduction (-55.1%) followed by intermediate goods (-31.6%), and there were lower reductions in consumer durables (-9.8%) and capital goods (-5.3%).

As in Argentina, growth of foreign sales in 2008 was due solely to rising export prices. The quantities exported by Brazil fell that year. The contraction in external demand brought about a fall in exported quantities in the first half of 2009, steeper than the inherently significant contraction in prices (see Graph 14). In 2008, due to economic growth for most of the year, imports accelerated in light of a significant increase in quantities, coupled with a significant rise in prices. In the first half of 2009, the reduction in imported quantities was far steeper than the fall in prices. This was wholly in keeping with the low in activity levels.

Graph 14
BRAZIL: PRICES AND QUANTITIES OF EXTERNAL TRADE FLOWS
(2005-2008 and first half of 2008 & 2009 - YOY variation - As %)



Source: FUNCEX, based on data from SECEX-MDIC.

- Paraguay -

In 2008, Paraguayan exports were driven by soybean sales, which rose by 72.7%, or a third of total sales. Their share in meat products, vegetable oils, flours, and cereals accounted for almost half of external sales. In the first half of 2009, all major export categories suffered significant declines, with the exception of cereals, which increased 34.1%. Sales of vegetable oils fell by 56.3%, soybean sales by 35.7%, and flour sales by 29.8%. This negative trend is explained mainly by falling commodity prices.

The composition of imports in 2008 was fairly evenly divided between capital goods (38.5%), intermediate goods (33.3%), and consumer goods (28.2%). After recording significant increases in 2008, all categories were down in the first half of 2009. The most significant reductions were in capital goods (-36.8%) and intermediate goods (-31.3%), but were less significant in consumer goods (-8.3%), a result consistent with the fall in activity levels.

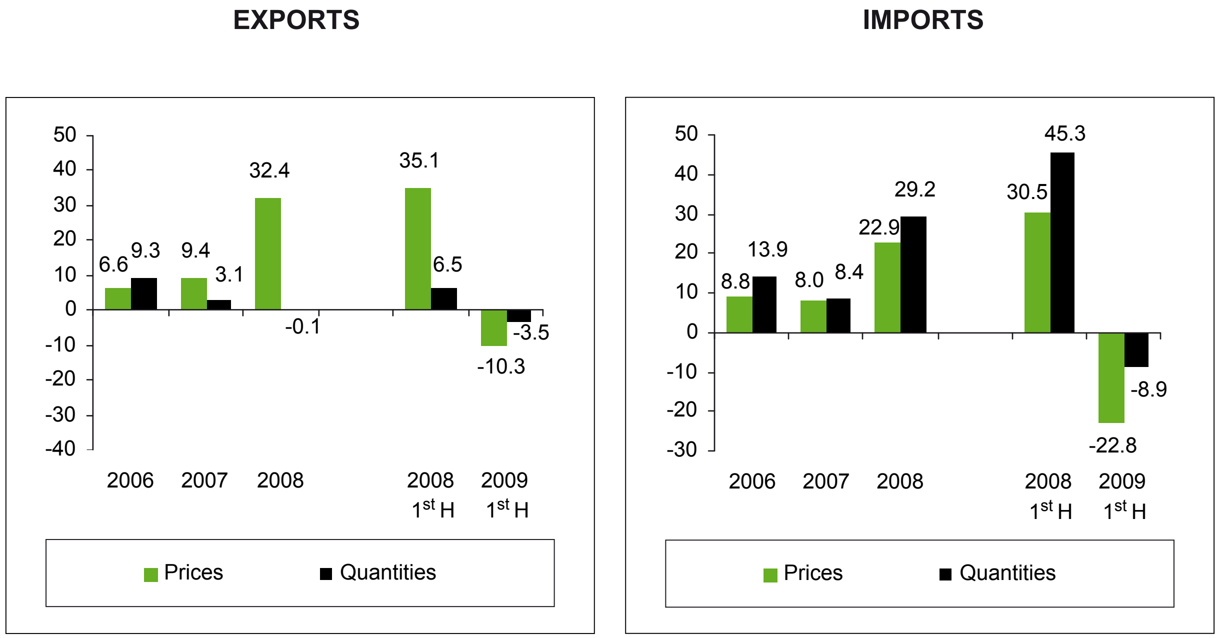
- Uruguay -

In 2008, external sales remained concentrated in cold-storage products and agricultural goods, with 27.3% and 10.9% of the total. Dairy products, milling products, and chemicals all displayed shares of around 8%. The reduction in foreign sales in the first half of 2009 was concentrated in cold-storage products (-28.3%) and textiles (-30.4%), while agricultural exports continued to grow, at a rate of 16.4%.

In 2008, two thirds of imports were intermediate goods, followed by consumer and capital goods in even parts. In the first half of 2009, the sharpest reduction was recorded in capital goods, purchases of which fell by -92.6% in line with a reduction in investment related to the completion of a major cellulose processing project and the contraction in activity levels. Purchases of intermediate goods fell by 39%, and consumer goods by 8.1%.

The growth in Uruguayan external sales in 2008 was due solely to variation in prices, as quantities stagnated (see Graph 15). The fall in exports in the first half of 2009 is explained mainly by falling prices, as the reduction of quantities was lower. The significant increase in foreign purchases in 2008 is explained by a significant increase in quantities and prices. During the first half of 2009, the drop in prices was far higher than the fall in quantities imported. The steeper decline of import than export prices favored Uruguay's terms of trade.

Graph 15
URUGUAY: PRICES AND QUANTITIES OF EXTERNAL TRADE FLOWS
(2005-2008 and first half of 2008 & 2009 - YOY Variation - As %)

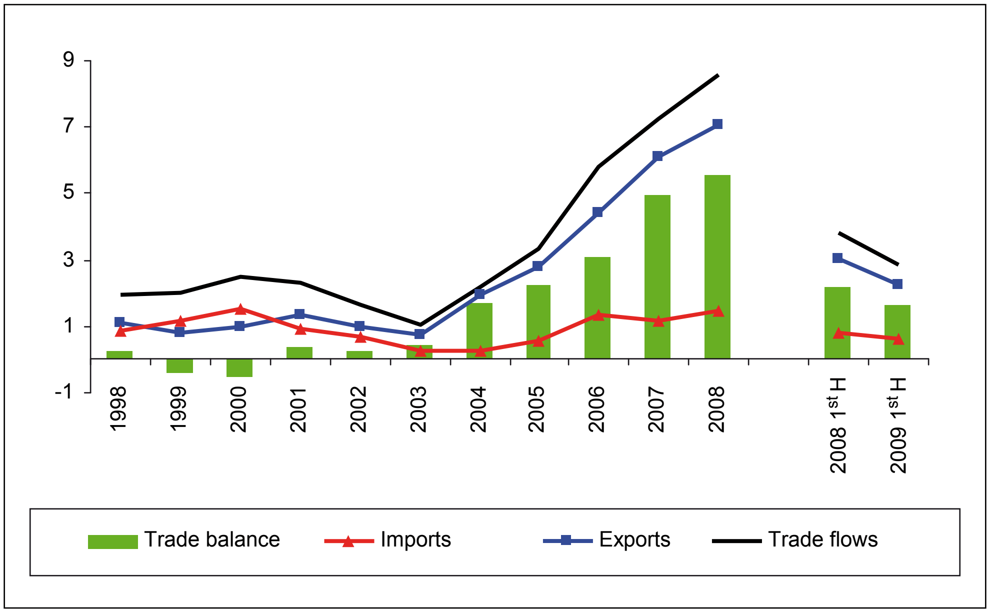


Source: Authors' own based on data from BCU.

D. MERCOSUR-Venezuela trade

In 2008, trade links between MERCOSUR and Venezuela deepened, with total reciprocal exports and imports reaching US$8.6 billion, 18.2% up on the previous year. In 2003-2008, trade had grown at the remarkable annual rate of 31.4%. This expansion is explained mainly by sales from MERCOSUR to Venezuela of US$7.1 billion in 2008. The surplus in favor of MERCOSUR was US$5.6 billion (see Graph 16). In the first half of 2009, the contraction in the bloc's exports to Venezuela was 24.8%, somewhat above the contraction suffered by the four partners' total external sales (-21.5%), but lower than those to the bloc itself (-29.8%).

Graph 16
MERCOSUR: TRADE FLOWS WITH VENEZUELA
(1998-first half of 2009 - In billions of US$)



Source: INDEC, SECEX-MDIC, BCP, and BCU.

Table 7
MERCOSUR TRADE FLOWS WITH VENEZUELA
(In millions of US$ - As %)

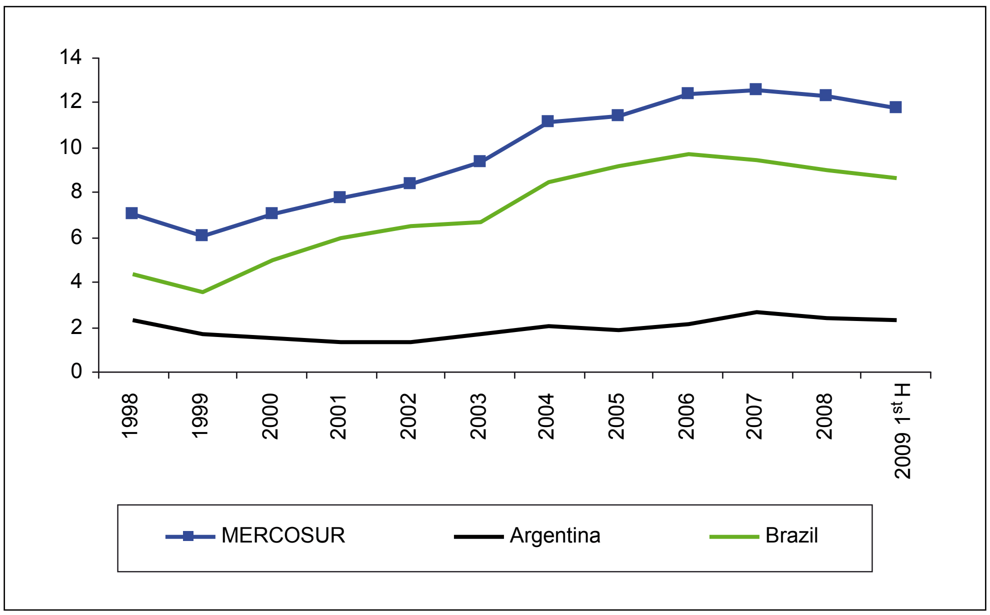
	1998	2002	2006	2007	2008	Variation 2008/2007	Variation 2008/2002	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
Exports to Venezuela						**Percentage**	**Percentage c.a.**				**Percentage**
MERCOSUR	*1,106*	*969*	*4,446*	*6,079*	*7,062*	*16.2*	*39.2*	*3,012*	*4,050*	*2,264*	*(24.8)*
Argentina	364	149	793	1,176	1,418	20.6	45.5	620	798	417	(32.8)
Brazil	706	799	3,565	4,724	5,150	9.0	36.4	2,190	2,960	1,661	(24.1)
Paraguay	8	10	8	85	257	202.6	72.7	112	144	80	(28.9)
Uruguay	28	11	78	99	237	140.5	66.3	89	148	106	18.5
Imports from Venezuela						**Percentage**	**Percentage c.a.**				**Percentage**
MERCOSUR	*855*	*689*	*1,356*	*1,149*	*1,490*	*29.7*	*13.7*	*799*	*691*	*597*	*(25.3)*
Argentina	58	7	25	24	25	6.8	22.9	11	14	5	(50.9)
Brazil	756	633	592	346	539	55.7	(2.7)	273	266	197	(27.6)
Paraguay	3	5	139	142	365	157.5	106.2	213	152	195	(8.3)
Uruguay	38	44	599	638	561	(11.9)	52.7	303	259	199	(34.2)
Trade Balance						**Absolute**	**Absolute**				**Absolute**
MERCOSUR	*251*	*280*	*3,091*	*4,930*	*5,572*	*13.0*	*5,292*	*2,212*	*3,359*	*1,667*	*3,346*
Argentina	305	142	768	1,153	1,393	20.8	1,251	609	784	411	763
Brazil	-49	166	2,974	4,378	4,612	5.3	4,446	1,917	2,695	1,464	2,689
Paraguay	5	5	-131	-57	-108	90.2	-113	-100	-8	-115	-98
Uruguay	-10	-33	-521	-539	-324	(39.8)	-291	-213	-111	-93	-71

Source: INDEC, SECEX-MDIC, BCP, and BCU.

In terms of the origin by country of exports to Venezuela, one fact to be highlighted is the significant increase in the proportion accounted for by the smaller partners in 2008. A year earlier, Brazil had been the origin of 77.7% of these sales, a proportion down 4.8 percentage points in 2008. In the last year, Argentina, Paraguay, and Uruguay accounted for 20.1% 3.6% and 3.4% of MERCOSUR sales respectively. There was a highly pronounced increase in sales by Paraguay and Uruguay, which exported US$260 million and US$240 million respectively to Venezuela. Both countries, however, remained in deficit with their trading partner, unlike Argentina and Brazil (Table 7).

In 2008, MERCOSUR's market share in Venezuela was 12.3%, 9 percentage points of which were from Brazil and 2.4 from Argentina (see Graph 17). This was slightly down on the previous year, particularly in the first half of 2009, perhaps indicating difficulties in the subsequent expansion of supply by MERCOSUR in that market.

Graph 17
MERCOSUR SHARE IN VENEZUELAN IMPORTS
(As %)



Source: LAIA.

E. Foreign direct investment in MERCOSUR[19]

In 2008, foreign direct investment in MERCOSUR countries rose 31.5% to US$56 billion, a record in nominal terms, exceeding the investment received at the end of the 1990s (see Graph 18). The entry of foreign capital, however, slowed abruptly in the first half of 2009, with just US$15.7 billion, 34.6% down on the same period a year earlier. In fact, income for 2008 was concentrated in the first three quarters, while the inherent instability of the international crisis affected it especially in the last quarter of this year and the first of 2009.

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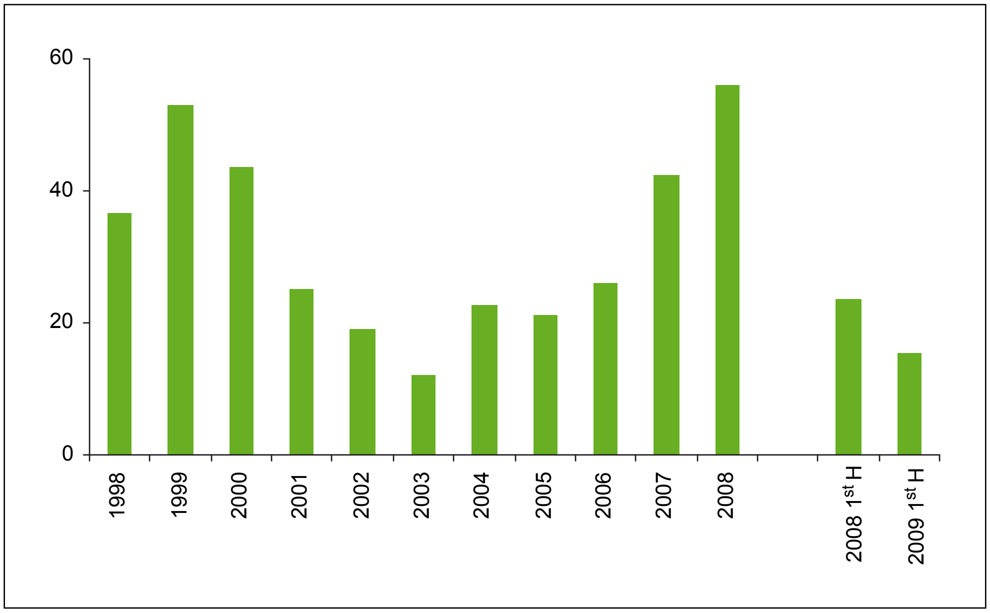
[19] Where Chapter I considers net FDI flows, this section limits itself to analyzing FDI inflows to each country's economy. See Annex II for FDI outflows from each country.

Graph 18
FOREIGN DIRECT INVESTMENT IN MERCOSUR
(1998-first half of 2009 - In billions of US$)



Source: ECLAC and BCP.

Brazil was the largest recipient of FDI in MERCOSUR, with 80.5% in 2008. However, the three remaining partners were the most dynamic recipients that year. Argentina received US$8.9 billion, implying year-on-year growth of 36.8%. Also flows to Paraguay and Uruguay saw increases over and above the bloc's average, 32.7% and 38.5% respectively. The contraction of the first half of 2009 particularly affected Argentina and Uruguay.

F. Conclusions

The rapid transformation of MERCOSUR's external context into an adverse situation with singular macroeconomic instability interrupted the phase of trade expansion experienced by the bloc's countries since 2003. However, other novel features of this same external environment, coupled with the effect of crisis containment policies, meant that MERCOSUR trade in this period performed better than the world average and was well above the other Latin American countries, whose trade was concentrated in the countries hardest hit by the crisis, especially the United States. The result is explained to a large extent by the growing importance of Asian markets, in particular China, as a destination for MERCOSUR's extrabloc exports and by the price stabilization of certain commodities. As on other occasions, intrabloc trade showed greater sensitivity to cyclical fluctuations, although this time it fell by a similar amount to extrabloc trade. Looking to the longer term, it should be noted that trade flows between MERCOSUR partners have continued to grow, up almost 60% on those of a decade ago in absolute terms.

Contents

ANNEX II

Table AII.1
ARGENTINA: EXTRA- AND INTRAZONE TRADE FLOWS
(In millions of US$ - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
Total exports	**26,434**	**25,651**	**46,569**	**56,246**	**70,021**	**24.5**	**33,504**	**36,517**	**27,250**	**-18.7**
MERCOSUR/total (%)	*35.6*	*22.3*	*21.3*	*22.1*	*23.1*		*22.5*	*23.5*	*22.8*	
MERCOSUR	*9,415*	*5,718*	*9,940*	*12,426*	*16,145*	*29.9*	*7,547*	*8,598*	*6,205*	*-17.8*
Brazil	7,949	4,846	8,152	10,485	13,260	26.5	6,156	7,104	4,961	-19.4
Paraguay	622	343	616	776	1,086	39.9	497	589	343	-31.0
Uruguay	843	529	1,172	1,165	1,800	54.5	894	906	708	-20.8
Extrazone/total (%)	*64.4*	*77.7*	*78.7*	*77.9*	*76.9*		*77.5*	*76.5*	*77.2*	
Extrazone	*17,019*	*19,932*	*36,629*	*43,820*	*53,875*	*22.9*	*25,957*	*27,918*	*21,045*	*-18.9*
NAFTA	2,679	3,744	5,932	5,804	7,331	26.3	3,247	4,085	2,401	-26.0
European Union	4,633	5,114	8,002	9,895	13,114	32.5	6,656	6,459	4,937	-25.8
LAIA[a/]	3,373	4,247	7,234	7,765	9,319	20.0	4,428	4,891	4,046	-8.6
Asia[b/]	4,007	4,435	8,568	11,713	13,796	17.8	6,353	7,443	6,218	-2.1
Other countries	2,328	2,393	6,893	8,643	10,315	19.3	5,274	5,041	6,218	17.9
Total imports	**31,379**	**8,988**	**34,150**	**44,781**	**57,423**	**28.2**	**28,114**	**29,309**	**17,389**	**-38.1**
MERCOSUR/total (%)	*25.3*	*32.2*	*36.8*	*35.8*	*35.4*		*36.9*	*89.2*	*33.3*	
MERCOSUR	*7,930*	*2,895*	*12,555*	*16,037*	*20,300*	*26.6*	*10,143*	*10,157*	*5,821*	*-42.6*
Brazil	7,055	2,517	11,750	14,523	17,977	23.8	8,912	9,065	5,109	-42.7
Paraguay	348	255	504	1,056	1,783	68.8	966	817	534	-44.7
Uruguay	528	122	301	458	540	17.8	264	276	178	-32.5
Extrazone/total (%)	*74.7*	*67.8*	*63.2*	*64.2*	*64.6*		*63.9*	*65.3*	*66.5*	
Extrazone	*23,449*	*6,093*	*21,595*	*28,744*	*37,123*	*29.2*	*17,971*	*19,152*	*11,567*	*-35.6*
NAFTA	7,163	2,012	5,550	6,893	8,936	29.6	4,309	4,627	3,011	-30.1
European Union	8,871	2,028	5,813	7,452	9,012	20.9	4,491	4,521	2,892	-35.6
LAIA[a/]	1,138	255	1,129	1,273	1,539	20.9	704	835	567	-19.5
Asia[b/]	4,792	1,072	6,365	9,115	11,943	31.0	5,660	6,283	3,846	-32.1
Other countries	1,485	727	2,738	4,011	5,694	41.9	2,808	2,886	1,253	-55.4
Total trade balance	**-4,946**	**16,662**	**12,419**	**11,465**	**12,598**		**5,390**	**7,208**	**9,861**	**19.5**
						Absolute				Absolute
MERCOSUR	*1,485*	*2,823*	*-2,615*	*-3,611*	*-4,155*	*-544*	*-2,596*	*-1,559*	*384*	*2,979*
Brazil	895	2,329	-3,598	-4,038	-4,717	-680	-2,756	-1,961	-148	2,608
Paraguay	274	87	112	-280	-697	-417	-470	-228	-191	278
Uruguay	316	407	871	707	1,260	553	630	630	530	-100
Extrazone	*-6,430*	*13,839*	*15,034*	*15,076*	*16,753*	*1,677*	*7,986*	*8,767*	*9,478*	*1,491*
NAFTA	-4,484	1,733	382	-1,089	-1,605	-515	-1,062	-543	-610	452
European Union	-4,238	3,086	2,189	2,443	4,102	1,659	2,165	1,937	2,045	-120
LAIA[a/]	2,234	3,992	6,105	6,492	7,780	1,288	3,724	4,055	3,479	-245
Asia[b/]	-785	3,363	2,203	2,598	1,854	-744	693	1,161	2,372	1,679
Other countries	842	1,666	4,155	4,632	4,621	-11	2,466	2,156	4,965	2,499

Notes: [a/] With the exception of MERCOSUR and Mexico. Mexico is included in NAFTA.
[b/] Includes Middle East.

Source: INDEC.

TABLE AII.2
BRAZIL: EXTRA- AND INTRAZONE TRADE FLOWS
(In millions of US - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
Total exports	**51,120**	**60,439**	**137,808**	**160,649**	**197,942**	**23.2**	**90,645**	**107,298**	**69,952**	**-22.8**
MERCOSUR/total (%)	*17.4*	*5.5*	*10.1*	*10.8*	*11.0*		*11.5*	*10.5*	*8.9*	
MERCOSUR	*8,877*	*3,311*	*13,986*	*17,354*	*21,737*	*25.3*	*10,459*	*11,278*	*6,196*	*-40.8*
Argentina	6,747	2,347	11,740	14,417	17,606	22.1	8,589	9,017	4,941	-42.5
Paraguay	1,249	560	1,234	1,648	2,488	50.9	1,112	1,375	697	-37.4
Uruguay	881	413	1,013	1,288	1,644	27.6	758	887	558	-26.4
Extrazone/total (%)	*82.6*	*94.5*	*89.9*	*89.2*	*89.0*		*88.5*	*89.5*	*91.1*	
Extrazone	*42,243*	*57,128*	*23,822*	*143,296*	*176,205*	*23.0*	*80,186*	*96,019*	*63,756*	*-20.5*
NAFTA	11,411	18,687	31,512	31,936	33,796	5.8	15,852	17,944	9,254	-41.6
European Union	15,250	15,609	31,045	40,428	46,395	14.8	22,146	24,250	15,990	-27.8
LAIA[a/]	3,506	4,226	13,051	14,812	17,076	15.3	7,590	9,486	5,014	-33.9
Asia[b/]	5,613	8,798	20,816	25,086	45,497	81.4	19,704	25,793	22,064	12.0
Other countries	6,464	9,807	27,397	31,033	33,441	7.8	14,895	18,546	11,434	-23.2
Total imports	**57,714**	**47,243**	**91,343**	**120,621**	**173,197**	**43.6**	**79,351**	**93,845**	**55,963**	**-29.5**
MERCOSUR/total (%)	*16.3*	*11.9*	*9.8*	*9.6*	*8.6*		*36.9*	*89.2*	*33.3*	
MERCOSUR	*9,428*	*5,615*	*8,968*	*11,630*	*14,934*	*28.4*	*7,037*	*7,897*	*5,758*	*-18.2*
Argentina	8,034	4,744	8,054	10,410	13,258	27.4	6,239	7,019	4,985	-20.1
Paraguay	351	383	296	434	657	51.5	320	338	212	-33.6
Uruguay	1,042	485	618	786	1,018	29.5	478	540	561	17.3
Extrazone/total (%)	*83.7*	*88.1*	*90.2*	*90.4*	*91.4*		*91.1*	*91.6*	*89.7*	
Extrazone	*48,287*	*41,628*	*82,375*	*108,991*	*58,263*	*45.2*	*72,315*	*85,948*	*50,205*	*-30.6*
NAFTA	16,008	11,760	17,355	22,575	22,576	0.0	14,037	8,538	11,725	-16.5
European Union	17,184	13,495	20,201	26,736	36,187	35.3	16,631	19,556	12,889	-22.5
LAIA[a/]	1,959	2,033	6,020	6,972	9,349	34.1	4,588	4,761	2,635	-42.6
Asia[b/]	7,881	7,996	22,887	30,715	53,357	73.7	24,415	28,942	16,761	-31.4
Other countries	5,254	6,344	15,912	21,993	36,794	67.3	12,642	24,152	6,196	-51.0
Total trade balance	**-6,595**	**13,196**	**46,465**	**40,028**	**24,746**		**11,293**	**13,453**	**13,989**	**6.6**
						Absolute				Absolute
MERCOSUR	*-551*	*-2,304*	*5,018*	*5,723*	*6,804*	*1,080*	*3,422*	*3,382*	*438*	*-2,984*
Argentina	-1,287	-2,397	3,686	4,007	4,348	341	2,350	1,998	-43	-2,394
Paraguay	898	177	938	1,214	1,830	616	793	1,037	485	-308
Uruguay	-162	-72	394	502	626	124	279	347	-3	-283
Extrazone	*-6,044*	*15,500*	*41,447*	*34,305*	*17,942*	*-16,363*	*7,871*	*10,071*	*13,551*	*5,680*
NAFTA	-4,597	6,927	14,157	9,361	11,220	1,859	1,814	9,405	-2,471	-4,286
European Union	-1,934	2,114	10,844	13,692	10,208	-3,484	5,514	4,693	3,102	-2,413
LAIA[a/]	1,547	2,194	7,031	7,840	7,727	-113	3,001	4,726	2,379	-622
Asia[b/]	-2,269	802	-2,071	-5,629	-7,860	-2,231	-4,712	-3,148	5,303	10,015
Other countries	1,209	3,463	11,485	9,040	-3,353	-12,393	2,253	-5,606	5,238	2,985

Notes: [a/] With the exception of MERCOSUR and Mexico. Mexico is included in NAFTA.
[b/] Includes Middle East.

Source: SECEX-MDIC.

TABLE AII.3
PARAGUAY: EXTRA- AND INTRAZONE TRADE FLOWS
(In millions of US$ - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
Total exports	**1,014**	**951**	**1,906**	**2,785**	**4,390**	**57.6**	**2,398**	**1,992**	**1,700**	**-29.1**
MERCOSUR/total (%)	*52.3*	*58.1*	*48.1*	*49.3*	*47.9*		*48.3*	*47.4*	*51.3*	
MERCOSUR	*531*	*553*	*917*	*1,374*	*2,104*	*53.1*	*1,159*	*945*	*871*	*-24.8*
Argentina	153	35	168	552	712	29.0	492	220	244	-50.3
Brazil	349	353	328	558	614	10.1	301	314	263	-12.4
Uruguay[a/]	29	165	420	264	777	194.2	367	411	364	-0.8
Extrazone/total (%)	*47.7*	*41.9*	*51.9*	*50.7*	*52.1*		*51.7*	*52.6*	*48.7*	
Extrazone	*483*	*398*	*990*	*1,411*	*2,286*	*62.1*	*1,239*	*1,048*	*829*	*-33.1*
NAFTA	83	42	74	80	83	3.4	29	54	23	-21.0
European Union	285	83	114	233	368	58.3	191	178	87	-54.6
LAIA[b/]	66	99	153	441	867	96.6	415	452	329	-20.7
Asia[c/]	18	48	101	166	389	134.5	233	157	138	-40.7
Other countries	31	126	548	491	579	17.8	372	207	252	-32.2
Total imports	**2,471**	**1,510**	**4,489**	**5,577**	**8,491**	**52.3**	**3,865**	**4,627**	**2,803**	**-27.5**
MERCOSUR/total (%)	*56.0*	*56.0*	*37.6*	*44.1*	*42.6*		*36.9*	*89.2*	*33.3*	
MERCOSUR	*1,383*	*845*	*1,689*	*2,461*	*3,618*	*47.0*	*1,611*	*2,007*	*1,098*	*-31.8*
Argentina	481	309	677	800	1,216	52.1	473	743	426	-9.8
Brazil	822	478	960	1,588	2,302	45.0	1,104	1,198	633	-42.6
Uruguay	80	58	52	74	100	36.2	35	66	39	11.8
Extrazone/total (%)	*44.0*	*44.0*	*62.4*	*55.9*	*57.4*		*58.3*	*56.6*	*60.8*	
Extrazone	*1,087*	*665*	*2,800*	*3,116*	*4,873*	*56.4*	*2,253*	*2,620*	*1,705*	*-24.4*
NAFTA	282	92	375	343	448	30.6	220	228	164	-25.5
European Union	284	142	243	313	446	42.4	200	246	168	-16.3
LAIA[b/]	30	29	227	246	527	114.0	288	238	249	-13.6
Asia[c/]	449	305	1,739	2,152	3,185	48.0	1,466	1,719	1,091	-25.5
Other countries	42	95	216	61	267	335.7	79	188	32	-58.9
Total trade balance	**-1,457**	**-560**	**-2,583**	**-2,792**	**-4,101**		**-1,467**	**-2,634**	**-1,103**	**-1.6**
						Absolute				Absolute
MERCOSUR	*-853*	*-293*	*-772*	*-1,087*	*-1,514*	*-427*	*-452*	*-1,062*	*-227*	*225*
Argentina	-328	-275	-509	-248	-504	-256	19	-523	-182	-201
Brazil	-473	-125	-632	-1,030	-1,687	-657	-803	-885	-370	433
Uruguay	-51	107	368	191	677	487	332	345	325	-7
Extrazone	*-604*	*-267*	*-1,811*	*-1,705*	*-2,587*	*-882*	*-1,015*	*-1,572*	*-876*	*139*
NAFTA	-199	-50	-301	-263	-365	-102	-191	-174	-141	50
European Union	1	-59	-129	-81	-78	3	-10	-68	-81	-71
LAIA[b//]	35	69	-75	195	340	146	126	214	80	-46
Asia[c/]	-430	-257	-1,638	-1,986	-2,796	-810	-1,233	-1,562	-954	280
Other countries	-11	30	332	430	311	-118	293	19	220	-73

Notes: [a/] Exports from Paraguay to Uruguay include sales entering the Nueva Palmira Duty-Free Zone. See Table A.II.4, Note [a/]. This clarification was omitted from *MERCOSUR Report 13*, Table 10, p. 47.
[b/] With the exception of MERCOSUR and Mexico. Mexico is included in NAFTA.
[c/] Includes Middle East.

Source: BCP.

TABLE AII.4
URUGUAY: EXTRA- AND INTRAZONE TRADE FLOWS
(In millions of US$ - As %)

	1998	2002	2006	2007	2008	Variation 2008/2007	1st H 2008	2nd H 2008	1st H 2009	Variation 1st H 2009/2008
						Percentage				Percentage
Total exports[a]	**2,769**	**1,861**	**3,985**	**4,498**	**5,949**	**32.2**	**2,964**	**2,985**	**2,566**	**-13.4**
MERCOSUR/total (%)	*55.3*	*32.6*	*23.6*	*27.7*	*26.9*		*26.0*	*27.8*	*27.6*	
MERCOSUR	*1,532*	*607*	*942*	*1,247*	*1,601*	*28.4*	*769*	*831*	*709*	*-7.9*
Argentina	513	113	301	441	507	15.0	254	253	168	-33.9
Brazil	935	432	583	728	987	35.5	466	520	499	6.9
Paraguay	84	62	58	77	107	38.9	49	58	42	-13.9
Extrazone/total (%)	*44.7*	*67.4*	*76.4*	*72.3*	*73.1*		*74.0*	*72.2*	*72.4*	
Extrazone	*1,236*	*1,254*	*3,043*	*3,251*	*4,348*	*33.7*	*2,195*	*2,154*	*1,857*	*-15.4*
NAFTA	210	239	715	773	429	-44.4	184	245	167	-9.3
European Union	459	445	668	832	1,150	38.2	592	558	407	-31.3
LAIA[b]	251	156	351	286	566	98.1	242	324	179	-26.0
Asia[c]	295	317	530	544	693	27.4	341	352	338	-0.8
Other countries	21	98	779	817	1,510	84.9	836	674	766	-8.4
Total imports[a]	**3,811**	**1,964**	**4,775**	**5,608**	**8,933**	**59.3**	**4,466**	**4,467**	**3,141**	**-29.7**
MERCOSUR/total (%)	*43.3*	*48.1*	*45.7*	*46.0*	*43.9*		*36.9*	*89.2*	*33.3*	
MERCOSUR	*1,652*	*944*	*2,182*	*2,580*	*3,919*	*51.9*	*2,055*	*1,864*	*1,508*	*-26.6*
Argentina	842	541	1,079	1,235	2,250	82.1	1,217	1,033	803	-34.0
Brazil	793	390	1,078	1,314	1,618	23.2	817	801	653	-20.1
Paraguay	16	14	26	31	51	67.5	21	30	22	5.6
Extrazone/total (%)	*56.7*	*51.9*	*54.3*	*54.0*	*56.1*		*54.0*	*58.3*	*52.0*	
Extrazone	*2,159*	*1,020*	*2,593*	*3,028*	*5,014*	*65.6*	*2,411*	*2,603*	*1,633*	*-32.3*
NAFTA	526	200	407	516	842	63.2	428	414	278	-35.1
European Union	802	352	477	578	769	33.0	345	424	312	-9.5
LAIA[b]	170	106	712	734	698	-5.0	366	332	256	-30.2
Asia[c]	454	191	745	860	1,396	62.3	604	791	495	-18.1
Other countries	208	171	252	339	1,309	285.9	667	642	292	-56.2
Total trade balance	**-1,042**	**-103**	**-790**	**-1,109**	**-2,984**		**-1,502**	**-1,482**	**-575**	**16.2**
						Absolute				Absolute
MERCOSUR	*-119*	*-337*	*-1,240*	*-1,333*	*-2,319*	*-986*	*-1,286*	*-1,033*	*-800*	*486*
Argentina	-328	-427	-777	-794	-1,743	-949	-963	-780	-635	328
Brazil	142	42	-495	-586	-631	-46	-351	-280	-154	197
Paraguay	67	48	32	46	56	9	28	28	20	-8
Extrazone	*-923*	*234*	*450*	*223*	*-665*	*-889*	*-216*	*-450*	*224*	*440*
NAFTA	-316	39	308	256	-413	-670	-244	-169	-111	133
European Union	-343	93	191	254	381	127	247	135	94	-152
LAIA[b]	81	49	-360	-449	-132	317	-124	-8	-77	47
Asia[c]	-159	125	-216	-316	-703	-386	-264	-439	-157	107
Other countries	-186	-73	527	477	201	-276	169	32	474	305

Notes: [a] Does not include movements originating in or destined for Duty-Free Zones and Customs Warehouses. See Table A.II.3, Note [a].
[b] With the exception of MERCOSUR and Mexico. Mexico is included in NAFTA.
[c] Includes Middle East.

Source: BCU.

TABLE AII.5
MERCOSUR: TERMS OF TRADE
(1998 Indices = 100)

Year	Argentina	Brazil	Paraguay	Uruguay	Venezuela
1998	100.0	100.0	100.0	100.0	100.0
1999	94.1	86.7	94.1	91.9	129.1
2000	103.5	89.4	92.6	95.8	195.2
2001	102.8	89.1	92.8	99.6	160.5
2002	102.2	87.9	89.5	98.2	171.0
2003	111.0	86.7	93.9	99.1	192.7
2004	113.1	87.5	96.6	95.7	230.5
2005	110.7	88.7	90.2	86.9	301.4
2006	117.3	93.3	88.5	84.8	359.9
2007	121.7	95.3	92.7	85.0	394.6
2008	137.9	98.7	99.4	90.1	487.0
1st H 2008	142.3	96.1	n.a.	86.2	n.a.
1st H 2009	133.0	92.7	n.a.	100.1	n.a.

Source: ECLAC, INDEC, FUNCEX, and BCU.

TABLE AII.6
MERCOSUR: FOREIGN DIRECT INVESTMENT
(In millions of US$)

	1998	2002	2006	2007	2008	1st H 2008	2nd H 2008	1st H 2009
Foreign direct investment in declaring economy								
MERCOSUR	*36,652*	*18,943*	*26,026*	*42,573*	*55,998*	*23,641*	*15,468*	*15,468*
Argentina	7,291	2,149	5,537	6,473	8,853	5,748	3,105	2,094
Brazil	28,856	16,590	18,822	34,585	45,058	16,710	28,348	12,684
Paraguay	342	10	173	185	246	138	108	184
Uruguay	164	194	1,493	1,329	1,841	1,045	796	505
Foreign direct investment abroad								
MERCOSUR	*5,194*	*1,867*	*30,647*	*8,668*	*21,817*	*9,254*	*12,564*	*-969*
Argentina	2,325	-627	2,439	1,504	1,351	665	686	821
Brazil	2,854	2,482	28,202	7,067	20,457	8,579	11,878	-1,798
Paraguay	6	-2	7	7	8	4	4	4
Uruguay	9	14	-1	89	1	6	-5	4
Net foreign direct investment								
MERCOSUR	*31,458*	*17,076*	*-4,621*	*33,905*	*34,180*	*14,387*	*2,904*	*16,437*
Argentina	4,965	2,776	3,099	4,969	7,502	5,083	2,419	1,273
Brazil	26,002	14,108	-9,380	27,518	24,601	8,131	16,470	14,482
Paraguay	336	12	167	178	238	134	104	180
Uruguay	155	180	1,495	1,240	1,840	1,039	801	501

Source: ECLAC and BCP.

CHAPTER III. THE INTERNAL AGENDA

This chapter outlines the main issues on MERCOSUR's internal agenda between July 2008 and June 2009, a period that covers the *Pro Tempore* Presidencies (PPT) of Brazil (second half of 2008) and Paraguay (first half of 2009). It is organized into five sections. The first reflects the measures arising from top level meetings of the MERCOSUR authorities, including Finance Ministers and Central Bank Presidents, to deal with the effects of the international crisis. The global episode contributed to some extent to speeding up certain negotiations and expediting the implementation of previous agreements, such as the local currency swap between Argentina and Brazil, and the evaluation of its possible extension to the other members of the bloc. Likewise, the impetus given to the currency swap between the major partners, the establishment of a mechanism to monitor trade flows, and the proposals to raise certain extrazone import duties, were also among the effects of the crisis on MERCOSUR.

The following sections detail the evolution of the major issues that have been the subject of negotiations within the bloc. The second section looks at trade-related aspects, while the third gives an account of asymmetries and regional productive integration. The last two sections are respectively devoted to institutional and other aspects relevant to the bloc, such as the membership of Venezuela.

In recent years, the internal agenda has made little progress. This was limited to the inclusion of the issue of production as one of the central axes in responding to asymmetries and trade tensions, the creation of FOCEM being one of the main achievements of MERCOSUR in the last five years. The installation of the MERCOSUR Parliament and the setting-up of the Permanent Review Tribunal have contributed to the institutional strengthening of the integration process.

The international crisis incorporated a new dimension to negotiating problems for the States Parties in 2008-2009. In this regard, one can see a fairly modest reaction to the crisis from MERCOSUR, through the implementation of financial measures, and a degree of coordination through meetings at the highest levels of the countries' economic authorities, especially when one remembers that the two largest partners are members of the G-20 (Chapter V). There was some progress on the agenda to consolidate the process, both in terms of productive integration (the creation of the MERCOSUR Guarantee Fund for SMEs and the use of the FOCEM for productive projects), institutional strengthening (such as the expansion of the functions of the MERCOSUR Secretariat), and a greater relevance of the social question in the negotiating axis (the structure of the MERCOSUR Social Institute and special treatment for family farming). In any event, the international scene was not conducive to more decisive progress in the period.

A. Measures to combat the international crisis

This section describes the negotiation and implementation of certain agreements that had been under discussion and were driven by the climate resulting from the international crisis. It looks at the implementation of the Local Currency Payment System, the proposals for currency swaps between partner countries, the creation of an authority to monitor trade flows, and the applications to amend the CET for certain sensitive products.

Local Currency Payment System (SML)

- Background -

The possibility of using local currencies in commercial transactions between Argentina and Brazil began in 2005 with the growth of bilateral trade and the observation that transaction costs were limiting trade access for small and medium enterprises.[20] The mechanism was approved at the 2007 Asunción Summit by CMC Dec. 25/07. Although this instrument provides for all MERCOSUR partners, so far progress has only been made implementing it in trade between Argentina and Brazil.

The SML is a scheme through which commercial transactions are agreed and materialized in local currencies, thus avoiding the intermediation of the dollar, the customary currency of international trade. The mechanism can be applied to transactions with financing terms of up to 360 days as an option and complement to other financial schemes. The transactions have to be channeled via entities authorized by the relevant central banks, their main goal being to reduce financial and administrative costs.

A clearing house for stock transfer in local currency between Argentina and Brazil with no risk hedging mechanisms for participants was set up to operate it. Unlike the exchange market, in this system, the international business agent receives/transfers local currency from/to the financial institution involved, which in turn receives it from/transfers it to the Central Bank. Clearance between *pesos* and *reals* occurs on a daily basis and leads to the liquidation of balances between the Central Banks in dollars.

The impetus of the initiative is bound up with the simplification and reduction of costs associated with bilateral exchange transactions in order to facilitate smaller companies' shares in trade flows. According to estimates from the Central Bank of Brazil (Landim [2009]), the system would involve a 2%-3% saving in the value of reciprocal trade.

- Evolution over the period -

Against a background of deepening global crisis in September 2008, capital outflow and contracting trade flows prompted the Argentine and Brazilian Central Banks to announce the operational provisions necessary to implement the Agreement. As of October the same year, conditions were in place to start utilizing the system and channeling transactions through it. The SML thus began its operations in a particularly adverse climate from the point of view of trade dynamics. Hence, at first sight, results of its implementation seem modest. From its inception up to 30 June 2009, there were 373 operations for a total of US$62.8 million. The average amount per transaction was around US$168,000. 95% of transactions were intended to finance exports from Brazil to Argentina, with the participation of 212 companies in both countries (Table 8).

Despite the downturn, the steadily rising number of transactions, businesses, and sectors that have made use of the SML since its launch express some degree of success in the design, implementation, and dissemination of the instrument (see Graph 19). The sectors that have used the system most in the early months of operation are energy, metals, automotive and auto parts, textiles, food, and cosmetics.

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[20] See IDB-INTAL [2008], pp. 98-102 and IDB-INTAL [2009c].

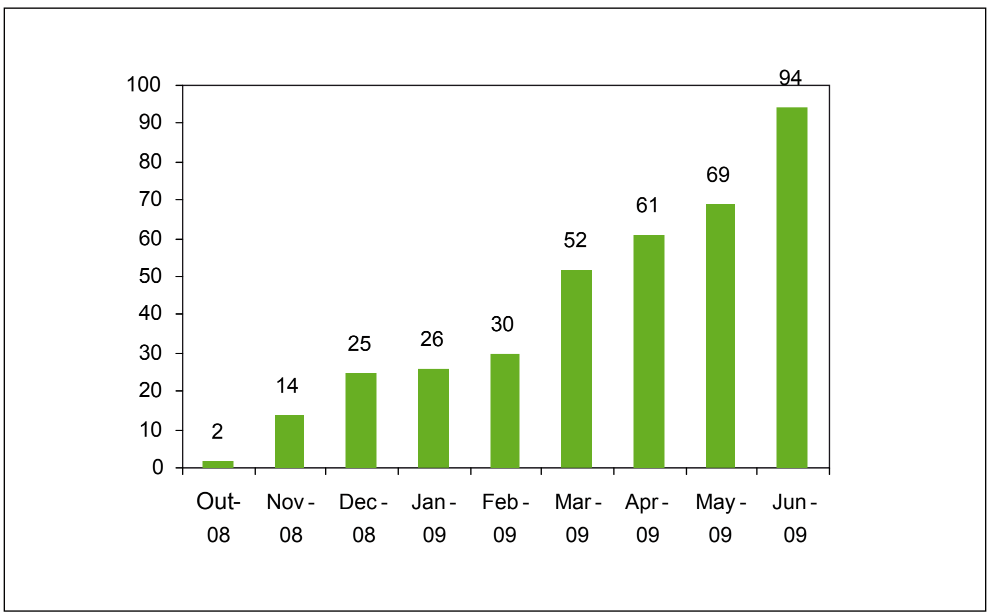
TABLE 8
TRANSACTIONS THROUGH THE SML
(10/03/08-06/30/09)

	Argentine Exports	Argentine Imports	*Total*
Volume transacted			
In millions of AR$	4	226.7	*230.7*
In millions of US$	1.1	61.7	*62.8*
Number of transactions	41	332	*373*
Number of companies	30	182	*212*
Argentine	15	87	*102*
Brazilian	15	95	*110*

Note: AR$ = Argentine *pesos*.

Source: BCRA.

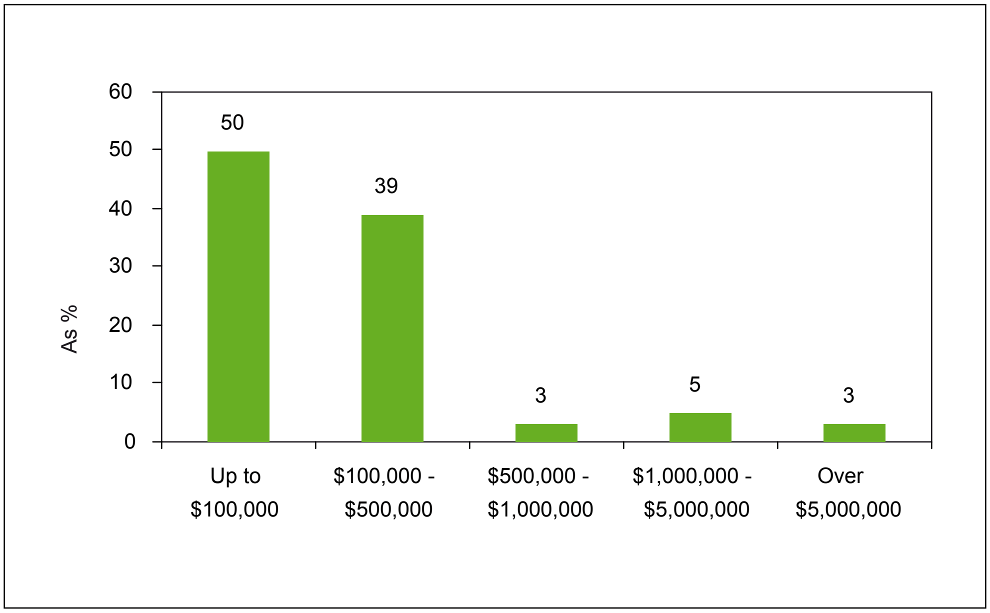
GRAPH 19
NUMBER OF TRANSACTIONS



Source: BCRA.

Nearly 90% of the 373 transactions made at this stage were in amounts of under AR$500,000 (approximately US$130,000), as shown in Graph 20, with a further 12 transactions for amounts in excess of AR$5 million (approximately US$1.3 million). 6 of these were from a single company for AR$101 million (approximately US$26.2 million), and 4 were from another for AR$37 million (approximately US$9.6 million).

GRAPH 20
NUMBER OF TRANSACTIONS BY TRANCHE[a/]
(Frequency distribution - As % of total transactions)



Note: [a/] Amounts expressed in Argentine *pesos*.

Source: BCRA.

A small portion of global bilateral trade was channeled through the new scheme. It can be assumed that the improvement in bilateral trade, and wider dissemination and experience of the new system will lend this instrument a higher profile. However, there are certain factors arising from traditional financial operations that jeopardize the rapid development of this channel. On the one hand, credit resources to prefinance exports -or even for working capital linked to foreign trade transactions- are linked to lines of anchoring usually denominated in dollars. Therefore, more extensive use of the SML would require greater expansion of financing lines in local currencies for foreign trade. On the other hand, some employers and exporters in Brazil have identified obstacles such as the lack of funding in local currency, the existence of exchange risks, and the perception that the benefits associated with cost reduction are minor. In reality, the SML is in competition with the traditional system, namely, the channeling of export and import transactions through the scheme of documentary credits in foreign currency provided by private banks. These transactions are made through anchored letters of credit with resources of their own that intervening banks have at their disposal abroad, or by using lines granted them by other institutions in the international financial centers. So, while the new system means lower costs than traditional schemes, these savings may not be sufficient to bring about a regime shift. It is even possible that banks will react by reducing the costs of the traditional system and, therefore, tending to reduce the advantage of the SML.

Despite these difficulties, the design and operation of the SML is a concrete breakthrough in the bilateral trade operation, helping to reduce costs and dedollarize transactions between Argentina and Brazil. According to estimates by the Central Bank of Brazil (Landim [2009]), between 10% and 20% of bilateral trade is expected to be channeled via this mechanism. The increased use of the SML and its eventual generalization seems, however, to require more profound changes in the financial systems and access to credit lines in local currencies.

BOX C
THE LAIA AGREEMENT ON RECIPROCAL PAYMENTS AND CREDITS, AND THE SML

The Agreement on Reciprocal Payments and Credits was signed on August 25, 1982, in the LAIA Council for Financial and Monetary Subjects by the Central Banks of some member countries in the *Asociación*[1] against the background of the debt crisis that hit the region in the same decade.

Its objectives are to reduce the use of convertible currency and facilitate trade transactions between the member countries, to stimulate financial relations between the region's countries, and to systematize mutual consultations over monetary, exchange, and payments matters between the Central Banks. The agreement has two main components: on the one hand, a multilateral payment clearance mechanism that works on the basis of four-monthly liquidation periods; and, on the other, a System of Guarantees (convertibility, transferability, and repayment) that facilitates and secures the transactions.

In the multilateral Clearing House, balances of the debits for the period of actual payments are consolidated and cleared on a four-monthly basis. To this is added any interest incurred by these debits. It operates across Central Banks through a reciprocal credit line in US$, the amount of which varies according to the trade flows between the respective countries.

The main differences between LAIA's Agreement on Reciprocal Payments and Credits (CCR) and the Local Currency Payment System (SML) are summarized below.

THE CCR-LAIA AND THE SML COMPARED

Differences	CCR-LAIA	SML
Member Countries	- 12 Countries	- Argentina-Brazil
Type of transactions admitted	- Trade in goods, including services and related expenses. - No deadlines are provided for transactions, each Central Bank being left to set its own.	- Initially for trade in goods with financing of up to 360 days, including services and related expenses. - Extension to all kinds of payments between countries is planned.
Instruments	- Determined in the agreement.	- No restrictions.
Currencies	- Commercial transactions are agreed in dollars. - Importers and exporters use the currency determined by each Central Bank's internal regulations.	- Commercial transactions are agreed in the currency of the exporting country. - Both importers and exporters pay and charge in their respective countries' currencies.
Central Banks Guarantees	- For reimbursement, convertibility, and transferability.	- No guarantees are given; only transactions actually paid are expedited.
Central Banks Clearance	- Multilateral and four-monthly, in US$.	- Daily or weekly, in US$.
Central Banks Credit	- There is a multilateral credit line mechanism. - Automatic Payment Program: multilateral payment plan for liquidity problems. - The depletion of a credit line does not entail suspension of the channeling of transactions.	- There is an eventual margin for when the balance does not allow the transfer. - It must be paid on Fridays or whenever it exceeds 80% of the established value. - The lack of recomposition of the eventual margin entails the suspension of registration of any new transactions.

Note: 1/ Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela, and the Dominican Republic.

Source: LAIA and BCRA.

It should be noted, finally, that during the 37th Council Meeting in Asunción, July 24, 2009, it was resolved to broaden the SML's scope in order to enable it to be used in all kinds of transactions between MERCOSUR States Parties. The new payment headings to be incorporated into the mechanism and the operating conditions are to be agreed bilaterally by the Central Banks.

Being created and institutionalized on the basis of CMC Decisions, the ultimate goal is for the system to be extended to intrazone transactions of the partner countries as a whole. During its PPT, Paraguay organized a "Seminar on Transactions in Local Currencies in MERCOSUR" in April 2009 with the intention of implementing flexible mechanisms to provide solutions to the financial crisis, an occasion on which officials from the Central Banks of Argentina and Brazil spoke about the characteristics of SML. At the LAIA headquarters in Montevideo, Uruguay, April 22, 2009, a meeting was held to focus on this system and its similarities and differences with the Agreement on Reciprocal Payments and Credits (CCR) operating in this area.

Currency Swaps between partner countries

- Background -

A currency swap between Central Banks is a quota agreement to make liquidity available to two or more countries in the other country's currency. The transactions are only materialized when necessary. A country thus has available open lines of financing that are not necessarily used, which obviously helps to boost each Central Bank's potential capacity to cope with a global situation with restricted liquidity. Should the funds be drawn on, they are to be used for the agreed purposes, with a previously established interest rate. If the funds are not used, the instrument has no cost.

With the deepening of the global crisis, several such agreements were concluded between various Central Banks both in the advanced countries (the US Federal Reserve with the European Central Bank, the Bank of England, the Bank of Japan, and the Swiss National Bank) and in emerging countries (the Federal Reserve with the Central Banks of Brazil, Mexico, Korea, and Singapore) (Chapter V). Likewise, the People's Bank of China ordered similar agreements with the Central Banks of Korea, Malaysia, Indonesia, Belarus, and Argentina.

- Evolution over the period -

Brazil led the supply of this type of mechanisms in MERCOSUR, establishing an agreement with Argentina and proposing the implementation of a similar instrument with Uruguay.[21]

Talks between the Argentine and Brazilian Economy Ministers opened in May 2009, aimed at creating a quota line in local currencies equivalent to US$1.5 billion for an estimated term of three years, and with a rate of interest yet to be defined. According to the Brazilian government, the aim of this line is to have instruments to cope better with the global crisis, following the experience of the US$30 billion agreement between the Central Bank of Brazil and the US Federal Reserve (Chapter V). In this context, Argentina and Brazil agreed that the swap should seek to strengthen liquidity, while the BCRA refused to accept that the line could be used to finance the bilateral trade imbalance. However, certain analysts in Argentina did understand that the scheme could finance imports from its neighbor. In Brazil, the Agreement was questioned because it was believed to favor Argentina in the short term, at a time when Brazil was facing major internal and external imbalances, with a sharp fall in GDP and the collapse of its foreign trade.

The agreement was finally signed in Brasilia by the Argentine Economy Minister and his counterpart from the Brazilian Treasury on August 19, 2009. The agreement consists of the availability to each country of

[21] No references have been found of such a potential offer to Paraguay, to date at least, with the public information available.

US$1.8 billion in local currency (US$300 million more than initially discussed) should either nation require it. The swap would operate with two accounts deposited in each Central Bank for AR$7 billion and R$3.5 billion. In any event, the entry into force, rules, and deadlines of the agreement are to be determined by the two countries' Central Banks.

Moreover, the Brazilian and Uruguayan Finance Ministers agreed to move forward in designing and implementing a similar instrument, but, at the time this Report went to press, there has been no progress in these bilateral negotiations.

Trade flow monitoring

- Background -

In the framework of the dialogue on the global crisis and its impact on trade flows in the region, Argentina proposed the establishment of a Trade Monitoring Committee at the Common Market Group Meeting in Brasilia in November 2008. This proposal was aimed at establishing regular follow-up and analysis of intra and extrazone trade flows through a specialized committee especially devoted to the task. The Common Market Group decided that the Trade Commission should be responsible for this and instructed it to hold a special meeting devoted to this specific issue, every other ordinary Commission meeting. In line with this brief, the initial meeting was to be held at its first meeting in 2009, with the delegations making the commitment to submit statistical data prior to this meeting.

- Evolution over the period -

At the Trade Commission Meeting in March 2009, Argentina submitted a proposal of monitoring objectives and actions. The Argentine initiative envisages the analysis of the recent evolution of trade in MERCOSUR and its States Parties, early detection of anomalous flows in terms of prices and/or quantities imported, and the submission of periodic reports for consideration by the Trade Commission that sound the alert and enable corrective action to be taken in the event of any difficulties. The proposal also envisages communication by the partners through the identification of Focal Points in each State Party responsible for the exchange of primary data, data storage, and data processing. A single database, centrally administrated by one of the countries or by the MERCOSUR Secretariat would be produced with the information exchanged by the States Parties. Finally, this early warning system would use a computer tool to periodically detect any products in a critical condition.

In moving forward with the initiative, the CCM decided to form a supporting Technical Group in the tasks of regular follow-up on and analysis of trade flows, focusing on the analysis of extrazone trade and leaving aside intraregional trade. The Focal Points of each State Party were designated accordingly and it was agreed that the Group produce monthly reports to be submitted at each CCM meeting, with monthly data and any data accumulating up to the last month analyzed. The reports would contain an introduction to the recent developments in MERCOSUR trade, as well as Annexes on any products identified by the early warning mechanism in each State Party, with details of the main origins and evolution of import prices.

The creation of a Technical Group for the monitoring and analysis of trade flows is one of MERCOSUR's responses to the deepening of the international crisis and its impact on MERCOSUR countries' global trade and imports. In any event, the fact that the Group has been instructed to pass over the analysis of intrazone trade and refrain from suggesting possible courses of action in the event of any alerts, limits its scope and highlights the difficulties MERCOSUR faces when tackling trade issues between partner countries.

Proposals to change the Common External Tariff (CET)

- Background -

The impact of the financial crisis on world trade flows pressed MERCOSUR into analyzing new alternatives and instruments regarding the structuring of the CET, without this affecting long-term negotiations on the issue. It should be noted that the procedure to amend the CET cuts across various different negotiating areas and is not a feasible dynamic mechanism for confronting immediate situations. MERCOSUR has a speedier mechanism to temporarily lower aliquots for third country import duties, only applicable to a limited number of products and to regional supply problems. There are, however, no such precautions for cases requiring the temporary hiking of duties in the event of exceptional circumstances such those as caused by the international crisis.

- Evolution over the period -

Argentina and Brazil drew up various different proposals to make specific adjustments in the level of the CET. Argentina favored the temporary raising of import aliquots applied to extrazone purchases, limiting this rise to the maximum tariff consolidated by the States Parties with the WTO. Under this proposal, the countries could temporarily and exceptionally increase aliquots for import duties on a maximum of 50 tariff positions of the MERCOSUR Common Nomenclature. Selection criteria for these products would be defined to this effect. The measures could be applied for a period of up to 12 months, extendable for a further 12 months, should the circumstances giving rise to their introduction persist.

Although limited to certain special situations, Brazil has also expressed its intention to set parameters for altering the CET. Under the provisions in GATT 94 (Article XXIV and Article XXVIII), it has favored a measure whereby a State Party could raise the CET for an initial maximum of two years under given circumstances.

Apart from this exchange of proposals, some members felt the very real need in the period under review to raise tariffs on certain products, given the current state of international trade. Brazil, for example, applied to do so for 11 positions in the dairy sector. Argentina requested the amendment of the CET for certain yarn, leather goods, and furniture. In neither case was consensus achieved at MERCOSUR level.

Although the crisis prompted a debate on the possible creation of a fast mechanism to temporarily alter certain CET levels for a small number of products, the proposals were not agreed. Nor was it possible to reach consensus over specific changes requested by some of the partner countries.

B. Trade issues

The CET for IT and Telecommunications goods

- Background -

In 2003, the CMC instated a Common Import Regime for new Capital Goods, and parts and components not produced in the States Parties, setting a lower import tariff than the current CET for these types of products. The Regime required the development of a Common List of capital goods not produced at regional level that would be eligible for preferential treatment. Until such time as this list could be drawn up, the States

Parties were authorized to keep National Lists of non-produced goods with 2% tariffs up to January 1, 2008. Thereafter, the regime stipulated that differential treatment would be limited to goods on the Common List. However, various reasons prevented the Decision being implemented, especially the opposition of the private sectors in Argentina -due to the regime clashing with other benefits granted to the internal production and marketing of these goods- and the reticence of Paraguay and Uruguay over the limitations on extrazone supply that such a regime might involve.

- Evolution over the period -

In December 2008, the CMC decided to extend the deadline for the Regime's entry into force to January 1, 2011, (CMC Dec. 58/08) and to defer to January 1, 2013, (CMC Dec. 59/08) the deadline for all imports of non-produced capital goods, and their parts and components on the Common List so that they are only accepted under the provisions of the regime created. The CMC also decided to create an *Ad Hoc* Group within the Common Market Group for the Capital Goods, and IT and Telecommunications Goods sectors, absorbing the powers to examine the consistency and dispersal of the CET, and to draw up the tariff review proposal for these sectors. It should be noted that a High-Level Group had been set up that made no progress in these tasks. Indeed, while the first meeting of the *Ad Hoc* Group ought to have been held in the first half of 2009, there is no sign of such a meeting.

Starting in 2009, the States Parties must submit to the Trade Commission quarterly statistics for intra and extrazone imports of any items classified as capital, IT, and telecommunications goods. The *Ad Hoc* Group has been instructed to prepare a review proposal for the CET for capital goods, which must be submitted at the first GMC meeting in the second half of 2010. Meanwhile, the States Parties can maintain the national capital goods import systems currently in force. Paraguay and Uruguay can, up to 31 December 2013, implement the 2% aliquot for extrazone capital goods imports. A similar review must be made of IT and telecommunications goods, for which it was decided to extend the deadline for Argentina and Brazil to implement a 0% aliquot on some or all imports of such goods to December 31, 2010. Paraguay and Uruguay have, up to December 31, 2016, been authorized to import extrazone IT and telecommunications goods with 0% aliquots on products on the lists submitted to the CCM, and 2% in other cases.

The elimination of double CET levying and the distribution of customs revenue

- Background -

The elimination of double CET levying is central to MERCOSUR's consolidation process and its progress toward the Customs Union.[22] For this reason, the provisions of the Common Market Council (CMC) through CMC Dec. 54/04, "Elimination of Double Levying and Distribution of Revenue", were a decisive message in establishing the free movement of extrazone imported goods complying with the Common Tariff Policy (PAC) through a two-stage program. The first stage, currently in force, applies to products with a 0% CET and 100% preferences granted by MERCOSUR as a bloc to its trading partners.

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22 Extrazone imports should be able to move freely in MERCOSUR once payment of the CET is made at the Customs Union's point of entry. However, this is not the case, as many products from extrazone undergo double CET levying when they are exported from one MERCOSUR country to another.

- Evolution over the period -

The second stage, which was to be implemented from January 1, 2009, would apply to extrazone goods levied with the same tariff by all States Parties. CMC Dec. 54/04 accordingly stated the need to agree and approve a mechanism for the distribution of customs revenue, the MERCOSUR Customs Code, and the fully functioning interconnection of customs management IT systems.

Despite an *Ad Hoc* Group being set up to draft the Customs Code and a special group to define the customs revenue distribution mechanism, the only requirement on which progress was made was in the IT interconnection of customs. On the other issues, the work was left incomplete, awaiting political definition in the scope of the GMC. Some of the issues yet to be defined are to do with the sample of goods covered by this second phase, the revenue distribution mechanism, and the administration and control body. In terms of its scope, Argentina and Paraguay understand that the sample has to be restricted to imports for which the CET is simultaneously applied in the four States Parties, so that products on exceptions lists would not be included until such time as the CET is made to converge. Brazil and Uruguay, on the other hand, favor a broader sample allowing the movement of goods paying the CET despite being included on a State Party's exceptions list. Under this option, only the automotive and sugar sectors would be excluded from the sample.

Regarding the distribution mechanism, Argentina, Brazil, and Uruguay have agreed on how to calculate each country's contributions. There is also agreement that a portion of the amount to be distributed is to go to a common fund and that the rest is allocated on the basis of variables making allowance for each country's intrazone imports and the degree of compliance with the tariff policy. However, there has been no agreement on the weighting of the criteria or the definition of the variables to be used for the distribution. Paraguay has proposed that all revenue should be subject to distribution and that the fund should not be set up.

Finally, regarding the definition of an administration and control body for the distribution mechanism, the position of some members is to create an intergovernmental body, while others propose a supranational body. Another alternative would be to set up an agency reporting to the MERCOSUR Secretariat.

During its PPT, Brazil prioritized these issues: not only did it seek to improve the functioning of the technical bodies tasked with shaping the technical proposals, but also of the policy decision-making groups MERCOSUR, namely, the Common Market Group and the Trade Commission.

At the GMC National Coordinators' meeting in December 2008, Brazil introduced a last-ditch proposal to reach consensus over both the elimination of double CET levying and customs revenue distribution. It proposed gradually moving forward in both of these areas with a first stage lasting a minimum of 2 years and only applicable to goods levied with a CET of up to 6%. In terms of the distribution mechanism, it proposed that a fixed amount of customs revenue be distributed among the States Parties. The proposal indicated -in no great detail- that the amount could initially be US$30 million and that it would be contributed by the countries in proportion to their intrazone trade surpluses, except for those with a deficit or even with a surplus of below 10% of their regional trade. The revenue was to be distributed as follows: 30% would be given to States Parties with an intrazone trade deficit, in proportion to the size of the deficit, and 70% would automatically be granted to Paraguay to offset the asymmetries associated with its landlocked status. The conditions for the implementation of the following stages would be defined in the mechanism's second year of operation, once approved by Decision of the CMC. Still pending were aspects such as the definition of the scope of the sample, the methodology for calculating contributions, the distribution formula, the creation

of the administration and control body, and the definition of technical aspects relating to operational and administrative procedures.
While Argentina was in general agreement about the elements proposed by Brazil, it questioned the sustainability and discretional nature of the amount committed (US$30 million), and suggested periodical monitoring of the possible effects of this first implementation stage on production and the location of investments in the States Parties.

Uruguay, for its part, also expressed general agreement with Brazil's position, although it felt that the proposal should be more explicit over deadlines and clearer about the amounts to be distributed and their means of allocation.

Paraguay objected to the Brazilian proposal, feeling that it did not allow for the creation of a supranational body responsible for managing regional customs revenue and ensuring that any asymmetries present in the bloc be overcome.

Faced with the inability to reach consensus over the Brazilian proposal, at the CMC Meeting in December 2008, Ministers agreed to hold an Extraordinary Council Meeting to discuss the matter, convened under Paraguay's PPT in the first quarter of 2009.

In the first part of 2009, Brazil circulated a new proposal to deal with this matter, suggesting beginning the process with extrazone imported goods that complied with MERCOSUR's Common Tariff Policy (PAC), which are given originating goods treatment, both in terms of their movement within the bloc and their incorporation in productive processes.[23] The proposal envisaged the participation of the four States Parties at this stage, while reserving special treatment for Paraguay: whereas Argentina, Brazil, and Uruguay would recognize PAC compliance certificates issued by the four States Parties guaranteeing free movement and avoiding double levying, Paraguay would continue to charge the CET on exports from partners not meeting origin requirements. To put it another way, Paraguay would, at this stage, continue to apply double CET levying.[24]

In this first phase, revenue collected by the States Parties' customs would not be distributed. In a second stage, Paraguay would join the scheme to eliminate double CET levying and would set a customs revenue distribution mechanism, create a administration and control body under the institutional structure of MERCOSUR, and the development of an IT management system for the customs revenue distribution mechanism -as a technical prerequisite.

In spite of the various attempts at rapprochement, the debate and coordination of interests in an aspect that may involve a drop in the collection of import duties for one or more of the partners-all the more so against a background of weakening regional growth and its impact on tax revenue. In fact, the most immediate impact is the revenue that would cease to be charged by dropping CET duties on imports from MERCOSUR originating in extrazone. These transactions totaled US$36.7 million in 2006 (the benchmark for the comparisons) or 2.3% of regional revenue from import tariffs.[25]

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[23] Goods on the national CET exceptions lists and goods imported under special regimes do not comply with the PAC.

[24] Paraguay is estimated to account for 2% of double levying of the CET on products not originating in MERCOSUR (Vaillant and Lalanne [2007]).

[25] This amount could be offset through the FOCEM.

The MERCOSUR Customs Code

- Background -

Article 4 of CMC Dec. 54/04, "Elimination of Double Levying and Distribution of Revenue", states that, for the purposes of implementing the free movement of goods imported from third countries, the MERCOSUR Customs Code must be approved and in force. The *Ad Hoc* Group for Drafting the MERCOSUR Customs Code (GAHCAM) completed the allotted task, drafting almost all the articles of this body of law, leaving pending aspects that, by their nature and implications, require policy definitions by GMC National Coordinators. The issues currently subject to decisions by this body are linked to the definition and scope of a "Customs Territory" (which includes special customs areas, duty-free zones, and territorial waters), export duties, and specific import duties:

i) Special Customs Areas (SCAs)

The issues to be resolved are the number of Special Customs Areas (SCA) permitted in each State Party and the temporary validity of the benefits established for them. It should be noted that SCAs are long-standing tools, used by Brazil and Argentina to promote regions distant from the major centers of consumption. Unlike the more modern duty-free zones, their production is largely intended for the internal market of the countries they are based in, meeting the integration requirements established in each case. It should be noted that products from Tierra del Fuego and Manaus are regarded as originating in MERCOSUR and therefore enter the States Parties' general customs territory under the free trade regime.

By CMC Dec. 08/94, the term of the current SCAs in Manaus, Brazil, and Tierra del Fuego, Argentina, (MERCOSUR's only SCAs to that date) was set at 2013. Brazil has expressed its intention to submit a proposal to extend the treatment in force in MERCOSUR for existing SCAs to 2023. It was not possible to draft an agreement on whether an SCA could operate in each partner country or only SCAs already operating (Manaus and Tierra del Fuego).

The explicit reference to the term of SCAs is not accepted by certain members, who believe it should not be made explicit in the Customs Code, as it would later hinder any amendment regarding deadline extensions.

At the request of Brazil, the question of whether goods produced in SCAs complying with the rules of origin may or may not be included in trade negotiations between MERCOSUR and third countries is also under discussion. On this question, some of the member countries felt that, by adopting the Kyoto Agreement's definition for SCAs,[26] they would become part of the MERCOSUR customs territory and their products would therefore enjoy the same rights as the general territory.

Finally, the inclusion in the Code of an article on territorial waters was discussed and consensus almost reached. However, after hearing several interpretations, it was felt that it would not be relevant to include in the body of law references to the entry, exit, and presence of goods in the Territorial Waters, the Contiguous Zone, the Exclusive Economic Zone, and the Continental Shelf, leaving this to continue to be governed by the laws of each State Party.

[26] The Kyoto Convention (http://www.customs.ae/customs), which simplified and harmonized customs procedures, was signed in May 1973 by members of the then Customs Cooperation Council, Brussels. Amended in 1999, it was ratified by over 40 members, the number required for its entry into force, only as recently in 2005.

ii) Export duties

Export duties are taxes levied by certain countries on their external sales. They were very widespread in Latin America until the liberalization process got under way in the 1990s, when they were eliminated.[27] However, Argentina has, since 2002, applied export duties to a wide range of products, including the soy complex and other key goods in the export basket, constituting a significant part of overall revenue. Various different debates arose out of the discussion of the MERCOSUR Customs Code: whether such rights should or should not be part of the Code; whether it is possible to authorize countries to apply them in intrazone trade; and whether their aliquots must be fixed as a whole by a joint MERCOSUR body.

Argentina's position contends that the export duties are a necessary instrument of trade policy and that their regulation in the Customs Code should be reflected so as to ensure the right of each State Party's jurisdiction to determine the conditions under which to apply them. Some partner countries consider this interpretation discretionary, as it would clash with the common customs rules. They contend that export duties should not be applicable in intrazone trade and that, if a reference to these taxes is included in the Code, they must be fixed by an organ of MERCOSUR.

iii) Minimum Specific Import Duties

Minimum import duties specific are taxes levied on imports. Unlike ad valorem tariffs, they are not percentages to be applied to the total amount imported, but fixed amounts per product unit. In some cases, these duties operate by replacing the ad valorem tariff; in others, the ad valorem tariff or specific duty is applied, depending on which gives greater protection. While there would seem to be consensus on their inclusion in the Code, the question of whether to remove the paragraph subjecting the application of Minimum Specific Import Duties to each State Party's national legislation is still under discussion.

- Evolution over the period -

At the Common Market Group meeting in March 2009, the Paraguayan PPT circulated a consolidated document on the issues pending definition in the Draft MERCOSUR Customs Code. The sensitivity of the issues under discussion and the lack of political initiative to take resolutions have hampered the conclusion of the final agreement to establish the Customs Code MERCOSUR.

Special import regimes

- Background -

MERCOSUR's concern to preserve the CET and avoid any perforations that might affect its integrity, became apparent in 2000, when the CMC decided to eliminate the unilaterally approved special import regimes, setting a five-year deadline for their elimination. This deadline was extended to January 1, 2008, and later to December 31, the same year.

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[27] Except for certain rare exceptions among a few products from some countries.

- Evolution over the period -

The Trade Commission moved forward in the treatment of this issue, seeking to focus on certain specific sectoral regimes, like the shipbuilding industry, aeronautics, health, and education. Proposals to treat more horizontal regimes, such as the importation of goods belonging to investment projects (submitted by Uruguay) or cross-border overland trade (Brazil) also emerged in this period. In this regard, a draft Decision creating a common regime for goods bound for scientific and technological research was submitted to the Council and approved by the CMC at the end of 2008 (CMC Dec. 40/08). Under this Regime, goods imported by nonprofit legal entities carrying out scientific or technological research and recognized by each country's competent authorities are exempt from payment of import duties.

Notwithstanding this, any of the States Parties can extend this benefit to scientists and researchers, who have to be entered in a special register. Each State Party's competent authorities have to keep a list of permitted imports and this information must be submitted to the CCM before June 30 every year.

In other the sectors, the Council authorized the Trade Commission to move forward with the work to reach a common set of rules to be considered by the GMC at its last meeting in the second half of 2010. It also decided to extend the deadline for the Common Market Group to define the treatment of the special import regimes unilaterally approved by the States Parties to December 31. 2010, insofar as they involve the total or partial exemption of the CET. Paraguay was authorized to extend its raw materials import program with a reduced aliquot of 2% to the end of December 2010. Similarly, the possibility of using drawback and temporary admission for intrazone trade has also been extended to December 31, 2010.

In the first half of 2009, Argentina circulated a methodological document entitled "Special Common Import Regimes: Precedents and Treatment Proposal", on the basis of which the CCM agreed a sectoral action plan.

During this first six months, work was done toward the formation of a common regime for the *aviation industry*, which obtained consensus for approval from Argentina and Brazil, while in Paraguay and Uruguay is still under scrutiny. According to the document, imports of parts, spare parts, components, inputs, and raw materials would be subject to the 0% aliquot, used in the industrialization, repair, maintenance, processing, modification, conversion, conservation, protection, and assembly of:

a) Aircraft, spacecraft, and other airborne vehicles and parts;
b) Aircraft engines, and parts and spare parts.

Finally, some progress was made in the common import regime for goods bound for *education* and a treatment proposal for a common import regime for *medicines*.

Non-tariff restrictions (NTRs)

- Background -

Since the Treaty of Asuncion, the question of non-tariff restrictions has been of a priority. The process of progressive trade liberalization generated by lower tariffs should have been accompanied by the dismantling of preexisting restrictions and not the creation of new restraints or obstacles to trade. Accordingly, since 1991, there have been numerous partially successful attempts to formalize and generate commitments to eliminate these restrictions. CMC Decs. 01/92, 03/94, 17/97, 22/00, 34/06, 06/07, and 27/07 were passed by the CMC. The Common Market Group also issued Resolutions 123/94 and 32/95. CMC Dec. 27/07 instructs States Parties to send lists of non-tariff restrictions and measures restricting its exports to the partners, and to submit to the GMC a treatment proposal for any obstacles identified.

The GMC was to approve any treatments defined for non-tariff restrictions and measures before December 31, 2008. The deadline for the implementation of the solutions agreed was to be December 31, 2010 for any measures implemented by Argentina and Brazil, and December 31, 2012, for any measures implemented by Paraguay and Uruguay.

- Evolution over the period -

During the period covered by this Report, lists of measures identified by each country as obstacles in their sales to the other partner countries were exchanged and comments and clarifications made on the restraints reported, but no progress was made on treatment proposals.

Apart from the "comprehensive" negotiation on NTRs, in practice numerous channels have been opened up to treat disputes over measures or procedures considered as restrictions affecting partners' free movement and market access: informal bilateral procedures (like the trade monitoring commission set up by Argentina and Brazil), the consultation mechanism in the Trade Commission, the dispute settlement mechanisms envisaged by the Brasilia Protocol, the *Ad Hoc* Tribunals, the Permanent Review Tribunal, and others.

A recurrent theme in the generation of trade restrictions in MERCOSUR has been the implementation of *import licensing*. In fact, one of the measures that Brazil committed to eliminating in the Treaty of Asuncion was the so-called Import Guides. Indeed, the treatment of this matter even became the central cause of two Arbitration Awards in MERCOSUR. In the first, the dispute was provoked by two provisions of the Brazilian Department of Foreign Trade Transactions in 1997 and 1998[28] involving the implementation of automatic licensing (AL) and non-automatic licensing (NAL). The Award ruled that AL is compatible with MERCOSUR's regulatory system in that they are limited to a register operated without delay during the customs procedure, whereas it contends that NAL is compatible with MERCOSUR's regulatory system only if it corresponds to the measures approved under Article 50 of the 1980 Treaty of Montevideo (TM) regarding a handful of goods related to health, safety, etc. To put it another way, the Awards accepted both types of Licensing but, in the case of AL, only as a statistical record that involved no delays and, in NAL, only when applied to particular goods that, by their very nature, require a permit.

Another Award ruled on a dispute whipped up between Argentina and Brazil over obstacles to the entry of Argentine products in the Brazilian market for phytosanitary purposes, as Brazil had internalized no previous agreements in that area. In this case, the Tribunal contended that the protection of human, animal, and plant health does not exonerate Brazil from meeting its obligation to incorporate the provisions of GMC Resolutions in its internal regulations.

In practice, these Awards have seen only limited compliance or were later the focus of fresh tensions. For example, despite the fact that one Award stipulates that NAL is incompatible with MERCOSUR, Argentina has made widespread use of them after the fact (see Chapter IV).

[28] Communiqués 37 of December 1997 and 7 of February 1998.

The liberalization of trade in services

- Background -

To promote free trade in the region CMC Dec. 13/97 approved the Montevideo Protocol on Trade in Services in MERCOSUR. It came into force on December 7, 2005. The Protocol provides that each State Party should specify a list of sectors, subsectors, and activities regarding which it will assume commitments, as well as the terms, limitations, and conditions in terms of market access and national treatment for every mode of provision. In compliance with the objectives of the Protocol, the States Parties would hold successive rounds of negotiations to complete the Liberalization Program of trade in services within a maximum of 10 years from the Protocol's entry into force.

- Evolution over the period -

At its meeting in July 2006, the CMC brought to a close the 6th Round of Negotiations and felt it necessary to define the parameters of subsequent Rounds by June 2007 in order to comply with the Protocol. After various different negotiations and postponed deadlines, the CMC approved the Action Plan for the Deepening of the Liberalization Program for Trade in Services in the Ambit of MERCOSUR in December 2008 "with a view to concluding it by 2015, according to the provisions of the Protocol of Montevideo".

In line with the Action Plan approved the following actions, deadlines, and stages were established. During the first half of 2009, the partners should perform a diagnosis of the current situation, defining the least sensitive sectors whose liberalization presents no great difficulties, those with an intermediate degree of difficulty for liberalization, and the highly sensitive, as well as those that might be subject to harmonization of regulatory frameworks.

During 2010, the States Parties should consolidate the regulatory status quo in sectors that as yet have no commitments and eliminate barriers of market access and national treatment in the least sensitive sectors, move forward in the harmonization or complementation of regulatory frameworks in sectors deemed necessary, and identify mechanisms to promote the least developed operators' growing share in the regional services market.

In 2012 they are to eliminate restrictions on market access and national treatment in sectors with an intermediate degree of difficulty for liberalization, move forward in harmonization or complementation of the regulatory frameworks in sectors thought necessary, identify any internal regulatory measures that may constitute barriers to intrazone trade with a view to their elimination, and consider the effects of deepening MERCOSUR disciplines on domestic regulations.

In 2014 they will have to eliminate barriers to market access and national treatment in highly sensitive sectors, complete the process of harmonization or complementation of regulatory frameworks, conclude the deepening of MERCOSUR disciplines on domestic regulations, and eliminate any regulatory measures that have been identified as intrazone trade barriers.

In short, the liberalization of trade in services in MERCOSUR continues to follow its own dynamic based on the negotiation through successive Rounds and with a new, deeper and more comprehensive plan.

C. Asymmetries and productive issues

Asymmetries and the FOCEM

- Background -

Natural and artificial asymmetries and how to tackle them in the regional ambit have been present in MERCOSUR debates since its inception. In fact, both Paraguay and Uruguay obtained differential advantages in the negotiating processes that led to the formation of MERCOSUR, including import tariffs on certain goods, special extended deadlines for adaptation to MERCOSUR rules, and favorable treatment in rules of origin and special import regimes. Argentina and Brazil accepted this differential treatment as part of the difficult process of achieving consensus at regional level. In fact, the Protocol of Ouro Preto in late 1994 was a clear demonstration of the negotiating capacity and spirit of the four partner countries, who reached an agreement that promised to be level-headed and generally balanced among the parties. However, Uruguay and Paraguay for various different reasons and using a variety of strategic approaches began to take issue with the scope of the negotiating balance in recent years -especially after the economic crisis of 1999-2002- reigniting the debate. As a landlocked country with the lowest per capita GDP of MERCOSUR members, Paraguay began to demand new exceptions and flexibilities in the issues on the internal agenda and in those linked to negotiations with third countries. Uruguay, for its part, espoused the cause of renewed treatment of asymmetries, targeting the consolidation of the free movement of goods and the freedom to negotiate individual agreements with extrazone countries.

It was against this background that the advisability of drawing up a Strategic Plan for Overcoming Asymmetries in MERCOSUR emerged, to be approved by late 2007, a deadline repeatedly extended.

One of the most important responses to this problem was the creation of the MERCOSUR Structural Convergence Fund (FOCEM), in which Paraguay is the smallest contributor and the largest recipient of disbursements. Although it is the beneficiary of FOCEM, Uruguay adopts a more critical stance regarding balance in MERCOSUR and continues to advocate more debate and freedom of action for negotiations with third countries.

- Evolution over the period -

The last CMC meeting in July 2009 approved the only two projects to be financed by the FOCEM during the period covered by this Report. The *Project to Implement the UNILA-BIUNILA and MERCOSUR Advanced Studies Institute Library* of the Federal University of Latin American Integration (UNILA) in the Foz do Iguaçu Trinational Region, is the first project to be approved for Brazil, with a total of US$22 million, US$17 million of which will be provided by the FOCEM and the rest by Brazil as a national contribution.

The *Technology development, Innovation and Conformance Assessment-DeTIEC* Project, is the 14th project approved for Paraguay, for a total of US$6.5 million. US$5 million of this will be provided by the FOCEM and the rest by the recipient country. The same amount is destined for: the generation and dissemination of technological knowledge; methodologies for product quality certification; security, promotion, and chaining guarantees for productive developments; strengthening the reconversion and associativity of SMEs; professional training in self-management and productive organization for cooperatives.

Table 9
FOCEM: SUMMARY OF PROJECTS APPROVED TO 7/30/09

Nº	Country	Description	Project Total (In millions of US$)	FOCEM Total (In millions of US$)	CMC Aproval		Total Disbursements to 07-30-09 (In millions of US$)
					Dec Nº	Date	
1	Paraguay	MERCOSUR - Habitat	12.91	7.50	8/07	1/18/2007	5.62
2	Paraguay	MERCOSUR - Roga	9.71	7.50	8/07	1/18/2007	0.60
3	Paraguay	Asuncion access and ring road	14.86	12.63	8/07	1/18/2007	1.26
4	Paraguay	Comprehensive support to microenterprises	5.00	4.25	8/07	1/18/2007	0.43
5	Paraguay	Laboratory biosafety	4.80	4.08	8/07	1/18/2007	0.05
6	Paraguay	Road corridors	16.99	14.44	11/07	5/22/2007	1.44
7	Regional	PAMA	16.34	13.89	8/07	1/18/2007	2.40
8	Uruguay	Melo - Arroyo Sarandí Route 26	7.93	5.31	8/07	1/18/2007	4.44
9	Uruguay	Productive internalization - software, biotecnology	1.50	1.28	8/07	1/18/2007	1.28
10	Uruguay	Social Border Economy	1.65	1.40	8/07	1/18/2007	0.14
11	Uruguay	Classifiers	1.88	1.60	11/07	5/22/2007	0.68
12	Uruguay	Multiple interventions in settlements	1.41	1.20	11/07	5/22/2007	0.66
13	Uruguay	Route 12-Route 54 Intersection-Route 55	4.37	2.93	23/07	6/28/2007	0.00
14	SM	Common External Tariff	0.05	0.05	8/07	1/18/2007	0.05
15	SM	Jurisprudential database	0.05	0.05	8/07	1/18/2007	0.05
16	SM	MAPPING	0.07	0.07	39/07	10/25/2007	0.07

Table 9 (Continued)

Nº	Country	Description	Project Total (In millions of US$)	FOCEM Total (In millions of US$)	CMC Aproval		Total Disbursements to 07-30-09 (In millions of US$)
					Dec Nº	Date	
17	Paraguay	Potable water systems and basic sanitation in small rural and indigenous peoples of the country	39.47	28.52	47/07	12/17/2007	1.56
18	Paraguay	Route 8, San Salvador - Rojas Potrero branch	6.34	4.90	48/07	12/17/2007	0.00
19	Paraguay	Tourist product development Iguazú, Misiones	1.30	0.99	7/08	6/30/2008	0.10
20	Paraguay	Paving Routes 6 and 7- Franco Cedrales	5.85	4.52	8/08	6/30/2008	0.00
21	Paraguay	Paving Route 2 - Bernardino Caballero	5.19	4.01	9/08	6/30/2008	0.00
22	Paraguay	Resurfacing Routes 1 and 6 - Graneros del Sur	4.00	3.09	10/08	6/30/2008	0.00
23	Paraguay	MERCOSUR YPORÄ	7.59	5.84	11/08	6/30/2008	0.00
24	Brazil	BIUNILA and IMEA	22.00	17.00	2/09	7/24/2009	0.00
25	Paraguay	Technology Development, Innovation and Conformance Assessment (DeTIEC)	6.47	5.00	10/09	7/24/2009	0.00
Totals			*184.82*	*152.04*			*20.80*

Source: UT-FOCEM/SM.

With these two new projects, the FOCEM had 25 approved in total up to June 30, 2009, for a total of US$197.7 million, US$152 million of which are contributed by the Fund. The degree of implementation of projects differs according to the case (Table 9). In the projects as a whole, the amount implemented comes to US$20.8 million (14% of the total to be financed by FOCEM). In a year-on-year comparison, the implementation of approved projects grew 156%.

In this period, FOCEM continued to strengthen institutionally and operationally. A step forward was taken at the CMC Meeting in December 2008, when it approved the criteria for the Register of FOCEM External Auditors (CMC Dec. 44/08) to certify the proper use of funds. The audit must be comprehensive, covering physical inspections, operational, accounting, and financial aspects, compliance with each project's specific requirements, product and results evaluation, etc.

Another action to strengthen the FOCEM was set out at the same Council meeting, raising the annual maximum to finance the operating costs of the FOCEM Technical Unit/MERCOSUR Secretariat up to 0.75% of the total amount set by Article 6 of CMC Dec. 18/08.[29]

CMC Dec. 12/09 was also passed, providing National Treatment to companies MERCOSUR business in Purchasing and Tendering carried out in the FOCEM Projects framework.

Finally, CMC Dec. 11/09 was approved, through which certain criteria are relaxed for the use of FOCEM resources allocated to finance productive integration projects under the Competitiveness Development Program (FOCEM II), opening up the possibility of the private sector or non-governmental organizations contributing full or partial counterpart funds to this type of projects. The beneficiary State Party, however, must guarantee payment of the counterpart in the event of non-compliance by the private sector entity.

Regional Productive Integration

- Background -

The strengthening of productive integration regional is a fixture in the bloc's agenda of priorities and has certain concrete, albeit as yet modest initiatives. These include the approval of the Productive Integration Program, the creation of the Support Fund for Small and Medium Enterprises (to implement a system of guarantees), and the constitution of a special *Ad Hoc* group to develop a regulatory framework for this mechanism. This has been complemented by initiatives promoted by other MERCOSUR organs, such as the initiative backed by the Commission of Permanent Representatives of MERCOSUR to formalize an Agency to propose policies and actions to boost productive complementation.

- Evolution over the period -

Among the actions developed under the Productive Integration Program are the intensification and complementation of the automotive sector, the development of regional providers in the oil and gas sectors, the integration of tourism-related productive chains, and the training of human resources. The common aim of

[29] Article 6: The total annual contribution of the States Parties to the FOCEM is US$100 million, made up of the following percentages, which take into account the historical average of MERCOSUR's GDP: Brazil 70%, Argentina 27%, Uruguay 2%, and Paraguay 1%.

these projects is to step up the integration process and to efficiently promote and explore the complementarity of the bloc's economies, while contributing to the management and reduction of existing asymmetries.

Box D
BUSINESS PORTAL OF THE PRODUCTIVE INTEGRATION GROUP IN MERCOSUR

Through CMC Dec. 07/09 of July 2009, the CMC decided to set up a business portal on productive integration in MERCOSUR in the ambit of the Permanent Regional Observatory.

As stated in the points of the Decision "the *States Parties of MERCOSUR display different degrees of economic development, size, and geographic location that make it difficult for the smaller partners to fully exploit the potential benefits of integration* […] *MERCOSUR's Productive Integration Program envisages the creation of a Regional Observatory for productive integration in MERCOSUR, as well as instruments to promote business initiatives, which is vital to the consolidation of the integration process*".

The Portal's aim is to promote and enhance business partnerships by constituting one of the agencies that generate the Productive Integration initiatives to be submitted to the Productive Integration Group (GIP), and an information exchange for the public and private actors involved. The establishment of the mechanism to operate the portal and the periodic submission of reports to the Common Market Group has been delegated to the GIP.

The *Program for Automotive Intensification and Complementation* addresses the integration of the automotive chain, the promotion of competitiveness among suppliers of auto parts, the development of information systems for the promotion of new businesses in the region, and the promotion of innovation and technology development in the regional automotive complex. An Executive Group for Automotive Chain Production Integration was set up with different technical meetings and missions to the bloc's countries during the period under analysis.

The *Development Program for Suppliers of the Petroleum and Gas Sectors* aims, with the support of public entities, to promote the coordination of a network of regional providers so that they can meet international standards of quality, innovation, and prices and increase their share as suppliers of the companies providing services in MERCOSUR. Technical meetings were held during the period under analysis, attended by various public and private bodies, as well as companies operating in the region, including the Brazilian Industrial Development Agency, the SEBRAE, Brazil's National Organization of the Petroleum Industry, and PETROBRAS. Progress was made in the development of a project for the structuring of supplier networks in the sector through the recruitment of a consultant who undertook technical missions to Uruguay and Argentina, and whose work will be completed with the formulation of a project for which financial support will be sought in the framework of FOCEM II.

The *Integration Program for Productive Chains* related to tourism in MERCOSUR aims at regional socioeconomic development through the promotion of various different tourist circuits in the States Parties and related sectors, such as textiles, food, handicrafts, furniture, design and decoration, transport, and construction.

The Timber and Furniture Competitiveness Forum was set up to take make the most of the member countries' comparative advantages and improve their global competitiveness. The Forum coordinates the structuring of the *Project to Strengthen the Productive Chain and Development of Timber and Furniture Suppliers* with a view to improving the competitiveness of SMEs supplying this chain, emphasizing complementarity and productive integration, and the insertion of SMEs in the international market. The project will be presented for financing from the FOCEM II.

Other initiatives to emerge in the field of productive integration in the period included an Argentine project to target sectoral initiatives in activities such as *yerba mate*, apiculture and honey products, and agrochemicals and fertilizers. Paraguay submitted a proposal for action in the agribusiness and civil construction sectors, considered key in the Paraguayan productive structure. Uruguay proposed focusing actions on the pharmaceutical sector for veterinary use, while the Social and Economic Consultative Forum has called for a specific initiative for the shipbuilding industry to be incorporated.

Finally, one of the most important advances in productive integration in the last year was the creation of the MERCOSUR Fund for Guarantees to Micro, Small and Medium Enterprises, decided by the Council at its meeting in December 2008.[30] The States Parties' initial contribution to the Guarantee Fund is US$100 million, divided as follows: Brazil 70%, Argentina 27%, Uruguay 2%, and Paraguay 1%. A term of 10 years is envisaged for the Fund, extendable on the basis of the system's effectiveness. The Fund may grant a guarantee or backing to new credit transactions for productive investments in research and development, innovation, training, and technology development, in the production and marketing of goods for export. The guarantee may not exceed 80% of the value of the loan or the original security, except in cases approved by the Management Council. The presidency of the Management Council is to be rotated among the States Parties in alphabetical order for a period of two years. The Fund's Operator will be recruited by international tender, conducted by the Management Council. In the event of financial non-compliance by the credit holder, the Intermediary Financial Institution will ask the Fund to fulfill the terms of the guarantee or refinancing granted. During the first two years of operations, the Management Council will establish prudent initial limits. So, for example, during the first year, the sum of the value of transactions performed by the Fund for businesses in any State Party may not exceed 25% of the Fund's total commitment capacity.

D. Institutional aspects

This section describes the progress in the consolidation of some organs of MERCOSUR: the main developments and guidelines of the bloc's institutional reform, the follow-up on the internalization of the MERCOSUR regulations, the initiatives in the ambit of the MERCOSUR Parliament, and the Advisory Opinions of the Permanent Review Tribunal.

Guidelines for the Institutional Reform

- Background -

Toward the end of 2005, the CMC[31] created the High-Level Group to draw up a proposal for the institutional reform of MERCOSUR. The deadline and the tasks were successively modified.[32] Until the end of the first half of 2008, the results consisted of expanding the functions of the accredited Permanent Representatives in Montevideo, modifying the Council's Internal Rules to institutionalize the MERCOSUR Ministers Meetings and budgetary matters relating to the MERCOSUR Secretariat and the Permanent Review Tribunal. The CMC extended the deadline for the Group carry out their tasks to June 30, 2009, including, among other things, the restructuring of the Secretariat, the improvement of the Dispute Settlement system, the improvement of the mechanism for incorporation, validity, and application of the regulations, the

[30] CMC Decision 41/08.

[31] CMC Decision 21/05.

[32] CMC Decisions 22/06, 54/07, 56/07 and 14/08.

development of a comprehensive budget, and the creation of a technical labor authority in the ambit of the MERCOSUR Secretariat.

- Evolution over the period -

Over the last year, the consolidation of the structure of the MERCOSUR Secretariat and its reengineering were the subject of various meetings and discussions in the framework of the High-Level Group and the GMC. As a result, in December of 2008, CMC Dec. 56/08 was approved, through which consideration of the process of restructuring of the Secretariat was begun, stating that it may contemplate the incorporation of functions currently assigned to the CRPM. For this purpose, the GMC was instructed to submit a proposal to the CMC for a Draft Decision in 2009 taking into account the new structure, functioning, and powers of the Secretariat and the CRPM.

In the negotiations during the first half of 2009, Uruguay noted that the guidelines established in CMC Dec. 56/08 are not mandatory, but merely indicative. On this point, Paraguay stressed that the initiative would require a disconnection of the holder of the SM from the GMC and a direct relationship with the CMC.

In relation to this aspect, some countries have emphasized that the politicization of the MERCOSUR Secretariat must be avoided: if its leadership should come to have a more political profile, it could be detrimental to its technical and administrative functions. It should be remembered that, to date, the line of all States Parties has been to appoint technical-administrative officials as Directors of the SM.

Apart from the restructuring of the Secretariat, a decision to create a High-Level Group on Institutional Relations between the CMC and the MERCOSUR Parliament (GANREL) was taken in the Council meeting at the end of 2008[33] in order to start drawing up a proposal concerning the interaction procedures between the two organs. The GANREL will be made up of representatives from the States Parties. Representatives of the MERCOSUR Parliament may be invited to participate in the GANREL's work in order to exchange views.

Improvements to the System of Incorporation, Effectiveness, and Application of MERCOSUR Regulations

- Background -

The effective enforcement of the rules issued by the decision-making organs -the CMC, GMC, and CCM- has been a focus of concern for the MERCOSUR partners ever since the bloc's inception. The process of incorporating MERCOSUR rules in the States Parties' regulatory framework is one of the weakest issues: a significant number of community provisions that should be incorporated into each State Party's legal system, -not all require it- display considerable delays. Over 50% of rules are estimated not to be internalized. A MERCOSUR Secretariat report in 2004 concluded that the average number of non-internalized provisions was as high as 67%, most of them Common Market Group Resolutions, with just 26% of internalization, followed by CMC Decisions (40% internalization), and Trade Commission Directives (43%) (Secretaría del MERCOSUR [2004]).

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[33] CMC Decision 47/08.

As a result, the partner countries have moved ahead in different kinds of initiatives. Among them, it was provided that certain rules do not require incorporation in national legislation, such as when it comes to matters related to the internal or organizational functioning of MERCOSUR. For closer monitoring and control of the issue, the Technical Meeting for the Incorporation of the MERCOSUR Regulatory Framework (RTIN) was institutionalized, meeting on three occasions over the period covered by this Report.

- Evolution over the period -

At its meeting in March 2009, the GMC instructed the RTIN "with regard to the rules that have not entered into force, to identify the most common causes of non-incorporation in order to contribute to the development of a diagnosis of the problems of the current system of internalization of the community rules". Similarly, the Common Market Group deemed it relevant to include a status report on rules requiring legislative approval on the agenda of the High-Level Group on Institutional Relations between the CMC and the MERCOSUR Parliament (GANREL).

In December 2008 CMC Dec. 35/08 (Follow-up and Update of the Regulatory History) was approved, stipulating that Decisions, Resolutions, and Directives not incorporated by any of the States Parties after five years from the date they were approved (or 2 years after the deadline for incorporation in the case of rules that state it explicitly) must be analyzed again by the decision-making body that issued them.

To this effect, the MERCOSUR Secretariat, in coordination with the RTIN, must regularly report to the PPT and other States Parties on the above rules. The decision-making bodies can instruct the subordinate forums that issued the rules to examine the advisability and interest of the States Parties in finalizing any proceedings pending for its entry into force.

The MERCOSUR Parliament

- Background -

The Protocol establishing the MERCOSUR Parliament was approved at the end of 2006 under the principle of citizen representation, making the Parliament the first MERCOSUR organ in which representation is not governmental. An initial period of transition of the Parliament was established, from 2006 to 2010, when the institution would be made up of 18 parliamentarians from each State Party. It was also established that, at the end of the first stage of transition, the criterion of citizen representation should be defined for States Parties to proceed to the election of national parliamentarians through elections by direct universal secret ballot.

- Evolution over the period -

In this period, the MERCOSUR Parliament stepped up negotiations to draw up a proposal on citizen representation and its proportionality, to be referred to the CMC. As a result of this, the Political Agreement for the Consolidation of MERCOSUR was approved in April 2009. This is linked to the proportionality of representation and the election of parliamentarians via direct universal secret ballot, in accordance with the mechanisms provided by the electoral legislation in the respective countries.

The Agreement presents a Parliamentary Dimension and other Judicial and Legal of MERCOSUR. For the former, it is considered essential to implement citizen representation with a criterion of diminished proportionality, and the expansion and consolidation of the powers of the MERCOSUR Parliament so as to facilitate the progressive evolution of its legislative and control powers.

The Agreement also provides for the need for relevant actions for the entry into force of the consultation mechanism of the Parliament's Constitutive Protocol, as well as regulating the application procedure of the Advisory Opinions and agreeing the criteria for the States Parties' contributions to the MERCOSUR Parliament's budget.

In MERCOSUR's Judicial and Legal Dimension, the Agreement sets out a work agenda, inviting the bloc's Permanent Forum of Supreme Courts to bring to completion the approval of a draft rule to create a MERCOSUR Court of Justice in the second half of 2010. It also refers to the advisability of evaluating proposals and approving a draft rule that would amend the Protocol of Olivos and review the rules and regulations of the Permanent Review Tribunal in order to endow it with new powers, such as the binding status of Advisory Opinions.

The Agreement stipulates that citizen representation with diminished proportionality, the creation of a MERCOSUR Court of Justice, and the expansion of the existing powers of the Permanent Review Tribunal must be coordinated simultaneously.

Box E
THE CITIZEN REPRESENTATION CRITERION PROPOSAL INCLUDED IN THE AGREEMENT

1. States Parties with a population of up to 15 million inhabitants will have a minimum of 18 seats.

2. States Parties with a population of between 15 and 40 million inhabitants will have a minimum of 18 seats, with 1 additional seat per 1 million inhabitants over 15 million.

3. States Parties with a population of between 40 and 80 million inhabitants will have a minimum of 18 seats and a maximum corresponding to Paragraph 2, with 1 additional seat per 2.5 million inhabitants over 40 million.

4. States Parties with a population of between 80 and 120 million inhabitants will have a minimum of 18 seats and a maximum corresponding to Paragraphs 2 and 3, with 1 additional seat per 5 million inhabitants over 80 million.

5. States Parties with a population of over 120 million inhabitants will have a minimum of 18 seats and a maximum corresponding to Paragraphs 2, 3, and 4, with 1 additional seat for every 10 million inhabitants over 120 million.

While, at the first stage of the Parliament, each State Party has 18 seats elected by the national Parliaments themselves, at the second transitional stage, Argentina and Brazil would elect just one third of the difference between the 18-seat floor and the maximum allocated to each of these two States. Once this stage is complete, they will take up their due maximum number of seats.

Brazil will thus elect 37 parliamentarians by direct election in 2010 and, once the transition phase establishing the new Parliament is complete, the 75 representatives Brazil will be entitled to will be elected in 2014. Argentina, on the other hand, will elect 26 parliamentarians in 2011 and 43 at the end of the transitional stage. Paraguay and Uruguay will keep their current allotment of 18 representatives.

During the stage covered by this Report, the MERCOSUR Parliament decided to create the Observatory for Democracy, backed the Revocatory Referendum called by the Bolivian authorities, and declared its support for the strengthening of Peace in the Region and the performance of the G-20 and MERCOSUR in the WTO. It also recommended to the CMC the creation of a Financial Crisis Monitoring Group and support for the role of the Río Group as a mechanism of peaceful consultation and dispute settlement.

Advisory Opinions to the Permanent Review Tribunal (TPR)

- Background -

With the signing of the Protocol of Olivos in February 2002, the Permanent Review Tribunal (TPR) was instituted as a permanent authority to ensure the correct interpretation, application, and enforcement of the key instruments of the integration process. The Tribunal can hear at first and final instance, or as a court of appeal at the request of a State Party involved in a dispute that is the subject of an earlier pronouncement by an *Ad Hoc* Tribunal. Also, further to the provisions of Article 3 of the Protocol of Olivos, the possibility was established of appearing at the TPR to request Advisory Opinions.

The Permanent Review Tribunal is made up of five arbitrators. Each State Party appoints a representative and deputy for a two-year period, renewable for no more than two consecutive terms. The fifth arbitrator, who is appointed for a non-renewable three-year period, is elected unanimously from the list of arbitrators to that effect, having to be a national of one or other MERCOSUR State Party.

- Evolution over the period -

During the period under review, the TPR issued two Advisory Opinions. The first (01/2008), resolved April 25, 2009, referring to the case, "The Estate of Carlos Schnek and others *vs.* the Ministry of Economy and Finance and others. Monies owed", requested by the Uruguayan Supreme Court of Justice. The second (01/2009), issued June 15, 2009, was the cause "Frigorífico Centenario S.A. *vs.* the Ministry of Economy and Finance and others. Monies owed", again requested by the Uruguayan Supreme Court of Justice. The two consultations are similar in that they were ordered by the Uruguayan Supreme Court and in the subject matter involved, namely, the reintroduction of the so-called "consular fee".

Both Advisory Opinions request the TPR to issue an opinion on the following points: (i) whether community rules take priority over the rules of a State Party's internal law, and if so, what would the (MERCOSUR or internal) regulations the National Judge should apply to the case be; and (ii) whether the Treaty of Asuncion allows States Parties to approve a national rule that reintroduces a rate like, in this case, the consular fee.

The TPR issued its Advisory Opinions on the basis of the analysis and evaluation of the background. The first of these determined that the TPR can establish a national rule's compatibility with MERCOSUR law, respecting the priority of regional over national regulations, although it is not possible for it to state its opinion over its constitutionality, applicability, or nullity, a matter falling exclusively to the remit of national jurisdiction. It also established that, in order to be able to state its opinion reliably, it had to know the status (rate or tax) given to the consular fee under applicable internal law, a status necessary to verify compatibility with the MERCOSUR rules.

The second case coincides with this diagnosis of the problem, while noting that the rules approved by the States Parties can clash with those resulting from the integration process and, therefore, these situations require an interpretation of the compatibility and legality of the two sets of rules and, more importantly, of their importance or priority.

In spite of this, it agrees with the First Advisory Opinion in the sense that national tribunals are the only ones qualified to state an opinion on the applicability or otherwise of the consular measure, noting that Advisory Opinions cannot, under MERCOSUR rules, be assimilated in the pre-judicial resources provided by other integration processes. Similarly, it coincides with the fact that, to state an opinion, it requires clarification on whether a rate or a tax is involved. In fact, there are no MERCOSUR rules to limit or harmonize internal tax structures (so, in the case of a tax, there might be no incompatibility), but regulations limiting the establishment of trade barriers or discriminatory measures (such as might apply in the case of a rate).

The TPR concluded that, only once the nature of the consular fee (levy or tax) had been established by the competent Uruguayan authority, could an opinion be effectively stated as to whether the rule constitutes a measure that the States Parties may adopt in a manner consistent with their commitments in the MERCOSUR integration process.

E. Other issues on the Internal Agenda

This section describes the negotiations related to the social dimension of the integration process, the creation of the Family Farming Fund, the process of Venezuelan membership of the regional integration scheme, and the Bank of the South.

The Social Dimension

- Background -

At the CMC Meeting in July 2006, the CRPM was entrusted with drawing up a proposal for the creation of a MERCOSUR Social Institute[34] to deepen the development of social issues in the region. As a result of the work carried out to this effect, in January 2007, the Council decided to create the MERCOSUR Social Institute (ISM), temporarily in the ambit of the Meeting of MERCOSUR Social Development Ministers and Authorities (RMADS),[35] establishing its headquarters in Asuncion, Paraguay. The Institute's objectives are: (i) to contribute to the consolidation of the social dimension as a key element in MERCOSUR's development, (ii) to contribute to overcoming asymmetries, (iii) to cooperate technically on the regional social policy design, (iv) to systematize and update regional social indicators, (v) to collect and exchange good practices in the social area, (vi) to promote horizontal cooperation mechanisms, and (vii) to identify sources of financing.

- Evolution over the period -

The CMC meeting in December 2008 decided on the Institute's structure, formalizing it as a technical research authority in the area of social policies and the implementation of the strategic lines approved by the RMADS, with a view to contributing to the consolidation of the social dimension as a central axis in the MERCOSUR process of integration. It was agreed the operation should be funded by voluntary contributions from the Social Development Ministries or their counterparts in the States Parties, in spite of which it could utilize resources from NGO contributions and/or from International Technical Cooperation.

The Council is the governing body of the ISM, which will consist of a regular government representative and a second-in-command from each State Party. An Executive Director appointed by the CMC is responsible for

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34 CMC Decision 16/06.

35 CMC Decision 03/07.

the proper execution all tasks assigned to the ISM and for its technical, administrative, financial, and assets management. The ISM is made up of four departments: (i) Research and Information Management, (ii) Regional Social Policy Promotion and Exchange, (iii) Administration and Finance, and (iv) Communication.

The Paraguayan representative will be the first Executive Director and thereafter nationalities will be rotated in alphabetical order. CMC Dec. 38/08 set the SM's budget for 2009 at US$228,000.[36]

In December 2008, the CMC also decided to set up the Coordination Commission for MERCOSUR Social Affairs Ministers (CCMASM)[37] to submit proposals to the CMC for the approval of specific regional social projects, to identify potential sources of funding for regional social projects, to implement technical cooperation agreements on matters endorsed by MERCOSUR, to supervise the proper implementation of regional social projects adopted, among other things.

The Family Farming Fund

- Background -

Viewing Family Farming as an aspect of the bloc's social dimension and in order to hierarchize it, the Common Market Group decided in 2004 to create the Specialized Meeting on Family Farming in MERCOSUR.[38] The aim was to strengthen policies for the sector and promote trade in the products of Family Farming in the region. In 2007, the CMG approved "Guidelines for the Recognition and Identification of Family Farming in MERCOSUR",[39] as a first step, targeting the establishment and improvement of differentiated public policies for family farmers so as to promote sustainable development in rural areas from the socioeconomic, cultural, and environmental point of view.

- Evolution over the period -

The most important breakthrough was the creation of the MERCOSUR Family Farming Fund (FAF)[40] at the end of 2008, whose main objective is to finance stimulus programs and projects for Family Farming and allow broad participation of the social actors in related activities. The regulations for the FAF were established at the CMC Meeting in July 2009.[41] The FAF will last five years once its management contract has been signed. After this period, the States Parties will evaluate the alternatives for its continued existence. The regulation expressly states that the FAF is a financial management instrument, and that its goal is to finance stimulus programs and projects for Family Farming. The financing of the Fund is determined by a US$15,000 fixed annual contribution per State Party and a US$300,000 annual contribution by Brazil (70%), Argentina (27), Uruguay (2%), and Paraguay (1%). The Specialized Meeting on Family Farming used FAF resources to

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36 US$227,952 (Argentina: US$54,488, Brazil: US$88,976, Paraguay: US$54,488, and Uruguay: US$30.000).

37 CMC Decision 39/09.

38 GMC Resolution 11/04.

39 GMC Resolution 25/07.

40 CMC Decision 45/08.

41 CMC Decision 06/09.

finance initiatives specifically indicated in its annual Work Program and in other specific projects approved by the GMC. A report on the use of these resources is to be submitted at the end of each year.

This period also saw the approval of Program of Policies for Gender Equality Promotion in Family Farming. The 2nd Module of the Rural Youth Course was held to strengthen the relationship between the region's youth leaders and define convergent policies to improve living conditions in rural areas.

Venezuelan membership

- Background -

Venezuela's entry as a full MERCOSUR partner requires legislative approval by the parliaments of the four founding partners, which had been achieved only in the cases of Argentina and Uruguay, and remained delayed by the members of the Brazilian and Paraguayan parliaments.

- Evolution over the period -

During the period covered by this Report, there was no progress over the Protocol of Adherence of Venezuela to MERCOSUR. Progress was made, however, in October 2009. The difficulties have arisen in Brazil and Paraguay. In the first case, in addition to the Executive's efforts, various parliamentarians objected to the approval of the Protocol in light of Venezuela's uncertainty over products taxed under the CET, the lack of clarification of the deadline for adaptation to the bloc's rules, and uncertainty about Venezuela's position in future trade agreements. However, on the above date, a Brazilian parliamentarian involved in the process made a positive statement regarding Venezuela's incorporation in MERCOSUR.

The problems in Paraguay were along similar lines to those originally expressed in Brazil. On the eve of the Summit of MERCOSUR Presidents in Asuncion in July 2009, the Paraguayan Chamber of Commerce sent a communiqué to the Senate rejecting Venezuela's entry (CNCSP [2009]). The Paraguayan Executive Power, which does not have a parliamentary majority, decided to withdraw the draft from the Congress in case it might be rejected and this might make it impossible to include it in the country's next legislative session.

The nationalization of certain companies with Argentine capital in Venezuela resulted in an unfavorable pronouncement by private entities (UIA [2009]), despite the fact that the parliamentary procedure for entry was already complete there.

The Bank of the South

- Background -

After a long process starting in 2004, the Founding Act of the Bank of the South was signed by the Presidents of Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay, and Venezuela in Buenos Aires, Argentina, in December 2007. The aim of the Bank is to contribute to the development and integration of the region, promoting access to company financing for productive investment and infrastructure projects.

The Founding Act stipulated that the Bank's central offices would be in Caracas, with two suboffices, one in Buenos Aires and another in La Paz. The institution's functions include financing development projects in three areas: (i) improving competitiveness, and developing science and technology, (ii) social sectors to combat poverty and social exclusion, and (iii) projects promoting the integration process.

The Bank is also expected to administer special emergency funds in response to natural disasters. The Bank's capital was agreed at the Ministerial Meetings in Montevideo in April 2008 and Buenos Aires in June 2008, with authorized capital of US$20 billion and subscribed capital of US$7 billion. Contributions were set as follows: Argentina, Brazil, and Venezuela are each to provide US$2 billion, Ecuador and Uruguay US$400 million, and Bolivia and Paraguay US$100 million. The initial contribution will, in the case of Argentina, Brazil and Venezuela, be 20%, and the rest in four annual installments; Bolivia, Ecuador, Paraguay, and Uruguay, will contribute 10% initially and the rest in nine installments.

The Credit Portfolio for Argentina, Brazil, and Venezuela will be four times the capital, and 8 times for Bolivia, Ecuador, Paraguay, and Uruguay. The exposure limit was set at three times the Bank's net assets up to a ceiling of four and a half, and borrowing at two and a half times the Bank's net assets.

In terms of government and administration, it was decided that the Bank of the South be formed by a Council of Ministers (the development banks' Boards of Governors), a Management Council (the Board of Directors), a Directorate (responsible for the Bank's functioning), and an Audit Board.

There have been some differences in the institution's final structuring, one of which arose from the interpretation of Article V of the Founding Act, through which a system of "democratic functioning" was agreed (one vote per country). Of the highest contributors to the Bank of the South (Argentina, Brazil, and Venezuela), only Venezuela supported democratic decision-making at all levels. Brazil and Argentina, on the other hand, supported this alternative for the Bank's various boards, but felt that countries contributing more ought to be given more of a say in specific credit management. In terms of the Investment Portfolio, discussions centered on whether infrastructure projects should be given priority.

While some advocated this alternative, others felt that, since infrastructure is the area with the highest multilateral investment in the region, social and agricultural investment ought to have been given priority.

Another issue was to do with the Bank's priority target groups for financing. While it was agreed the Bank of the South should invest in financial intermediation for national public enterprises, SMEs, cooperatives, and workers self managed enterprises, some countries voiced certain objections to financing large private-sector companies.

- Evolution over the period -

During the Economy Ministers' meeting in May 2009, the signatory countries of the Founding Act defined the terms of the future entity's articles of association, with its parliamentary treatment left pending the start of its activities. The abovementioned capital guidelines were set on this occasion, as was the democratization of decisions. On this matter, it was decided that each country should have one vote in all organs, including the Directorate. However, the backing of two-thirds of the capital contributed to the Bank will be needed to approve projects over US$70 million. Accordingly, the vote of at least two of the most important contributors -Argentina, Brazil, or Venezuela- must be obtained for such projects.

The Presidents of Argentina, Brazil, Ecuador, Paraguay, Uruguay, and Venezuela signed the Agreement Establishing the Bank of the South on the island of Margarita, Venezuela, September 26 (IDB-INTAL [2009e]).

F. Final remarks

The stabilization of the world economy toward the second and third quarter of 2009 gives a glimpse of a regional scenario more conducive to consolidating agreements and negotiations that tend to deepen the integration process. Some issues are likely to take on greater relevance, such as productive integration, institutional improvement and strengthening, and the use and expansion of instruments like the SML. The FOCEM will remain a useful tool for the administration of asymmetries and the construction of regional public goods, and is expected to be strengthened both institutionally and operationally. Highly significant in this respect are the decisions to provide businesses in MERCOSUR with national treatment in purchasing and tendering within the framework of FOCEM Projects and the relaxation of criteria to finance productive integration projects under the Competitiveness Development Program (FOCEM II).

In institutional matters, and in particular the structure of the MERCOSUR Secretariat, major efforts are being made to improve its functioning and redefine its powers by incorporating functions currently assigned to the Commission of Permanent Representatives.

In short, the stabilization of the MERCOSUR economies is likely to enable the bloc to concentrate on the outstanding issues on its negotiating agenda through instruments that have proved successful, while trying to resolve the attendant dilemmas of the integration process, treatment of which has been extremely slow where issues such as double CET levying, the Customs Code, and special import regimes are concerned. Otherwise, the postponement of these dilemmas and the lack of definition in central aspects of the negotiating process will dent confidence in MERCOSUR and limit the strengthening of the bloc's productive and trade fabric.

CHAPTER IV. SECTORAL TENSIONS AND DISPUTES AGAINST A BACKGROUND OF REGIONAL TRADE ADJUSTMENT

A. An overview

The triggering of the global economic crisis put fresh strain on the commercial fabric of MERCOSUR. Commercial trade experienced the symptoms of the crisis extremely intensely, affected by the contraction in real income and the credit shortage in the world's major economies.

As detailed in Chapter II of this Report, foreign trade in each of the MERCOSUR countries was badly affected and intrazone trade even more badly. This formed a set of circumstances that were ripe for the reawakening of old trade tensions in sectors considered sensitive by MERCOSUR's various partners, in large part reversing the downward trend in trade difficulties or conflicts seen up to mid-2007.

Thus, from the last quarter of 2008, with the collapse of the world economy and its impact on the region, protection claims resurfaced in some industrial sectors. These were not flatly dismissed by the authorities. In fact, to minimize the impact of the critical situation in terms of job losses and damage to the productive fabric, partner countries tended to take various measures, some proactive, others defensive. In Argentina these claims translated into global foreign trade administration measures, which also affected the other MERCOSUR partners, although they always remained within the rules. No disputes were brought before the WTO.

In Brazil, for its part, the main reaction came in the form of plans for major fiscal expansion, to shore up activity levels or slow the pace and duration of the fall. Uruguay and Paraguay also used different stimulus mechanisms to tackle the crisis.[42] Import control instruments were also used in all three countries, though to a lesser extent than in Argentina.

Various different factors helped to deepen this trend toward the end of 2008. First, the disparity between the bloc's two largest partners' exchange rate policies. Whereas in Brazil, the global crisis translated into an immediate steep depreciation of the currency through the financial and real channels, in Argentina a foreign exchange policy designed to contain the fluctuations of the exchange rate was still the order of the day. This led to a serious disturbance in the bilateral real exchange rate, which, by modifying relative competitiveness, prompted claims from Argentina's industrial sector.

This was in addition to the fact that the minimization of the bilateral structural deficit with Brazil in manufacturing trade had already been a priority industrial policy goal for the Argentine government (Morosi [2008]). This goal was consolidated with the change in the authorities responsible and the creation of the Production Ministry in November 2008.

This type of episode is nothing new in the history of MERCOSUR. When the effects of the Asian and Russian crises reached the Brazilian economy at the end of the 1990s, contributing to a significant devaluation of the *real* in January 1999, internal trade disputes began to proliferate in the absence of a flexible, effective mechanism to resolve them. At the time, the sharp devaluation of the Brazilian currency was followed by an escalation of protective measures in Argentina, designed to offset -at least partially- the deterioration of real bilateral parity, inevitable under the rigid scheme of the convertibility regime prevailing at that time.

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42 See Chapter I of this Report and ECLAC [2009].

It is also worth looking back over the events of 2004-2005, when the Argentine authorities began to take measures to protect national industry in order to maximize the gains from the process of economic growth then being experienced by the country, which was beginning to recover after the profound crisis of 2001-2002. At that stage, however, a certain negotiating mechanics started up at the bilateral level involving private voluntary restraint export agreements, clearly motivated and promoted by their respective governments. However, the context of economic and trade expansion at the time makes comparisons unrepresentative. In effect, what was being administrated was the allocation of profits in an environment of strong growth, with a trade dynamic characterized by an increase in the Brazilian share in Argentine imports. These conditions differ significantly from the economic and trade-related contractionary environment of the period covered by this Report. Perhaps this substantial difference helps explain why most private agreements were then reached without any effective mediating official restraint measures.

On the contrary, beyond the similarities or differences regarding the moment in the economic cycle when trade tensions intensify, there are currently factors that have tended to limit any acrimony between the partner countries. As had been the case in certain specific sectors, "the China factor" was a potential threat that tended to created solidarity between the parties in an increasingly broad number of headings.

In this sense, the increasing influence of China on MERCOSUR and world trade brought certain changes in intrabloc trends, becoming strong competition for various industrial sectors in each country in their respective domestic markets, and for Brazil's industrial exports to the rest of the bloc. Thus, the perception of a common external danger helped to bring some negotiating positions closer together: Brazilian exporters agreed to restrain their sales to Argentina to ensure a given share in this market.

In addition, although perhaps more concentrated in certain areas, there has been an increase in Brazilian investment in Argentine production. As a reaction to the aforementioned episodes of previous tensions or to the trade barriers that started being implemented before the worsening of the crisis, these investments were driven to some extent by Argentina's goal of circumventing trade restrictions-actual or potential.

Thus, Brazilian capital was concentrated in Argentina's sensitive segments, like the textile chain or footwear production. This situation prompted the Brazilian negotiators to adopt a more flexible position when deciding self-restraints in trade in these sectors and to increase the intrasectoral *affectio societatis* between the warring parties. It is worth mentioning that investments have been mainly one-way: Argentina's presence in Brazil has not expanded, probably due to the lower offensive capacity of the country's industrial sector and the evolution of foreign exchange variables.

In parallel to the bilateral voluntary agreements between private individuals, several instruments have been used as trade defense measures in the period under analysis. The extension of the use of "criterion values" by customs and the implementation of anti-dumping duties can be mentioned in this respect. There have even been incipient attempts to generalize the adoption of trade administration tools (of the flex factor-type used in the Common Automotive Policy).[43] However, the mechanism most used by the Argentine government was

[43] The Flex regime consists of a coefficient of export deviation, via which a limit on exports from each country is defined per US$1 imported. See IDB-INTAL [2008], p. 113.

the application of non-automatic import licensing (NAL),[44] which also prompted a considerable number of claims from partner countries, mainly Brazil. Such licensing, applicable to imports of any origin, including MERCOSUR, tended to hinder transactions and create uncertainty in the business model.

It should be noted that this tool had already been used by both Argentina and Brazil, although in the latter more extensively, albeit not linked to the current crisis.[45] Licensing is a way of managing quotas arising from trade defense measures (anti-dumping or safeguards), but its application can also be linked to safety standards, or environmental or public health issues. NAL can be considered a factor in increasing the times and costs of import transactions. If, in addition to these charges, there is uncertainty over the final outcome of the administrative procedure, the effects are clearly far from being merely temporary and can effectively discourage imports. For certain headings, such as those affected by seasonal factors, NAL can cause permanent shrinkages in trade.

By way of quantifying the importance of NAL in Argentina's foreign trade, it is estimated to cover tariff items representing 8% of the value of Argentina's total world imports in 2008. In the case of imports from Brazil, this share rises to 8.9%. At the aggregate level then, NAL would not appear to be slanted against Brazilian products, all the less so when one thinks that, in the case of China, this percentage is 18.4%.

Table 10
ARGENTINE IMPORTS 2008
(In millions of US$)

	Brazil	China
Total imports	17,978	7,145
Imported items with NAL	1,607	1,312
Imported items with other restrictions	306	208
Total imports subject to restrictions	1,913	1,520
% with NAL	8.9%	18.4%
% total with restrictions	10.6%	21.7%

Source: Authors' own based on data from INDEC, Ministry of Production, and CNCE.

Taking into account the other existing restrictions, such as anti-dumping measures, safeguards (definitive and interim), and current private agreements, the percentage of Argentina's imports from Brazil affected rises to 10.6%. In the case of China this percentage is 21.7%.

44 Under the WTO's Agreement on Import Licensing Procedures, *import licensing* is defined as "administrative procedures used for the operation of import licensing regimes requiring the submission of an application or other documentation (other than that required for customs purposes) to the relevant administrative body as a prior condition for importation into the customs territory of the importing Member". In the case of *non-automatic import licensing*, it states that "the period for processing applications shall, except when not possible for reasons outside the control of the Member, not be longer than 30 days if applications are considered as and when received, i.e. on a first-come first-served basis, and no longer than 60 days if all applications are considered simultaneously". WTO Agreement on Import Licensing Procedures *http://www.wto.org/english/docs_e/legal_e/23-lic.pdf*.

45 According to the latest Report to examine Brazilian trade policy (WTO [2009]), Brazil, for various reasons, applies NAL to 3,500 tariff positions out of 9,765. For more details, see Ochoa [2009].

It should be noted that these figures of the trade impact of different kinds of administrative barriers do not differ significantly from other analogous historical periods. Thus, during the wave of conflicts in 2004-2005, the sample of Brazilian imports affected was estimated at 10.5%, not counting the then troubled automotive sector (IDB-INTAL [2005], p. 51).

One should, however, differentiate between the potential maximum restrictive effect estimated by these calculations and the effects in reality. Indeed, although trade impact estimates account for the greater scope of restrictions on products originating in China -due to which a further decline in such imports should be expected- the data point to other conclusions. Looking at Argentine imports in the first half of 2009, purchases from Brazil saw an overall contraction of 43%, in which the subset of positions with NAL contracted 58%. In contrast, the total contraction of purchases from China was 36%, 38% down in the licensing subgroup, just 2 percentage points above the total.

In other words, while the sample potentially affected by NAL is higher in the case of China *vis-à-vis* Brazil, NAL does not, in practice, seem to have been too relevant in causing a further contraction in Chinese imports to the one already marked by the economic conditions, which does seem to have happened with imports originating in Brazil.

Table 11
ARGENTINE IMPORTS - FIRST HALF OF 2009
(YOY variation - As %)

	Positions affected by NAL	Positions not affected by NAL	*Total*
World Total	*-46.9*	*-37.6*	*-38.3*
Origen Brazil	-58.3	-41.2	*-42.7*
Origen China	-37.8	-35.0	*-35.5*

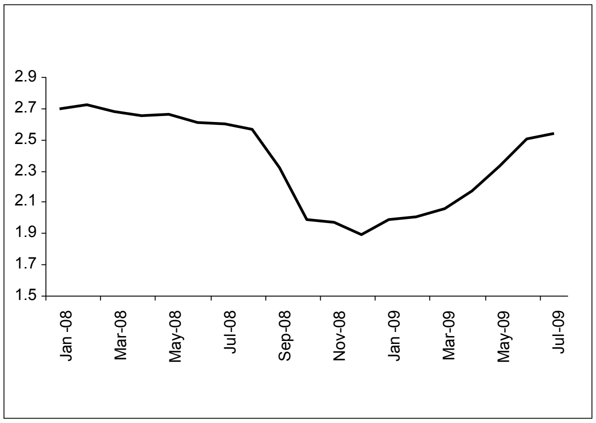
Source: Authors' own based on INDEC and Ministry of Production.

Another interesting element to analyze is the possible correspondence between the escalation of restrictions (as measured by the trade value affected by adding new products to the NAL regime) and the evolution of the bilateral real exchange rate between Brazil and Argentina.[46] This had reached a low during December 2008, 24% down on the peak of August 2008. As of January 2009, however, the nominal appreciation of the Brazilian *real* and the nominal depreciation of the Argentine *peso* meant that parity again recovered with a V-profile. In July 2009, parity reached levels of similar to those of pre-August 2008.

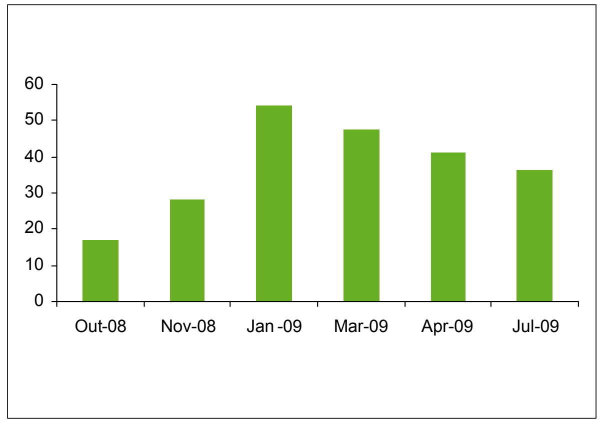
The readjustment of the bilateral real exchange rate was consistently processed by the NAL regime. In effect, Brazil's share in the imports affected by the various resolutions that give legal support to NAL reached a high (54%) in the one corresponding to January 2009 (very probably designed weeks before) and then began to fall evenly and steadily.

[46] In *pesos* per *real*, adjusted for national consumer price indices. A negative slope indicates a *real* depreciation/*peso* appreciation. A consumer price index adjusted from various different provincial price indices was used for Argentina.

GRAPH 21
REAL EXCHANGE RATE: ARGENTINA/BRAZIL
(AR$-R$ - December 2001 Base=1)



GRAPH 22
BRAZILIAN SHARE IN IMPORTS INCLUDED IN ARGENTINE NAL
(As %)



Source: Authors' own based on data from INDEC, BCRA, BCB, and IBGE.

Clearly, then, the gradual disappearance of serious bilateral foreign exchange disruption to some extent moderated NAL's emphasis on imports from Brazil.

As well as the measures applied by Argentina and their impact on certain sectors in Brazil, and, to a lesser extent, Uruguay (e.g. textiles), this period, again on the Brazilian side, saw the government's concern to preserve certain outputs linked to agribusiness and affecting both Argentina (wines and dairy products) and Uruguay (e.g. dairy products).

Paraguay's dispute with Brazil over energy provision, in terms of both price and availability, became extremely intense in the period under analysis, although it was finally channeled by the revision of the Treaty of Itaipú.

Faced with the outbreak of episodes like these, it is worth asking why countries have resorted to unilateral measures or informal private agreements, instead of using the Competitive Adaptation Mechanism (MAC) agreed by Brazil and Argentina in 2006.[47] This instrument requires proof of the existence of damage or threat of injury and, therefore, requires time and processes that are not always wanted or cannot be complied with. More than 3 years after being registered under LAIA's ECA 14, the MAC is still inoperative[48] and governments do not seem to want this to change. In short, due both to the preservation of degrees of freedom and the shortening of application times, this scheme -based on rules and procedures, and agreed at a bilateral level- remains idle. By nature, the instrument seems not to be fitted for a context of acute instability such as has been unleashed in the wake of the global crisis.

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[47] The MAC aims to repair any major damage (or prevent the threat) to a national industry due to a substantial rise in imports. The mechanism is organized as a Competitive Adaptation Program for national production when imports of a product originating from one of the signatory countries see a substantial increase that may cause significant damage or threat of damage to a branch of production.

[48] Article 30 of the Protocol in ECA 14 of the MAC envisages that "it will enter into force simultaneously when both Parties report to the LAIA General Secretariat that they have incorporated it into their internal laws under the terms of their respective legislation". This process has not yet been made effective.

B. Analysis of the main sectoral disputes or negotiations

Introduction

There follows an analysis of the main sectoral disputes during the period evaluated in this Report. For a clearer understanding, these are identified according to the countries involved (those adopting the measure and those affected) and the status of the measures adopted (unilateral, private agreements, etc.)

Tables 10 and 11 summarize three types of situation: products with NAL and a private agreement, products with NAL and no private agreement, and products with other kinds of restrictions and a private agreement. Some sectoral disputes originate in Argentina, others in Brazil, while Uruguay is affected in at least two cases.

Table 12
SECTORAL CONFLICTS ACCORDING TO FEATURES AND RESOLUTION

		Bilateral agreement	No bilateral agreement
Features of the restriction	Through NAL (new)	Wooden furniture Dairy products	Yarns and fabrics Clothing Household linen Tires
	Through NAL (preexisting)	Footwear White goods	
	Other reason	Auto parts Paper Wines	

Source: Authors' own based on data from MECON and Ministério da Fazenda.

Table 13
SECTORAL DISPUTES ACCORDING TO COUNTRIES INVOLVED[a/]

		Country adopting measure	
		Brazil	Argentina
Country affected by measure	Argentina	Wines Dairy products	
	Uruguay	Milk	Clothing
	Brazil		White goods Yarns and fabrics Wooden furnitures Footwear Clothing Tires Household linen Paper

Note: [a/] Includes major cases under discussion and/or negotiation. This list is not exhaustive. In fact, in the ambit of the MERCOSUR Trade Commission, there are other sectoral trade issues, such as Argentina's consultation over Uruguay's entry barriers on Argentine wines and sparkling wines, or Paraguay's consultation over Brazil's mandatory quality certification for plastic seat imports, that are not addressed here as they are highly detailed and specific.

Source: Authors' own based on MECON and Ministério da Fazenda.

For Paraguay, although not presented in the table due to its being a rather more general dispute, an analysis of its energy negotiation with Brazil is included. This was extremely relevant in the period and, as mentioned above, concluded mid-year with the signing of new agreements over Itaipú.

Box F also reflects the main features of Argentina's -and to a lesser extent Brazil's- anti-dumping policy during the period.

Box F
ARGENTINE AND BRAZILIAN ANTI-DUMPING POLICY

Since the outbreak of the global economic crisis, the use of the trade defense mechanisms provided for in multilateral trade agreements has been on the increase. Thus, during the second half of 2008, the number of new measures being applied by WTO member countries was up 45% on the same period in 2007 (OMC [2009a]).

Against this background, in October 2008, the Argentine government decided to relax the application procedures for anti-dumping rules and so speed up the times involved in order to make the instrument more dynamic. To this end, investigations were cut from 18 months to 11. The interval between the claim and the opening of the case was also reduced, from six months to one month. The deadline for the application of the preliminary measures was also shortened from the six months it originally used to take to adopt this provision to five months.

To what extent has anti-dumping policy Argentina affected Brazil? Including the opening of new investigations, the application of temporary duties, and the measures currently in force, the suits directed at products from Brazil affected 44 tariff positions, representing US$262 million in Argentine imports during 2008.

The new openings include **ceramic articles** (a measure also including products originating in Uruguay) and **multiprocessors**, affecting US$6 million of total imports. The application of preventive duties included **acrylic yarns** and **stainless steel cutlery**, representing imports of US$28 million.

A further 37 positions were affected by preexisting duties still in force, reaching products like **bicycle tires**, **stainless steel tubing**, **flat-rolled iron and steel**, **hand saw blades**, and **glasses and tumblers**, representing imports of US$228 million.

The aggregate positions affecting Brazilian products between July 2008 and July 2009 were up 15% on the value of Brazilian imports in 2008. In the case of products originating in China, the increase was considerably higher, reaching 41%. In terms of imports in 2008, the positions affected for purchases from China reach a total of US$208 million.

It can be concluded that, although there was a marked increase in the opening of new investigations by Argentina, most of these were aimed at products of Chinese origin.

Brazil was also an active user of anti-dumping measures in the period. However, these were mainly targeted at extrazone countries. This instrument was used less against unfair trade practices within the bloc than in Argentina. According to WTO information to December 31, 2008 (OMC [2009b]), the introduction of one measure was detected during the period under review, affecting a single tariff position (polypropylene tape from Argentina). Similarly, among the definitive measures still in force, only one involves imports from MERCOSUR under the chemical heading: phosphate monohydrate from Argentina.

Application of Non-Automatic Import Licensing Regimes (NAL): Sectors with private agreements

- Wooden Furniture[49] -

This group of goods was incorporated in Argentina's NAL regime in early March 2009. In the product sample covered by the measure, Brazil occupies a prominent place in Argentine imports, with a share of around 45% of the total during 2007 and 2008. China is also a major supplier, but quite a way off, with between 20% and 25% of Argentina's external purchases in the heading. For Brazil, the Argentine market represents approximately 10% of total exports in these goods.

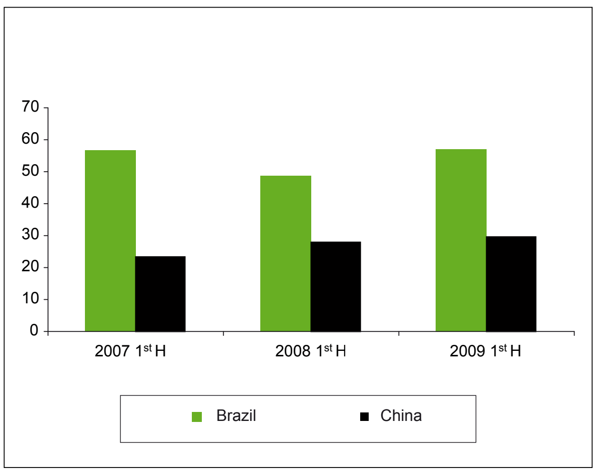
[49] It should be noted that this sector is part of the First MERCOSUR Competitiveness Forum. Both disputes and the channeling of solutions agreed outside the Forum expresses the initiative's lack of success.

One fact to stress is that, as of the start of 2009, there was a significant low in the average price of Argentine imports of these products, especially from Brazilian. The country's statistics suggest that the drop in average prices was more pronounced in sales to Argentina than in total sales. This may be to do with a process of stock liquidation in Brazilian supply directed at the Argentine market. Subsequently, the price recovered and rose to far higher levels.

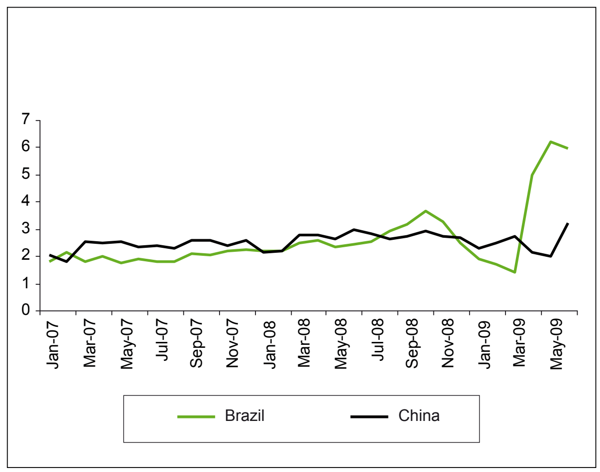
After the introduction of NAL there was a substantial fall in Argentine imports, especially those from Brazil. They were also down from China, but only from May. From then on, there were similar falls in both cases.

A private sector agreement was struck in early June, with Brazilian exporters pledging to restrict exports to Argentina to 35% in 2009 as compared to 2008, requiring a 37% reduction over the second half of the year.

Graph 23
ARGENTINE FURNITURE IMPORTS
(Share in total - As %)



Graph 24
ARGENTINE FURNITURE IMPORTS
(Average price by origin - US$/kg)



Source: INDEC.

- Footwear -

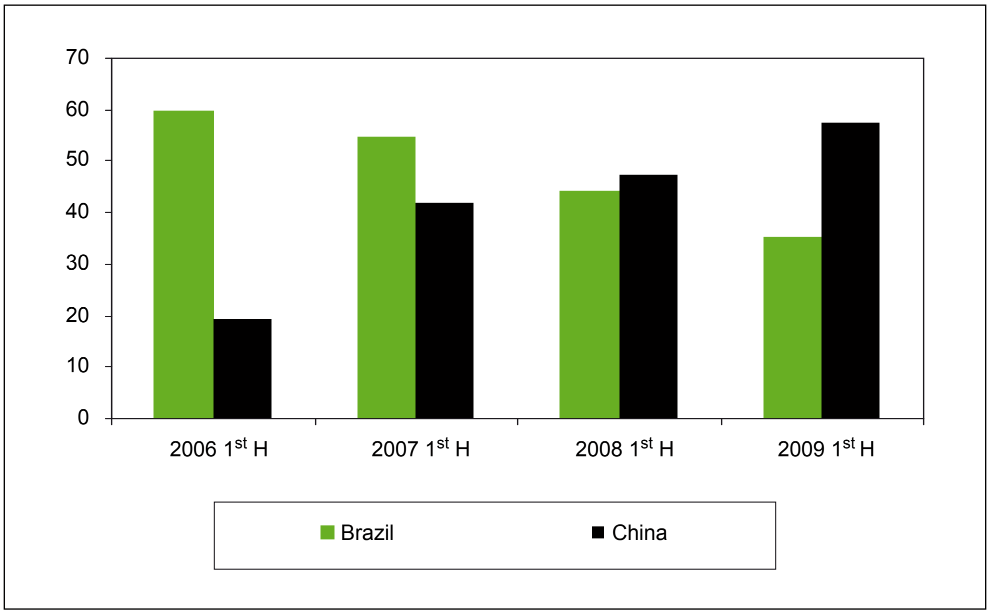
This sector has a long history of bilateral sectoral misunderstandings and negotiations due to the sharp disparities in both scale of output and exports, and because of the average size of Argentine and Brazilian firms.

Voluntary restraint agreements on Brazilian exports for 12 and 12.5 million pairs per year had been signed in 2004 and 2005 respectively, but according to Argentine producers, they were not fully complied with.

Since then, Brazilian exports have expanded with the growth of the Argentine domestic market. This destination thus gradually gained prominence as a buyer of Brazilian exports, reaching 12% of total placements. This is partly explained by the difficulties faced by Brazilian producers over continued growth in the global footwear market in the face of intense competition from Chinese and other Asian countries' products.

Chinese buoyancy in this sector was also visible in the Argentine market: the share in footwear from this origin has gained prominence, displacing footwear from Brazil. Thus, in the first part of 2009, Argentina's imports from China exceeded those from Brazil. This common threat perceived by Brazilian and Argentine producers acted as a catalyst in uniting the once conflicting parties.

Graph 25
FOOTWEAR: SHARE IN ARGENTINE IMPORTS
(As %)



Source: INDEC.

Another, perhaps more specific, facilitating factor has been the growing share of Brazilian capital in Argentina's footwear sector. Because of the productive internationalization of government-supported Brazilian players already inserted in the global market, and as a way of avoiding the effects of previous bilateral agreements and potential export restraint measures, several Brazilian firms purchased Argentine production companies and invested in greenfield investments, focusing mainly on sports and casual fashions in both cases.

In response to this, Argentine industrialists expressed their interest in reaching some agreement, rejecting tougher measures like WTO safeguards. Both parties constantly expressed the desire to face the threat posed by Chinese supply together, which, from the start of the crisis and the fall in consumption in developed countries' markets, seemed be flooding regional markets.

Finally, the agreement reached makes provision for an annual quota of 15 million pairs of Brazilian origin, over a three-year term. This is 19% down on the volume recorded in 2008. Imports from China are expected to be brought under control through trade defense mechanisms.

- Dairy products -

This activity has a fairly long history in terms of intrabloc trade restrictions originating in Brazil. In 2001, Brazil set a minimum price of US$1,900 per tonne for powdered milk from Argentina.

The measure steered most of Argentina's exportable supply to other markets. With the sharp rise in international powdered milk prices -the main product traded in this sector- since 2003, compounded as of late 2006, the minimum price ceased to be relevant, as it was lower than the international price. The Argentine product thus gradually started reentering Brazil, without putting downward pressure on the fluid milk price in the Brazilian market.

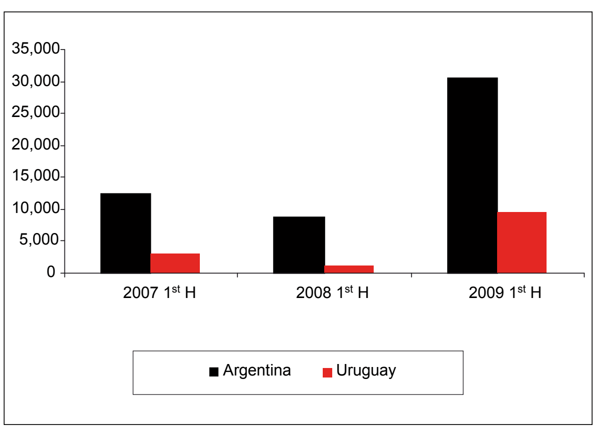
From the outbreak of the international economic crisis, dairy product prices resumed their downward trend driven by the fall in international trade and shrinking consumption. The volume of Argentine powdered milk exports to Brazil grew significantly from December 2008. Thus, over the first quarter of 2009, shipments were up 341% in volume and 101% in value, with an average price of US$2,100 per tonne. Even more noticeable under the crisis, Uruguayan exports to Brazil also rose, channeling sales that had previously gone to other countries.

Faced with such a rapid and pronounced increase in imports in this sector, the Brazilian authorities decided to apply NAL, temporarily administrating dairy imports. This incentive was designed to speed up the negotiation of a new self-regulation agreement with Argentine producers, finally reached in June 2009. This was based on setting a minimum price, taking as a benchmark the average value of powdered milk in Oceania published by the United States Department of Agriculture (international benchmark price for the sector). A quota was also agreed equivalent to the average exported over the past five years, plus 50%, or 2,600 tons per month. Once these requirements had been met, Argentine goods would receive favorable treatment in NAL procedures.

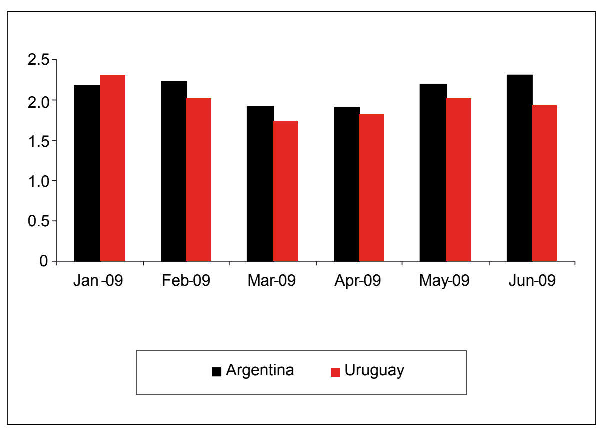
Nonetheless, such an agreement could not be reached with Uruguayan producers. Unlike Argentine milk, the incoming volume of the product of Uruguayan origin during the second quarter showed the same buoyancy as between January and March. This meant that, in the third two-monthly period, Uruguayan milk had a 47% share of the total volume imported by Brazil, unprecedented in the traditional dominance of the Argentine product, whose quota of Brazilian purchases averaged 80% over the past two years.

Thus, in the absence of an agreement, the Brazilian government decided to set a 10,000-tonne quota on powdered milk imports from Uruguay between September and December 2009.

GRAPH 26
BRAZILIAN POWDERED MILK IMPORTS
(Tonnes)



GRAPH 27
BRAZILIAN POWDERED MILK IMPORTS
(Average price by origin - US$/kg)



Source: MDIC Alice-Web.

- White Goods -

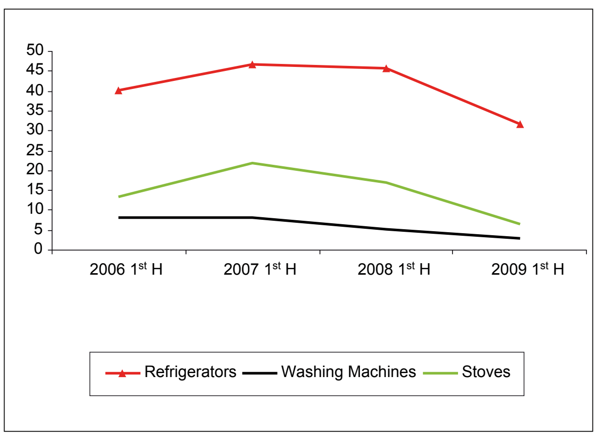
This group of products was included under a NAL regime by Argentina in 2004, when negotiations started between the Brazilian and Argentine private sectors, ending in a voluntary restraint commitment on exports by Brazilian firms.

Brazil occupies a prominent place in Argentina's imports of these products. This is extremely pronounced in the case of refrigerators, while in the other two items in this sector -washing machine and stoves- the leading place of Brazilian products is less noticeable. Although their predominance had been on the wane since 2006, the context of growth of the Argentine market, and hence of its imports, made peaceful coexistence between Argentine producers and suppliers from Brazil and elsewhere possible.

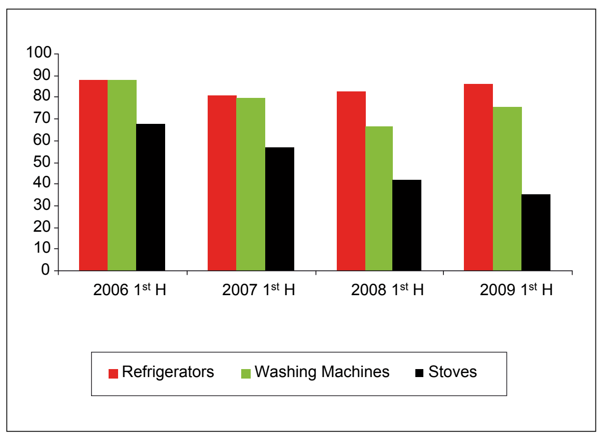
With falling consumption of durable goods as of October 2008, the Argentine government began to up stringency levels in the application of NAL, which remained in force to protect the activity of Argentine producers. These measures and the shrinkage in consumption contributed to a sharp decline in Argentine imports from the sector in the first half of 2009, although Brazil's share did not fall in most headings.

Accordingly, a new round of private negotiations was launched, although no agreement had been reached at the close of this Report.

Graph 28
ARGENTINE WHITE GOODS IMPORTS
(Origin Brazil - In millions of US$)



Graph 29
ARGENTINE WHITE GOODS IMPORTS
(Brazilian share in total - As %)



Source: INDEC.

Application of Licensing Non-Automatic Import Regimes (NAL): Sectors with no Private Agreements

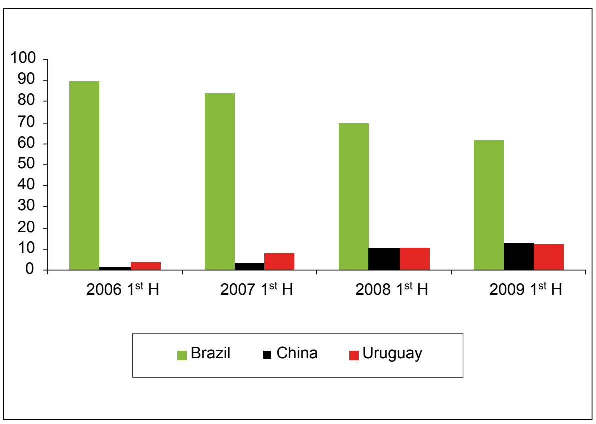
- Textiles -

In this heading, two large groups have been affected by Argentina's application of NAL: clothing and fashions, on the one hand, and household linen, on the other. Although there have been 10 positions with NAL since 2007 (essentially sweaters and baby clothes), many additional positions were incorporated during the period covered by the Report: from October 2008, 30 clothing positions were added (mostly suits and knitwear); in March 2009 14 household linen positions were added (bed, bathroom, and kitchen linen); and in April this year a further 84 clothing positions, covering much of the sectoral sample that still lay outside the licensing regime.

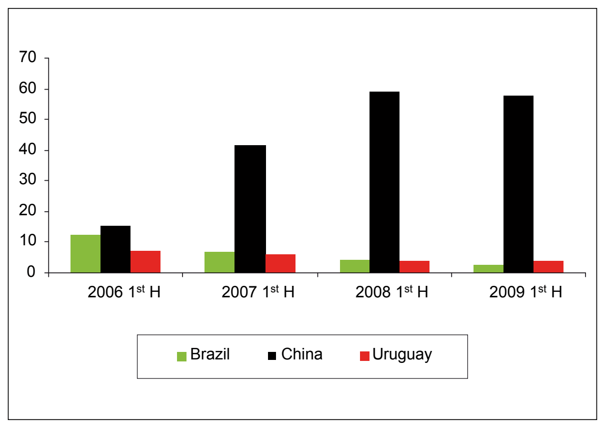
In garments and fashions, the spectrum of products with NAL represents approximately 72% of total imports. China's preeminence as the dominant supplier in this subgroup is clear, with a quota of 58% of the total. Brazil has a leaner and, at the same time, falling share. While there is no evidence of NAL affecting imports in either country to any great extent, there may be a greater willingness to seek to discourage purchases from China. Nevertheless, while imports from China dropped 21% in volume over the first half of 2009, those from Brazil shrank by 50%. Also affected in this area were imports from Uruguay, which reported similar falls to garments from China.

Brazil was the prominent origin for Argentine household linen imports, although its share has been declining in recent years. Uruguay was the second largest supplier up to 2007, when it was overtaken by China. The subgroup affected by NAL affects a higher proportion of Brazilian imports than other supplier countries.

GRAPH 30
ARGENTINE HOUSEHOLD LINEN IMPORTS
(Share in total - As %)



GRAPH 31
ARGENTINE CLOTHING IMPORTS
(Share in total - As %)



Source: INDEC.

After the application of licensing, sharp differences were seen in the variation of imports by origin: Brazil's volumes were 30% down in the first half of 2009, a much steeper fall than that recorded by Uruguay (-7%), while China was almost able to keep its flow of sales constant.

However, these semi-annual trends underwent serious changes as of June, when imports from China fell sharply (as did those from India and Pakistan, which had benefited from a degree of trade diversion in the previous months). Purchases from Brazil recovered, but were still well down on the previous year.

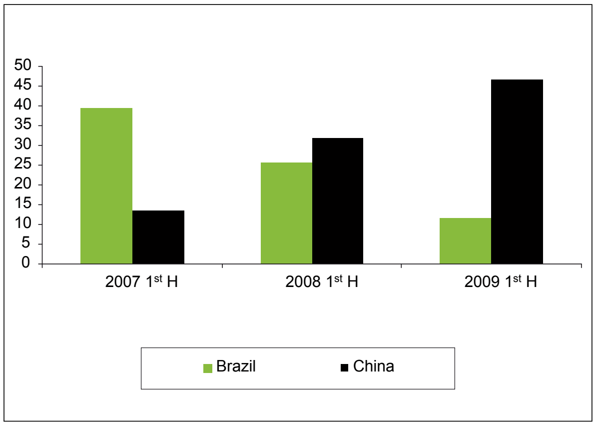
- Textile raw materials -

In 2004, Argentina established NAL for certain cotton fabrics (denim and shirt fabrics). This resulted in private quota agreements for products of Brazilian origin. At the end of 2008, this regime was extended to incorporate synthetic fabrics and knitwear. More positions were added in July 2009, including other cotton fabrics and also yarns, which had until then been excluded.

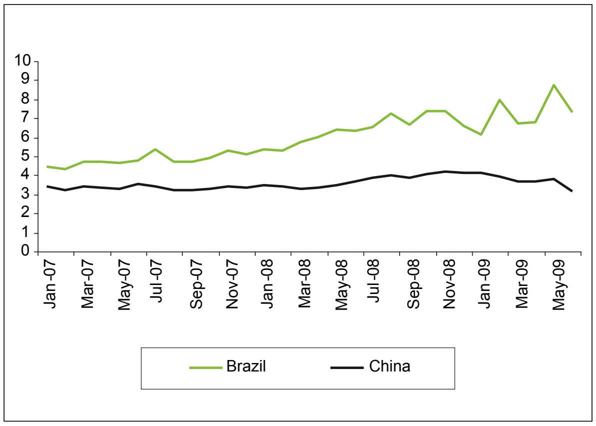
While Brazilian products predominate in Argentine imports such as denim, Chinese supply has a growing share in the aggregate: since 2008, it has exceeded the Brazilian share in value and volume. The segment of positions affected by NAL is slanted toward imports from China, which are those most affected by its application.

This sector had still concluded no bilateral agreements by the close of this Report.

Graph 32
ARGENTINE COTTON YARN AND FABRIC IMPORTS
(Share in total - As %)



Graph 33
ARGENTINE COTTON YARN AND FABRIC IMPORTS
(Average price by origin - In US$)



Source: INDEC.

- Tires -

Characterized by a high degree of oligopolization at global level, international companies operate in this sector in Argentina and Brazil, with a high share of the world market in this product. However, there are companies that, in the framework of MERCOSUR, only have an industrial presence in Brazil, while a local firm also operates in Argentina. This configuration of regional supply means that firms based in both countries account for significant levels of intraindustrial trade. Production in Argentina specializes in tires for light vehicles (automobiles and vans), with Brazil mainly producing tires for trucks and buses, except for firms operating exclusively in Argentina, with production in these headings.

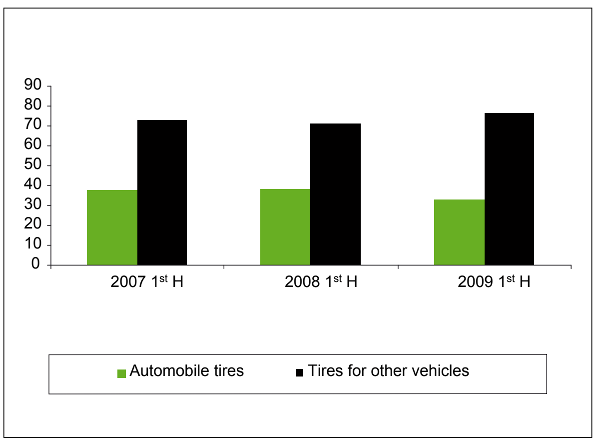
Bilateral trade in light vehicle tires has remained favorable for Argentina in recent years. However, a different result is obtained when also taking into account tires for heavy-duty vehicles and agricultural machinery. It is worth remembering that the Brazilian share in Argentina's total imports is more relevant in the latter heading than in automobile and van tires. Most of the total tire supply of this type available in the Argentine market is Brazilian in origin.

Argentine production had nonetheless begun to slow in 2007, despite the fact that at the time significant growth was being seen in Argentina in automotive output. The causes of this may be linked to the increase in import volumes, which in the case of products for automobiles and vans rose over 15% in 2008 from all sources, while Brazil's climbed at a rate of 12%.

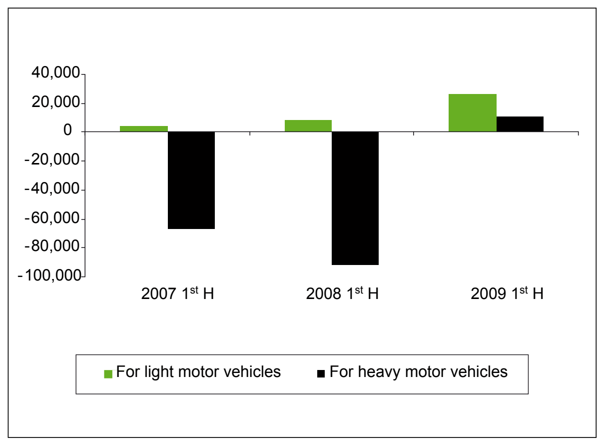
The Argentine authorities' response was to apply NAL to this product as of January 2009. The measure covered the tire sample and included headings where Argentine output is inadequate to supply its own market.

The measure seemed to be more to do with a response to encourage greater diversification in Argentine output, than the economic situation. This may have been in an attempt to seek to promote greater internal development of heavy vehicle tires, a position encouraged from firms located exclusively in Argentina and the sector's unions. The restrictions brought steep falls in all tire imports entering the Argentine market and even created supply problems in products with low local production, such as heavy goods and agricultural vehicles.

GRAPH 34
BRAZILIAN SHARE IN ARGENTINE TIRE IMPORTS
(As %)



GRAPH 35
ARGENTINA: TIRE TRADE WITH BRAZIL
(In units)



Source: INDEC.

Sectors under private negotiation with no application of NAL

- Auto parts -

There were three product groups in this sector involved in private bilateral negotiations in the period, namely, brakes, clutches, and batteries. Bilateral trade in auto parts should be analyzed against the background of regional automotive trade under the Common Automotive Policy (PAC). Due to the high degree of productive complementation between the terminals installed in the region, there is a highly significant trade in auto parts. Equivalent to 40% of the value of total bilateral automotive trade, trade in auto parts has traditional and increasingly been in surplus for Brazil.

The sectoral crisis shrank bilateral trade by over 30% in the first half of 2009. The lion's share of the shrinkage was due to lower Argentine imports, which fell 46% in the period. In contrast, Brazilian purchases of Argentine auto parts were down just 7% in the same period, giving rise to a slight and unusual sectoral surplus in favor of Argentina during the first half of 2009.

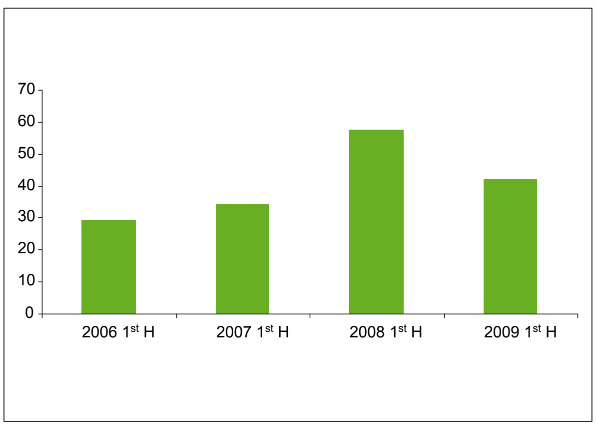
The specific case of *brakes* represents 5% of the total value of Argentine auto parts imports from Brazil, although this share rose slightly toward the end of 2008 and early 2009.

Brazil's share in Argentine imports in this product is high, as happens in all headings in this sector. From the start of 2008, it has shown an upward trend, standing at around 75%.

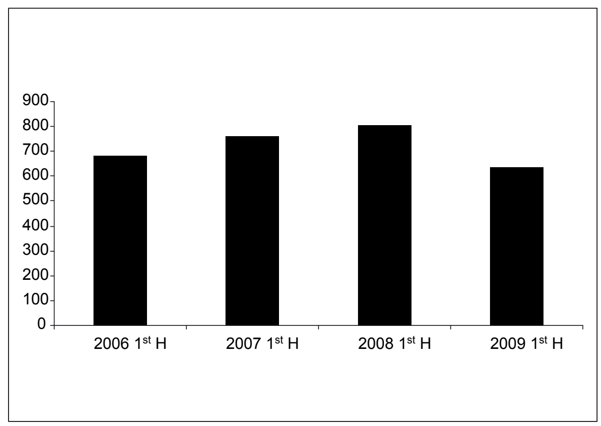
After several meetings, the two countries' Chambers signed an agreement setting a quota on Brazilian brakes exports for the second half of 2009, with an implicit reduction of 30% on the values of the first half. Should the agreement be carried through, Brazilian exports to Argentina would end the current year almost 40% down on 2008.

Clutches represent under 3% of Brazilian exports of auto parts to Argentina. As with brakes, the Brazilian share in total Argentine imports has risen over the last year and a half to 75% in mid-2009. In July the same year, the representatives of the respective business chambers reached an agreement under which Brazilian clutch exports bound for the spare parts market may not, in 2009, exceed 74% of the tonnage marketed in 2008, with a ceiling of US$15.5 million. This would mean a 20% reduction in first half exports to Argentina.

GRAPH 36
ARGENTINE BATTERY IMPORTS
(Origin Brazil - Average price per unit - In US$)



GRAPH 37
ARGENTINE BATTERY IMPORTS
(Origin Brazil - Thousands of units)



Source: INDEC.

Where *batteries* were concerned, the preponderance of the Brazilian product in Argentina's imports is even higher than in the other two cases, exceeding 90% in the past two years. Since 2005, the two countries' sectoral chambers have agreements based on the voluntary restraint of Brazilian exports to the Argentine market. In late April 2009, a new agreement was signed, effective for the rest of the year, that set a 850,000-unit ceiling, 38% down on 2008 figures.

No major changes in recent trends are seen when analyzing bilateral trade: the Brazilian origin prevails in total Argentine imports in the three products. There has been a slight rise in recent months against a background of falling absolute values due to the collapse of automotive production. Nor is there any noticeable change in the average prices of Brazilian sales, except for batteries, whose values fell during 2009. However, this was against the extraordinarily high prices of 2008.

It would seem, then, that the duress alleged by Argentine companies originates in the appreciable fall in domestic demand in the Argentine market, especially the spare parts market, of particularly importance for batteries and brake parts. However, the strong influx of batteries from Brazil during April, May, and June is of concern, as this may lead to a failure to comply with the quota for the second quarter.[50]

[50] Faced with this phenomenon, batteries were included in Argentina's NAL regime in late August 2009.

- Wines -

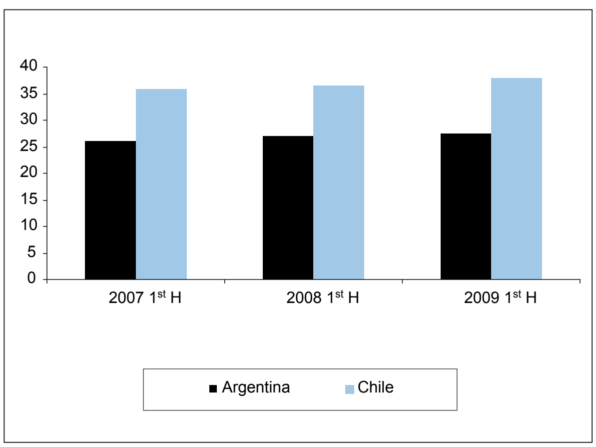
This particularly sensitive sector for Brazilian producers signed a voluntary restraint agreement for Argentine exports in 2005, setting a minimum price of US$8 per crate (equivalent to US$1.8 per liter). This represented an increase in import prices, which had the effect of slowing the growth of Argentine wines in the Brazilian market. As a result of the agreement, Chilean wines regained the lead in Brazilian wine imports, a place it had lost in 2004 to the Argentine product.

In mid-2008, Brazilian producers proposed a new voluntary restraint agreement, this time raising the minimum price to US$4 per liter, given the significant appreciation of the Brazilian *real* at the time. The proposal was not well-received on the Argentine side, which specified that any agreement ought to have made provision for a revision of the Brazil-Chile agreement, which includes a tariff elimination regime that would enable Chilean wine to enter the Brazilian market with a zero tariff as of 2010.

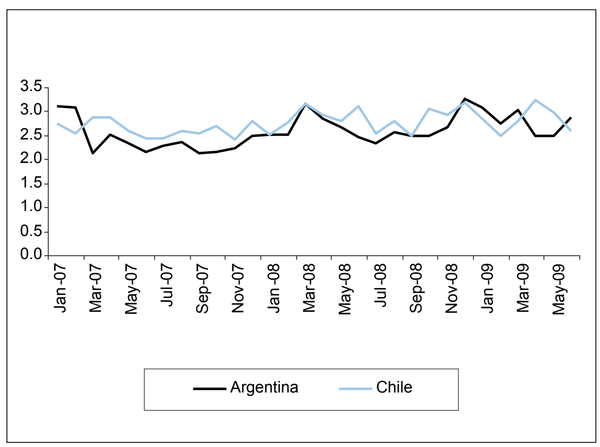
The pressure decreased following the depreciation of the Brazilian *real* during the second half of 2008, although the negotiations carried on. The end result was a package that includes a sectoral development program at the MERCOSUR level, taking in producers from Argentina, Brazil, and Uruguay. Similarly, there was a commitment to a parallel negotiation between Brazil and Chile to alter the timetable for trade deregulation in wines between the two countries.

From an analysis of Brazilian imports, the difficulties attendant upon the self-regulation agreement including just Argentina clearly emerge: first, Chile has regained and maintained the lead in Brazilian wine imports in recent years; second, average prices between Argentine and Chilean placements do not differ greatly, the gap between the two narrowing sharply.

GRAPH 38
SHARE IN BRAZILIAN WINE IMPORTS
(As %)



GRAPH 39
BRAZILIAN WINES IMPORTS
(Average price by origin - US$/liter)

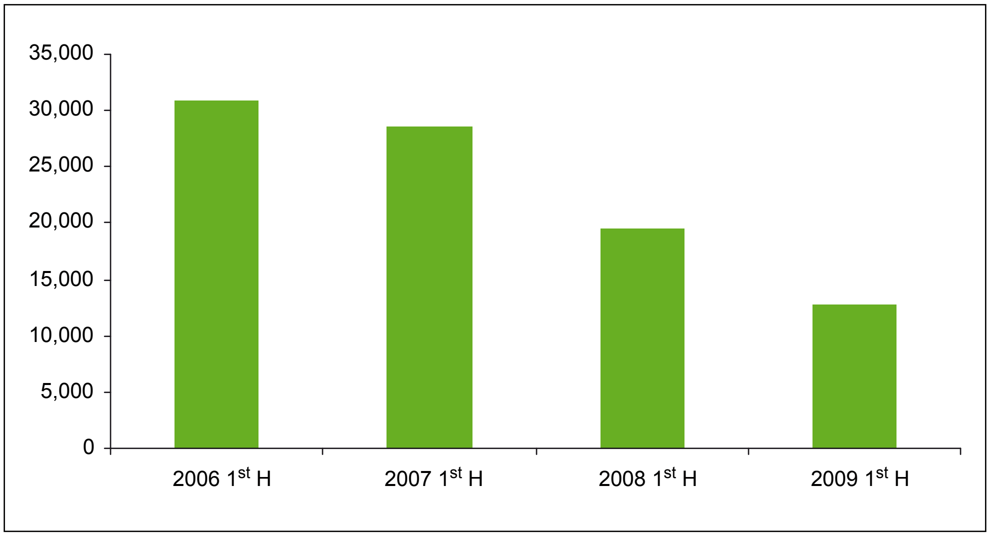


Source: MDIC Alice-Web.

- Paper -

In this sector there is a private bilateral agreement between Argentina and Brazil that is renewed annually. It sets a 50,000-tonne limit on the entry of uncoated writing and printing paper from Brazil. Yet, in spite of the limit, Brazil's share in Argentina's imports predominates. The high degree of sectoral productive concentration in both countries has certainly played an important role in the remarkable continuity of this peace, reducing the number of counterparts and facilitating control of the agreement.

GRAPH 40
ARGENTINE IMPORTS OF PRINTING AND WRITING PAPER
(Origin Brazil - Tonnes)



Source: INDEC.

BOX G
PROGRESS IN THE RESOLUTION OF A HISTORIC DISPUTE: THE NEW ITAIPÚ AGREEMENTS BETWEEN BRAZIL AND PARAGUAY

Historically, Paraguay has made claims about what its governments regarded as unfair clauses in the management, repayment, and availability and price of electricity generated by the Itaipú Dam.

This issue gained relevance after the more recent change of government in Paraguay, as the new President made the reformulation of the Itaipú agreements one of his main campaign issues.

Under the Itaipú Treaty, signed in 1973, Paraguay is entitled to 50% of the energy from Itaipú. It uses just 5% of this and the remaining 45% can be sold to Brazil at below market prices. The Paraguayan claims were summarized in six points:

1. The free availability of Paraguayan energy to be sold in other markets.
2. Better compensation for any Paraguayan energy ceded to Brazil.
3. A review of the debts of Itaipú Binacional (the dam's administrative body).
4. Increased levels of comanagement of the dam.
5. Binational inspection.
6. Completion of unfinished works, such as the right bank substation and the navigation sluicegate, provided for under the 1973 Treaty and left unfinished.

After gruelling negotiations over a dispute that gained much prominence during the period covered by this Report, the Presidents of Brazil and Paraguay signed a declaration on July 25, 2009, stipulating that, among other things, progress be made in the renegotiation of various aspects of the Itaipú Dam Treaty.

The Declaration incorporates the resolution of certain priority points, stipulating an increase in compensation for Paraguayan electricity. Paraguay would, as a result, triple its revenues from the sale of electricity to Brazil, which would rise from the current US$120 million a year to US$360 million. For this increase in the price of electricity to come fully into force, it must be approved by both countries' Congresses.

Progress was also made on the possibility of Paraguay selling part of its electricity from Itaipú in Brazil at market prices. Regarding the possibility of selling this electricity in third markets, the agreement indicates Brazil's willingness to ensure this is done from 2023, when the 1973 Treaty expires.

It further stipulates that Itaipú Binacional should finance a 500KW high-tension line in Paraguay between the right bank substation and Villa Hayes. At the close of this Report, the two countries had signed the Reversal Notes to submit to their respective Congresses for approval of the Agreement.

C. Final remarks

Against a background of the global crisis and its impact on activity and employment levels in MERCOSUR, trade tensions again took on the prominence of earlier periods, such as 1999 or 2004-2005, largely reversing the falling trend in difficulties or disputes up to mid-2007.

Thus, both unilateral measures and the application of Non-Automatic Licensing as applied to imports from around the world (including MERCOSUR countries) gained in momentum, as did the resumption of private voluntary trade administration agreements between Argentina and Brazil.

Aside from the actions taken by Argentina and their impact in the period on certain sectors in Brazil and, to a lesser extent, Uruguay (e.g. textiles), again on the Brazilian side, was seen the government's concern to preserve certain output linked to agribusiness and affecting both Argentina (e.g. wines and dairy products) and Uruguay (e.g. dairy products). There is clearly, then, a degree of synchronization between foreign exchange movements within the bloc and unilateral trade barriers. The Argentine government's decision to question the structural deficit in manufacturing trade with Brazil also looms large in the explanation of the extension of trade administration measures. In all cases, the common threat of China to MERCOSUR producers helped to bring negotiating positions closer.

In any event, taking into account how the scope of the international crisis has affected the volume of world trade, the number and scale of disputes within the bloc over the last year is relatively modest and in keeping with previous episodes in the history of MERCOSUR. In spite of this, the total cyclical effect of lower activity levels and the impact of protection measures have meant a shrinkage in trade flows, as described in Chapter II of this Report.

At the same time, the lack of rules and a high dose of unilateralism and discretionality have once again outweighed other considerations in negotiations about these tensions. In fact, the difficulty of channeling them institutionally at the MERCOSUR level has been in evidence, considering that a system like the MAC has been agreed, which has not yet been put into operation.[51] This need is all the more compelling considering that many of the conflicts in certain productive sectors are recurrent ones.

Notwithstanding these weaknesses, events surrounding the sectoral conflicts over the last year would suggest that certain lessons have been learned: the care not to generate trade diversions, more agreement between private sectors in confronting the ever steeper competition from extrazone imports and, at government level, the understanding that MERCOSUR's productive development should be a factor of greater homogenization within the bloc.

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[51] See Note 6.

CHAPTER V. THE EXTERNAL AGENDA

A. An overview

As seen in Chapters I and II, the sharp contraction in the world economy beginning in 2008 and deepening in the first quarter of 2009 had an extremely significant impact on international trade flows. While there was no mass protectionist reaction at the global level, certain countries implemented trade defense mechanisms (increased tariff and non-tariff barriers) to protect domestic production in industries such as steel and the automotive industry, or reintroduced export subsidies, for example in the dairy sector. Moreover, the fiscal and financial packages implemented to overcome the crisis, which had a favorable impact in limiting the decline in activity and global trade, in some cases included clauses that favor domestic over imported goods and services ("buy national").[52]

The development of the traditional external MERCOSUR agenda was pushed to the background due to the depth of the international economic crisis, while the bloc's two most active partners took part in the debate on global regulation prompted by the disturbance. However, there is no clear evidence of united action against the events. In a phase characterized by falling international trade flows, trade protection measures, and the respective contractionary internal macroeconomic dynamic, MERCOSUR countries reacted with positions displaying different strategies of integration in the world economy, as seen in previous years.

Argentina kept up a defensive model, reflected in restrictive measures on both sensitive intra and extrazone imports (Chapter IV). Although Brazil also sought to manage the trade flow in the activities most threatened by the global crisis, it sought a greater role in international trade negotiations and was extremely active in coordinated strategies against the global crisis. Differences in position between the two largest MERCOSUR partners had already emerged during the Doha Round negotiations.[53]

Uruguay continued to insist, with Paraguay's support, on providing greater flexibility in the bloc's external negotiations through the incorporation of a bilateral approach. In this respect, Uruguay continued to strengthen its rapprochement with the United States under the Framework Agreement on Investment and Trade signed in 2007, through the signing of two additional Protocols in the areas of trade facilitation and public participation in trade and the environment, and a Memorandum of Understanding. Paraguay showed some interest in expanding MERCOSUR's relations with Arab countries, while focusing more on the internal agenda, especially in measures aimed at correcting asymmetries, as described in Chapter III of this Report.

In line with these diverse positions and the difficult external context, the bloc's trade negotiations with third countries moved at a snail's pace, although its agreements with extraregional countries were consolidated and strengthened. At the same time, certain disciplines were incorporated in the framework of existing agreements with neighboring countries. More specifically, in the framework of the South-South strategy driven by Brazil and supported by Argentina -and to a lesser extent by the other partners- MERCOSUR reaffirmed its ties with other developing economies. Relations with the developed economies, supported by the smaller partners concerned about market access, made no progress or did so at a slower pace, as in the case of the MERCOSUR-EU negotiation, which is bound up with the multilateral negotiations of the Doha Round.

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[52] See OECD-UNCTAD-WTO [2009] and IDB-INTAL [2009e].

[53] Argentina was less willing to provide market access concessions for industrial products in these negotiations without a substantial decrease in entry barriers and distortions in agriculture in OECD countries. Brazil was more flexible, emphasizing the importance of concluding the negotiations and feeling it would send a powerful message against protectionism. See IDB-INTAL [2008] and Cristini [2009].

Taking into account the efforts and initiatives of the States Parties, this chapter reviews the participation of some of the countries in the bloc in the forums spawned by the international crisis. It also describes and analyzes the evolution of MERCOSUR's external agenda, both with Latin America and the rest of the world. Despite no formal progress being made in the links between MERCOSUR and China, this interrelationship is studied because of its increasing share in world trade and trade in the region.

B. MERCOSUR members' participation in the response to the international crisis

Faced with the gravity of the crisis, the leaders of both the advanced and the emerging economies sought an appropriate response to the new context. This led to concerted action designed to restore growth, as well as to discussions for a reform of the international financial architecture. The decisions focused on the role, governance, and capacity for action of the multilateral and regional credit organizations, and on the creation of bodies to regulate activity in the financial and capital markets. The G-20 became a forum for discussion and coordinated action in response to the crisis,[54] with active participation from Argentina and Brazil.

One concrete result of the coordination efforts at the bilateral level and in the context of the exceptional volatility in the financial markets was the implementation of currency swaps between the various countries' central banks, including those of the largest MERCOSUR partners, namely, United States-Brazil, Argentina-Brazil (Chapter III), and Argentina-China.

Measures in response to the crisis in the framework of the G-20

At the first summit in Washington, D.C., in November 2008, it was agreed that G-20 members should move ahead in macroeconomic coordination, including fiscal, monetary, exchange, trade, employment, and environmental policies. These issues were added to the discussion on the international financial architecture, which had been the group's main task since its creation in 1999 in response to the Asian crisis. Regarding macroeconomic coordination, G-20 leaders pledged to undertake concerted fiscal expansion unprecedented in recent decades, for a total of US$5 trillion.[55] In parallel, the central banks affirmed their commitment to restore the credit channel and maintain expansionary monetary policies for as long as necessary.

While there were coincidences regarding the need to make use of all the tools available to avoid a global economic depression, there were differing positions regarding the advanced economies' fiscal and monetary stimulus packages. The representatives of the developing countries, together with the EU, noted that the increase in developed countries' money issue would translate into higher global inflation. Similarly, the emerging economies suggested that the OECD countries' growing borrowing may lead to a change in the orientation of capital flows and that they would therefore face an increase in their domestic interest rates to contain their outflow in the short term. In particular, Argentina called on the international community to lessen the negative impact of exit strategies on the less developed countries in order to avoid a widening of the income gap between countries. Brazil made a statement to the same effect, although it emphasized the need for the advanced economies to make a speedy recovery from the crisis.

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[54] The G-20 is made up of the G8 countries (Germany, Canada, United States, France, Italy, Japan, United Kingdom, and Russia), and 11 other states: Saudi Arabia, Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Republic of Korea, South Africa, plus Turkey, the twentieth member of the G-20 being the European Union (EU).

[55] G-20 London Summit, Final Communiqué: (http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409)

The G-20 also underscored the importance of strengthening world trade and investment to restore growth. At the London Summit in April 2009, it reiterated its commitment to resisting the application of new protectionist barriers to investment and trade in goods and services, and extended it to the end of 2010. Attempts were made to avoid new import barriers, export stimulus measures inconsistent with the WTO, and competitive devaluations. The importance of achieving an "ambitious and balanced outcome" to the Doha Round negotiations was also noted, although no deadlines were set for this.

On the other hand, in response to emerging countries' claims and the need to reform the global financial architecture, the London Summit agreed to capitalize and increase the lending capacity for International Financial Institutions (IFIs) like the IMF, the World Bank, and the main Regional Development Banks. It also decided to review the instruments available and the governance of these organizations. In relation to the IFIs anchoring and lending ability, it was decided to triple the resources available from the IMF to US$750 billion, the issuing of a new item of Special Drawing Rights (SDRs) for US$250 billion, and at least US$100 billion in additional loans by the multilateral development banks, plus an additional US$250 billion for trade financing and the sales of gold reserves agreed by the IMF to finance the poorest countries. Argentina suggested that the measures regarding IFIs were key to developing countries, due to the lack of space for an expansionary fiscal policy on account of the reduction in external financing after the crisis. For MERCOSUR countries, the new global allocation of SDRs by the IMF for US$250 billion meant potential access to international liquidity equivalent to 5% of its Reserves.[56] The resources for the recapitalization of IFIs came mostly from OECD members, although it should be noted that the Brazilian President anticipated his country would contribute US$10 billion to the IMF (Ministério da Fazenda [2009]).

In terms of the stabilization instruments available, the London Summit's final communiqué stressed the need for the resources contributed to IFIs to be used "effectively and flexibly". In response to this the IMF launched a new Flexible Credit Line.[57] This claim was submitted by the emerging economies, among which the Argentine Economy Ministry's suggestion stood out, geared to eliminating conditionalities in loans granted by the multilateral credit organizations.

More representation for emerging and developing economies was one of the outcomes reached over the governance of IFIs, bringing forward the review of IMF member countries' voting quotas and percentages to January 2011. It was also agreed to take measures to enhance the credibility and responsibility of IFIs via better strategic oversight and decision-making. Both proposals were driven by developing countries, with strong support from both Argentina and Brazil.

Last, the G-20 established guidelines to strengthen national and international financial regulation and oversight through the creation of the Financial Stability Board (FSB), the successor to the Financial Stability Forum (FSF). The functions of this organization will be to coordinate banking regulations, supervise transnational banks, develop early warning reports, and exchange information between the supervisors of individual member countries. Against this background, the authorities in Argentina and Brazil stated that the incorporation of emerging countries in the FSB is one of the G-20's most important breakthroughs in the redesign of the international financial architecture.

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[56] SDRs are a potential asset against the freely usable currencies of IMF member countries. Their holders can obtain these currencies in exchange for their SDRs via two operations: voluntary exchange agreements between member countries or the appointment by the IMF of member countries with sound external conditions to buy SDRs from member countries facing fragile external conditions. If none of these transactions are performed, SDRs do not form part of the international reserves.

[57] The IMF approved an agreement for US$47 billion under the Flexible Credit Line in April 2009.

Currency Swaps

Faced with the deepening of the international crisis, some countries' central banks established currency swap agreements, reinforcing existing lines and creating new ones. As mentioned in Chapter III, swaps are quota agreements that make provision for a currency exchange between two central banks, allowing them to obtain liquidity in another country's currency. The United States and China were the most active countries in the signing of swaps.

Between the second half of 2008 and the first half of 2009, the Federal Reserve agreed various bilateral lines with the developed economies central banks, such as the European Central Bank (ECB), the Bank of Japan (BoJ), the Swiss National Bank (SNB), and the Bank of England (BoE), while expanded the scope of existing agreements with China, Japan, and Korea. In addition, it reached new agreements with developing countries like Mexico, Brazil, and Singapore. The swap agreed between the United States and the largest MERCOSUR economy aimed to support the liquidity of the Brazilian financial system against a background of sharp capital outflows, for the sum of US$30 billion (15% of the South American country's international reserves) distributed periodically, with a ceiling of US$5 billion per transaction. The agreement negotiated was until the end of April 2009, but was extended first to October 30 the same year and then to February 2010, like other currency swaps endorsed by the FED (BCB [2009b]).

Recent transactions by China find a precedent in the Chiang Mei initiative. China, Korea, and Japan have had a currency swap commitment since 2001 in case one of them should experience monetary tension due to a high demand for foreign currency. In addition to strengthening bilateral economic relations, the agreement aims to promote financial stability in the Asian region after the impact of the crisis in the 1990s. Faced with the recent increase in uncertainty, China, Korea, and Japan agreed to extend swap lines to the countries of the Association of Southeast Asian Nations (ASEAN), launching multilateral agreements totalling nearly US$120 billion. Similarly, the Bank of China agreed a currency swap with the Central Bank of the Argentine Republic (BCRA) for a 3-year period, amounting to ¥70 billion (approximately AR$38 billion or US$10 billion), about 20% of Argentina's reserves. This was the first agreement of its kind signed by China with a Latin American economy and sought to give the yuan a greater share in region's money markets. For the Argentine monetary authority, the resource improved the country's external position and generated confidence, increasing its capability to respond to the outflow of capital. The measure was received with suspicion by Argentina's private sector, which was leery of any conditions being placed on the use of the yuan in the purchase of Chinese goods.

C. Extraregional negotiations

Against the background of the international crisis, MERCOSUR's trade liberalization negotiations showed no significant progress. The deadlock of the Doha Round instilled a loss of momentum in the bloc's external agenda, especially where developed countries were concerned. In particular, despite certain contacts, negotiations toward a biregional trade agreement between MERCOSUR and the EU remained at a standstill, as has been the case since late 2004.

The differing positions of Brazil and Argentina over agricultural and industrial products in the Doha Round is also reflected in MERCOSUR's potential bilateral agreements, translating into low buoyancy in the negotiating processes and the limited scope of any understandings reached.

On the other hand, the deadlock in the multilateral negotiations continues to drive the smaller MERCOSUR partners to claim greater flexibility in external negotiations via authorization to negotiate bilaterally with other countries or blocs. Uruguay, in particular, is stepping up its relationship with the USA, using the Trade and Investment Framework Agreement in force between the two countries since January 2007 as a benchmark.

Finally, the notable dynamism of Brazil's external agenda is aimed at improving the country's positioning as regional leader and as a rising presence in various international forums.

MERCOSUR-India: The Agreement's entry into force

After ratification by the signatory countries, the Fixed Preference Agreement between MERCOSUR and India signed in 2003 came into force, June 1, 2009. The six-year period between the conclusion of the negotiating process and implementation finally led to Brazilian and Argentine legislative approval. This was the first trade agreement to be applied between MERCOSUR and an extraregional country. Despite the modest scale of the agreement, it can be seen as a first step on the way to gradually building a strategically significant relationship, given the growing importance of India as a leading player in the world economy.

The agreement set three levels of preferences: 10% 20%, and 100%. From a total of over 10,000 products, MERCOSUR granted preferences in 452 tariff items, mainly chemical and pharmaceutical products, tools, and machine parts. The 13 products in which MERCOSUR granted a 100% margin of preference have an applied tariff of 0% in the bloc, while the other concessions were made in positions with an average Common External Tariff (CET) of between 5% and 7.5%. India, for its part, granted preferences in 450 items. The lowest preferences (10% and 20%) were applied on products with higher tariffs, while the 100% preference was granted on products with an average tariff of 3.1%. The agreement's relevance to trade is extremely limited in both senses, as the preferences are significant in cases where the existing tariff is zero or very low.

In 2008 MERCOSUR's exports to India stood at around US$1.95 billion, or 0.7% of total exports (Table 14), while imports from India reached US$4.35 billion in 2008, contributing to 1.7% of the bloc's total foreign purchases (Table 15). For India, meanwhile, trade in goods with MERCOSUR accounted for about 2.5% of exports and 0.7% of imports. At the aggregate level, in 2008, MERCOSUR saw a trade deficit with India, explained mainly by the bilateral balance with Brazil, which is slightly offset by Argentina's bilateral surplus.

Table 14
MERCOSUR EXPORTS TO INDIA
(In millions of US$ FOB - As %)

Countries	India			World		% Share	
	2006	2007	2008	2007	2008	2007	2008
Argentina	908.6	868.7	829.7	55,025.2	68,637.7	1.58	1.21
Brazil	936.4	954.5	1,102.0	157,265.4	193,120.8	0.61	0.57
Paraguay	3.1	3.9	4.4	3,424.2	4,585.3	0.11	0.10
Uruguay	5.1	8.4	8.5	4,512.5	5,946.9	0.19	0.14
Total	*1,853.3*	*1,835.5*	*1,944.5*	*220,227.3*	*272,290.7*	*0.83*	*0.71*

Source: LAIA and DATASTREAM.

Table 15
MERCOSUR IMPORTS FROM INDIA
(In millions of US$ CIF - As %)

Countries	India			World		% Share	
	2006	2007	2008	2007	2008	2007	2008
Argentina	303.2	383.7	491.8	44,439.6	57,118.2	0.86	0.86
Brazil	1,549.3	2,267.3	3,748.7	126,652.0	182,404.1	1.79	2.06
Paraguay	25.1	31.1	35.5	5,962.8	7,723.9	0.52	0.46
Uruguay	34.9	49.4	74.5	5,620.3	8,685.5	0.88	0.86
Total	*1,912.5*	*2,731.5*	*4,350.5*	*182,674.8*	*255,931.7*	*1.50*	*1.70*

Source: LAIA and DATASTREAM.

MERCOSUR sales in India are concentrated in a few products needing little manufacturing like soy oil, wheat, and copper concentrates. MERCOSUR's purchases from its partner include mainly chemicals, auto parts, processed fuels, and machine parts.

India had in recent years set the pace in talks to expand and deepen preferences on the agreement's entry into force. When it does come into force, it will, then, be possible to resume these negotiations, opening the door to extension of the preferences to new products of more consequence to trade and with the aim of moving toward the formation of a free trade area. In any event, for this to come about would require MERCOSUR countries to reach consensus over deepening the Agreement.

MERCOSUR-South Africa Customs Union (SACU): The signing of the Fixed Preference Agreement

At the 36th MERCOSUR Summit in December 2008, the member countries signed the Fixed Preferences Agreement with SACU, signed and sealed by SACU Ministers in April 2009. Now the negotiating process is complete, the entry into force of the new agreement requires endorsement by the four MERCOSUR members' parliaments and the five SACU members (South Africa, Namibia, Botswana, Lesotho, and Swaziland).

The agreement is an extension of the convention negotiated four years earlier, but never signed. The original negotiation between the two blocs began with understandings reached in December 2000 by the MERCOSUR-South Africa Framework Agreement Negotiating Commission to strengthen existing relations and establish conditions for a future free trade area. After the other SACU members joined the process in October 2003, talks were assumed to be complete in December 2004, with the signing of a Fixed Preference Agreement in Belo Horizonte, Brazil. This included a partial elimination offer for approximately 500 products from each party. Subsequently, however, SACU said it was not happy with the result achieved and it was agreed to reopen the negotiations in order to reach a fresh understanding. The agreement finally signed provides that SACU grant immediate preferences in 1,064 tariff positions and MERCOSUR in 1,052, with preference margins of 10%, 25% 50%, and 100% (Table 16).

In 2008, MERCOSUR countries exported goods to SACU for approximately US$2.8 billion, almost exclusively to South Africa (Table 17). The main products are oils and soy pellets, motor vehicles and auto parts, road and agricultural machinery, wheat, poultry, and crude oil. Imports from SACU, totaling US$1 billion in 2008, mainly include ferro alloys and other mining products, bituminous coal, and flat-rolled steel (Table 18). Commercial trade with SACU thus comes to 1% of MERCOSUR exports and 0.4% of imports, with a resultant surplus for all four members of the bloc.

Table 16
MERCOSUR-SACU NEGOTIATION
(Reciprocal offers)

MERCOSUR offer to SACU	
Preference level (As %)	**Number of NCM positions**
100	764
50	53
25	89
10	86
Differential treatment	60
Total	*1,052*

SACU offer to MERCOSUR	
Preference level (As %)	**Number of NCM positions**
100	465
50	166
25	140
10	279
Differential treatment	14
Total	*1,064*

Source: Text of the Agreement.

Table 17
MERCOSUR EXPORTS TO SACU
(In millions of US$ FOB - As %)

Countries	SACU			World		% Share	
	2006	2007	2008	2007	2008	2007	2008
Argentina	918.5	1,003.4	1,022.9	55,025.2	68,637.7	1.82	1.49
Brazil	1,475.3	1,773.7	1,781.4	157,265.4	193,120.8	1.13	0.92
Paraguay	9.1	17.8	18.6	3,424.2	4,585.3	0.52	0.41
Uruguay	52.8	26.4	21.6	4,512.5	5,946.9	0.58	0.36
Total	*2,455.7*	*2,821.4*	*2,844.6*	*220,227.3*	*272,290.7*	*1.28*	*1.04*

Source: LAIA and DATASTREAM.

Table 18
IMPORTS OF MERCOSUR FROM SACU
(In millions of US$ FOB - As %)

Countries	SACU			World		% Share	
	2006	2007	2008	2007	2008	2007	2008
Argentina	118.6	131.3	220.3	44,439.6	57,118.2	0.30	0.39
Brazil	457.9	555.2	827.9	126,652.0	182,404.1	0.44	0.45
Paraguay	2.1	2.6	3.3	5,962.8	7,723.9	0.04	0.04
Uruguay	7.1	12.0	15.0	5,620.3	8,685.5	0.21	0.17
Total	*585.6*	*701.0*	*1,066.5*	*182,674.8*	*255,931.7*	*0.38*	*0.42*

Source: LAIA and DATASTREAM.

The sectors covered by the agreement are agriculture, fisheries, textiles and clothing, optical appliances, auto parts, plastics and their manufactures, chemicals, steel, electronic goods, IT goods, capital goods, and tools. The preferences granted do not cover the main products currently traded, which constitutes a constraint when evaluating the relevance of the agreement signed.

It also sets out specific standards concerning rules of origin, safeguards implementation, and dispute settlement, while establishing a Joint Administration Committee to meet at least once a year to ensure the Agreement's proper functioning and implementation. More advantageous access conditions for the bloc's smaller economies (Paraguay and Uruguay) are also provided, benefiting products such as red meat, soy, dairy products, and hides.

While the immediate trade implications of the Fixed Preference Agreement do not appear significant, it is nevertheless a first step in deepening the relationship between the two blocs and provides the spaces for contact and communication needed to go on to achieve more ambitious agreements.

It, therefore, opens the door to moving forward with the plan to establish a trilateral free trade area, which has been encouraged by the dialogue in the ambit of the IBSA (India, Brazil, and South Africa) initiative.

MERCOSUR-Gulf Cooperation Council (GCC)

Talks with the GCC began in 2006, parallel with the negotiation with Israel, although subsequently the two initiatives displayed different dynamics. There have been three negotiating rounds with the GCC, with no progress being made on two issues still pending:

i) Defining the general rule of origin: The GCC is calling for a minimum regional content of 35%, while MERCOSUR is seeking a more demanding standard and will not accept less than 50%. In other words, the GCC wants any preferences from MERCOSUR to involve goods with a regional content of just 35% (value added in those countries), whereas MERCOSUR would only give preference to goods with a regional added value of at least 50%.

ii) Implementing a preferential safeguards mechanism.

These issues, coupled with the GCC's claim to improve MERCOSUR's tariff elimination offer, are holding up the talks. Over the last year, it was agreed to send more up-to-date basic texts for negotiation. The buoyancy of the Middle Eastern economies aroused the interest of various MERCOSUR actors in this agreement, with outstanding opportunities for food exports, and agricultural and industrial manufacturing, areas in which the GCC countries are major net importers.

Other ongoing negotiations

In 2004, the **MERCOSUR-Morocco Framework Agreement** was signed, which included the negotiation of a fixed preference agreement as a first step toward a free trade agreement. The talks were suspended in 2006 and 2007, and contact reestablished in April 2008 to move the process forward. In the first half of 2009, the consolidated proposal for negotiating modalities was send together with basic texts for an eventual Fixed Preference Agreement.

The 35th MERCOSUR CMC Meeting in Tucuman in July 2008 approved the MERCOSUR-Jordan Framework Agreement, which makes provision for negotiations to create a free trade area. The remission of the consolidated proposal for negotiating modalities was finalized in the first half of 2009. For trade in goods, MERCOSUR's proposal specifically makes provision for the gradual elimination of tariffs over a 10-year period at different speeds according to product category.

The **MERCOSUR-Israel Trade Agreement** was signed in late 2007, as mentioned in *MERCOSUR Report 13*. The negotiations faced certain obstacles over Israel's liberalization of agricultural products (mainly meat and milk), as their internal law narrowly restricts concessions in these areas. The treatment to be given goods from the West Bank territories under Israeli administration is currently under discussion.

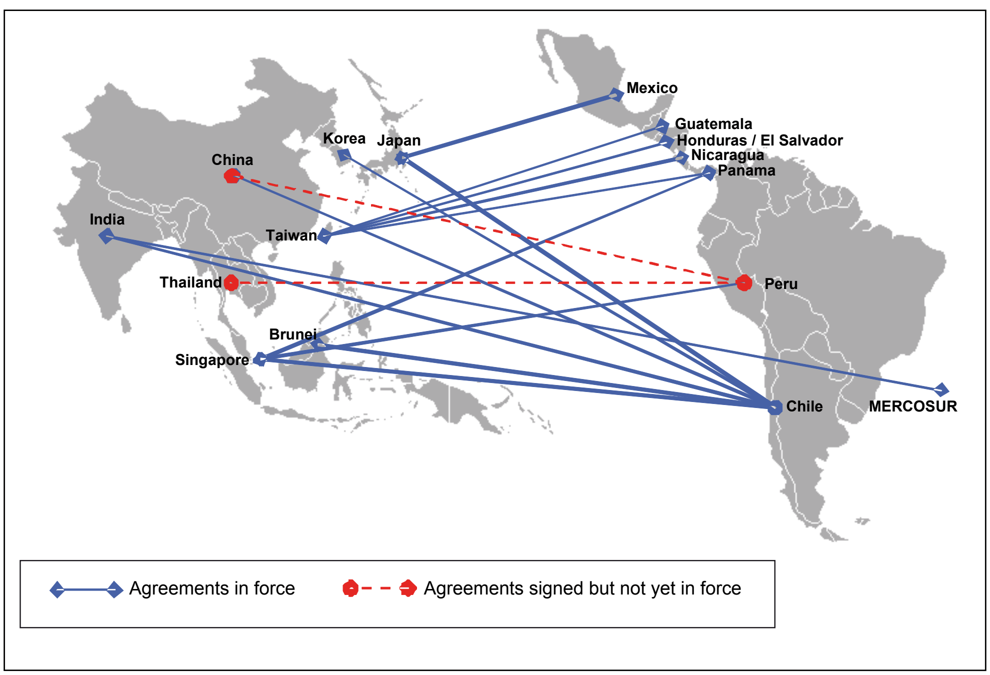
Meanwhile, the **MERCOSUR-Egypt Framework Agreement** was signed in Puerto Iguazú in July 2004, ahead of the negotiation of a fixed preference agreement with the ultimate goal of forming a free trade area. In October 2008, an exploratory meeting to exchange views and set an agenda for future talks was held in Cairo, Egypt.

Ties with Asia

- Overview -

The Asia-Pacific Region -and China in particular- has significantly enhanced its relevance in the world economy in recent decades, a phenomenon reflected in Latin America's commercial trade with the region. Asia-Pacific countries are, in fact, now the main partners of several Latin American countries and their importance is growing. MERCOSUR appears to be lagging behind in the negotiation of bilateral agreements with Asia-Pacific that has accompanied the buoyancy of trade flows. Most initiatives have emerged in the countries of the Pacific Basin, while only the Agreement with India is recorded in the case of MERCOSUR (see Graph 41).

GRAPH 41
LATIN AMERICA-ASIA/PACIFIC TRADE AGREEEMENTS



Source: Authors' own based on data from ECLAC.

MERCOSUR is keeping a negotiating front open with **South Korea**, with whom it has been holding regular dialogue since 1997, exchanging information and discussing ways to further mutual understanding, while increasing bilateral trade. Over two years, an impact study was conducted to determine the feasibility of a trade agreement, concluding in October 2007. Although the study noted that the agreement could benefit the parties, the reactions of private agents in Argentina and Brazil were against starting any kind of trade negotiations.

In keeping with the current pattern of trade between MERCOSUR and East Asia, trade with South Korea is mainly interindustrial, with South American sales concentrated in agricultural raw materials and minerals, and imports from Korea consisting largely of industrial products. Studies indicate that, at the aggregate level, a trade liberalisation agreement would benefit MERCOSUR, provided the agricultural sector is included. The main opportunities are in sales of soy oil, maize, cheese, chocolate, fish, tobacco, leather, wood manufactures, and chemical compounds, while the most relevant threats affect the automotive industry, and the plastics and chemicals sectors.

In August 2008, Korea submitted a document to MERCOSUR, proposing the creation of an Advisory Group to establish criteria to start negotiations aimed at reaching a free trade agreement. Similarly, in July 2009, a Memorandum of Understanding was signed to establish a Joint Advisory Group for the Promotion of Trade and Investment.

The 1st **MERCOSUR-ASEAN** Ministerial Meeting was held in Brasilia, Brazil, in November 2008, opening up the prospect for a possible trade negotiation. Also during the last year, the working meetings continued, aimed at deepening **MERCOSUR-Japan** integration, at which proposals were submitted for cooperation in strengthening trade and investment.

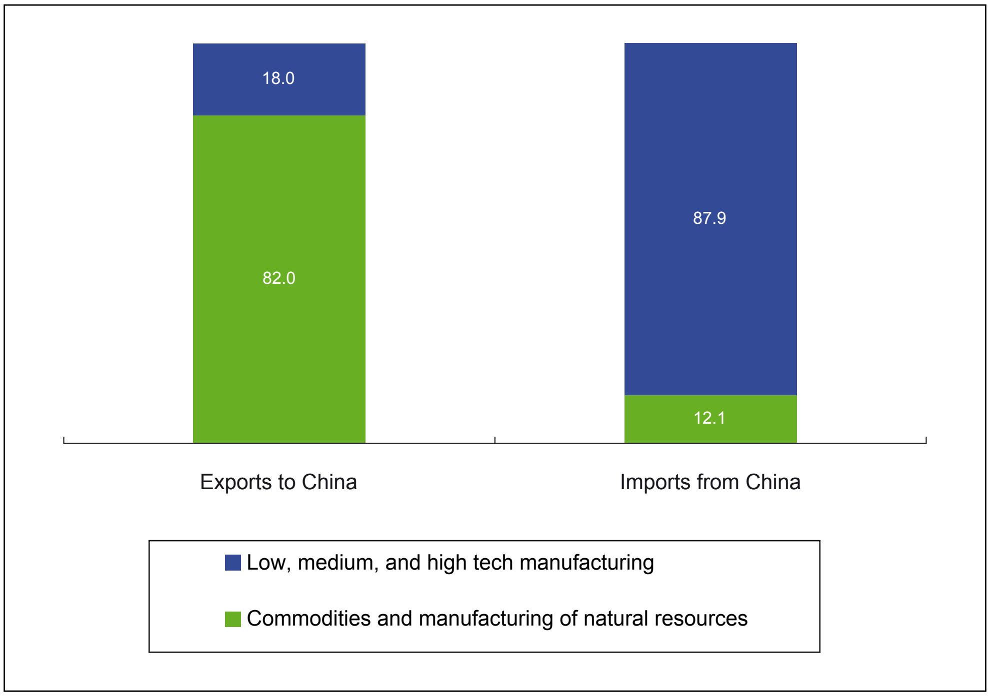
- The People's Republic of China -

China has a strong demand for raw materials, intermediate inputs, and capital goods, and is an exporter of labor-intensive manufactured products to developed markets. The provision of inputs and capital goods in China is performed in advanced countries or through an intraindustrial trade network based in east Asia. Latin American exports to China are concentrated in natural resources, while imports from China are composed principally of medium- and high-technology manufacturing (see Graph 42). This pattern hampers the chances of export diversification and insertion in Asian value chains.

Since joining the WTO in December 2001, China has gradually dismantled various non-tariff import barriers and trade-related domestic policies, but continues to use certain trade measures such as industrial policy instruments. However, sanitary and phytosanitary regulations, and other technical trade barriers are in the process of harmonization with international standards. The export regime presents a degree of complexity in the wake of measures affecting foreign sales in the country, among which are export duties, VAT relief on external sales, and bans and export licensing.

China's average WTO-consolidated *ad valorem* tariff is 9.8% (14.9% for agricultural products and 9% for non-agricultural products). This figure is significantly lower than the mid-1990s, when it stood at 36%. The fall was driven by economic reform, which took the average to 16% in 2001 and continued thereafter as part of China's commitments to enter the WTO. It should be noted, however, that the tariff peaks are concentrated in the chapters where MERCOSUR has comparative advantages, namely, cereals, flours, beverages, and tobacco (Table 19). In addition, the entry of these products faces other obstacles, such as tariff quotas with low aliquots for purchases inside the quota and extremely high outside.

Graph 42
STRUCTURE OF LATIN AMERICA-CHINA TRADE
(% of trade flows)



Source: ECLAC.

Table 19
TARIFF PEAKS OF CHINA
(Tariffs for selected chapters - 2008)

Chapter	*Ad valorem* tariff, as %
Cereals	65
Flours	65
Beverages	65
Tobacco	65
Sugars	50
Fertilisers	50
Photographic products	47
Automobiles and parts	45
Cotton	40
Wool	38

Source: WTO.

With China's recent exponential foreign trade growth, it has become one of MERCOSUR's main trading partners, in exports and imports alike (Table 20). Given the importance of trade in industrial goods to China and raw materials for MERCOSUR, the relationship of the bloc's countries with China is asymmetrical. In 2008, Chinese sales to MERCOSUR represented 2.3% of the country's exports, while imports from the bloc were 2%. In contrast, MERCOSUR exported 8.5% of its external sales to China and bought 12.6% of its total imports (Table 21). This asymmetry would require greater initiative from the bloc both in terms of trade promotion and reciprocal investment.

Table 20
CHINA'S POSITION IN TRADING PARTNER RANKINGS

Country	Exports		Imports	
	2000	2007	2000	2007
Argentina	6	2	4	3
Brazil	12	1	11	2
Paraguay	17	19	5	4
Uruguay	4	5	7	4

Note: Top 5

Source: IMF.

Table 21
MERCOSUR-CHINA TRADE
(In millions of US$ - As % - 2008)

Countries	Exports to China			Imports from China		
	Millions of US$ FOB	% of total exports	% of Chinese imports	Millions of US$ CIF	% of total imports	% of Chinese exports
Argentina	6,390	9.3	0.57	7,104	12.4	0.5
Brazil	16,395	8.5	1.45	21,739	11.9	1.52
Paraguay	93	2.0	0.01	2,471	32.0	0.17
Uruguay	171	2.9	0.02	908	10.5	0.06
MERCOSUR	*23,049*	*8.5*	*2.04*	*32,222*	*12.6*	*2.26*

Source: LAIA.

The challenge for MERCOSUR is to overcome the technical, health, financial, and administrative obstacles affecting its exports in order to diversify and expand the bloc's exportable supply. It could thus take advantage of China's demand for consumption and investment. At the same time, attention should be focused on the penetration of Chinese exports in sensitive sectors in order to minimize disputes. Furthermore, a higher density of business relations between China and MERCOSUR would attract investment, and joint projects and ventures, developing new businesses and enabling the insertion of MERCOSUR products in Chinese value chains, which demand imports of processed inputs.

In the framework of its strategy to consolidate its position as a regional point of reference and achieve a leading presence in the global arena, Brazil is pursuing an active external agenda, among which is the deepening of its partnership with China. During the Brazilian president's visit to Beijing in May 2009, both countries expressed the will to deepen cooperation in various areas of multilateral negotiations (G-5, BRIC, IMF reform). Among the understandings reached was the medium-term intention to move toward approval of a Local Currency Payment System for trade between the two countries, taking the system implemented between Argentina and Brazil as a model.

Similarly, the First Summit of Heads of State and Government of Brazil, Russia, India and China (BRIC) was held at Yekaterinburg, Russia, June 16, 2009. The meeting addressed issues of energy and food security, measures to cope with the global crisis, and economic cooperation initiatives, as well as emphasizing the need to reform international financial institutions in order to give developing countries and, in particular BRIC, an enhanced role. Although Argentina's contact with China was more limited, there have been various public and private missions to the Asian country in the last year to develop business opportunities and reciprocal investment, and strengthen the bilateral relationship. Uruguay has a keen interest in increasing its ties with China. On the occasion of the Uruguayan President's official visit to Beijing in March 2009, bilateral agreements were signed on trade, investment, sports, cooperation, communication, water resources, and tourism. The visit included several business rounds between entrepreneurs from the two countries, prominent in which was Chinese firms' intention to increase their share in infrastructure projects and hydrocarbon exploration in Uruguay. Finally, while Paraguayan trade with China has acquired great relevance, reaching a third of the country's imports in recent years, contact between the two countries is limited, as they have no diplomatic relations. Paraguay is one of the 23 countries around the world (and the only South American country) to recognize the government of the Republic of China (Taiwan), (not to be confused with the People's Republic of China).

Other initiatives toward rapprochement: The case of Uruguay-USA.

One of the main axes of the bilateral relationship between Uruguay and the USA is the *Trade and Investment Framework Agreement*[58] signed in January 2007, negotiated when during talks about the possibility of achieving free trade between the two countries. The agreement created a Trade and Investment Council[59] whose aim is to examine the bilateral relationship in order to identify opportunities for trade liberalization and boost investment. Against this background, two protocols to the Framework Agreement were signed in October 2008, involving substantive commitments on trade facilitation and public participation in trade and the environment. A Memorandum of Understanding was also signed with a view to moving ahead in cooperation on energy efficiency and renewable energy.[60]

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58 *Trade and Investment Framework Agreement* (TIFA). The USA and Uruguay had established a Joint Commission on Trade and Investment (JCTI) in February 2002 and signed the *Treaty concerning the Encouragement and Reciprocal Protection of Investment* in December 2005, which came into force in November 2006.

59 *United States-Uruguay Trade and Investment Council* (TIC).

60 See *United States and Uruguay Continue to Advance Bilateral Trade Relations by Signing Two Protocols to the United States Uruguay Trade and Investment Framework Agreement* http://www.sice.org/TPD/URY_USA/Negotiations/Protocols_sign_e.pdf.

In 2008, Uruguay's trade with the USA showed a US$315 million deficit for Uruguay (Table 22). Exports totaled US$214 million (3.6%) and imports US$530 million (6.1%). Sales consisted mainly of agricultural produce, in particular meat and meat preparations, hides, cheeses, and timber. Uruguayan purchases from the USA take in a wide variety of industrial goods, including fertilizers, cellphones, plastics, harvesters, auto parts, road machinery, computers, etc.

Table 22
URUGUAY: US TRADE
(In millions of US$ - As % - 2008)

Heading	Millions of US$		% Share	
	USA	World	In Uruguayan Trade	In US Trade
Exports	214.2	5,946.9	3.6	0.01
Imports	530.1	8,685.5	6.1	0.04
Trade Balance	*-315.9*	*-2,738.6*	*11.5*	*-0.04*

Source: LAIA.

Given the scale of the two countries, the importance for the USA of trade with Uruguay is extremely low. However, the US does have a strategic position as neighbor and partner of the two largest economies of South America, which makes initiatives designed to deepen the relationship workable. These could include the US granting unilateral tariff preferences for Uruguayan textile products and clothing (US Senate [2009]).

D. Subregional negotiations

The moderate progress in negotiations in the Latin American ambit were limited to ongoing integration processes, notable among which was the formation of UNASUR. MERCOSUR's integration initiatives with other countries in the region through various Economic Complementarity Agreements (ECA), signed in the framework of the Latin American Integration Association (LAIA), displayed some minor progress bound up with the incorporation of the Trade in Services and Investment chapters.

Union of South American Nations (UNASUR)

- Background -

As described in *MERCOSUR Report 13*, the establishment of the Union of South American Nations (UNASUR) in May 2008 was announced by the signatory governments as an important step toward regional integration. The project has a highly ambitious and wide-ranging agenda on various social, political, and cultural issues, lessening the importance of integration and trade liberalization issues. Table 23 sets out some of the organization's main features.

TABLE 23
MAIN FEATURES OF UNASUR

Objectives	To build a space for integration and union, giving priority to political dialogue, social policies, education, energy, infrastructure, financing, and the environment, among others areas.
Decision-making System	Consensus-based. Decisions may be taken with the presence of three-quarters of the member countries, and any absent countries must respond in the next 30 days. Any country may exempt itself from applying an approved policy definitely or indefinitely.
Presidency	The PPT is held successively in alphabetical order for one year.
Member Countries	Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Guyana, Paraguay, Peru, Surinam, Uruguay, and Venezuela.
Main Structure	Council of Heads of State and Government *Ordinary annual and extraordinary meetings.*
	Council of Ministers and Ministers of Foreign Affairs *Ordinary biannual and extraordinary meetings.*
	Council of delegates *Executive body formed by a representative from each country, with preferably bimonthly meetings.*
	General Secretariat *Based in Quito. Secretary appointed by the Council of Heads of State and Government, with a renewable 2-year mandate.*
	South American Energy Council.
	South American Defense Council.

Source: IDB-INTAL [2008], p. 144.

- Evolution over the period -

In the second half of 2008 and the first half of 2009, the President Pro Tempore (PPT) was held by Chile, then Ecuador. Attention focused mainly on analyzing the political crisis in Bolivia and the search for measures to normalize the situation in the second half of 2008. With this goal, the Chilean PPT called an emergency Summit in Santiago de Chile, Chile, on September 15, 2008, which decided to give the Bolivian government "the fullest, most resolute support".

The South American Defense Council (CDS) was subsequently created in May 2009. The CDS is a space for the discussion and promotion of exchange and the coordination of the region's armed forces. The signing of a military cooperation agreement between Colombia and the USA resulted in an Extraordinary Summit of UNASUR Heads of State in Bariloche, Argentina, in August 2009, at which the situation was discussed.

Among the slim progress made at the economic level of integration over the last year, the UNASUR countries agreed on the need to revitalize the final form of the **Bank of the South** (Chapter III).

Relations between MERCOSUR and Central America and the Caribbean

Formal contact between MERCOSUR and the **Central American Integration System (SICA)**, made up of Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama, began in October 2004.

After a few meetings and rounds of talks, the draft Partnership Agreement currently under analysis by the two blocs was presented in September 2008. A free trade agreement is not being sought, given the existing asymmetries between MERCOSUR and SICA, but rather a political and economic cooperation agreement.

Talks between MERCOSUR and the **Caribbean Community (CARICOM)** are at an early stage. MERCOSUR recently expressed its intention to hold further meetings with a view to stepping up relations and moving toward greater integration, albeit with no concrete progress.

Other subregional negotiations

- MERCOSUR-Chile -

Integration is being conducted under **ECA-35**, signed in June 1996 and put into effect in October the same year. A program of progressive liberalization of trade in goods was established, lasting up to 2014. In the last year, the process showed signs of progress, with negotiations being concluded in two issues: (i) the extension of the Agreement's General Regime for products produced or originating in Free Zones; and (ii) the approval of the consolidated text on Rules of Origin. In addition, it was decided to initiate dialogue to incorporate the investment sector in the Agreement.

- MERCOSUR-Bolivia -

Negotiations are being conducted under **ECA-36**, signed in December 1996 and in force since February 1997, which, in trade terms, makes provision for a phased tariff elimination program. Recently, Bolivia called on the bloc to relax the agreement's rules of origin regime, especially for textile products, given the suspension of benefits from the USA through the Andean Trade Promotion and Drug Eradication Act (ATPDEA). Faced with this request, MERCOSUR pledged to adopt specific support measures in the event of an emergency, based on the principle of solidarity.

- MERCOSUR-Peru -

ECA-58 was signed in November 2005 and came into force bilaterally as the signatories incorporated it in their respective internal legislations. In the last year, talks were held for a second meeting of the Agreement's Administrative Commission. At a working meeting, MERCOSUR presented the proposal for the negotiating parameters to incorporate trade in services in ECA-58.

A list of applications for compensation was also submitted under the provisions of Art. 40 of the Agreement, through the signing of the free trade agreement between Peru and the USA, which will erode the tariff preferences granted to the members of MERCOSUR under the Agreement (IDB-INTAL [2008], pp. 148-150). The US-Peru agreement replicates the free trade agreement model adopted in recent years by the USA, with certain adjustments in labor and environmental issues, the clauses of which are more demanding than those of previous agreements. It includes a wide range of trade and not directly trade-related issues, and adopts WTO-Plus disciplines in several areas: services, investments, intellectual property, competition policy, etc. This is significantly different to ECA-58, which is limited to goods.

- MERCOSUR-Colombia/Ecuador/Venezuela -

ECA-59, which formalizes the integration process, was signed in October 2004 and came into force bilaterally as of its incorporation into each country's internal legislation. During the 3rd Meeting of the Agreement's Administrative Commission in Montevideo in October 2008, Colombia and MERCOSUR agreed to start talks toward incorporating trade in services in the Agreement. An *Ad Hoc* Working Group was established for that purpose, and it was stipulated that Ecuador can adhere to the process of incorporating services and make any consultations necessary in this regard.

- MERCOSUR-Cuba -

ECA-62 was signed in July 2006 and came into force between Argentina, Brazil, and Cuba in July 2007. It was subsequently extended to the other partners with internalization by Uruguay (September 2008) and Paraguay (February 2009). Unlike other such agreements signed in the Latin American ambit, ECA-62 does not mention the formation of a free trade area as an explicit goal, but limits itself to "boosting commercial trade between the signatory parties". The first meeting of the Agreement's Administrative Commission was held in Havana, Cuba, in June 2009.

MERCOSUR's commercial trade with Cuba is in surplus (Table 24). Trade is of little relevance to the South American bloc, contributing 0.23% of its exports and 0.04% of its imports. Sales to Cuba mainly include food products with varying degrees of processing (wheat, corn, soya, meat, oil, milk, flours, coffee, etc.), while imports from Cuba largely consist of pharmaceutical products.

Table 24
MERCOSUR-CUBA TRADE
(In millions of US$ - As % - 2007)

Countries	Exports to Cuba			Imports from Cuba		
	Millions of US$ FOB	% total exports	% of Cuban imports	Millions of US$ CIF	% total imports	% of Cuban exports
Argentina	143.3	0.26	1.9	4.4	0.01	0.4
Brazil	315.0	0.20	4.1	64.3	0.05	5.1
Paraguay	0.3	0.01	0.0	0.8	0.01	0.1
Uruguay	53.9	1.19	0.7	3.2	0.06	0.3
MERCOSUR	*512.5*	*0.23*	*6.7*	*72.7*	*0.04*	*5.8*

Source: LAIA.

- Other issues -

The **Residence Agreements** for the MERCOSUR countries, Bolivia, and Chile came into force in June 2008. The Agreements simplify the residence application procedures in the signatory countries, regardless of the applicants' migrant status. Applicants may receive a temporary residence permit, valid for two years, that ensures equal civil and labor rights, the right of access to public education, and rights of movement. This can later be made permanent.

E. Results and prospects of the MERCOSUR external agenda

During the period under review, the issues of MERCOSUR's external agenda bore the mark of the global crisis. The largest partners made great negotiating efforts in the framework of the G-20, seeking to join forces with other nations, developed and developing, to find a coordinated way out of the international crisis.

Against this background and faced with increasing protectionist pressures at global level, aspects related to the bloc's trade relations were relegated to second place. This phenomenon was apparent in the developed nations, which had to focus on solving the problems being experienced by their own economies, rather than forging closer trade ties with other regions. Clear examples are the stalemate in the EU negotiations and the failure of the Doha Round, whose latest complex set of talks took place during the international crisis, undermining the granting of concessions of the various different parties involved.

Apart from the individual participation of Argentina and Brazil in the above forums, the main developments centered on initiatives already under way, especially with other developing economies. This tended to deepen the South-South profile of the external agenda in recent years, which is linked, among other factors, to the greater opportunities raised by the opening of trade with the subset of more dynamic economies worldwide. In any event, progress was only made regarding the entry into force of the agreement signed with India and the signing of the Fixed Preference Agreement with SACU.

In line with earlier trends, Brazil has become an increasingly relevant player in the international arena, marking a widening gap between it and the other countries in the region. Brazil is going through a new phase in which, after centering its international insertion strategy on MERCOSUR, it is beginning to address various initiatives more autonomously against a background of poor policy coordination between the bloc's members.

Argentina resumed a more active role in various international forums, particularly through its participation in the G-20, although with a different center of gravity than Brazil. Meanwhile, Uruguay, with the support of Paraguay, insists on incorporating a bilateral approach to other economies, stressing the intensification of its link with the USA on the basis of the Trade and Investment Framework Agreement, in force between the two countries since 2007.

In the future, the importance of the crisis agenda is likely to wane, with aspects linked to trade negotiations and investment promotion regaining the ascendancy. But for there to be any concrete progress, it will be necessary to determine the external agenda's priorities in a world that promises to be different from that of recent years by seeking consensus within the bloc. Only this will bring the cohesion needed for the partners to support joint negotiations in the face of the opportunities provided by a new expansionary phase at global level.

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