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MARCEL VAILLANT

Economic integration means liberalizing the rules which govern the movement of goods and production factors by distinguishing between two groups of countries: those which are party to the agreement and those which are not. This discrimination might generate an ambiguous final outcome, in the sense that trade may be more or less open than previously. Integrating entails becoming exposed to more competition from the output of another »club member,« while possibly creating more protectionism against the output of a third party which has not signed the treaty. This phenomenon makes it particularly rewarding to study trade liberalization in the context of an economic integration process.

Countries which decide to integrate and grant each other preferential treatment usually belong to a particular geographical and/or cultural region, which is why agreements of this kind tend to be classified as regionalist. During the 1990s, regionalism spread as a strategy by means of which economic globalization could unfold. Regional Trade Agreements (RTAs) proliferated rapidly during that decade, growing from around 50 in the early 1990s to 215 in 2003. By 2007 the number is expected to reach 300 (OMC, 2003). There are various explanations for this phenomenon: for example, multilateralism as a mechanism for advancing the reciprocal, non-discriminatory liberalization of trade was showing signs of wear (Krugman, 1991), and regionalism is a strategic response to discrimination imposed by others (Baldwin, 1996).

This paper does not set out to explore the broader motives behind this new wave of regionalism. Rather, it seeks to draw on the ideas reflected in the abundant literature on the topic to describe the genesis and evolution of a specific trade bloc: the Mercado Común del Sur (MERCOSUR).[1] This bloc stands out as an ambitious agreement by four countries of the South (Argentina, Brazil, Paraguay and Uruguay) to achieve economic

1. See, inter alia, Frankel (1997); De Melo and Panagariya (1993); World Bank (2000); BID (2002).

integration. Drawing on this case, the article will offer some general reflections on integration paths for economies of the South and propose a number of general arguments to explain the perceived incentives which encourage nations to opt for integration.

Birth of an Ambitious Project[2]

In the international economy, most trade takes place between neighbors or within regions. There are patterns of specialization and models of behavior that have been verified empirically and explain why neighboring economies manifest the closest trading links. Shorter distances, contiguity, a common language, cultural patterns, and relatively similar stages of development account for much of the relative intensity of commerce between neighbors. All these factors apply within MERCOSUR. The members are geographically close with shared borders, remote from the rest of the world, with not dissimilar levels of development. These economies constitute what is known as a natural trade bloc. If these countries were to liberalize their trade, they would trade more with each other whether or not they applied a discriminatory trade policy towards the rest of the world (integration policies). There is evidence in the region to corroborate these statements. However, if this is the case – if the same thing would happen »naturally« simply by opening up trade – why do they need integration agreements? The advantage of an agreement is that it ensures access to each other's markets on a reciprocal basis. Besides, economic integration permits the development of a framework for cooperation which can become an essential ingredient in the economic development of member countries.

Regional integration in the Southern Cone of America has taken place against a backdrop of two processes which are worth recalling here. The first is the revival of regionalism or economic integration (reciprocal and discriminatory trade liberalization) in the early 1990s as an alternative to the multilateral format of trade liberalization (reciprocal and non-discriminatory). The second process is a shift in how all Southern Cone economies have pursued growth, from a model founded on import sub-

2. For a detailed description and evaluation of the trade agreement, its content, legal framework and institutional structure, see Secretaría del MERCOSUR (2004).

stitution to one based on opening up their trade. The regional agreement was created as an instrument to facilitate, jointly determine and drive the integration of these economies as the international economy entered a new stage of globalization. The biggest change was witnessed by the Brazilian economy, which opened unilaterally and more fundamentally from the late 1980s and especially in the early 1990s. The integration agreement analyzed here should be seen within the context of this shift in paradigm, for it was intended to support and consolidate the unilateral strategy of liberalization which all economies in the region were embarking upon, albeit at different speeds.

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Over a decade after the Treaty of Asunción of March 1991, the founding moment of MERCOSUR, both processes – regionalism and liberalization – are again acutely topical. Regionalism has been established in the international economy as one approach to liberalization. The paradigm is illustrated most clearly by the EU, where momentum is being maintained with regard to both deepening and widening. Two examples suffice: the common currency and Eastern enlargement. At the same time, the multilateral strategy is once again provoking a degree of skepticism due to its slow pace and meager results. The World Trade Organization (WTO) has created a global framework of rules and a dispute settlement system, but the commitment is nevertheless weak. Member states are looking to regional agreements to create firmer foundations for their economies to participate in global exchange.

The Southern Cone countries have committed themselves to opening up their trade, their economies have been restructured and they must expand their markets to ensure sustainability for their export strategy. The Treaty of Asunción constituted a reciprocal free trade agreement which was conceived in addition as an instrument for building a common market incorporating the economies of Southern countries at a relatively similar stage of development. It differed from earlier attempts at integration in its universal approach (in contrast to lists of products). The aim is to integrate in order to achieve growth and promote economic and social development for the peoples of the member states.

The integration agreement was formulated around two major time lines: the Trade Liberalization Program (TLP) and the Regime of Adaptation to MERCOSUR (RAM). These two instruments govern the process of commercial integration, still the linchpin of the agreement. The TLP dates back to the initial Treaty of 1991 and was the basis for creating the Free Trade Area (FTA). Intra-regional tariffs were gradually eliminated by using a linear and automatic reduction scheme. This liberalization scheme was announced in advance by the member countries' governments and then carried out twice a year on a regular basis, as envisaged at the outset. Its rigorous implementation makes it a model specimen of public policy adopted by the member countries.

The second instrument, the RAM, emerged from the Ouro Preto summit of December 1994. It was set up to finalize the Free Trade Area as the Trade Liberalization Program was reaching completion. However, this new instrument broadened the terms of liberalization, slowing down the construction process of the Free Trade Zone. A new list of products excluded from the intra-regional free trade was defined. Now that the schedule laid down for these RAM lists has been fulfilled, the integration agreement can be described as a universal, non-tariff, free trade zone with a degree of harmonization in terms of trading policies adopted towards third parties.

It was also at the Ouro Preto summit of 1994 that the members of the trade agreement adopted a Customs Union (CU) format. To begin with, agreement was reached on a basic structure for the Common External Tariff (CET), along with a convergence schedule for sectors in which political preferences were still not congruent. However, 10 years after this new direction was adopted, the CET has not yet established a common structure. There are still exceptions for certain member countries and sectors, unharmonized special trade regimes, there are no common trade defense mechanisms and so many national differences remain. This highly perforated CET system explains why rules of origin are still required for goods traded within the region. Member countries are still applying different national policies to a major chunk of the tariff universe.

Economic Relevance in the Global Economy

Since MERCOSUR was founded it has increasingly caught the attention of the big players in the global economy (blocs, countries, international or-

ganizations, private sector) that have different interests in this initiative for a regional bloc of economies of the South. The strategy chosen by the MERCOSUR members for economic integration makes this an ambitious venture. Its model is similar to the European format, developing through a sequence of stages with increasingly close economic relations. Moreover, this region is primarily a magnet for the world economy due to its relative abundance of natural resources. And finally, it constitutes a potential market which could attract global interest if it manages to steer a course of stable growth.

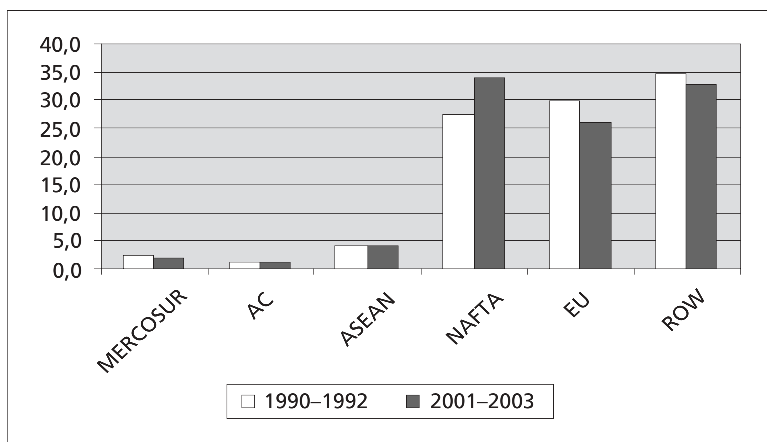
If we assess the significance of the Southern Cone bloc by looking at how it has performed in respect of three parameters (production, trade, and foreign direct investment), however, we obtain a more differentiated picture, enabling us to place the above in a broader perspective (Baraibar and Vaillant, 2004). First, we can study MERCOSUR's performance between the end of the 1980s (1990) and 2003 (thus using the most recently available annual statistics). Moreover, MERCOSUR's performance can be compared with that of other trade blocs: the Andean Community, the North American Free Trade Area (NAFTA), the European Union of 15 member states (EU-15), and the Association of South-East Asian Nations (ASEAN). These blocs were chosen because they combine two criteria: their importance to the world economy and their importance to MERCOSUR.

With regard to production, momentum was lower than for the world economy as a whole and this is reflected by a decline in MERCOSUR's share of global production. In the period under review the economic weight of the bloc decreased, from 2.6 percent in the early 1990s to 2.0 percent in the last three years considered (2001–2003) (see figure 1).

Looking at global trade patterns, the five trade blocs account for two-thirds of international trade. Half this trade is intra-regional, with a mostly upward trend in the period under review. With regard to MERCOSUR, trade within the bloc increased in line with the integration process (reaching about 20 percent), but it remains low compared with other blocs (less than half the average for the five blocs as a whole). These statistics illustrate how the integration process is advancing.

If we consider imports, the region's share of world trade fell, from 1.4 percent in 1995 to less than 1.0 percent in 2003. As regards exports, on the other hand, the growth rate was slightly higher than for world trade as a whole between 1995 and 2003, when the share of world exports rose from 0.9 percent to 1.0 percent. In both cases trade share was noticeably

Figure 1:
Trade Bloc Shares of Global Production (%)

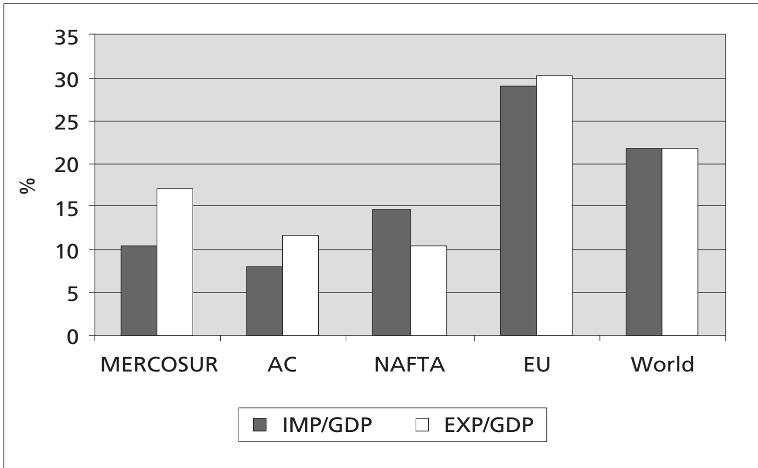


Source: based on data from Baraibar and Vaillant (2004). AC = Andean Community. ROW = rest of the world.

lower than share of production, reflecting the fact that the region is relatively closed compared with the world economy as a whole. In 2003 global trade was 22 percent of global production, while for MERCOSUR the figure was 10.5 percent for imports and 17 percent for exports of regional production (see figure 2).

The 1990s brought rocketing international capital movements. In 1990 global foreign direct investment (FDI) flows were about four times as high as those registered in 1980. The EU and NAFTA countries were the principal destinations. Investment in blocs in the South focused initially on ASEAN, where the FDI inflow in 1990 was six times higher than in 1980, and on the Andean Community, where it trebled over the same period. MERCOSUR showed similar values, but the increasing flow into the region did not begin until later. The formal launch of the agreement in 1991 coincided with a substantial inward flow of FDI. In 1995 inward FDI was three times as high as in 1990, and in 2000 it was four times the total for 1995. One factor which boosted the bloc's ability to attract this investment and explains what has been called the »FDI boom« (Chudnovsky, 2001) were the privatizations initiated by governments in the region. Towards

Figure 2:
International Trade as Percentage of Production (GDP) in 2003



Source: based on data from Baraibar and Vaillant (2004).

the end of the period for which statistics are available (2003) a decline set in, although the volume never dropped to the levels seen prior to the integration agreement (see table 1).

In 2003 the region accounted for a somewhat higher share of global FDI (1.9 percent) than of global production (1.7 percent), whereas in 1990 share of global production was larger (2.6 percent) and the capacity to attract FDI considerably lower (0.5 percent). This is one of the few areas in which the bloc's role in the world economy is substantiated by real economic data.

A degree of caution is required, however, because FDI is increasingly focusing on Brazil. Table 1 demonstrates this eloquently. This gain in share by the largest country in the bloc is not merely a new phenomenon associated with the recent crisis (notably in Argentina), but the result of a more far-reaching process which has been going on since the outset, a trend which should sound an alarm with regard to the outcome of the integration process. We shall examine these matters in the following section.

Table 1:
FDI into MERCOSUR Countries:
Annual Average for the Period (US $ Million)

Period/ Country	*Argentina*	*Brazil*	*Paraguay*	*Uruguay*	*MERCO-SUR*
1990–1993	2 763	1 361	93	68	4 285
1994–1997	6 229	9 429	155	144	15 957
1998–2001	10 966	28 168	157	248	39 538
2002–2003	632	13 367	47	219	14 264

Source: from UNCTAD database as cited in Baraibar and Vaillant (2004).

Benefits of Regional Integration and Obstacles to Full Economic Integration

The first and fairly obvious benefit which the MERCOSUR countries have derived from integration is preferential access to a larger market. A simple quantification of the differentiated impact of this for member countries is comparison of the size of the region – excluding the country concerned – with the size of the country itself. Among other things this shows the great asymmetry between members: in the case of Brazil, the populations of the other countries, and hence the market they represent, amount to only about one-third of its own. For Uruguay, on the other hand, with its low density of population, the other countries constitute a market 64.6 times the size of its own. If production is our measure, Paraguay finds itself in a region almost 124 times as big as its own economy. Argentina is in an intermediate position by comparison with its fellow members: while the bloc gives it access to an economy several times larger than its own (almost three times for production and nearly five times for population), it is not as small as Paraguay or Uruguay, in respect of which the size of the regional market is overwhelming.

One necessity facing the three smaller members (Argentina, Paraguay and Uruguay) is the opportunity to sell their products to the rest of the world. Small economies have specialized structures, producing large quantities of only a few products and consuming small quantities of many products. This specialization can be related to a certain external vulnerability, given that the country will be bound by the access require-

ments of the markets they are specializing in. The products in respect of which the minor MERCOSUR countries enjoy conventional competitive advantages face international markets which can be difficult to enter. External vulnerability can be reduced if the size of the market that can be accessed under free trade conditions is bigger, broadening the range of products and services in which a country can specialize.

The three smaller MERCOSUR countries have not yet profited from joining a larger market.

For small economies, therefore, economic integration is another instrument for surmounting the constraints of their restricted domestic market. Modern manufacturing technology means that economies of scale play a dominant role in competitiveness. When the scale is bigger (or when more is produced), production costs per unit fall. International trade makes it possible to exploit these efficiency gains. Comparison indicates that regional integration plays a central role in this process.

However, the three smaller MERCOSUR countries have not yet profited from joining a larger market. For Argentina and Uruguay, integration brought with it a loss of their share in MERCOSUR's industrial production during the first phase. A number of recent papers have documented this phenomenon for Argentina (Sanguinetti, Triastaru and Volpe, 2003) and Uruguay (Labraga and Lalanne, 2004). Table 2 shows how the countries with which we are concerned have evolved as a manufacturing base over a longer period, confirming this effect.[3]

Economic integration has displayed two essential characteristics which explain the poor industrial performance of the bloc's three smaller economies:

i. The abolition of import tariffs on intra-regional trade by and large followed a previously announced schedule. Non-tariff barriers (NTB), however, were not eliminated with the same efficiency, and these continued to influence intra-regional trade. The existence of non-tariff

3. The phenomenon must also be examined at subregional level within the countries concerned, especially in the case of the two geographically larger members. This permits more accurate comparisons in assessing the development of agglomerated industrial centers within the bloc and how their evolution relates to the progress of integration (Terra and Vaillant, 2000).

Table 2:
Manufacturing GDP in MERCOSUR (US $ Million at 1995 Values and %)

	1980–1982		*1990–1992*		*2000–2002*	
	US $ million	*%*	*US $ million*	*%*	*US $ million*	*%*
Argentina	36 350	22.9	36 507	22.3	39 440	20.5
Brazil	117 415	74.1	121 986	74.6	148 008	77.1
Paraguay	991	0.6	1 218	0.7	1 300	0.7
Uruguay	3 798	2.4	3 772	2.3	3 207	1.7
MERCOSUR	158 554	100.0	163 483	100.0	191 955	100.0

Source: author's calculations based on ECLAC data (Economic Commission for Latin America and the Carribean).

barriers acts as an incentive to locate investment and production in the big market. This is due in part to the direct effect they have on prices and in part to the uncertainty they create about future results. The damage caused by barriers is not only direct, due to the way they hamper trade flows, but also indirect, because of the likelihood that future barriers might be imposed on current location decisions.

ii. Although the bloc opted for a customs union format, 10 years after the Ouro Preto Protocol it continues to operate like a free trade area when it comes to the rules governing circulation of goods within the integrated zone. The only goods to which preferential customs treatment is applied in intra-regional trade are those considered native under the current Rules of Origin (RO). The consequences are considerable in terms of the ability to attract industrial processes to small market economies, which have a low level of vertical integration in their industrial structure. It has been demonstrated that the Rules of Origin stimulate demand for and translate into higher prices for regional inputs. Small economies, which could offer advantages in shorter production chains, are unable to develop this specialization in the current scenario. Indeed, they are prevented from doing so because if goods are not native, even if they comply with common trade policy (Common External Tariff and common preferential regime for third parties), the tariff must be paid again as soon as the goods cross another border within the region.

In other words, the existence of NTB and the continued application of the RO to the full customs universe have left the elimination of hurdles and restrictions to intra-regional trade stranded halfway in terms of exploiting the integration potential.

During the 1990s, the trade bloc made progress towards abolishing tariffs. Today, however, tariffs offer an incomplete yardstick and tell us little about the difficulties still being posed by market access. Zignago and Mayer (2004) have therefore estimated the explanatory power of borders by studying the extent to which domestic production is favored as against production from the rest of the world. The results for the 1990s show that on average in the world economy, a country buys 273 times more from itself than it would buy from any other country when the control variables (market size, distance, tariffs, and so on) are similar. There are differences, however, between North–North trade, with a ratio of 130, and South–South trade, with a ratio of 327! If countries have a preferential trade agreement, this border effect coefficient is reduced to 42. The result is clear: preferential trade agreements diminish border effects substantially for the regions examined in this analysis. This also applies to the four countries of MERCOSUR, although the border effect coefficient within the bloc (120) is still considerable (by comparison: the ratio for the EU is 47, for Canadian–US trade 52, and for ASEAN 81. Only the Andean Community has even stronger border effects, with a ratio of 330).

Zignago and Mayer (2004) also conducted a longitudinal analysis of changes in border effects in the world economy as a whole and region by region. They demonstrate a declining tendency, especially within the framework of regional trading agreements. The two blocs that have proved most successful in reducing border-related fragmentation are the European Union and NAFTA. In the regional structure composed by our four Southern economies, the border effect fell noticeably in the 1990s, but it remains high.

Geographical trade models which specify the complex interaction between economies of scale, transport costs and market size show that the level of industrialization of peripheral economies (those which are not within industrial heartlands) forms an irregular U-curve when set against the depth of integration achieved (Krugman and Venables, 1990). When levels of integration are very low, industry is spatially dispersed; as integration proceeds, strong incentives emerge to concentrate manufacturing where market size is greater. If integration progresses effectively, economies that were once peripheral come closer to the industrial core, thereby

increasing their capacity to retain manufacturing activity on their territory.[4] Consequently, if economic integration has led to deindustrialization in the smaller, more peripheral economies of MERCOSUR, this is not due to high but to low integration. To the extent that regional integration has only managed to advance a few first steps, it has exacerbated the negative bias against manufacturing locations in smaller economies, as the theoretical literature predicts (the U-shaped pattern).

Negotiating with Third Parties: Projects and Problems

As already mentioned, MERCOSUR is an agreement with ambitious goals for economic integration. The trading strategy it adopted was a Customs Union format. The CU is not often used in the global economy when setting up preferential trading agreements because it is associated with a greater degree of commitment among member countries to developing common policies and institutions.[5] There are a number of explicit reasons why this format was selected. One has already been described and relates to the fact that this model of preferential agreement permits more intensive regional integration, ultimately eliminating Rules of Origin and thereby permitting a more universal circulation of intra-regional trade. The other motive frequently cited is that a CU strengthens the region's hand when negotiating with third parties because this integration model calls for a common trade policy.

The comparative advantages of the four MERCOSUR countries are heavily weighted towards goods with an intensive input of natural resources. These are the productive factors which the Southern Cone boasts in abundance. Many of the sectors concerned have problems accessing the international market, especially the big industrialized markets. There is a close correlation between the comparative advantages the bloc can offer and the protectionist core of trade policies adopted by the wealthy nations. This is especially evident in the case of agricultural food

4. Terra and Vaillant 2000 calibrated the center-periphery model for the economic geography of Argentina, Brazil, Paraguay, and Uruguay and in simulations with low and average levels of integration they obtained results of this type for the smaller countries in the bloc.
5. Of the 215 current regional trade agreements, only 14 have been notified to the WTO as customs unions (OMC, 2003).

Table 3:
Manufacturing Production in Latin America
(US $ Million at 1995 Values and %)

	1980–1982		*1990–1992*		*2000–2002*	
	US $ million	*%*	*US $ million*	*%*	*US $ million*	*%*
MERCOSUR	158 554	61.6	163 483	58.1	191 955	54.7
Chile	6 746	2.6	9 908	3.5	14 520	4.1
AC	30 773	12.0	33 382	11.9	36 134	10.3
MCCA	6 063	2.4	6 883	2.4	10 298	2.9
Mexico	55 134	21.4	67 835	24.1	98 209	28.0
TOTAL	257 270	100.0	281 490	100.0	351 117	100.0

Notes: AC – Andean Community; MCCA – Central American Common Market.

Source: author's calculations based on data from ECLAC.

products, but not confined to them. The regional integration initiative could be regarded as an instrument for correcting this unequal access to the global economy.

As the previous chapter showed, the member countries display a low dynamism compared to other regions, reflected in the aggregated figures for production and trade. The situation is equally worrying when we undertake a more specific comparison. If we consider the relative performance of manufacturing output compared with the other countries of Latin America, we will note that the Treaty countries come up with negative values. Table 3 illustrates this decline by comparing the share of industrial production for the three-year period at the beginning of three successive decades. The fastest growing countries were Chile and Mexico, where industrial output rose fastest, and their record is particularly striking when set against Argentina and Brazil (see table 2). This may partly be explained by their success in negotiations with third parties, especially the dynamic industrialized economies of the North.

Obtaining better terms of access to the markets of industrialized countries is a priority, and indeed a strategic necessity in sustaining the model of trade liberalization and export-driven growth adopted by the MERCO-

SUR countries from the 1990s onward. Opening up trade implies replacing inefficient domestic production with production from the rest of the world offered at a better quality and price. It is vital, therefore, to ensure that the productive resources no longer required as a consequence of this are channeled into domestic activities that promise greater relative efficiency. If these favorable sectors then encounter problems of global market access, the liberalization model will be constrained in its progress and limited in its sustainability.

There is a link between the beneficial effects of negotiating trade conditions with third parties and the ability to establish a unified market. If there is a common trade policy,[6] it will be easier to express a negotiating position. If there is merely an intention to adopt a common trade policy but it has not yet been fully implemented, or even made to function partially, this will mitigate the potential for deriving national or collective advantages from joint negotiations with third parties.

Joint negotiations of MERCOSUR members with third parties have developed vigorously over the last 10 years, but the results have frankly been meager. Joint preferential agreements were struck very quickly with Chile and Bolivia, but a joint agreement with the Andean Community was only concluded in 2004. It is evident that this latter agreement will face serious implementation problems. Further negotiation scenarios have proliferated, but any significant talks have foundered or been suspended. Many factors have contributed to this outcome, but one which cannot be ignored is the region's own inability to progress towards a common trade policy, which would include as one of its constituent elements a clear negotiating position for each of the areas described above.

It is particularly worth noting what happened in trade negotiations with the European Union. Negotiations between the EU and MERCOSUR, which were initiated in 1999 after ratification of the Interregional Framework Agreement geared towards the creation of an Interregional Association, led to the formation of several committees with the aim of reaching agreement on political, commercial, and cooperation issues (Arcuri and Vaillant, 2004). However, the strategy developed by both parties is based

6. There are various components in a common trade policy. The salient ones are: a classification system for common goods; similar customs valuation systems, which normally requires a common customs code; a common external tariff; shared trade defense rules (anti-dumping, anti-subsidy, protective clauses); a similar preferential trade scheme for third markets; harmonized or shared special trade regimes.

on different and contrasting views. MERCOSUR is attempting to improve access – particularly for agricultural products – to the European market, which underlines a systemic approach and leads to conditions being imposed on the continuation of the negotiations, currently based on a liberalization offer perceived by MERCOSUR as asymmetric. The EU wants to be sure that it can count on definite trade norms, including customs issues as well as trade in services, investment, government procurement, intellectual property, and sustainable development. The EU also regards it as necessary to establish clear rules with respect to free circulation within the MERCOSUR countries, harmonization of customs norms, and a trustworthy system of conflict resolution. In order to achieve this, a negotiation process in two phases was proposed, which should begin with the question of norms, and continuing with negotiations on market access, including a better MERCOSUR offer regarding custom duties.

We can observe a shift in direction on the part of Brazil towards an option which privileges South–South negotiations, especially within South America, as a substitute for trade negotiations with the economies of the North.

More than any other talks, these offered MERCOSUR an opportunity to enhance its own agreement by joining a process of integration with a third party. This is not a trade agreement which waters down existing preferences (as might be the case with the Free Trade Area of the Americas, FTAA, in an American context), but it does require MERCOSUR to function as a Customs Union. It is actually one of the few global precursors of bloc-to-bloc associations of this kind. Given the integrated nature of this association, which goes beyond the trade link to include political and cooperation aspects, the agreement with the European Union stands out as an ideal proposal to enable the bloc to profit from the technology of economic integration which the EU can be claimed without any exaggeration to have invented.

Unfortunately, on this count again the balance is negative. Broadly speaking, since MERCOSUR was launched in the early 1990s, not a single trade negotiation of any significance has been concluded with third markets. Some thought should be given to why the record on external negotiation has been so poor. One factor already mentioned is the slow progress of the Customs Union. However, deeper causes must be sought

which might relate to the true policy preferences of member states, in particular Brazil, rather than those currently being expressed openly.

Generally, we can observe a shift in direction on the part of Brazil towards an option which privileges South–South negotiations, especially within South America, as a substitute for trade negotiations with the economies of the North. This attitude does not hold out particularly good prospects for future consolidation of the Customs Union: first, given the concrete economic relevance such agreements can have, besides the objectives they may be pursuing in terms of international relations, and secondly given that many of them highlight the erratic or incomplete functioning of the Customs Union and do not qualify as joint preferential agreements. The format they need in order to be politically acceptable makes them the worst possible agreements from an economic perspective.

Hopes have been expressed more recently in relation to the agreements with India and China. It would be wrong to talk of irrelevance, but it can be argued that they do not appear to be the kind of trade agreements likely to further the bloc's joint functioning. Moreover, there are no well-founded reasons for believing that MERCOSUR's bargaining position will be any better when dealing with these highly populous, distant Asian nations than with an integrated Europe, with which the Southern Cone has long, continuous historical ties, political, economic, and cultural. Brazil is the country with the most reservations about signing agreements with the industrialized nations, but it is also the country which stands to gain the biggest markets and to benefit from increased bargaining power provided by joint negotiations.

It is clear that the difficulties encountered by the bloc in negotiating with the industrialized world are not all of their own making. While MERCOSUR may be a small fish in the global pond, it remains the biggest regional economic player in Latin America. The industrialized nations, both American and European, have come to the negotiating table with a broad, all-embracing agenda, but with trade offers which any sober observer is bound to describe as unacceptable. In those sectors in which the industrialized nations have a clear interest, the objective is total liberalization based on general rules, but when they want to defend particular sectors there is no limit to their particularism. It is logical that the domestic political elites within the Southern bloc, especially within its largest member, do not favor trade negotiations in this vein.

In a recent book, Lorenzo and Vaillant (2004) argued with regard to the creation of the Free Trade Area of the Americas (FTAA) that strength-

ening the case for liberalization depends on the groups who will benefit from increased exports and investments in outside markets. Their ability to put pressure on their home government depends critically on the scope for improving access to their trading partners' markets. The industrialized countries have the option of pursuing an active policy to push for liberalization in an emerging market where a particular sector or focus attracts their interest, and making significant concessions in their own market in sectors where the Southern bloc can clearly benefit. This will strengthen the alliance of pro-agreement exporters in the South, encouraging liberalization and causing their markets to open up. In the case analyzed by Lorenzo and Vaillant (2004), it will be difficult for the United States to improve its access to markets for electronics, high tech and capital goods if it is not prepared to make significant concessions at the core of its protectionist structure for agriculture and traditional manufacturing. What goes for the bigger partner certainly goes for the Southern bloc and emphasizes the relevance of the domestic factor in international negotiations.

Conclusions

The 1991 Treaty of Asunción constituted a reciprocal initiative towards trade liberalization, additionally conceived as an instrument for building a Common Market, undertaken by economies of the South at similar levels of development. Since it was founded it has increasingly caught the attention of the major players in the global economy. However, the only conspicuous impact that the bloc has made on the global economy derives from its capacity to attract FDI, although there has been a continuous trend towards geographical concentration within the bloc, favoring Brazil as its largest member.

In a context of asymmetric market size, gradual integration generates strong disparities in the industrial location of manufacturing activities. The present situation therefore poses a choice between moving ahead and turning back. Moving ahead means greater integration. This option inevitably entails a deeper commitment and the creation of common institutions capable of managing, among other things, the two issues described earlier: non-tariff barriers and rules of origin in intra-regional trade. These have both acted as a brake on the intensification of economic integration. Turning back would require the smaller economies to adopt

defensive measures to stem the tide of concentration in the largest country, reducing the level of integration.

At the same time, a process of broadening MERCOSUR is under way. The majority of the countries in South America are either integrated into the bloc or else associate members or candidates.[7] Negotiations about free trade agreements between the bloc and several other states or regions are also on track. One cannot be sure whether a joint preferential trade agreement with another country or bloc will be a substitute for pressing ahead towards a fully fledged MERCOSUR trade agreement. One might expect, to take the reverse approach, that a joint trade policy ought to be a basic requirement for any joint trade agreement. In that sense one might expect there to be a positive complementary relationship between broadening the base and setting up new agreements on the one hand and deepening the structure of the present regional agreement on the other. To bring that about, however, real joint agreements have to be concluded with third parties, and one critical factor here is doubtless the kind of partner one should choose.

It is not clear whether the current approach to broadening the bloc and extending relations with third markets will strengthen relations between the four members in a manner which will enable them to resolve the various problems preventing proper functioning of the trade agreement. Furthermore, the characteristics of these essentially South–South agreements encourage a certain pessimism about their ability to promote a functioning Customs Union, although they could certainly help the region to exert greater political influence in the global arena. Even so, one cannot tell how this greater political influence might translate into more favorable conditions regarding issues of concern to the region in particular and the South in general. The history of these new relations is too brief to allow an informed judgment.

MERCOSUR trade agreements with industrialized economies signify improved market access for products of interest, thus realizing the benefits of joint negotiation. In addition, however, they pave the way to intensifying the commitment of the four member countries in that they are obliged to apply stricter rules to implementing their regional trade agreement. Negotiations with both the United States (via the FTAA or bilater-

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7. Chile, Bolivia, and Peru are associate members and Venezuela has asked to become one. To be an associate member, the country must enter into a universal trade agreement with the bloc (Free Trade Area).

ally) and the European Union are fundamental. In particular, a possible agreement with Europe could, more than any other, encourage the bloc to function more effectively as a Customs Union. But negotiating with the North is not easy, for the wide-ranging gains facilitated by these agreements are associated with a complex and adverse political economy which can be overcome only with a great deal of political will and leadership on both sides.

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