



Trade in services in the Mercosur Area: economic assesment and issues for liberalization¹

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Keywords: liberalization, trade in services, Mercosur

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TRADE IN SERVICES IN THE MERCOSUR AREA: ECONOMIC ASSESMENT AND ISSUES FOR LIBERALIZATION

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ABSTRACT

The main figures related with the contribution of services to growth and trade in the Mercosur countries are analyzed. They will suggest that the smaller countries have a lot to win with a liberalization in services in Mercosur. The critical points of the negotiation are stressed, mainly those proposals that can bring at the end a regulatory environment that is more restrictive than now to international trade in services. Special attention will be given to the issue of rules of origin in services, which can be a source or restrictions to international capital mobility in the services sectors.

Introduction

In recent years, governments have been paying more attention to the role of the service sector to economic development. In part because the liberalization of services was an important issue in the agenda of the Uruguay Round, the contribution of the service industries to the overall level of activity, employment and trade has been put in the front page and subject of analysis, political economy measures and negotiation between countries.

In this respect, the Asuncion Treaty, which initially established the making of an economic union between Argentina, Brazil, Paraguay and Uruguay, foresaw that the liberalization of trade will not include only movement of merchandise, but also of services. This point can be very important to the design of development strategies in these countries, because as will be seen in this paper, the services sector has been one of the most dynamic activities in that area since the beginning of the nineties.

In the next section the main figures related with the contribution of services to growth and trade in the Mercosur countries are analyzed. They will suggest that Argentina, Paraguay and Uruguay have a lot to win in terms of trade creation with a liberalization in services in Mercosur. The smaller economies, and specially Uruguay, have shown abilities to overcome their reduced domestic markets and export services to Argentina and Brazil.

The negotiation process between the Mercosur countries in the liberalization of services is analyzed in the following section. The critical points of the negotiation are stressed, mainly those proposals that can bring at the end a regulatory environment that is more restrictive than now to international trade in services. Special attention will be given to the issue of rules of origin in services, which can be a source or restrictions to international capital mobility in the services sectors.

The Services Sector

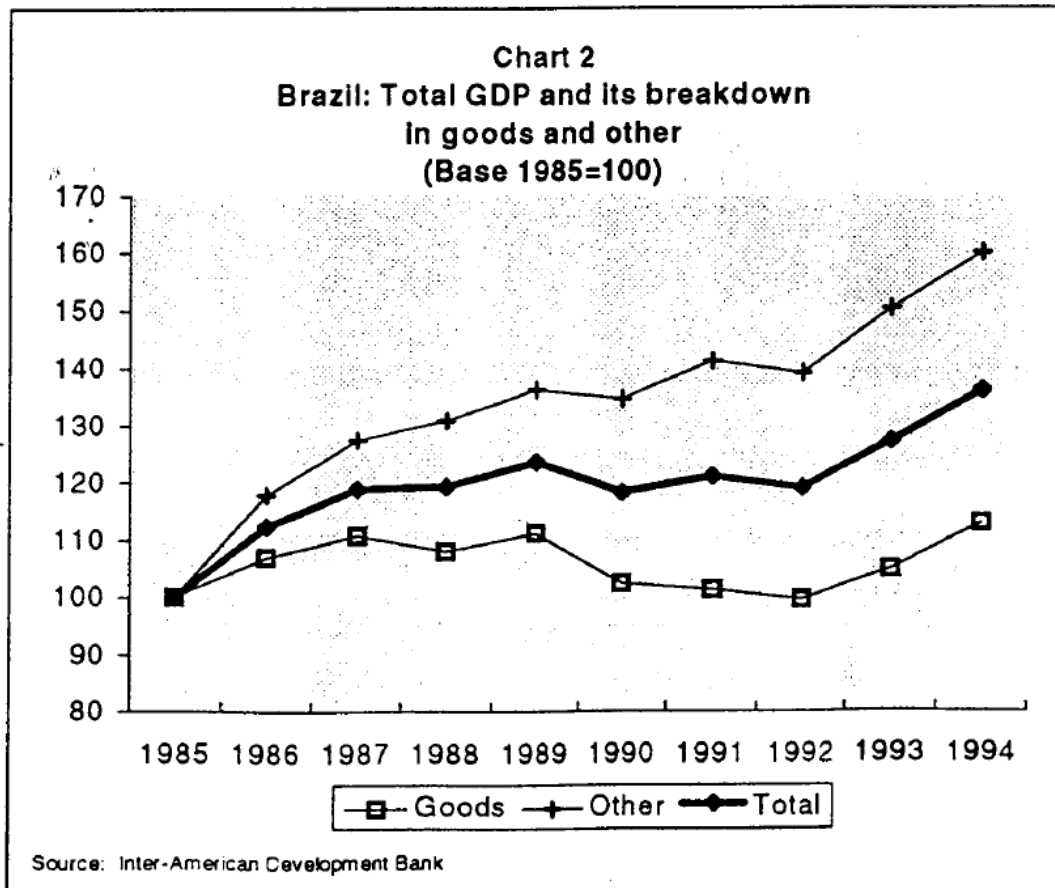
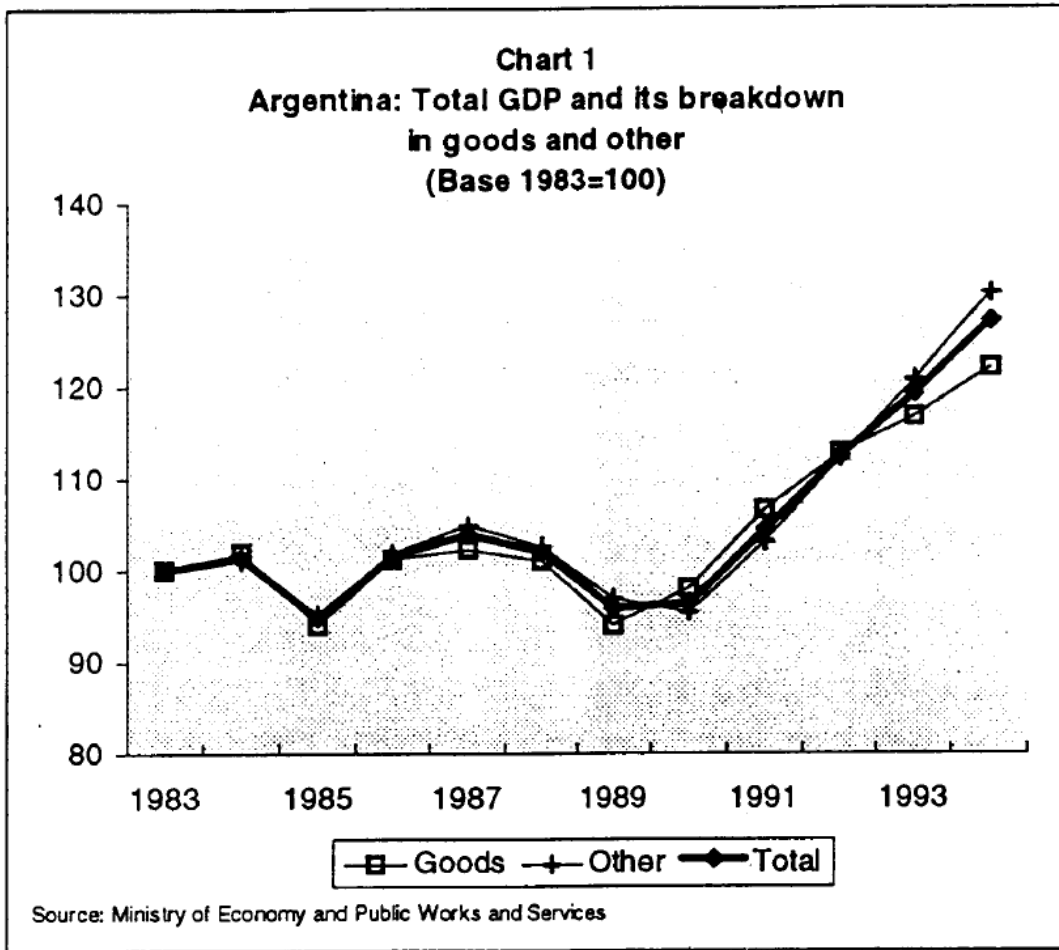
The stabilization programs applied since the late eighties and beginning of the nineties in Argentina, Paraguay and Uruguay, and since 1994 in Brazil, mostly based in the use of the exchange rate as a nominal anchor, induced a rapid growth in the non-tradable sector of these economies and, as a consequence, in the services sector of these countries. The consumption boom in Argentina after the Convertibility Plan provoked a strong change in relative prices that favor the production of home goods and services, simultaneously with a deterioration of the current account. In the case of Uruguay, its services sector was benefited not only by the stabilization program of this country itself, which did not have the rapid results of the Argentinean plan², but mainly because of the expansion of Argentinean consumption and its spillover on the Uruguayan economy. In Paraguay, the unification of the multiple exchange rate system that was put in practice since the beginning of the eighties and the fiscal reform that was applied since 1989 permitted the implementation of a stabilization program, with a gradual slowdown in the devaluation rate. In Brazil, the Plano Real also induced a consumption boom and the expansion of the non-tradables sector.

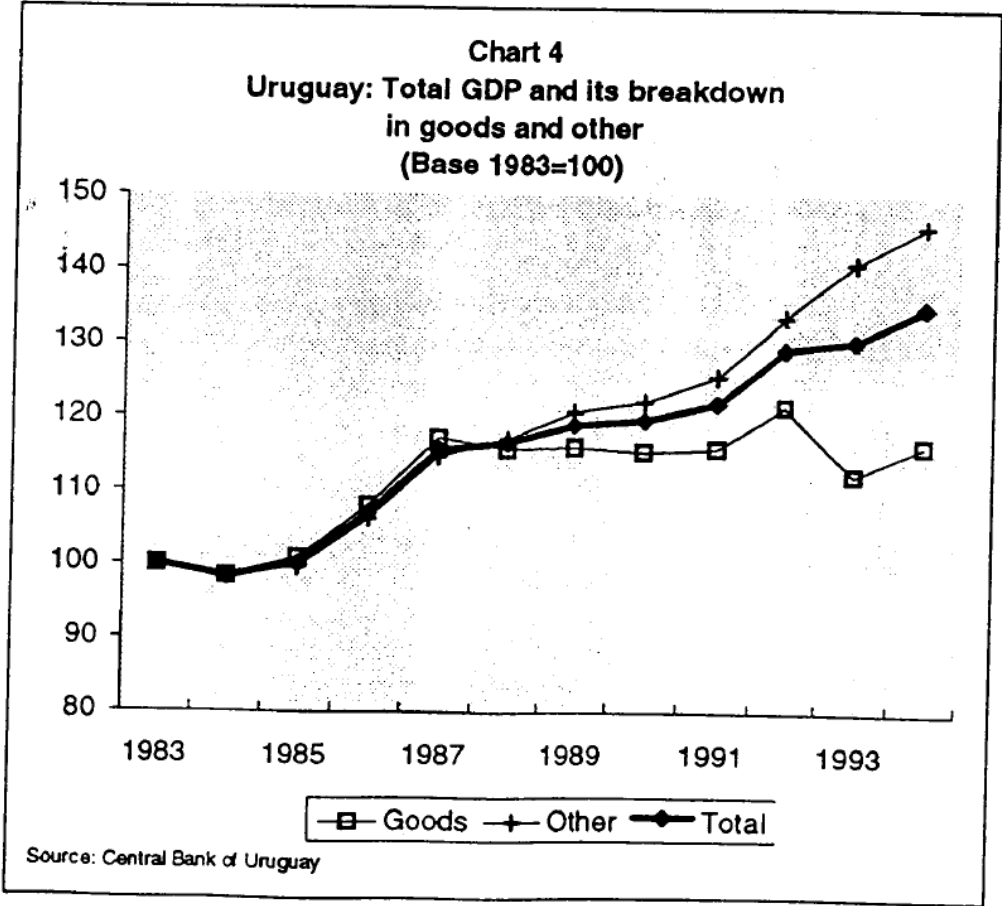
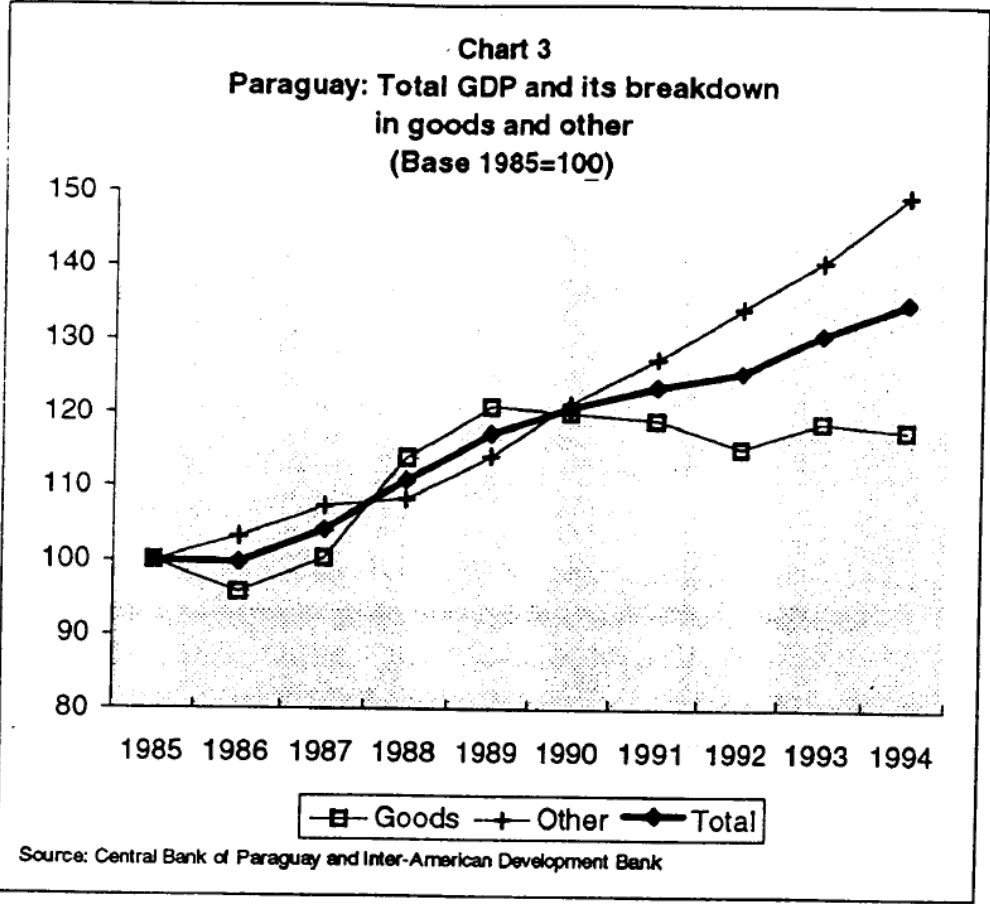
The strong link between the non-tradables of Argentina and Uruguay is the principal explanation of the fast growth of the services sector in the last country, which annual rate of growth between 1990 and 1994 was 4,5% on average (Chart 4)³. The goods producer sector grew scarcely at an annual average rate of 0,2%. On the other hand, in Argentina the rates of growth in the goods production sector and in the services sector were higher and not so diverse as in the case of Uruguay: the average growth rate of the services sector was 8,1% per year between 1990 and 1994, and in the goods sector was 5,6% per annum (Chart 1).

In Brazil, the services sector grew faster than the goods producers sectors during the years of the Cruzado Plan, an stabilization effort that took place in the mid-eighties. After that, the evolution of goods and services was similar, but in the recession of 1990 the services sector performed better. The Plano Real made another impulse to internal consumption and improved the performance of the services sectors again (Chart 2). In Paraguay, the goods producer sector was almost stagnated since the late eighties (it dropped at an annual average rate of 0,5% between 1989 and 1994), while the services sector grew at an average annual rate of 5,6% since that period. On average, the Paraguayan GDP grew at an annual rate of 2,9% since 1989 (Chart 3).

² The inflation in Uruguay is still higher than 20% a year.

³ The services sector includes utilities and construction, wholesale and retail trade and hotels and restaurants, transport and communication, financial intermediation, real estate, renting, business services public administration, defense and compulsory social services, education, health and social work, and other community, social, personal service activities. The statistical offices of the countries do not usually consider the construction as a service sector.





Because of its rapid growth during the nineties, Uruguay has the most important services sector in the Mercosur in relative terms. Its contribution to the GDP, about 68% in 1994, is similar to that of developed countries, which is around 72%⁴. By the other hand, in Argentina and Brazil the contribution of services to GDP was about 64% and 62% respectively in 1994 and were closer to the average figures in developing countries, where the contribution of services to GDP is 58%. In Paraguay, the size of the services sector is similar to the average of the developing countries, but is also growing very fast since 1990. In the Mercosur countries as a whole, the figures are strongly influenced by Brazil and services represented about 63% of GDP in 1994 (see Charts 5 to 9).

The international transactions in services in the Mercosur countries is the counterpart of the developing of the non tradable sector over the last years. Exports of services grew at a faster rate than exports in merchandises in the countries of the Mercosur since the mid eighties. In the period 1986-1993, exports of merchandises grew at an average annual rate of 8,6% in current dollars, while the exports of “invisibles” grew at an average annual rate of 13,1% (see Table 1). If services transactions identified in the current account are divided between “investment income”, “transfers”, “official transactions” and “commercial services”, we find that the last category, which includes transport, travel and other private services⁵, grew at an average annual rate of 10,7% in current dollars.

Transport services is the most important item between the commercial services, as it represents the 46% of the exports of this category. But it lost participation during the last decade as the receipts from travel grew at a faster rate since 1986. The average annual growth rate of travel was 13,3% in the 1986-1993 period, while transport grew at an average rate of 8,4%, similar to that of merchandises. Brazil and Uruguay registered the faster rates of growth in exports of travel services, while in Argentina and Paraguay the balance of this item was deteriorated in the period under analysis. Meanwhile, the “other services” grew at an average annual rate of 13,5% in this period (see Table 2).

Travel in “invisibles” has a strongly negative balance for the countries of the Mercosur as a whole, and is also very negative in “commercial services”. But the consolidated figures are influenced by the current account of Brazil, the largest partner and the main importer of services in the Mercosur. In the cases of Paraguay and Uruguay the trade in “invisibles is almost balanced, becoming positive in the former country since 1992.

⁴ See *Liberalizing International Transactions of Services: A Handbook* – United Nations and The World Bank, Chapter I.

⁵ Other private services is short of “other goods and services”. In this paper we include in this category labor and property income, as reported by GATT. In the fifth edition of the IMFs Balance of Payments Manual (1993) the labor income is not listed as a service. Other goods and services also include advertising, brokerage, communications, leasing (other than charters), management, merchanting, non-merchandise insurance, processing and repair, professional and technical services and subscriptions to periodicals. Obviously, the important limitations in balance-of-payments statistics for services result in a significant downward bias in services-trade data.

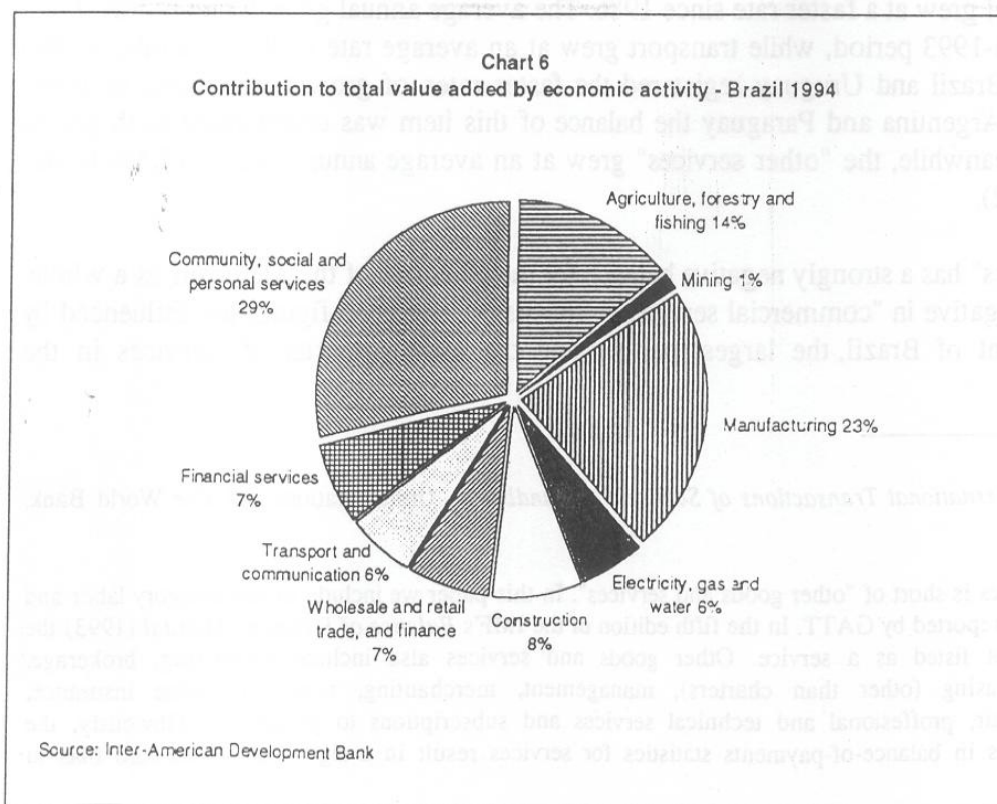
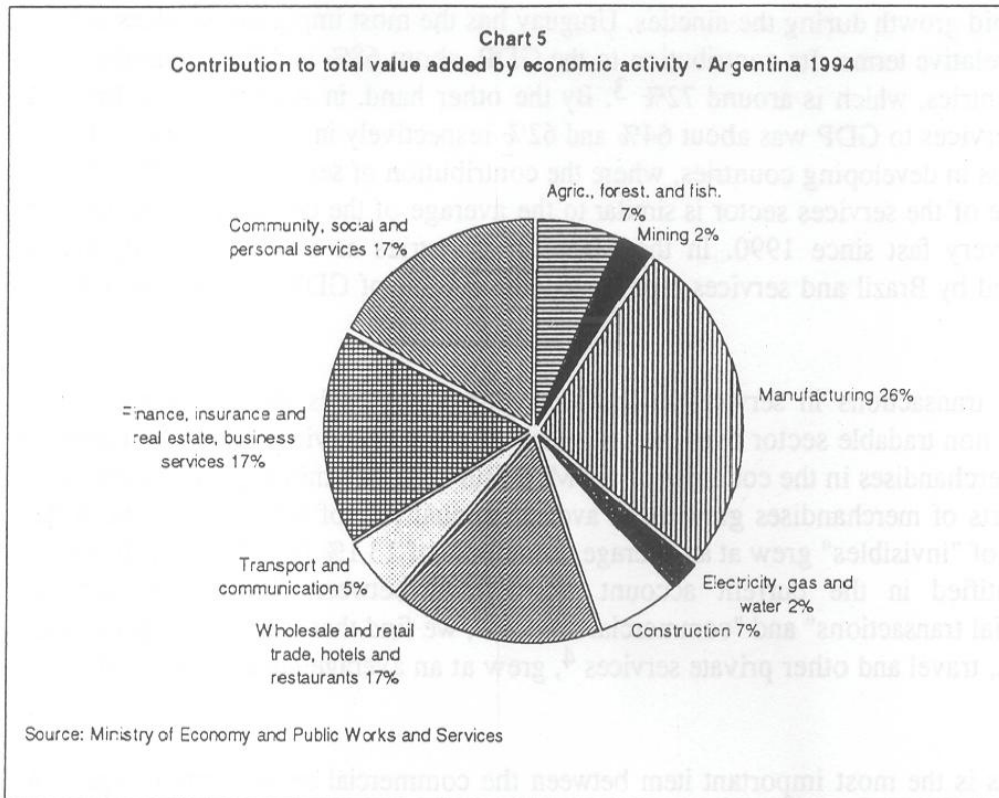
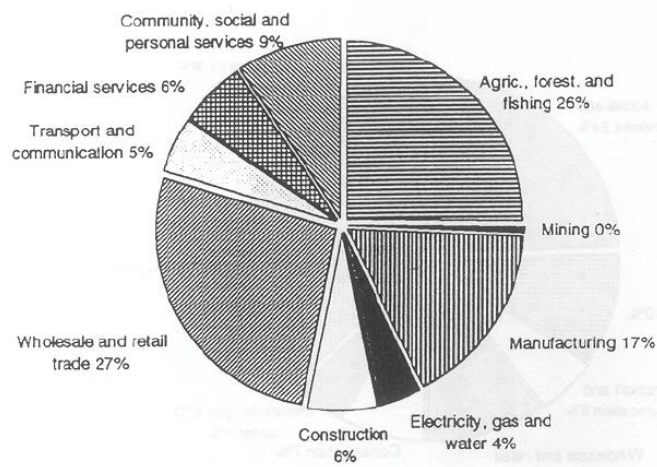
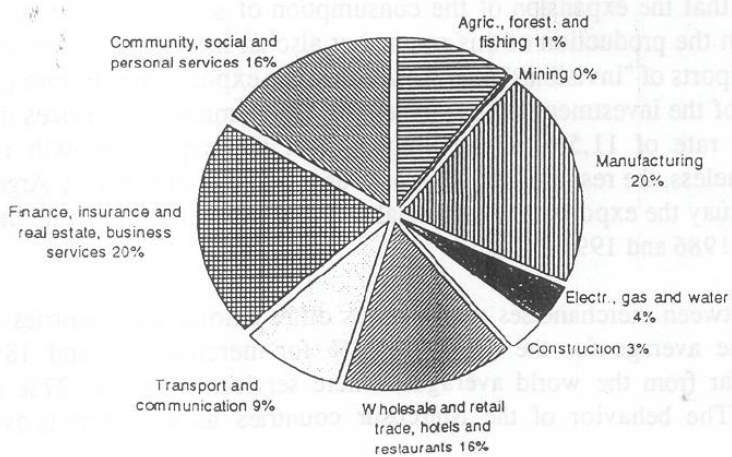


Chart 7
Contribution to total value added by economic activity - Paraguay 1994

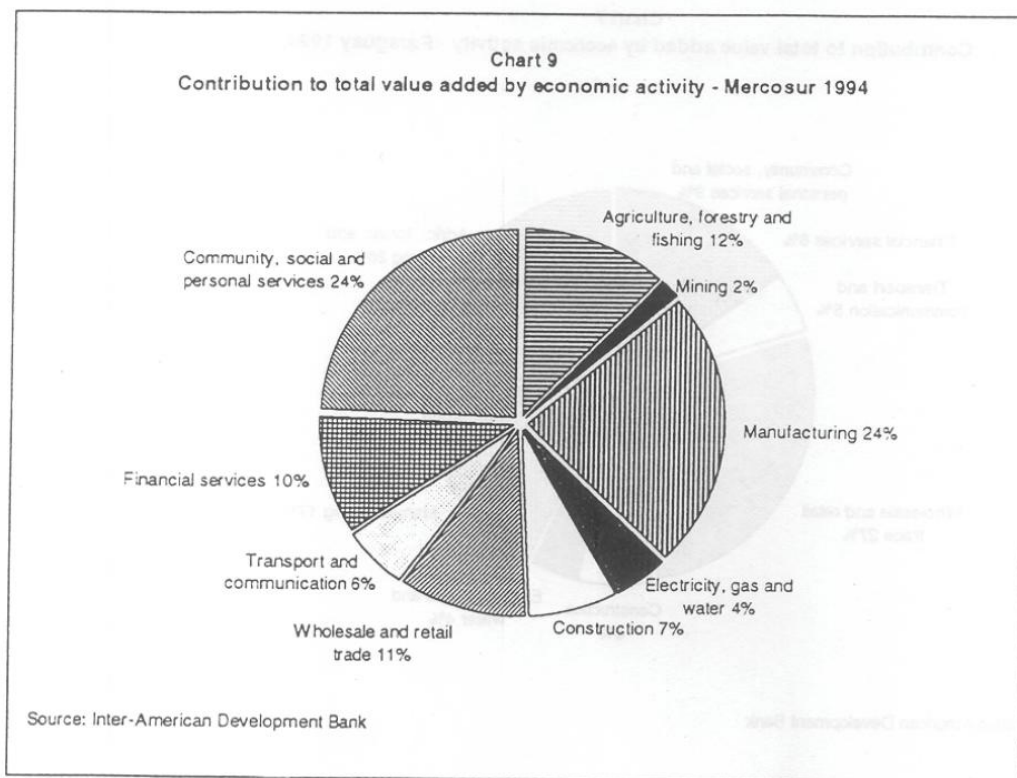


Source: Inter-American Development Bank

Chart 8
Contribution to total value added by economic activity - Uruguay 1994



Source: Central Bank of Uruguay



It is important to point out that the expansion of the consumption of services in the Mercosur promoted not only a boom in the production of this sector but also an increment of the imports. The annual growth rate of imports of “invisibles” was slower than the exports growth rate (3,7%), but it reflects the constancy of the investment income expenses. The commercial services imports grew at an annual average rate of 11.5%, slightly higher than the exports growth rate of commercial services. Nevertheless, the result of the Mercosur as a whole is affected by Argentina. In Brazil, Paraguay and Uruguay the exports of commercial services grew at a faster rate than the imports of this kind between 1986 and 1993⁶

The composition of trade between merchandises and services differ among the countries of the Mercosur (see Table 3). The average for the region is 82% for merchandises and 18% for invisibles in exports, too far from the world averages, where services represent 37% of the current account transactions. The behavior of the Mercosur countries as importers is over the world average figures: in the 1986-1993 period, imports of “invisibles” represented the 50% of the debits in the current account.

⁶ Probably, after the implementation of the Plano Real in Brazil in 1994, a deterioration in the balance of commercial services can be observed, specially in travel. But this data was not available at the time of this report.

Table 1
Trade in Merchandise and invisibles
Mercosur countries 1986-1993
(Millions of dollars)

Item	1986		1990		1993	
	Debit	Credit	Debit	Credit	Debit	Credit
Current Account, of which	45101.2	36615.2	58685.5	59347.1	78159.7	68714.8
Merchandise FOB	20128.7	30863.6	27289.7	46837.2	46045.9	55127.0
Invisibles	24972.5	5751.8	31295.8	12509.9	32113.8	13587.8
Of which:						
Investment income	17363.4	1468.5	19714.7	3332.3	16380.5	2840.9
Official transactions	596.9	155.0	1111.1	258.2	598.1	344.6
Unrequited transfers	85.1	210.5	67.0	1962.7	265.2	2431.0
Commercial services	6927.1	3917.6	10403.0	6956.7	14870.0	7971.3
Of which:						
Transport	3014.4	1994.8	4461.5	2751.5	6386.0	3502.6
Shipment	888.6	904.1	1316.5	1182.5	2737.7	1563.4
Passenger services and other	2125.3	1090.7	3145.0	1569.0	3648.3	1939.2
Travel	1703.8	1053.1	2890.4	2652.1	4553.7	2531.2
Other private services	2208.9	869.7	3051.1	1553.1	3930.3	1937.5
Of which:						
Labor and property income	485.9	73.7	1422.1	556.8	187.0	7.0
Labor income	23.0	53.7	5.0	43.8	0.0	0.0
Property income n.i.e.	462.9	20.0	1417.1	513.0	187.0	7.0
Other services	1723.0	796.0	1629.0	996.3	3743.3	1930.5

Source: IMF Balance of Payments Statistics and Annex A

Table 2
Trade in Merchandise and invisibles
Mercosur countries 1986-1993
(Average nominal rate of change)

Item	Mercosur		Argentina		Brazil		Paraguay		Uruguay	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Current Account, of which										
Merchandise FOB	12.5%	8.6%	19.7%	9.7%	9.0%	8.2%	17.5%	14.6%	14.6%	6.9%
Invisibles	3.7%	13.1%	4.2%	13.0%	3.2%	13.1%	8.9%	15.5%	4.3%	11.9%
Of which:										
Investment income	0.8%	9.9%	-0.9%	22.6%	-0.8%	1.3%	-3.6%	-5.2%	0.2%	15.2%
Official transactions	0.0%	12.1%	-4.3%	22.5%	1.6%	-2.4%	-27.3%	-31.1%	12.2%	-7.9%
Unrequited transfers	17.6%	41.8%	34.5%	61.3%	8.2%	42.4%	-9.4%	19.9%	8.9%	1.4%
Commercial services	11.5%	10.7%	11.6%	6.1%	11.6%	12.7%	15.0%	19.1%	7.2%	12.2%
Of which:										
Transport	11.3%	8.4%	15.1%	6.7%	9.1%	7.4%	13.4%	41.4%	17.1%	22.2%
Shipment	17.4%	8.1%	40.7%	-1.3%	11.7%	8.8%	14.9%	18.8%	17.0%	41.8%
Passenger services and other	8.0%	8.6%	7.4%	9.2%	7.8%	5.3%	6.2%	80.4%	17.2%	16.3%
Travel	15.1%	13.3%	15.6%	5.9%	17.5%	43.1%	16.3%	4.7%	-4.2%	8.2%
Other private services	8.6%	12.1%	-2.9%	4.5%	12.1%	11.5%	30.2%	39.6%	6.6%	8.3%
Of which:										
Labor and property income	-12.8%	-28.6%	-11.5%	-24.0%	-100.0%	-100.0%	nc	-100.0%	-100.0%	nc
Labor income	-100.0%	-100.0%	-100.0%	-100.0%	-100.0%	-100.0%	nc	-100.0%	nc	nc
Property income n.i.e.	-12.1%	-13.9%	-10.9%	-11.1%	-100.0%	-100.0%	nc	nc	-100.0%	nc
Other services	11.7%	13.5%	6.3%	7.3%	12.5%	11.9%	30.2%	49.3%	8.4%	8.3%

Source: IMF Balance of Payments Statistics and Annex A

Brazil is the main importer of services in absolute value, but Argentina is in relative terms the most intensive importer of “invisibles”. In this country, services represented 55% of all debits to the current account in the period under consideration. On the other hand, Paraguay and Uruguay are more intensive exporters of services, and “invisibles” represented almost one third of the current account credits in the 1986-1993 period. In Uruguay, besides, exports of services had been growing at a faster rate since 1990, and in 1993 reached 41% of the credits in the current account, the sole country in the Mercosur where exports of “invisibles” are more intensive than world averages.

Revealed comparative advantage (RCA) indices show that Mercosur countries as a group are relatively more specialized in exports of merchandises and not in “invisibles” in general⁷ (Table 4). This is also true for each country when the average figures of the 1986-1993 are considered, but in the cases of Paraguay and Uruguay the RCA index of merchandises is closer to unity than in Argentina and Brazil. Nevertheless, the Mercosur countries are on average relatively specialized in transport services, mainly because of the influence of Argentina. The RCA index for shipment is above unity for all Mercosur countries except Paraguay, and Argentina and Uruguay have apparent comparative advantage in passenger services and other transportation.

When the figures of 1993 are considered, Uruguay appears as the only country in Mercosur with revealed comparative advantage in “invisibles” as a whole. Uruguay and Paraguay showed revealed comparative advantage in commercial services in 1993, and Argentina lost its comparative advantage in this sector in the period 1986-1993.

Considering the RCA indices only in the context of the Mercosur countries, Argentina, Paraguay and Uruguay show revealed comparative advantage in commercial services with respect to Brazil. However, Argentina had experimented some deterioration in this index and Brazil shows a tendency of improvement in its comparative advantage in travel services (see Table 5).

The Mercosur Negotiations

The Asuncion Treaty, which established the main regulatory principles of the liberalization process in the Mercosur, foresaw the opening of the goods and services markets within Argentina, Brazil, Paraguay and Uruguay. The fall in the tariff barriers to trade was explicitly established in the Asuncion treaty, and the reduction of tariffs and the elimination of the products initially exempted was carried out without accidents until December of 1994, when the Ouro Preto Treaty confirmed the formation of a custom union by the end of the century. A new agenda of elimination of all the remaining exemptions to free trade inside the Mercosur and convergence of the national tariffs to a Common External Tariff, suitable for third countries, was established. In spite of the great progress in opening the trade in goods, little had been done with regard

⁷ The revealed-comparative-advantage (RCA) index is defined as the ratio of exports of a given “product” to a country’s total exports divided by a similar ratio for the world. An RCA index above unity indicates that the country is relatively specialized in the “product” in question.

to trade in services. The agenda of Las Leñas established that by the end of 1993 a General Agreement for Services⁸ in Mercosur had to be proposed to Common Market Group, the higher authority in the negotiation process. This task was entrusted to the Working Group 10 (WG10), on harmonization of macroeconomic policies. The WG10 created an Ad Hoc Committee to carry out the negotiation in services.

Table 3
Composition of world and countries of Mercosur Trade
(Percentage)

Item	World		Mercosur		Argentina		Brazil		Paraguay		Uruguay	
	1986	1993	1986	1993	1986	1993	1986	1993	1986	1993	1986	1993
Credit (exports)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Merchandise	65.5	62.2	84.3	80.2	77.3	73.5	88.4	84.9	68.4	67.2	66.6	59.1
Invisibles	34.5	37.8	15.7	19.8	22.7	26.5	11.6	15.1	31.6	32.8	33.4	40.9
Of which:												
Investment income	12.9	14.9	4.0	4.1	4.1	8.4	3.8	2.3	6.7	1.8	5.7	8.5
Official transactions	1.4	0.9	0.4	0.5	0.8	1.6	0.3	0.1	0.8	0.0	1.0	0.3
Unrequited transfers	4.7	4.9	0.6	3.5	0.2	3.3	0.6	3.8	1.4	1.9	1.8	1.1
Commercial services	15.5	17.0	10.7	11.8	17.6	13.2	7.0	8.9	22.6	29.1	24.9	31.0
Transport	4.7	4.3	5.4	5.1	8.4	6.6	4.6	4.2	0.7	3.0	5.3	12.1
Shipment	2.1	1.8	2.5	2.3	2.5	1.1	2.6	2.6	0.6	0.8	0.7	4.7
Passenger services and other	2.6	2.4	3.0	2.8	5.9	5.5	1.9	1.5	0.1	2.2	4.6	7.3
Travel	4.5	4.9	2.9	3.7	5.3	4.7	0.3	2.3	17.6	9.2	15.8	15.2
Other private services	6.4	7.9	2.4	2.8	2.9	1.9	2.0	2.4	4.3	17.0	3.7	3.7
Labor income	0.4	0.4	0.1	0.0	0.4	0.0	0.0	0.0	1.6	0.0	0.0	0.0
Property income n.i.e.	0.5	0.7	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other services	5.5	6.8	2.2	2.8	2.3	1.9	2.0	2.4	2.7	17.0	3.7	3.7
Debit (Imports)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Merchandise	64.1	60.6	44.6	58.9	37.6	61.4	45.9	55.5	71.6	80.1	51.2	67.1
Invisibles	35.9	39.4	55.4	41.1	62.4	38.6	54.1	44.5	28.4	19.9	48.8	32.9
Of which:												
Investment income	13.8	15.9	38.5	21.0	40.7	17.7	39.5	24.6	9.7	2.7	24.2	12.4
Official transactions	1.7	1.1	1.3	0.8	1.8	0.6	1.2	0.9	0.8	0.0	1.2	1.4
Unrequited transfers	5.1	5.5	0.2	0.3	0.2	0.6	0.2	0.2	0.1	0.0	0.3	0.2
Commercial services	15.3	16.9	15.4	19.0	19.7	19.7	13.2	18.5	17.8	17.2	22.1	18.9
Transport	5.4	5.1	6.7	8.2	6.4	7.9	6.5	7.9	13.1	11.5	7.1	10.8
Shipment	2.9	2.6	2.0	3.5	0.7	3.5	2.1	3.0	10.5	10.0	2.9	4.3
Passenger services and other	2.5	2.5	4.7	4.7	5.7	4.3	4.5	5.0	2.7	1.5	4.2	6.5
Travel	4.2	4.7	3.8	5.8	7.6	9.7	1.9	4.0	4.0	4.1	10.9	4.1
Other private services	5.8	7.2	4.9	5.0	5.8	2.2	4.7	6.9	0.7	1.6	5.1	4.0
Labor income	0.4	0.5	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property income n.i.e.	0.5	0.6	1.0	0.2	3.6	0.7	0.1	0.0	0.0	0.0	0.6	0.0
Other services	4.8	6.1	3.8	4.8	2.0	1.4	4.6	6.9	0.7	1.6	4.5	4.0

⁸ In Spanish, an "Acuerdo Marco sobre servicios"

Source: MF Balance of Payments Statistics and Annex A

The Ad Hoc Committee obtained rapid progress in the identification of the regulations in services in force in the four countries of the Mercosur and in the determination of the critical issues in the negotiation of a General Agreement. By the end of 1993 the Ad Hoc Committee raised to the Common Market group its main results and conclusions and asked for an extension in its works along 1994. But because of the priority granted to the negotiation in goods and the making of the Common External Tarriff, the Ad Hoc Committee in services received little feed-back from the Common Market Group and WG10 in 1994.

Table 4
Revealed comparative advantage of Mercosur countries
respect to the world average

Item	Mercosur		Argentina		Brazil		Paraguay		Uruguay	
	1986	1993	1986	1993	1986	1993	1986	1993	1986	1993
Merchandise	1.286	1.289	1.180	1.181	1.349	1.364	1.044	1.080	1.017	0.950
Invisibles	0.456	0.523	0.658	0.702	0.336	0.401	0.917	0.869	0.967	1.083
Of which:										
Investment income	0.311	0.277	0.315	0.563	0.294	0.154	0.523	0.118	0.440	0.570
Official transactions	0.312	0.547	0.566	1.718	0.187	0.129	0.596	0.025	0.732	0.339
Unrequited transfers	0.122	0.726	0.050	0.686	0.124	0.789	0.300	0.391	0.384	0.228
Commercial services	0.690	0.681	1.136	0.774	0.449	0.521	1.461	1.709	1.604	1.817
Transport	1.169	1.188	1.801	1.531	0.983	0.973	0.150	0.699	1.142	2.813
Shipment	1.191	1.236	1.187	0.605	1.277	1.437	0.292	0.415	0.355	2.565
Passenger services and other	1.151	1.152	2.294	2.227	0.748	0.625	0.037	0.913	1.773	3.000
Travel	0.646	0.755	1.423	0.961	0.075	0.468	3.953	1.883	3.545	3.126
Other private services	0.372	0.358	0.451	0.246	0.320	0.308	0.679	2.153	0.587	0.464
Labor income	0.382	0.000	0.941	0.000	0.082	0.000	4.241	0.000	0.000	0.000
Property income n.i.e.	0.114	0.015	0.375	0.058	0.033	0.000	0.000	0.000	0.000	0.000
Other services	0.394	0.411	0.423	0.278	0.362	0.354	0.490	2.478	0.679	0.534

Source: IMF Balance of Payments Statistics and Annex C

Table 5
Revealed comparative advantage of Mercosur countries
respect to the Mercosur average

Item	Argentina		Brazil		Paraguay		Uruguay	
	1986	1993	1986	1993	1986	1993	1986	1993
Merchandise	0.917	0.916	1.049	1.058	0.811	0.837	0.791	0.736
Invisibles	1.444	1.342	0.738	0.766	2.013	1.660	2.123	2.069
Of which:								
Investment income	1.013	2.035	0.946	0.556	1.682	0.426	1.416	2.061
Official transactions	1.813	3.139	0.598	0.236	1.908	0.045	2.345	0.619
Unrequited transfers	0.412	0.945	1.018	1.088	2.458	0.538	3.154	0.314
Commercial services	1.646	1.138	0.651	0.766	2.117	2.512	2.324	2.670
Transport	1.541	1.289	0.841	0.819	0.129	0.589	0.977	2.368
Shipment	0.996	0.490	1.072	1.163	0.245	0.336	0.298	2.076
Passenger services and other	1.993	1.933	0.649	0.543	0.032	0.793	1.541	2.604
Travel	2.205	1.273	0.117	0.620	6.124	2.493	5.492	4.139
Other private services	1.211	0.687	0.861	0.859	1.825	6.013	1.579	1.296
Labor income	2.462	nc	0.216	nc	11.094	nc	0.000	nc
Property income n.i.e.	3.305	3.849	0.290	0.000	0.000	0.000	0.000	0.000
Other services	1.074	0.676	0.919	0.862	1.246	6.034	1.725	1.301

Source: IMF Balance of Payments Statistics and Annex D

After the sign of the Ouro Preto Treaty and the effective launching of the Mercosur since January 1st. 1995, the main attention in the negotiations was put on the problems imposed on the external equilibrium of this countries, specially in Argentina and Brazil, because of the Mexican crisis. So, during the first part of the year the attention was concentrated on the proposals of Argentina and Brazil on the application of non-tariff barriers to discourage imports, and on the effects of some modifications in Brazilian tariffs for some goods. Specially conflictive was the issue of the automobile industry, a sector which regulation intra-Mercosur was postponed in the Ouro Preto Treaty.

When the tempest soothed, a new Ad Hoc Group on services began to work in September on the tasks ordained by the Common Market Group Resolution 20/95. The priority task of this Group is to elaborate a General Agreement on Services for Mercosur. The agenda of the Ad Hoc Group includes the following topics:

1. General norms and principles
2. Liberalization mechanism.
3. Institutional provisions and dispute settlement.
4. Analysis of complement norms related with sectors included in the Sectorial Annexes of the General Agreement on Trade in Services (GATS).

Discussion of main issues

All the members of the Mercosur coincide in elaborate a General Agreement on Services that follows the principles established in GATS. Nevertheless, some particular aspects became controversial.

1. **Most-Favoured-Nation Treatment.** One of the controversial aspects of the negotiation has been the application of the Most-Favoured-Nation (MFN) Treatment. There were two proposals, one adopting an unconditional MFN Treatment in the Mercosur, a mirror image of the Article II of the GATS, and other establishing a non-turning back MFN Treatment. In this second proposal, the preferential agreements celebrated with third countries before the Agreement on Services in the Mercosur will not be affected by the MFN Treatment. There is a problem here with the preferential agreements established with other countries of ALADI. The Ad-Hoc Group asked to ALADI for information on preferential agreements in the area.

2. **Mechanism of liberalization.** Another controversial aspect was the mechanism of liberalization within the Mercosur. Mainly three alternatives were analyzed, first by the Ad-Hoc Committee of Services in the WG10 and since 1995 by the Ad-Hoc Group of Work on Services. The first alternative foresaw a complete liberalization on services, with general principles that guaranteed free access to markets and National Treatment for all services sectors since the Agreement takes effect. Nevertheless, a list of exemptions could be introduced by the members, with a schedule for gradual reduction.

The second alternative was exactly the opposite. The General Agreement would established general obligations and disciplines and guaranteed free access to markets and National Treatment, within a period of time. In the meantime, restrictions would be eliminated according to a schedule. The third alternative was similar to the second, adopting a gradual liberalization mechanism which involve the periodical definition of “positive lists” of sectors to liberalize. For example, in the first round a list of sectors to be liberalized will be defined, and a specific working group will be in charge to define a calendar of liberalization for each sector. In the second round, the working groups will conclude the definition of schedule and a second list of commitments will be elaborated. In the third round, the program of liberalization for the sectors of the first list will be implemented, the working groups define the schedule for the second list and third list will be elaborated, and so on.

The main problem with the adoption of the mechanism of liberalization is whether the Mercosur can be considered to has “substantial industry coverage, provide for national treatment for the industries involved and do not result in higher external barriers for services and services suppliers originating in non-members states”, as is foreseen in the Article V of GATS on economic integration.

This discussion was in great part overcome because the Argentinean and Uruguayan schedules of specific commitments in the GATS was so wide that any initial schedule of commitments in the Mercosur will be large enough to secure “substantial industry coverage”. The Ad-Hoc Group is now analyzing the specific commitments in the GATS made by the members of the Mercosur to find sectors or subsectors where preferential treatment can be granted to the other partners. Accordingly with the last meeting of the

Ad-Hoc Group, the negotiators of the four countries will analyze the making of a schedule of initial commitments for certain sectors which liberalization process will begin after the sign of the Agreement on Services. During a time of 10 years, the market of services would be completely free within the Mercosur.

3. **Rules of origin.** An important point that determines to what extent the Mercosur will discriminate against foreign supply of services is that of the rules of origin. It has to be stressed that the negotiators considered, at a certain moment, the distinction between a *free trade area* and a *custom union* in services like in goods. The Ad-Hoc Committee analyzed whether a rule of origin must be applied when the members of the Mercosur maintain its own regulations with regard to the third countries. In December 1993 the Ad-Hoc Committee decided that an explicit mention about rules of origin should be introduced in the General Agreement, with application to all sectors, but considering the possibility that specific rules could be applied to some of them. In April 1994, the Brazilian negotiators proposed that a standard for classification should be the composition of capital and the control of the firm. They suggested that at least 80% of capital and the effective control of the firm should belong to Mercosur citizens.

This issue, which may be transformed in a strong barrier to foreign access to Mercosur markets, is still discussed. Following the approach adopted in the Uruguay Round negotiations, measures to protect domestic providers of a service can be separated into two broad categories: those that affect market access and those that influence national treatment. At the present stage of the negotiations, each country of the Mercosur could establish its own rules of access to markets, but the status of “national firm” in Mercosur terms would be more restrictive.

It is important to stress that a “rules of origin” regime in services would be much more distortionary than it is in the case of trade in goods in the configuration of a custom union. In the latter case, it acts as a non-tariff barrier and discriminates against the non-member countries production. But in the case of services, it introduces biases against certain firms in the *domestic markets*, discriminating against those firms that do not fulfill the requirements to be considered “national” in Mercosur terms.

In other regional trade agreements, the concept of origin is not present explicitly. The usual criteria is to consider “national” any firm which address is in one of the member countries, so this point of discussion is unusual in Mercosur terms. Furthermore, a “rules of origin” regime in the Mercosur will have negative implications for foreign investment, a point that is also unusual in the making of custom unions, where many times the external tariff is seen as a way to stimulate foreign direct investment, avoiding the effect of the tariff in the access to the domestic market by producing goods domestically.

If the Mercosur adopts restrictions to grant national treatment to foreign investments in services, many of the benefits of trade creation that this agreement looks for will be lost. First, if we think in terms of consumption activities rather than in consumption of goods, strategies of product differentiation make as important the service content in those activities as the good that is being consumed itself. So restrictions to market access and national treatment in services can reduce the benefits from trade liberalization in goods. Second, much of the spillover effects of innovation and

technological progress in industrial countries is contained in the form of services. So, restrictions to foreign investment in services can be prejudicial to technological progress in developing countries. Third, given the high content of services in the production of tradable goods, a large availability of services of good quality is an important factor to improve competitiveness of exports.

Conclusions

The services have won participation in the GDP of Argentina, Paraguay and Uruguay and have been one of the most dynamic industries in these countries during the stabilization efforts that took place since the beginning of the nineties. The balance of payments figures show some degree of revealed comparative advantage in commercial services in Argentina, Paraguay and Uruguay, in terms of Mercosur average, but only Paraguay and Uruguay maintain this category in term of world average standards.

The negotiation of trade liberalization in services in the Mercosur did not have much progress since 1991. The agenda foresee the making of a General Agreement of Services for the Mercosur, that in the most part will follow the principles adopted in GATS. But some important issues remain unsolved, like the Most Favoured Nation treatment, the mechanism of liberalization and the introduction of some rules of origin. This last issue is the most important from an effective liberalization point of view, because if it is accepted, there will be a reversal in the unilateral process of liberalization that Argentina, Paraguay and Uruguay accomplished recently. Also, it will introduce a discrimination against foreign suppliers in the market of services of the Mercosur countries.

The figures showed in the paper suggest that Argentina, Uruguay and maybe Paraguay will be benefited from a vast liberalization of services in the Mercosur. But even the industrial development of Brazil depends on the availability of services. So, it is expected that the negotiations in services in the future will not be concentrated in the issue of rules of origin, but in the harmonization of the rules to market access in each country. That will be specially hard in those sectors where market failures issues like asymmetric information and moral hazard problems may justify some regulation from the public sector, like in the financial and insurance sector.