"REGIONAL INTEGRATION IN LATIN-AMERICA: The MERCOSUL`s Impacts in Regional Trade Flows"

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Regional Integration in Latin-America:

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Abstract

MERCOSUR is one of the youngest regional integration agreements, gathering two of the largest and most developed latin-american economies (Argentina and Brazil). The unparalelled growth of intra-regional trade is one of the most visible results of this agreement, raising the question of whether or not this type of integration scheme distorts regional trade flows. In fact,

This papers approaches the MERCOSUR Regional Agreement, showing its efforts, main goals and tries to conclude if its impressive growth in regional trade distorts or not the patterns of trade flows in the region.

Applying different sets of empirical methodologies, it is found that intra-MERCOSUL trade growth is mainly, the result of Trade Creation, therefore not affecting in a negative way international trade flows.

Kewords: Economic Integration, Trade: Forecasting and simulation, Trade: other; Country and Industry Studies of Trade

1 - Introduction

Latin American Regional Integration Agreements have already a long and painful history, often ending with a negative outcome. This was the result of particular economic structure, developed by the latin-american republics through 1945 to 1982[2].

With that structure overcome by a wide range of economic and political changes experienced by the majority of these countries, new conditions were created in order to implement a sucessfull relaunch of new latin-american integration schemes, within an open and global world economy.

In 1985, the two major South American economic powers, Argentina and Brazil, began serious negotiations, experimenting different approaches toward economic integration. This is how the MERCOSUR Trade Agreement was born, being one of the latest integration schemes in Latin America, that opposite to previous experiences has become a stronghold in economic integration.

[1] This paper is based upon a Master Degree Thesis in International Economics (ISEG-UTL), written by the author in 1999 under the supervision of Prof. Maria Antonina Lima.

[2] See Bulmer-Thomas (1995)

This paper tries to illustrate MERCOSUR trade effects, resorting to "traditional" trade effects' measurement methodologies. The first section shows MERCOSUR evolution, efforts and goals since the initial approach between Argentina and Brazil, the Assunción Treaty, that founded this regional Agreement to its actual stage. The second section is where it is applied a range of trade impacts' methodologies, showing the effects of Trade Creation (TC) and Trade Diversion (TD) within MERCOSUR. The third and last section derive a conclusion from what was applied.

2 - MERCOSUL: Efforts and Main Goals

Although being neighbours and sharing common natural resources and boundaries, Argentina and Brazil never faced each other in serious friendly talks, rather developed an extensive rivalry, that can be traced since the Tordesillas Treaty in 1494[3]. For almost 500 years, these two nations engaged in a series of conflicts, and each of them wanted to play the role of *the* South American regional power. In doing so, they opted in *"living with their back turned to each other"* as Ferrer (1995) well states.

During the twentieth century, both nations developed vast industrial sectors, resourcing to autarkic policies, generally known as the Import Substitution Model[4]

Only after the authoritarian regimes collapsed in Argentina (1983) and Brazil (1985), began approaching talks between the two powers, with the Foz do Iguaçu joint statement, in which they "...*"expressed their firm political decision in speeding up the bilateral integration process and to explore new ways of forming a latin-american regional economic space"* (In Ferrer, 1995; pp 821).

In March 29th 1991, it is signed the Assuncion Treaty, that expands the bilateral talks among Argentina and Brazil to other two neighbouring nations: Paraguay and Uruguay. This Treaty was the founding document of MERCOSUL[5] (Southern Cone Common Market).

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[3] The Tordesillas Treaty was signed in 1494 between Portugal and Spain, splitting the Globe in two major influence areas. The dividing meridian crossed South America in what is today Argentina and Brazil, forever marking a conflicting area among these countries.
[4] For more details see Domingues, 1999 - Appendix 1.
[5] For a more detailed chronology, see Ferrer (1995) and Pereira (1996). To a deep understanding of the institutional mechanisms of MERCOSUL see Laird (1997) e Pereira (1996).

Figure 1
The MERCOSUL

FONTE: MCCIS (1998)

The MERCOSUL occupies 70% of South America (see figure 1), from the Amazonian rain forest to Tierra del Fuego. The combined population exceeds 60% of the entire South American population, and its GDP is over 1.019 billion US Dollars[6] (Campbell, 1998). It's geographical size means that MERCOSUL is the major world economic bloc (four times bigger than the EU), according to this criteria

The Assuncion Treaty articles, forecasted a transition period that should end in 1994. During those years, the four nations should apply the necessary measures in order to low all existing tariffs. The tariff cuts should encompass a linear and automatic reduction of the entire tariff barriers applied to all traded goods in the area. In fact, on December 31st 1994, all regional trade barriers had been eliminated, with some exceptions (some goods were considered by the producer countries as highly sensitive and therefore, extended deadlines were applied for its total tariff removal.[7]. The main goal was to achieve the Common Market by January 1st 1995, but this was considered too ambitious, and therefore a more hybrid form was adopted: the participants must adopt a Common External Tariff (CET) applied to imports from partners subject to most

[6] Current Dollars.
[7] Circa 300 products produced by Brazil, Argentina and Uruguay with other 399 Paraguayan products comprise the Common Market's exceptions list. This list is valid until the year 2001.

favoured nation rates (Laird,1997), but have the chance of diverge (in an ascending or descending way) some tariffs until the year 2000. (Olarreaga and Soloaga, 1997).

In that way, by January 1st 1995 a Customs Union and the Common Market came into force, with the implementation of the CET[8]. The Common Tariff covers a total of 8.000 goods and products, ranging from 0% to 20%. Still, there are some exceptions, referring to each nation's sensitive goods, making this integration agreement an imperfect Common Market (or incomplete Common Market) (Olarreaga e Soloaga, 1997).

There are other type of exceptions, such as preferential regime situations, offered to other latin-american republics and specific regional status in some countries[9].

The weighted average tariff level is bound to be at the 11,5%, significant lower than that of the previous existing national tariff levels of each of the four member countries (see table 1).

Table 1
MERCOSUL's Weighted Average Tariff

	External Tariffs 1986a	External Tariffs 1991	External Tariffs 1996	Internal Tariffs 1996b
Argentina	*40,9%*	*12,2%*	*11,8%*	*0,4%*
Brazil	*79,8%*	*21,2%*	*13,1%*	*0,0%*
Paraguay	*20,1%*	*9,4%*	*8,8%*	*0,8%*
Uruguay	*35,8%*	*21,5*	*10,8%*	*0,9%*
MERCOSUL 1-01-1995	-	-	***11,5%***	***0%***

a – *External Tariffs* – Outside MERCOSUL Import tariffs applied
To the year 1996, line MERCOSUL, the plotted value refers to that agreed in the Ouro Preto Protocol
b – Internal Tariffs –Inside Area existing tariffs that still apply, although the Free Trade Agreement.
In line MERCOSUL, the value refers to the agreed goal of 0% (Regional Free Trade)
SOURCE: Adapted from Laird (1997), Olarreaga e Soloaga (1997) and Mendoza (1997)

From the above table, we can see the efforts carried by MERCOSUL nations in such a brief period of time (1986-1996).

In 1986, Brazil was applying a weighted average external tariff of almost 80%. Ten years later, its regional trade is almost totally free, while its exterior trade is taxed

[8] The CET implementation was preceded by the Ouro Preto Protocol, which outlined its status December 1994.

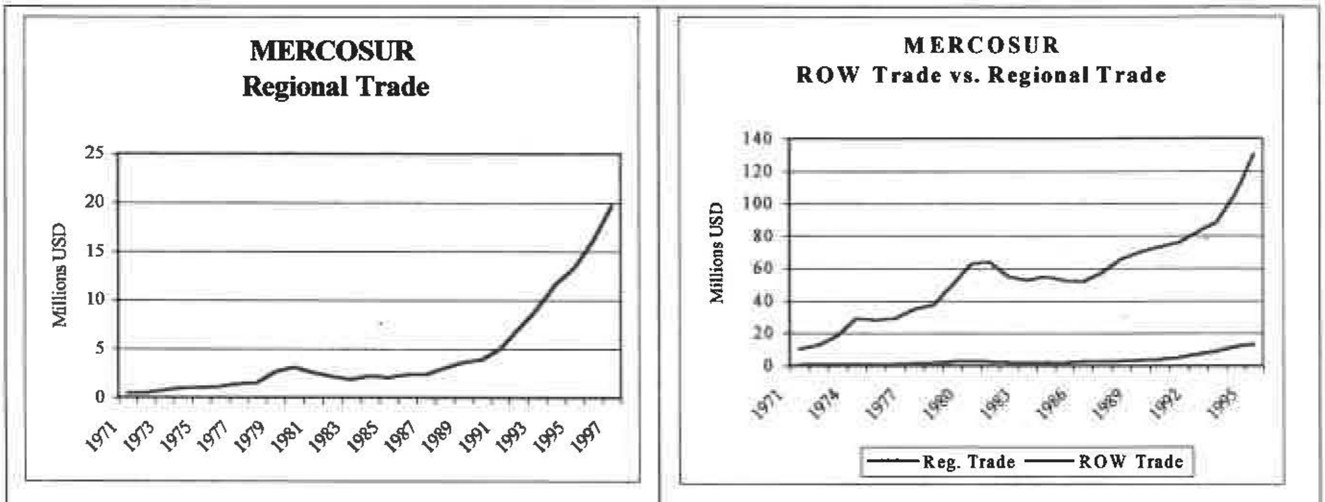
by an advaloren tariff of circa 13%, two percentual points more than the scheduled CET.

It should be stressed out that MERCOSUL's CET is much lower than the average national external tariffs applied by the four member nations before it came into force (with the exception of Paraguay, although its share in total external regional trade is rather small). Moreover, the PEC is far away from the WTO imposed tariff limits (35%)[10].

The results of such efforts in trade liberalization are quite impressive, as shown in graphics 1.

Graphics 1

MERCOSUR Trade (1971-1997)



SOURCE: Authors' own calculations based on CEPPI (1997) data

Regional trade grew from a stagnant two to three billion USD since 1971 to 1988. After this period, and as a result of trade liberalization, regional trade was boosted to almost 20 billion USD in 1997. Also notable is the fact that this growth in regional trade does not substitute trade with the rest of the World, quite the contrary, it reinforces the trend of trade liberalization of this four nations.

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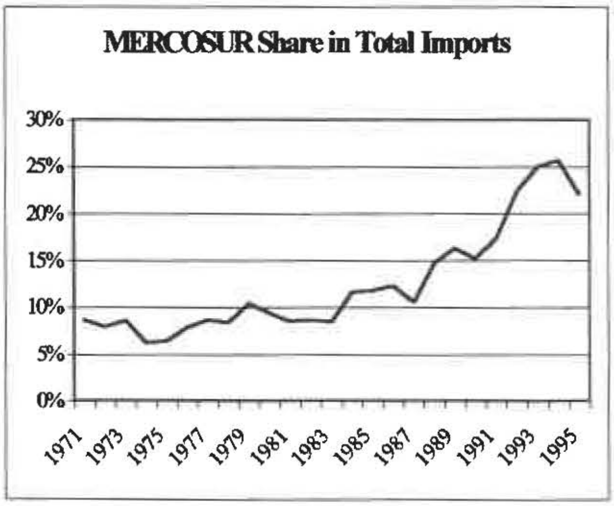
[9] Manaus (Brazil) and Tierra del Fuego (Argentina) are off-shore areas which will keep their status until the year 2013 (Olarreaga e Soloaga, 1997).

[10] MERCOSUL's goals form a wide spectrum of policies, from monetary issues to cultural matters. To those interested in the study of these affairs, please see Laird (1997), Bouzas and Lustig (1992) and Velloso et al (1994).

Also important is the share that MERCOSUR represents in total Imports and Exports of this area.

Graphic 2
MERCOSUL Share in Total Imports and Exports
(1971-1997



SOURCE: Authors' own calculations based on CEPPI (1997) and ONU (1997) data

2 - Regional Trade Impacts upon MERCOSUL formation

In order to evaluate the regional trade impacts upon MERCOSUL formation, since 1995, we employ some methods for quantifying these impacts. The applied methodolgies should be able to 1) **measure intra-regional trade effects**; and 2) **assert some conclusions on whether or not MERCOSUL induces negative effects on external trade with the Rest of the World.**

The chosen methodologies are ex-post models, meaning that the effects' measurement are drawn out through data collected after the integration has occured. These type of analysis encompasses a range of advantages, mainly the fact that they are built in such a way that it is always possible to upgrade them with new available data, being a all-time "ready to use" research and analysis tool (El-Agraa, 1994).

We begin to aplly the *Shares in Apparent Consumption Methodology*, based on the Truman[11] methodology and enriched by the EFTA study[12]. We then use the *Income Elasticity of Import Demand Method*, based upon Balassa (1967).

We end this section with a sectorial impact analysis.

a) Shares in Apparent Consumption

The first of the ex-post applied models is usually labeled as one of the best in terms of Custom Union Theory adjustment. (Africano, 1995).

This model is based upon the construction and analysis of *ratia,* and the subsequent detection of **Trade Diversion** and **Trade Creation** (TD and TC) through the change in actual values from the predicted values estimated by the hypothesis of economic integration absence.

Considering Apparent Consumption (C) equals $C=Y-B+M_w+M_p$, in which Y stands for GDP of the country in study, B its total exports, M_P imports originated in partner countries and M_w imports originated in third countries ($M_w+M_P=M$).

The three *ratia* proposed by Truman, 1969 (in Africano, 1995)[13] were built.

For the *anti-monde*, we chose two different alternatives: the first reports to the initial Truman proposal (simple analysis of changes facing the average *ratia* levels in the pre-integration period). In fact although fallacious[14], its graphical illustration is quite good[15]. The second alternative rests on the EFTA Secretariat proposal[16], in which the hypotetic scenario is normalised through equations.

We therefore have a period of 17 years (n=17), enough to absorb all the long-standing structures of the pre-integration period, and another period of 7 years, capable to show the general outline that economic integration induced in four countries' trade flows.

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[11] Truman. E (1969) – The European Economic Community: Trade Creation and Trade Diversion, *Yale Economic Essays*, vol. 9, pp. 201-257.

[12] See Cardoso (1995), Africano (1995) and El-Agraa (1994). Also see Domingues (1999) Chapter -III.

[13] See equations (1.1), (1.2) e (1.3)

[14] For a critic view see Domingues (1999)- Chapter III.

[15] The pre-integration period chosen is one of the most economic disruptive periods for these economies, mainly the Energy Crisis (1973-1979), the Debt Crisis (1982-1985) and the political and economic liberalization (1984-1988). We therefore can consider this sample as highly representative of the pre-integration period, avoiding some of the main criticisms to this methodology.

[16] EFTA (1992), Les Effects de l'AELE et de la CEE sur les Echanges, *EFTA Bulletin*, Vol. XIII, n.5 Juin.

Built the Domestic Supply *ratio* (equation 1.1), Third Countries' Supply *ratio*(equation 1.2) and Partners' Supply *ratio* (equation 1.3), we achieved their average values for the pre-integration period (1971-1988) and then, compare their changes in the following years (1988-1995).

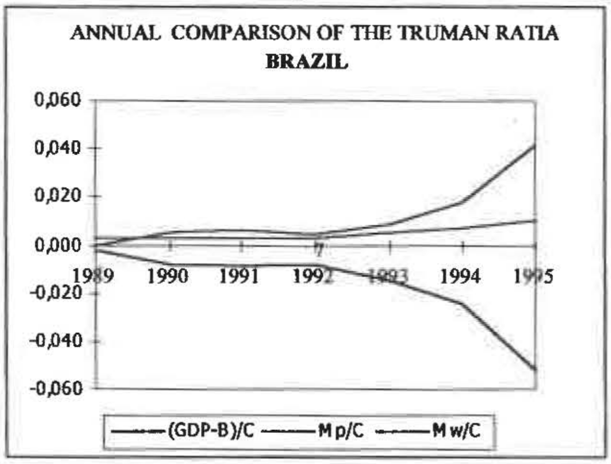
$$\text{Domestic Supply } ratio\text{: } DS = \frac{Y-B}{C} \quad (1.1)$$

$$\text{Third Countries' Supply } ratio\text{: } DW = \frac{M_w}{C} \quad (1.2)$$

$$\text{Partners' Supply } ratio\text{: } PS = \frac{M_p}{C} \quad (1.3)$$

Some common trends were observed for the four nations forming the MERCOSUL, but we single out Brazil, as an example.

Graphic 3



SOURCE: Author's own calculation based on CEPPI (1997) data
NOTES:

- (GDP-B)/C= Domestic Supply Ratio
- Mp/C=Partners' Supply Ratio
- Mw/C=Third Countries' Supply ratio

In the case of Brazil, we can clearly see that since 1988, the Domestic Supply *ratio* has consistently fallen, specially since 1992 (the first MERCOSUL year). This phenomenon may have two basic explanations: 1) A sharp export increase or 2) an increase in Apparent Consumption. By the available data, we consider that both movements occurred, that is, Consumption has augmented (through higher Agreggate Demand) as well as a major openness to foreign markets (economic liberalization resulting) implied a sharp export flow increase.

Equally interesting are the other two *ratia* evolutions. Both Third Countries' Supply and Partners' Supply have been growing in an extraordinary way, when compared with the average values of 1971-198. These results are consistent with the Truman concept of **Double Trade Creation** (both internal and external)[17].

These values show clearly that the Brazilian economy has now a degree of trade openness higher than in previous years.

The three other countries reproduce the results shown for Brazil. Both Argentina, Uruguay and Paraguay show similar trends in the *ratia* evolution. Therefore, we can summarize the results:

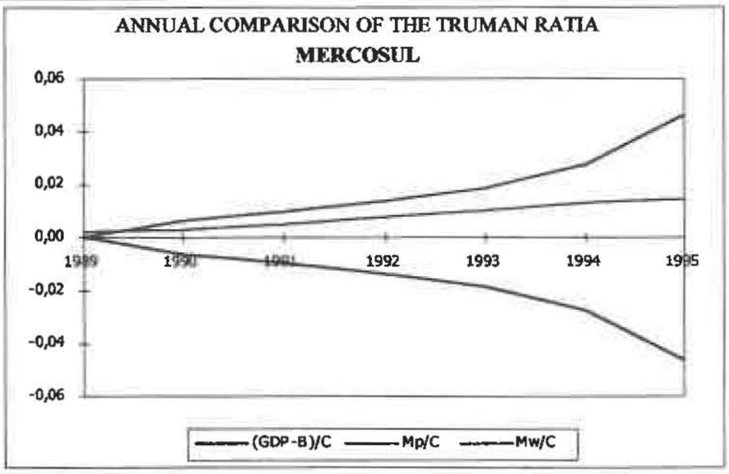
- Domestic Supply is substantially lower in the post-integration period, when compared with the previous period (this phenomenon is higher in Uruguay and felt later in time in Argentina).
- Third Countries' Supply increases steadily and in a progressive way in all four countries, but with a major effect in Brazil. Paraguay shows a sharp increase between 1988 and 1995, but then stabilizes.
- Partners' Supply has also increased in all MERCOSUL members, but in a more visible way in Uruguay and Paraguay

It seems relevant to stress that, although economic integration has stimulated regional trade within MERCOSUL, this one has not affected in a negative way the external trade. On the contrary, the analysis of Third Countries' Supply shows us that it tends to increase after the integration (with the notable exception of Uruguay). It is plausible to assert that given this numbers, we can consider that all four countries experienced Double Trade Creation since 1988, and that this effect is being cumulative, in other words, it tends to increase even further as the time goes by.

In order to illustrate this proposition, we built the trade shares for the entire MERCOSUL area. Taking the bloc as a region, we clearly detect the effects described above. The degree of exterior openness is higher than the degree of regional openness, although a range of external tariffs still subsist (see Graphic 4).

[17] To definitions of this concept we suggest Africano (1995).

Graphic 4



SOURCE: Author's own calculation based on CEPPI (1997) UN (1997) and IMF (1998) data

NOTES:

- (GDP-B)/C= Domestic Supply Ratio
- Mp/C=Partners' Supply Ratio
- Mw/C=Third Countries' Supply ratio

Quantifying the Trade Effects is easily made, using the EFTA Methodology[18].

This method proposes a linear trend of the evolution shown by the trade shares, normalising the hypothetical scenario (*anti-monde*) through the following equations:

$$\text{Total Trade Effect - } TTE = M_P^{\,t_2} - \left[\left(\frac{M_P^{t_n}}{C^{t_n}} - \frac{M_P^{t_0}}{C^{t_0}}\right)\cdot\frac{t_2 - t_n}{t_n - t_0} + \frac{M_P^{t_n}}{C^{t_n}}\right]\cdot C^{t_2} \qquad (1.4)$$

$$\text{Trade Diversion} - TD = M_W^{\,t_2} - \left[\left(\frac{M_W^{t_n}}{C^{t_n}} - \frac{M_W^{t_0}}{C^{t_0}}\right)\cdot\frac{t_2 - t_n}{t_n - t_0} + \frac{M_W^{t_n}}{C^{t_n}}\right]\cdot C^{t_2} \qquad (1.5)$$

$$\text{Trade Creation - } TC = M^{t_2} - \left[\left(\frac{M^{t_n}}{C^{t_n}} - \frac{M^{t_0}}{C^{t_0}}\right)\cdot\frac{t_2 - t_n}{t_n - t_0} + \frac{M^{t_n}}{C^{t_n}}\right]\cdot C^{t_2} \qquad (1.6)$$

Considering t_0 e t_n the year indexes referring to the pre-integration period (*o* the first year of that period and *n* the last) and t_2 the year index to which the study reports (Africano, 1995)[19].

[18] EFTA (1992), Les Effects de l'AELE et de la CEE sur les Echanges, *EFTA Bulletin*, Vol. XIII, n.5 Juin.

[19] To calculations effects we follow Africano (1995), where t_0 is counting from 0, this means n=17.

Table 2
Quantifying the Trade Effects by MERCOSUL member nation

	TC	TD	Total Effect (TC-TD)
Argentina	*10.831,756*	*7.895,557*	*2.936,199*
Brazil	*18.174,356*	*13.559,254*	*4.615,101*
Paraguay	*809,358*	*493,360*	*315,998*
Uruguay	*815,242*	*380,563*	*434,680*

NOTE: Year of Study (t2)=1995; Pre-integration period beginning (to)=1971;
End of the pre-integration period (tn)=1988
Values inUSD_{1990} Millions
SOURCE: Authors' own calculations based on CEPPI (1997), UN (1997)

We clearly see that all four member countries experience Trade Creation Effects between 1988 and 1995. Brazil has had a total effect of 4,6 billion USD, while Argentina records a value of 2,9 billion. Uruguay and Paraguay, have similar effects (434 millions and 315 millions).

b) Income Elasticity of Import Demand Model

The well known Balassa Model (Balassa,1967), rests on a framework built upon a set of Income Elasticities of Import Demand (IEID) (defined has $\eta_j = \dfrac{\Delta\%M_j}{\Delta\%Y}$, where $\Delta\%$ represents the annual average rate (measured in % points), M_j the imports originated from area $_j$ and Y the country's GDP), comparing their values in both pre and post-integration periods.

One increase in such elasticity means that the importing economy is much more open to imports originated in a given area than in previous periods.

Using this methodology we conclude that one increase in the total IEID is a strong indicator of TC. On the contrary, a lower IEID of third countries imports is a clear effect of TD (El Agraa, 1994).

Applying Balassa (1967), we computed the average annual change rate of imports (according its origins) and the one of GDP of each of the four MERCOSUR's member nations, getting the respective IEID (by import origin areas and periods)[20].

The two selected periods are referred to pre-integration period (1971-1988) and post-integration period (1989-1995).

Table 3 presents us the results, showing the changes on IEID of the four MERCOSUR countries, between the two periods.

Table 3
Total, MERCOSUL originated imports and Rest of The World originated imports' Income Elasticity Demand (1971-1988 and 1989-1995)

	Total Imports IED		MERCOSUL' originated Imports IED		ROW originated Imports IED	
	71-88	*89-95*	*71-88*	*89-95*	*71-88*	*89-95*
ARGENTINA	*5,08*	*6,49*	*7,08*	*8,19*	*4,75*	*6,07*
BRAZIL	*1,83*	*10,56*	*2,67*	*13,19*	*1,79*	*10,19*
PARAGUAY	*2,56*	*6,32*	*3,34*	*7,00*	*2,24*	*5,87*
URUGUAY	*6,25*	*5,00*	*7,50*	*5,52*	*5,50*	*4,61*

SOURCE:: Author' own calculations based on CEPPI (1997), UN (1997)

According to Balassa (1967) assumptions, we easily see that for three of the MERCOSUL members, there are clear signs of TC. In fact, both Total Imports' and MERCOSUL originated Imports' IED increase in a consistent trend between the two periods. We stress Brazil's results, which MERCOSUL originated imports' IED increase from 2,67 to 13,19, that is, during 1971 to 1988, 1% increase in the GDP would generate a 2,6% increase in MERCOSUL's originated imports. After 1989, the very

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[20] CEPPI (1997) data.

same GDP increase would therefore produce a 13,1% increase in the same type of imports.

Uruguay clearly deviates from this pattern, being the only country with a decrease in every IEID in the second period (1989-1995). A careful analysis show us that, although average imports did increase between the two periods, their growth was not enough to produce a higher IEID with the high GDP growth rates experienced by this economy during the 1989-1995 period (3,1% average).

The Balassa Model (1967), allows us to assert that there is a clear TC effect derived from the MERCOSUL formation, specially in Brazil.

c) __Sectorial Impact Analysis.__

The sectorial analysis impacts are in the core of most MERCOSUL trade effects studies, due to the fact that most debates are stuck on the Brazil-Argentina intra-industry trade (as noted by Yeats, 1997 and Flôres, 1997).[21].

Using CEPPI (1997) data, we computed the average sector export values for two distinct periods (1984-1988 and 1989-1995), studying the changing patterns in the bilateral export structure of Brazil and Argentina[22].

<u>Argentina</u>

Argentinean exports to Brazil and to the Rest of the World (ROW) are shown in table 4.

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[21] CEPPI(1997) data only provides bilateral trade flows between Argentina and Brazil. Trade with the other two member countries are not provided, unabling a deep sector analysis. However, trade among the two bigest MERCOSUL economies comply circa 90% of MERCOSUL regional trade, and therefore the core results shown in this section should not diverge much from the actual situation of the entire bloc.

Table 4
Argentina Export Structure by Sector
(Total=100 %)

SECTORS	***1984-1988***		***1989-1995***	
	BRAZIL	***ROW***	***BRAZIL***	***ROW***
Energy and Oil	*4,0%*	*3,4%*	*2,9%*	*1,6%*
Textiles and Apparel	*9,1%*	*6,3%*	*6,3%*	*6,9%*
Wood and Paper	*3,6%*	*1,1%*	*2,1%*	*2,0%*
Chemical Products	*12,6%*	*5,9%*	*10,2%*	*7,5%*
Agriculture and Subsections	*58,0%*	*70,3%*	*52,3%*	*67,8%*
Iron And Steel	*0,1%*	*4,9%*	*0,8%*	*5,4%*
Non-Ferrous Metals	*0,9%*	*2,0%*	*0,6%*	*1,8%*
Mechanical Manufactures	*4,8%*	*3,0%*	*7,3%*	*3,6%*
Automobile Industry	*5,2%*	*1,0%*	*15,5%*	*1,5%*
Electrical Manufactures	*0,8%*	*0,5%*	*1,0%*	*0,7%*
Electronic Manufactures	*0,9%*	*1,6%*	*1,0%*	*1,2%*
TOTAL EXPORTS	**596**	**7.370**	**2.287**	**10.358**
% Period Change	**-**	**-**	**283%**	**40%**

SOURCE:: Author's own calculation based on CEPPI (1997)
NOTE: TotaL in USD_{90} millions

During the 1984-1988 the export structure was not much different. when considering its destinations. Both Brazil and ROW were major agriculture products' buyers (58% of total exports to Brasil and 70% for the ROW). The following export industries were to both markets textiles and apparel and Chemical products (the latter with a bigger share in Brazil).

Although with similar export structure, we must stress out the different magnitude of trade flows, with the Brazilian market counting only 8% of total Argentinean exports. This value jumps to almost 22% in the second period (1989-1995).

In fact, a major shift in the total export structure occurs in this second period. Albeit a continuing leading role in agriculture exports share (52% in the Brazilian market and 67% for the ROW), a new phenomenon arises: Automobile exports to Brazil boost to almost 15% export share and the mechanical manufactures grow to almost 7%.

[22] For a better understanding of Argentina's export structure, please see Cepeda (1998).

These two industries are the ones which tend to worry several authors, who consider that this shift is a major symptom of Trade Diversion (Yeats, 1997).

However, some other authors tried to approach this fact in a different way. Although Brazilian Market share in Argentinean exports jump to 22%, Cisneros and Campbell (1998) note that this regional concentration of Argentina's exports are not being made with a loss of market share in other areas or regions. These authors show that between 1991 and 1995, the only markets where Argentina lost market share were Mexico, Peru, Korea and Japan (countries with little meaning to Argentina's exports).

In order to illustrate this position, we use one indicator of Comparative Advantage, as established by CEPPI (1997)[23]. In a rather simple approach we may say that this indicator tries to grasp the industries in which one economy may have "strong" and "weak" points. It therefore assumes that a nation will tend to export products produced by sectors which show "strong" points (that is, comparative advantage)[24].

The indicator notation is as follows:

$$VC_{ik} = \left[\left(\frac{X_{ik} - M_{ik}}{Y_i}\right) - \left[\left(\frac{X_{ik} + M_{ik}}{X_i + M_i}\right) \cdot \left(\frac{X_i - M_i}{Y_i}\right)\right]\right] \cdot 1000 \quad (4.7)$$

Where for sector k:

X_{ik} = Exports of country i; M_{ik} = Imports of country i;

For country i:

Y_i = GDP; X_i = Total Exports; M_i = Total Imports;

The indicator will assume positive values for sectors where a comparative advantage exists and negative values for those industries with a comparative

[23] To understand some definitions of the Comparative Advantage concept, see, Krugman (1991), Gandolfo (1990) and Chacholiades (1990).

disavantage. In order to avoid changes in the indicator that are nor specific of the country but rather, the result of changes in the share of a given sector k in world trade, trade flows (X and M) are adjusted through a year base notation[25]. Computing Comparative Advantage year-based (CA90), we crossed them with the average export change rate between the two periods 84-88 and 89-95 (see graphic 5).

The implicit assumption is that the major change in exports should occur in industries with the highest CA90. In the same way industries with a comparative disavantage should be the ones with the lowest change in average exports.

Graphic 5
Export Change vs. Comparative Advantages

SOURCE:: Author calculus based on CEPPI (1997)

Clearly, it is seen that the sector with the highest share in exports growth to Brazil is the one which has the highest CA, that is , the sector where Argentina gets its better competitive position. The second industry that experienced stromg growth is teh Auto-Industry although recording a Comparative Disadvantage.

[24] Note that, opposite to Yeats (1997) study, when computing Comparative Advantage for Brazil and Argentina, we do not use a Revealed Comparative Advantage technique, because we do not exclude the share that these countries have in total world trade.

[25] In this study, we have 1990 (r). The trade flows are multiplied by $e_k^n = \frac{W_k^r}{W^r} : \frac{W_k^n}{W^n}$, where W stands for world trade.

Somehow, these results are similar to those Yeats (1997) got, but in no way assume such a negative record as outlined by the author. In fact, when including the agriculture sector, we can easily see the lesser importance that auto-trade and mechanical manufactures play in the bilateral Argentinean-Brazilian trade. Even if we could assume the presence of a strong TD sign (referring to auto-industry), we could still argue that this negative effect was not a MERCOSUL impact by the reason that this industry is one of two industries which are contemplated by the MERCOSUL Free Trade Integration Scheme .[26] Has noted by Mendoza (1997) " *It is managed trade, not free trade, that governs auto trade in the Mercosur countries. (...) Mercosur rules will not apply to the auto sector until the year 2000, when tariffs will be set at 20 percent and intra-Mercosur trade will be duty free ...* ".

Another argument that may be raise1d, concerns the perspective of analysis. Like Yeats (1997), we are just looking to one of the sides of trade (exports). If we equally consider the import-side (Devlin,1997 and Cohen,1997), we would show that auto-industry exports growth are not more than a small reward to the higher and higher trade deficits recorded by Argentine in the latest years. Figueroa and Rins (1997) show that auto trade is the responsible for the biggest share in the Argentinean Trade Deficit.

We must not forget that a regional growth dynamic must occur in some of MERCOSUL's industries. Establishing a regional market, raises a set of conditions that attracts not only multinational companies as well as nation-member companies to across-border ventures. Business are planned not in national markets terms, but in regional markets. Flôres (1997), seems to understand this phenomenon, considering that

[26] The other industry is the Chemical Products sector. Both Argentina and Brazil, traditionally intervene in these two industries, considering them has "economy structuring" (Mendoza, 1997). By that reason, both nations kept strong industry incentives in these sectors, developing efforts in getting FDI in order to expand its auto and chemical industries. The importance given to those industries has been such, that they were not included in MERCOSUL Free Trade negotiations, and still today, strong divergences remain in the way they will be included (Figueroa e Rins, 1998).

"...complementarity rather than a devastating struggle is likely to take place in the car and transport sectors, enabling both Argentina and Brazil to take advantage of the integration..." (pp 13)

Has referred by The Economist (1996), major world auto companies are responding massively to MERCOSUL's growth (and latin-american economies in general), chosing one of the two South-American giants to invest[27]. In conclusion, has Cisneros e Campbell (1998) note *"...evidences indicate that the regional integration process has boosted a never seen intra-industry trade growth..."* (pp 5).

Brazil

Opposite to the Argentinean case, some differences among export structures were already clear in the period 84-88. This is not strange, due to the fact that only 2,5% of total Brazilian exports were directed to Argentina. In the following period, the average exports to Argentine soared to more than 7%, still much less than the Argentinean counterpart. Table 5 shows us the average Brazilian exports structure in 84-88 and 89-95.

While agriculture products' export share were near one third of total exports to the ROW, they only complied 14% of total exports to Argentina (being only the third sector in terms of Brazilian exports to this market).

The leading sector was the Chemical Industry with 27% of the total exported, followed close by Iron and Steel with 24% share.

Table 5
Brazilian exports' Structure by Sectors
(Total=100 %)

SECTORS	1984-1988		1989-1995	
	ARGENTINA	ROW	ARGENTINA	ROW
Energy and Oil	2,9%	4,1%	1,4%	1,8%
Textiles and Apparel	0,9%	8,3%	4,5%	8,7%
Wood and Paper	4,1%	4,2%	7,3%	6,3%
Chemical Products	27,2%	7,9%	19,4%	8,5%
Agriculture and Subsections	13,5%	37,8%	8,7%	32,1%
Iron And Steel	24,0%	16,5%	11,3%	19,2%
Non-Ferrous Metals	3,1%	3,4%	2,2%	4,8%
Mechanical Manufactures	10,1%	8,1%	16,0%	9,7%
Automobile Industry	5,4%	5,2%	21,9%	5,4%
Electrical Manufactures	2,1%	1,3%	4,9%	1,8%
Electronic Manufactures	6,7%	3,1%	2,4%	1,7%
TOTAL EXPORTS	654	26.156	2.506	34.615
% Period Change	-	-	283%	32%

SOURCE:: Author's own calculations based on CEPPI (1997)

After MERCOSUL came into force, Brazilian export structure shifted even further from the one to the ROW. As already exoerienced by Argentina, auto-industry became the major cause for this change, now counting for 22% of bilateral exports. However, Brazil has a strong auto-trade with the rest of the World (exporting in average almost 2 billion US Dollars).

Once more we apply the Comparative Advantage Methodology, has we can see in graphic 6.

We may observe that Brazilian auto exports growth to Argentina have a leading position in the total export growth, but unlike in Argentina they do respond to a Comparative Advantage of the Brazilian Economy. (They are not a major cause of concern). However mechanical manufactures' exports to Argentina, may arise some worriness, due to the fact that they have grown quite fast, albeit a strong comparative disadvantage.

[27] Until year 2000,FDI of 4.206 US million Dollars are expected to be placed in Argentinean auto-sector. MERCOSUL total auto

Graphic 6
Export Change vs. Comparative Advantages

SOURCE:: Author 's own calculations based on CEPPI (1997)

Some explanations may be oriented to the kind of arguments developed for the Argentinean case, but we would like to focus two strong situations: In spite of the comparative disadvantage, mechanical manufactures exports to the ROW have been one of the ones which recorded major increases between 84-88 and 89-95, jumping from 2.1 billion USD to 3,6 billions (this record is only surpassed by Iron and Steel exports)[28]. In the same way, this industry has been one of the most affected sectors by the fast trade liberalization, showing a massive trade-deficit.

We therefore might assume, that in spite of some signs of TD in Brazil-Argentina trade flows (in Argentinean Auto-Industry and Brazilian Mehanical Manufactures) some plausible explanations may count in their favour. The high concerns referring MERCOSUL as a stumbling block in world economy integration may be overrated, being MERCOSUL a serious attempt of industry complementarity and regional competiveness, as alrady shown in a vast set of studies. We note the ones published by Hinojosa-Ojeda (1995), Flôres (1997).

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industry should record 20 billion until 2001 (Cisneros and Campbell, 1998).

4 - Conclusion

We arrive to two major conclusions. First, under the assumptions of the applied models, we have found that the MERCOSUL member countries have experienced a strong effect of Trade Creation. This effect is not only large, but has been cumulative since 1988. The Trade Creation recorded by MERCOSUL countries is also double folded, that is, Internal Trade Creation (resulting from free trade within the area) and External Trade Creation (resulting from the sharp decrease of external tariffs, especially in Brazil).

The results shown by the Shares in Apparent Consumption Method, are corroborated by the Balassa (1967) method, which applies the Income Elasticity Import Demand methodology. With the Uruguayan exception, MERCOSUL as a whole shows positive signs of Trade Creation.

Second, in trying to focus Trade Creation per sectors, in the Brazil-Argentina trade flows, we noted some signs of Trade Diversion, especially in Argentinean auto-exports to Brazil, and mechanical manufactures in the opposite export flow. Both impacts, tend to be explained not only by the absence of MERCOSUL rules, concerning auto-trade and a natural shift in companies investing in the area, that tend to plan their operations in the Region MERCOSUL, and not in country A or B, as previously.

[28] This massive growth allowed that the CA90 jumped from -9,5 to -4.5 in 1995 (year-base terms):

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