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MERCOSUR
Mercado Común Del Sur
Common Market of the South

A Study on the Origins, Organizational Structure, Latest Developments and the Contemporary Trade Patterns of MERCOSUR

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A Study on the Origins, Organizational Structure, Latest Developments and the Contemporary Trade Patterns of MERCOSUR

1. Mercosur: A Background

Raison d'être - A Historical Context

Upon independence from the European colonial powers, Latin American leaders had a vision of an integrated Latin America. However, political conflict prevailed in the nineteenth century. Economic elites during this period and the early twentieth century were engaged in primary product exports to the United States and Europe with little focus on Intra-Latin America trade (Cason, 2011, p. 30). The years following the Second World War saw the rise of military dictatorships in Latin America trying to ensure internal control in their respective territories.

During these years, Latin American countries experienced a decline in their terms of trade. There was growing recognition of the potential of the manufacturing sector to create jobs and modernize the economy. This led to the implementation of the Import Substitution Industrialization (ISI) model during the years of the Great Depression and in the post war period. The aim of ISI was to develop and promote an industrial base which could create linkages[1] and to reduce current account deficits. Given the anti-imperialist fervor and accommodation of lobbies in favor of protection, measures like high tariffs, quotas and exchange rate controls were undertaken by the countries in the region. The effective rate of protection[2] was in many cases higher than the nominal rates of tariff (Reyes & Sawyer, 2011, pp. 192-193). Thus, while industrialization did take place, it came at a high opportunity cost and led to inefficient allocation of resources. Prices of goods which Latin American countries were now able to domestically produce were higher than those of competitors in the world markets (Cason 2011, 1). On the other hand, exchange controls through which the local currencies were managed created a disincentive for exports and thus reduced the ability to generate foreign exchange.

Brazil and Argentina, the two largest economies of the region, had unresolved territorial disputes for most of 19th and 20th centuries (Wrobel, n.d.). Defense of national priorities and the influence of the armed forces were characteristic of both these countries, and contributed to mutual distrust without consideration of the need for closer economic, political or cultural relations (Oelsner, 2012, p. 190). Bilateral relations also soured over disputes over the use of water resources of the Parana River[3]. However, after the diplomatic negotiations in October 1979, the Acordo Tripartite was signed between Brazil, Argentina and Paraguay, ending the dispute. This treaty laid the foundation for positive relations between Brazil and Argentina.

Brazil and Argentina had also pursued nuclear programs during the postwar period (Oelsner, 2012, p. 190). In 1980, relations strengthened with an agreement to collaborate on nuclear matters and in other areas like shared water resources, electric interconnection and the establishment of a consultation mechanism on issues of common interest (Oelsner, 2012, p. 192). Brazil supported Argentina during the Falklands War in 1982, which further reinforced a partnership of trust between the two countries. By 1985, both countries had democratic governments. Being democracies, there was much more scope for an open dialogue and for a move towards mutually beneficial outcomes (Placek, 2012). Presidents José Sarney of Brazil and Raul Alfonsin of Argentina embarked on a process of cultural, political and economic rapprochement leading to the establishment of PICE (Argentina-Brazil Integration and Economics Cooperation Program).The principles of PICE became a prerequisite for aspiring members (Oelsner, 2012, p. 198). The rising importance of regionalism and shared hegemony (Pelufo & Ignacio, 2004) were recognized as important elements in international affairs (Manzetti, 1993, pp. 101-102). The increasingly marginal role of the Southern Cone in world trade, the debt crisis, formation of regional blocs in other parts of the world, came to be perceived as security related issues (Treaty of Asuncion, 1991). Security was now seen in the larger context where these leaders saw the necessity to provide an impetus to their economies to compete globally and to improve their bargaining power in trade negotiations (Treaty of Asuncion, 1991) (Manzetti, 1993). This established the raison d'être for closer ties and integration between the two countries.

Alfonsin and Sarney saw the PICE agreement as a way to strengthen their democracies (Cason, 2011, p. 38)and lower the external security threat by reducing military influence and aggression (Pelufo & Ignacio, 2004). Moreover, through regional integration, the leaders looked to stimulate intra-sect oral integration as an attempt to boost ISI in a broader framework (Cason, 2011, p. 39), though this attempt to keep ISI alive hampered the progress of PICE. Opening up protected economies during a time of high inflation and balance of payments crises was difficult and during the years 1988 and 1989, the process of integration seemed in jeopardy. With the initiative of Presidents in both countries, Fernando Collor De Mello and Itamar Franco in Brazil and Carlos Menem in Argentina, who espoused neoliberal policies, the agenda for integration was back on track by 1991(Pelufo & Ignacio, 2004). The end of the Cold War ideologically established, "There Is No Alternative"[4]. The new market friendly approach to integration reduced the focus on a detailed sectoral approach.

Uruguay and Paraguay share their borders with Argentina and Brazil. They have historically played the role of buffer states between Argentina and Brazil in the 19th and 20th centuries

(Oelsner, 2012, pp. 188-190). As a result, the economies of both these countries have been subject to influence and integrated with the bigger economies of Argentina and Brazil[5]. MERCOSUR was established in 1991 at the Treaty of Asuncion with its founding members as Brazil, Argentina, Uruguay and Paraguay.

Important Milestones

Table 1: Important Milestones in the Development of Mercosur

Event	Year	Outcome
PICE Agreement (Argentina-Brazil Integration and Economics Cooperation Program)	1986	Brazil and Argentina sign the PICE Agreement which laid the groundwork for the formation of MERCOSUR
Treaty of Asunción	1991	Establishment of MERCOSUR (Southern Common Market) between Argentina, Brazil, Paraguay and Uruguay with the goal of creating a common market by 1995
Protocol of Ouro Preto	1994	Formalization of the customs union with a legal personality and establishment of its institutional structure
Interregional Framework Cooperation Agreement with the EU	1995	Interregional Framework Cooperation Agreement signed by MERCOSUR and The EU
Joining of Chile and Bolivia	1996	Chile and Bolivia joined as associate members of MERCOSUR
Protocol of Ushuaia	1998	Protocol of Ushuaia on Democratic Commitment signed
Protocol of Olivos	2002	Member states realizing the need for improving the system of Settlement of Disputes to ensure legal certainty

Joining of Peru	2003	Peru, an Andean Community member, joins Mercosur as an associate member.
Fund for the Structural Convergence of MERCOSUR (FOCEM)	2004	FOCEM established with the aim to promote structural convergence, development of competitiveness, promotion of social cohesion--especially in minor economies and underdeveloped regions--and support of the operations of the institutional structure and to strengthen the integration process.
Pact with Andean Community of Nations	2004	Cooperation agreement signed with the Andean Community of Nations – Thus, Colombia and Ecuador become associate members of Mercosur
Constitutive Protocol for the Parliament of MERCOSUR	2005	Mercosur Parliament, also known as Parlasur, comes into legal existence.
Protocol for Accession of Venezuela	2006	Venezuela signs membership agreement (Full admission was pending as Venezuela's entry not ratified by Paraguay)
Inauguration of Mercosur Parliament	2006	Mercosur Parliament inaugurated. It aims to ensure parliamentary cooperation at the institutional level with the aim of harmonization of domestic legal systems to incorporate Mercosur regulations. This is to make certain a climate of legal certainty and predictability in the integration process
Montevideo Protocol	2011	The Protocol of Montevideo signed. It establishes actions to be taken against any member country where democracy/constitutional order is compromised
Accession of Venezuela/Suspension of Paraguay	2012	Paraguay suspended on application of the 'Democracy Clause' of the Ushuaia Protocol. Venezuela acceded upon the consent of Argentina, Brazil and Uruguay.
Mercosur Parliament Elections	2015	Mercosur Parliament Elections scheduled to be held in 2015

Source: Gathered by author from various relevant sources.

Institutional Structure

As per Article 2 of the Protocol of Ouro Preto 1994, the following six organs of Mercosur were established:

1. The Council of the Common Market
2. The Common Market Group
3. The Mercosur Trade Commission
4. Joint Parliamentary Committee (no longer a part of the MERCOSUR Institutional Structure)
5. The Economic-Social Consultative Forum
6. The Mercosur Administrative Secretariat

Apart from the above organs, the following organs of Mercosur came into existence subsequently:

7. Mercosur Parliament (inaugurated in 2006)
8. Permanent Court of Review of Mercosur (Created in 2002)
9. Court for Administrative-Labor of Mercosur (Created in 2003)
10. Mercosur Center for Rule of Law (Created in 2004)

The three most important organs of Mercosur are The Council of the Common Market, The Common Market Group and The Mercosur Trade Commission. These are inter-governmental organs with decision making powers. They are explained in detail below (Treaty of Asuncion, 1991) (International Democracy Watch, n.d.):

Common Market Council	• Highest level organ of Mercosur responsible for its political leadership and decision making • Works to ensure compliance with the objectives and time limits set for the final establishment of the common market. • Comprises Ministers of Foreign Affairs and the Ministers of Economy of the member states • Meets twice a year (the Presidents of the member states participate at least once a year) • The presidency of the council rotates every six months, in alphabetical order.
Common Market Group	• The Executive organ of the Common Market is co-ordinated by Ministries of Foreign Affairs • Duties include monitoring complaince with the Treaty, take steps to enforce the Council decisions, propose measures to apply the trade liberalization programme, coordinate macroeconomic policies, negotiate with third parties, and ensure progress towards formation of the common market. • Comprises four permanent members and 4 alternates from each member state which represent the Ministry of Foreign Affairs, Ministry of Economy and the Central Bank. • Decisions are taken by consensus with representation of all member states.
Trade Commision	• Enforce instruments of the common trade policy adopted by member states • Enfore the implementation of the Common Trade Policy • Counselling on problems related to intra-Mercosur trade relationships • Comprises 4 permanent members and 4 alternates coordinated by the Ministries of Foreign Affairs of members states. • Includes a network of Technical Committees devised to target and supervise work according to the subject area

Member States

- ***Permanent Members*** – Argentina, Brazil, Paraguay, Uruguay and Venezuela

- ***Associate Members*** – Bolivia, Colombia, Ecuador, Peru and Chile

Key Facts and Figures[6]

- Population: 276 million
- GDP (current prices): US$ 3.30 trillion
- GDP per Capita (current prices): US$ 11,945
- Official Languages: Spanish, Portuguese, Guarani
- Headquarters: Montevideo, Uruguay
- Foreign Currency Reserves: US$ 466 billion
- Presidency Pro Tempore: Brazil

Objectives

Under Article 1 of the Treaty of Asuncion which founded MERCOSUR, the objectives of Mercosur are as follows (Treaty of Asuncion, 1991):

1. The free movement of goods, services and factors of production between countries through, among others, the elimination of customs duties and non-tariff restrictions on the movement of goods, and any other equivalent;

2. The establishment of a common external tariff and the adoption of a common trade policy in relation to third States or groups of States and the coordination of positions in regional and international economic and commercial forums;

3. The coordination of macroeconomic and sectoral policies between States Parties: foreign trade, agricultural,

industrial, fiscal, monetary, foreign exchange and capital, services, customs, transport and communications, and any other areas that may be agreed upon, in order to ensure proper competition among States Parties;

4. The commitment of States Parties to harmonize their legislation on the relevant matters in order to strengthen the integration process.

Democracy in Mercosur and the Ushuaia Protocol

Presidents José Sarney of Brazil and Raul Alfonsin of Argentina envisioned Mercosur consolidating democracy and a step towards economic inclusion (Manzetti, 1993). Through co-operative efforts, these leaders looked to resolve contentious domestic and foreign policy issues (Manzetti, 1993). Reciprocal political support by the re-established democracies in the mid-1980s created trust between the two societies. Mercosur was envisaged to create a collective strength to better shield against external influence and aggression. This explains the successful resistance of Mercosur against the Free Trade Area of the Americas.

The Ushuaia Protocol was created in 1998 in response to the events in Paraguay in 1996 when General Oviedo, the commander of Paraguay's army, attempted a coup against President Juan Carlos Wasmosy. In case of a breakdown in democracy in a member state, the Protocol empowers the other member states to suspend the right of participation of that member state in the various bodies (Protocolo de Ushuaia, 1998) and integration processes of Mercosur. The institutionalization of these democratic clauses was seen as a tactic to enhance its image and gain legitimacy at the international scene.

The Ushuaia Protocol was invoked upon the impeachment of President Fernando Lugo (see paragraph below) in July 2012 and Paraguay was suspended from Mercosur in July 2012.

Latest Developments

Mercosur and Venezuela

Venezuela was provisionally admitted to Mercosur in 2006 after President Hugo Chavez announced his decision to pull Venezuela out of the Community of Andean Nations (CAN). Since then, its full accession had been blocked by Paraguay, whose Senate had refused to ratify Venezuela's admission, citing lack of democracy in Venezuela (Klonsky, Hanson, & Lee, 2012).However, upon ouster of Paraguayan President Fernando Lugo in June 2012, the other three members of Mercosur invoked the Democracy Clause of the Ushuaia Protocol and suspended Paraguay. The leaders of these three nations cited that with its suspension, Paraguay's right to affect Mercosur votes was removed (Beioley, 2012). On July 31, 2012, Venezuela became the fifth full member of Mercosur. For its integration into Mercosur, Venezuela must comply with the provisions of the Treaty of Asuncion, the Protocol of Ouro Preto, and the Olivos Protocol for the settlement of disputes and the existing general rules as follows (KPMG, 2012):

- Venezuela must establish a timetable for adoption of the Common Nomenclature of Mercosur (NCM) and the Common External Tariff (AEC). In no more than 4 years, Venezuela must adopt the NCM and the AEC as follows:

  – In no more than 60 days, at least 3% of tariff lines of the NCM;

  – From the second year, at least 20% of tariff lines of the NCM;

  – From the fourth year, the remaining tariff lines.

- It must establish a Commercial Liberalization Program with its respective timetables - Venezuela must, in conformity with the different schedules concluded with the member states, adopt programs of commercial liberalization leading to reduction in trade tariffs for imports from member states.

- It must define the conditions and courses of action, within the Framework of the Treaty of Asunción to be negotiated with third party countries/groups of countries, for the purpose of its accession on the part of Venezuela, with reference to the International Instruments and Agreements concluded by them.

Accession of Venezuela has some important consequences. Hugo Chávez, who has been re-elected in 2012 for 6 more years, advocates a Mercosur that prioritizes social concerns and moves away from 'elitist' corporate models (Klonsky, Hanson, & Lee, 2012). He has nationalized many industries and propagates a Mercosur 'decontaminated of neo-liberalism'[7], suggesting a political personality with an anti-American stance. Argentina, under Nestor Kirchner and now Christina Fernandez de Kirchner, is also left of the center and supports Venezuela on many issues. On the other hand, Brazil and Uruguay are moderate in their political views. The current government of Paraguay, led by Federico Franco of the Colorado Party, is right of center. Notwithstanding different approaches, the trade bloc inherits USD 378 billion of GDP upon Venezuela's entry. Venezuela, which has faced food shortages, stands to benefit from cheaper food imports (Klonsky, Hanson, & Lee, 2012). Argentina could benefit from import of oil from Venezuela at special prices(El Tribuno, 2012) and Brazil will benefit from gaining access to the Venezuelan market for its agricultural, industrial and manufactured products(Sreeharsha, 2012).

Suspension of Paraguay and Its Impact

Paraguay was suspended from Mercosur on June 25, 2012 on the grounds of interruption of democratic order thus invoking the Ushuaia Protocol on Democratic commitment which requires "full democratic institutions as an essential precondition for the development of the integration process" (MercoPress, 2012). Paraguay's President Fernando Lugo was removed from office on June 22, 2012(Associated Press, 2012) following an impeachment process which lasted only 2 days.

The Mercosur leaders expressed their disapproval describing the move as ‘legislative, congressional or institutional coup’ as President Lugo was denied sufficient time to present his defense (Merco Press, 2012). The suspension of Paraguay was immediate and effective, until the next presidential elections takes place in April 2013, and leaves the country with no political rights in the trade bloc while it remains suspended (Beioley, 2012). However, the Mercosur member countries stopped short of imposing economic sanctions on Paraguay (BBC, 2012) and continue their normal trade and economic relationship with Paraguay (Ishmael, 2012).

Internal Tariff Liberalization

The Mercosur member countries agreed to a gradual and steady elimination of tariffs on Intra-Mercosur trade beginning June 30, 1991 and complete elimination of tariffs by December 31, 1994(Cason, 2011, p. 58). Uruguay and Paraguay were given an extra year to comply by these rules. Limited exceptions to this rule were allowed. These exceptions were included in the ‘Adaptation Regime’ list and complete elimination of these tariffs was to be achieved by January 01, 1999(Bohara, Gawande, & Sanguinetti, 2004, pp. 65-88). Two sectors of sugar and automotive were excluded from the trade agreement.

Thus, in 1991, tariffs on Intra-Mercosur imports were decreased by 47%. Successive reductions took place every six months and zero tariffs were achieved by Dec 31, 1994.

This had a positive impact as Intra-Mercosur trade grew from USD 4.7 billion in 1991 to USD 10 billion in 1994(Victor, n.d.). Between 1991 and 1995, Intra-Mercosur exports as a proportion of its total exports climbed from 11.1% to 20.5% and Intra-Mercosur imports as a proportion of its total imports climbed from 15.3% to 18.1% (Laird, 1997).

By 2006, more than 99% of tariff lines were converged to zero. As of June 2012, sugar continued to be excluded from the trade agreement and trade in automotive products was actively managed (Trade Regulations, Customs, and Standards, 2012).

Convergence towards Common External Tariff (CET)

The Mercosur member countries committed to setting a Common External Tariff (CET) i.e. a Customs Union by the end of 1994. The maximum CET allowed i.e. the bound tariff for any product was 22% (Arancel Externo Común, 2009). The CET was implemented on January 01, 1995.There were four exceptions allowed to the CET (Bohara, Gawande, & Sanguinetti, 2004) to facilitate structural adjustment and achieve a competitive position in the respective industries (Laird, 1997). The exceptions were as follows:

– The internal tariff on items in the ‘Adaptation Regime’, as listed in the previous paragraph, was linked to the CET for the purpose of convergence. If the internal tariff was higher than the CET, member countries could set a higher external tariff.

- A general exceptions list was allowed for each country. Approximately 300 tariff-line items were listed by each country in this general exceptions list. CET was to converge for these items by 2001 (2006 for Paraguay).
- CET on 1136 tariff-lines pertaining to the capital goods sector was to converge to 14% by 2001 for Argentina and Brazil (2006 for Uruguay and Paraguay).
- CET in the computers and telecommunications sector, varying between 0% and 16%, was to converge by 2006 for all the countries.

Tariff Escalation was a feature of Mercosur's CET i.e. lower tariff on raw materials and primary goods and higher tariffs on manufactured/value added/finished goods (Laird, 1997). This suggests Mercosur's effort to incentivize the manufacturing sector by maintaining sufficient barriers to allow time for the industrial base to achieve competitive strength.

As per the decision of the Common Market Council on Dec 16, 2010, each country was unilaterally allowed to decide a tariff independent of the CET for a specified number of tariff lines (see Annexure A for details).The average CET applied by Mercosur in 2011 was 11.50% and the member countries are allowed to apply import tariffs independent of the CET only on computer and telecommunications products, sugar and some capital goods (USTR, n.d.). An exception to the bound tariff of 22% is automotive sector where tariffs of up to 35% can be applied[8].

With slowing economic growth since the financial crisis of 2008, there has been a rising tendency to apply protectionist measures (Plummer, 2012). In December 2011, the bound tariff was increased to 35%, the maximum tariff allowed by the WTO, on a maximum of 100 products. Each country was allowed to decide their list of 100 goods unilaterally. In June 2012, Argentina proposed that the bound CET be increased from 22% to 35% on imports (MercoPress, 2012). Although the proposal was not accepted by Mercosur, the list on which 35% import duty could be levied was expanded to 200 products (ibid.). Brazil and Argentina have been interested in increasing the CET due to slower economic growth and their limited ability for further economic stimulus measures; an increase in the CET is of particular importance to Argentina, which was cut off from the international financial markets following its sovereign debt default in 2001, to maintain its trade surplus (MercoPress, 2012).

Intra-Mercosur Trade

As per the figures in Annexure A, Intra-Mercosur exports between 2001 and 2011 increased by more than three and half times, while their share in the total merchandise exports of Mercosur has decreased from 17% to 15%.This relative decrease in Intra-Mercosur exports is in stark contrast from the years between 1985 and 1997 when these figures rose remarkably for the two heavyweights, Brazil and Argentina when exports to Mercosur member states as a percentage of total exports rose from less than 10% to approximately 35%

for Argentina and from less than 5% to more than 15% for Brazil (Cason, 2011, p. 75). One of the reasons for fall in this trade could be the recurring trade disputes between Brazil and Argentina (see paragraphs on Argentina-Brazil Trade Disputes below). For example, from 2008 onwards, under the excuse of depreciation of the Brazilian Real relative to the Argentinean Peso, Argentina has more than doubled the number of products subject to Non-Automatic Import Licensing, a non-tariff barrier (Baer & Silva, 2012). In retaliation, Brazil has applied similar barriers to several agribusiness and automobile exports of Argentina to Brazil[9]. Other reasons for fall in the Intra-Mercosur trade could be the relatively small size of the Mercosur market compared to other major partners of Mercosur and increased diversification in the trade of Mercosur.

Argentina-Brazil Trade Disputes

Devaluation of the Brazilian Real

Brazil experienced hyperinflation throughout the 1980s and in the early 1990s. To mitigate the same, Brazil introduced Plano Real, or Real Plan, which introduced a new currency, took fiscal and monetary measures and decrease the of balance of payments deficit. As a result, the Brazilian currency appreciated which reduced the competitiveness of Brazilian exports in the international markets. On the other hand, Brazil's external debt had risen substantially in the 1990s. In 1998, the cost of servicing the debt was close to USD 60 billion, approximately 7% of the GDP (Bailey & Stecher, n.d.). This forced Brazil to devalue its currency. Following the devaluation, the Brazilian Real depreciated by approximately 40% (Cason, 2011, p. 99) thus effectively halving the cost of Brazilian exports. Argentina retaliated by imposing tariffs on Brazilian imports. Such events have threatened the existence of the trade bloc.

Tariffs on Sugar Imports

Sugar has been one of the very sensitive areas of trade negotiations since the inception of Mercosur. Many provinces in Northwest Argentina depend on the production of sugar (Juarez-Dappe, 2010) while Brazil heavily subsidizes its sugar production. Argentina extended the 20% tariff on sugar imports from Brazil until 2005. This 20%tariff was to end in the year 2000 as per the agreements of Mercosur. However, as of 2012, sugar continues to be excluded from the trade agreement (USTR, n.d.).

Quantitative Restrictions on Automobile Imports

As per the Ouro Preto Agreement of 1994, a Common Automobile Policy was called for. However, Brazil placed restrictions on automobile imports in 1995 while also subsidizing automobile exports. These actions of Brazil in 1995 were in breach of the Mercosur agreements. The dispute was eventually solved by presidential diplomacy (Gómez-Mera, n.d.).

2. Structure of Merchandise Trade with China, EU and North America

This section analyzes the trend in Mercosur's merchandise trade (including agricultural trade) between 2001 and 2011 (refer Annexure A B, C and D for the merchandise trade figures and tables). For this purpose, trade statistics for the years 2001, 2006 and 2011 of Mercosur with its major trading partners namely China, North America[10] and the EU are considered. Trade with these 3 regions comprises close to 50% of Mercosur's total merchandise trade.

Mercosur – China

Merchandise exports to China have increased by more than 16 times from USD 3.14 billion to USD 51.12 billion between 2001 and 2011. These exports figures are USD 10 billion higher than to North America and more than 11 times higher compared to the trade bloc's exports to India (see Chapter 4 on Mercosur-India trade figures).Imports from China show a similar trend by rising more than 17 times from USD 2.84 billion to USD 49.55 billion. Thus, while there has been a huge increase in total trade volume with China during this time period, the trade balance of Mercosur with China has little changed.

Merchandise exports to China comprise a larger share of Mercosur's total merchandise exports in 2011 compared to 2001, rising from 3% to 15%. This figure of 15% is only 2 percentage points below the 17% share of imports from North

America and 4 percentage points below the 19% share of imports from the EU. This suggests the at par importance of Chinese markets and of South-South trade for Mercosur during a time when demand from developed countries has been growing at a slower rate, especially since the financial crisis of 2008. One of the important factors for China's increasing trade with Mercosur has been China's direct shipping links through the Panama Canal. China also plans to build a train route in Colombia connecting the Caribbean Coast of Colombia to its Pacific Coast (Carroll & Branigan, 2011). This will assist to channel the transport of raw materials from Mercosur countries to China.

A distinct feature of the trade relationship between Mercosur and China is that a very high percentage of Mercosur's exports to China are of raw commodities while imports from China have been concentrated in industrial products. For example, 77% of Brazil's merchandise exports to China in 2009 consisted of raw materials and commodities while 98% of merchandise imports from China were of industrial products[11]. From the total merchandise trade of USD 100 billion between Mercosur and China in 2011, USD 25.4 billion consisted of fuels and mining products. Almost 100% of these fuels and mining products were exported by Brazil[12]. Interestingly, in 2001, Brazil exported only USD 0.55 billion of fuels and mining products to China[13].

Since the last decade, there has been a surge in the number of high-level exchanges between China and Latin America.

Between 2004 and 2010, two of the five most frequent countries visited by Chinese officials were Brazil and Venezuela (Koleski, 2011). In 2009, China offered a loan of USD 10 billion to Petrobras, the Brazilian state owned oil company (Hearn, 2012). In 2012, Brazil and China signed a currency swap agreement of value equivalent to USD 30 billion in local currencies (Langlois, 2012). Such strategic initiatives are seen as a part of the 'checkbook diplomacy' opted by China in the recent years. In 2012, China also proposed a free trade agreement with Mercosur (BBC, 2012).

Mercosur – European Union

The European Union (EU) is the largest trading partner of Mercosur in merchandise trade, though it accounts for a lower share in Mercosur's total merchandise trade in 2011 compared to 2001. The EU has emerged as Mercosur's biggest export market. Merchandise exports to the EU have more than tripled between 2001 and 2011. However, the EU constitutes a lower share of Mercosur's total merchandise exports in 2011 at 19%, down from 24% in 2001. Similarly, the EU's share in the total merchandise imports of Mercosur fell from 26% to 19% between 2001 and 2011. However, the EU continues to be Mercosur's largest supplier of merchandise.

The EU, as a part of its Latin America Strategy, has encouraged the economic integration process of Mercosur (European Commision, 2007). The EU-Mercosur Framework Cooperation Agreement signed in 1995 provided support for

Mercosur's integration process[14]. The two regions strengthened their relationship by affirming their commitment to strategic bi-regional ties at the Rio Summit in 1999[15]. Currently, the two regions are involved in negotiations for a comprehensive trade agreement (European Commision, 2012). Such initiatives have led to sustained trade ties between the two regions.

Mercosur – North America

Although the merchandise exports from Mercosur to North America have almost doubled between 2001 and 2011, the increase in this export volume is much lesser compared to the increase in Mercosur's exports to the EU, China or Intra-Mercosur. Increase in the volume of merchandise imports from North America has also been lower compared to these trade partners. However, imports have risen at a higher rate compared to exports.

North America is the second largest trading partner of Mercosur but its relative share in the bloc's total merchandise trade has declined from 24% in 2001 to 14% in 2011. This suggests an increased diversification in Mercosur's merchandise export markets and decreased reliance on North America. Treatment of agricultural exports and capital goods imports has been a stumbling block in trade negotiations between Mercosur and United States (Sanguinetti & Bianchi, 2002).

Mercosur has sought to diversify its trade with different regions (European Commision, 2007) to reduce its dependence on one particular partner. It has resisted the Free Trade Area of the Americas (FTAA) envisioned by the United States for a western hemispheric wide free trade area (Viswanathan R., 2012). The accession of Venezuela in July 2012 solidifies such position of Mercosur. It has also entered into South-South arrangements and granted associate member status to the Latin American countries of Bolivia, Colombia, Ecuador, Peru and Chile.

3. Mercosur: Services Trade

This section considers the trend in the commercial services trade of each member state of Mercosur between 2001 and 2011 while comparing it with the trend in the total commercial services trade of Mercosur (refer Annexure E for services trade figures). The total commercial services trade of Mercosur tripled in the ten years between 2001 and 2011. Exports as well as imports of all member countries grew on an absolute basis during this time period. While the total trade has grown, all but one country, Brazil, have seen their share in the total trade of Mercosur decreasing.

Brazil

As of 2011, Brazil accounts for almost three-fourths of the total commercial services trade of Mercosur and is a net importer of commercial services. It accounts for 80% of the total commercial services imports of Mercosur and 66% of the total commercial services exports of Mercosur. In 2011, of the USD 73 billion of commercial services imports, USD 19.9 billion, or 27.26%, was from the United States (USTR, n.d.).

Argentina

Argentina's services imports doubled from US$ 8 billion to US$ 16 billion while its services exports grew at a much faster rate, more than tripling from US$ 4.5 billion to US$ 14 billion during the same time period. However, its share in the total commercial services trade of Mercosur has declined from 32% to 20% between 2001 and 2011 as Brazil's services trade has grown at a much faster rate.

Paraguay and Uruguay

Between 2001 and 2011, Paraguay's total commercial services trade tripled from US$ 1 billion to US$ 3 billion. However, its share in the total commercial services trade of Mercosur fell to 1.8% in 2011 from 2.2% in 2001. Uruguay too saw its corresponding share fall from 5% to 4% during the same period. Thus, both the countries, given their smaller relative size compared to their larger counterparts like Brazil and Argentina, continue to be marginal players in the international services trade of Mercosur.

4. Mercosur and India

The Preferential Trade Agreement of 2009

The Preferential Trade Agreement (PTA) between Mercosur and India came into effect on June 01, 2009. The objective of the PTA, signed on January 25, 2004, was to strengthen the existing relations between the two regions and promote expansion of trade by granting reciprocal fixed tariff preferences. The ultimate objective is to create a Free Trade Area (FTA) between the two parties. Six rounds of negotiations were held between the two parties to operationalize the PTA. There were 5 annexes finalized as an outcome of these negotiations. These annexes are summarized below (see footnote for link to the annexes)(Ministry of Commerce, Government of India):

Annex 1: This was the Offer List of Mercosur to India containing tariff reductions on imports of 452 Indian products. The major products covered in this offer list were food preparations, organic chemicals, pharmaceuticals, essential oils, plastics & articles, rubber and rubber products, tools and implements, machinery items, electrical machinery and equipment.

Annex 2: This was the Offer List of India to Mercosur for tariff concessions on 450 products of Mercosur. The major products covered in this list were meat and meat products, organic & inorganic chemicals, dyes & pigments, raw hides and skins, leather articles, wool, cotton yarn, glass and glassware, articles of iron and steel, machinery items, electrical machinery and equipment, optical, photographic & cinematographic apparatus.

Annex 3: This annexure contained details regarding the Rules of Origin. The Rules of Origin specified the treatment of the traded goods and services with reference to their Country of Origin for the purpose of applying tariff concessions as per the PTA.

Annex 4: This annexure contained details regarding the rights and obligations of the parties for application of Safeguard Measures[16].

Annex 5: This annexure highlights the Dispute Settlement Procedures in case of disputes arising due to breach of terms negotiated in the PTA or regulated as per the agreements negotiated at the WTO.

India – Mercosur: Trade Volume Analysis

This section analyses the trend in the merchandise trade between India and Mercosur between Financial Year (FY) 2000-2001 and 2011-2012 (refer <u>Annexure F</u> for India-Mercosur trade figures).

Merchandise trade between Mercosur and India increased by more than 13 times between this time period. Exports to Mercosur increased from USD 0.36 billion to USD 6.45 billion and imports from Mercosur increased from USD 0.53 billion to USD 5.41billion. However, this volume of trade is a fraction of the trade between Mercosur and other regions like North America, EU or China. One of the reasons affecting the trade relationship is the lack of a direct shipping route between India and Latin America. For example, shipping a product from Brazil to Mumbai via Europe takes more than 27 days and via Singapore more than 36 days (Chanda, Panja, & Biswas, n.d.). This increases the cost of shipping and inventory management. The turnaround time in the Indian ports is also very high (24-72 hours compared to 9 hours in Hong Kong/Singapore)(Singh, 2011).Due to this reason, transport of perishable goods is not possible.

Commodities like fuels and mining products, soy and sugar comprise a majority share in the trade between India and Mercosur. India imported fuels and mining products of USD 2.31 billion from Mercosur in 2011[17]. A record USD 2 billion of soy oil in 2010 was imported from South America, most of which came from Argentina, the world's largest soy oil exporter (Viswanathan R., 2011). Imports of sugar from Brazil in 2009 and 2010 totaled USD 2 billion[18]. Brazil is also India's largest trading partner in the bloc accounting for more than 85% of the total trade with Mercosur.

The Capitalized Annual Growth Rate (CAGR) of India's merchandise trade with the world was 22.88% between FY 2001-2002 and 2008-2009 and 17.53% between FY 2008-2009 and 2011-2012. The respective figures for India's trade with Mercosur were 23.46% and 35.11%. This suggests trade grew at a much higher rate with Mercosur than with the rest of the world in the years following the financial crisis of 2008. This also highlights the importance of regional diversification and South-South trade in India's external trade, and the impact of the PTA between India and Mercosur which came into effect on June 01, 2009.

India-Venezuela: Trade Volume Analysis

Venezuela's entry into Mercosur in July 2012 increases the trade relationship between India and Mercosur by more than 50%. Total trade between the two countries was USD 0.53 billion in financial year 2007-2008. This rose to USD 6.92 billion in 2011-2012 due to surge in the quantities of crude oil imported by India from Venezuela as India has sought to diversify its crude oil basket due to the US sanctions on Iran (Mishra & Kalyanaraman, 2012). Of the total bilateral trade of USD 5.34 billion in 2010-2011, USD 5.17 billion comprised of crude oil imports by India. Thus, India has a high trade deficit with Venezuela.

5. Conclusions

Mercosur has made impressive progress in its trade relationship with North America, the EU and recently with China since its inception. This is especially significant as less than three decades ago, the two big economies of the bloc, Argentina and Brazil, were characterized by hyperinflation, economic stagnation, and low productivity. Its flexible framework has allowed its smaller member countries more time to adjust to the integration process.

However, many challenges remain to be addressed to ensure the continuation of the integration process at a healthy pace. Internally, recurring disputes between Mercosur member states, especially between Argentina and Brazil, highlight the domestic constraints faced by the member countries during the integration process. These disputes need long term solutions. Externally, to address falling growth rates, Mercosur, especially Argentina, has resorted to protectionist measures. While these might be effective in the short run, such measures lower efficiency, decrease economic welfare and are not seen favorably by international investors. For transition towards a common market and ultimately an economic union, cooperation towards common objectives and an approach that takes into consideration the structural differences between the countries' economic realities will be essential.

Exports of natural resources have played an important role in the growth of Mercosur member countries in the last decade. These natural resource rich countries have benefited from the rise in global commodity prices. A slump in global prices or lower growth in major and emerging economies, especially China, could change the dynamics of the integration process. Lower reliance on elevated commodity price levels and increased focus on diversification, productivity and competitiveness would lead to sustained economic growth.

Mercosur's engagement with China, not only in terms of increased trade but also in areas like foreign direct investment and co-ordination between the central banks suggests scope for strong strategic ties in future. Relatively low engagement with the United States has made consolidation of such partnership with China possible. Such a partnership could be replicated with other countries of the South given the increased relevance of South-South trade in the recent years. Such affiliations will contribute towards creation of a multi-polar world and balance of power in the coming years.

Mercosur and India are regions conscious of social inclusion alongside their development agendas. Substantial scope exists for Mercosur and India to explore complementarities and benefit from increased bilateral trade. Mercosur stands to benefit from India's world class capabilities in software and pharmaceutical industries and export of agricultural products like soybean and corn. On the other hand, India can secure its oil and other natural resource needs by partnering with Mercosur countries. However, there have been hurdles in the bilateral trade relationship like protectionist measures implemented by Argentina for certain goods from India.

With the changing balance of power internationally, India's strategic association with a regional blocs like Mercosur has been long overdue. Both the regions have taken a unified stance on many international issues in the recent years. While an increased number of executive level exchanges have taken place between the two regions in the last few years, institutional level exchanges and consultations will ensure that both the sides understand each other's unique needs, priorities and the strategic imperatives they face. Language and cultural gaps should be addressed by increased people to people contacts.

Mercosur has much to gain as a regional trade bloc given the rise of regionalism at the global level in the past few decades. The size of the major economies and trade blocs like the US, EU, ASEAN and China and the cohesiveness of their policy approach is an important source of their bargaining power. In a similar way, consolidation of interests amongst the Mercosur member states and pursuit of shared interests with strategic partners will be their source of legitimacy and higher bargaining power in international affairs. In this way, it could leverage its economic position to play an important role in shaping international regimes.

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Annexure A

Tables – Exceptions to the CET and Mercosur Trade Figures

Table 2: Exceptions allowed to the CET as of Dec 16, 2010

Member State	No. of Tariff Lines Under The Exceptions List	Maximum Date Till When An Independent External Tariff Can Be Applied
Argentina	100	31-Dec-15
Brazil	100	31-Dec-15
Paraguay	649	31-Dec-19
Uruguay	225	31-Dec-17

Source: www.mercosur.int

Table 3: Intra-Mercosur Merchandise Trade

Trade Flow	Intra-Mercosur Exports		Intra-Mercosur Imports		Total Intra-Mercosur Trade	
Value	US $ billion	% share in total exports	US $ billion	% share in total imports	US $ billion	% share in total trade
2001	15.18	17%	15.95	19%	31.13	18%
2006	25.80	14%	25.95	19%	53.40	16%
2011	53.79	15%	53.40	16%	107.19	16%

Source: WTO Statistics Database

Table 4: Mercosur's Merchandise Trade with the World

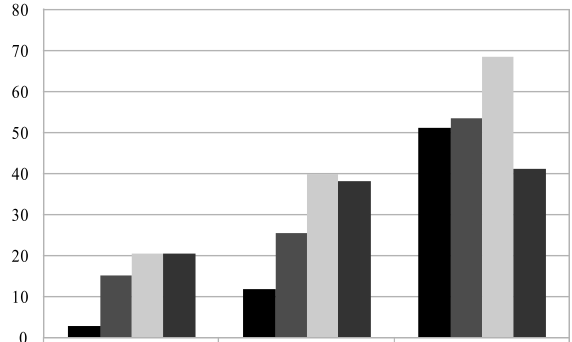
Region	World (in USD billion)		
Year	**2001**	**2006**	**2011**
Exports	87.82	190.25	353.46
Imports	84.20	139.54	333.85
Total	172.02	329.79	687.31

Source: WTO Statistics Database

Annexure B

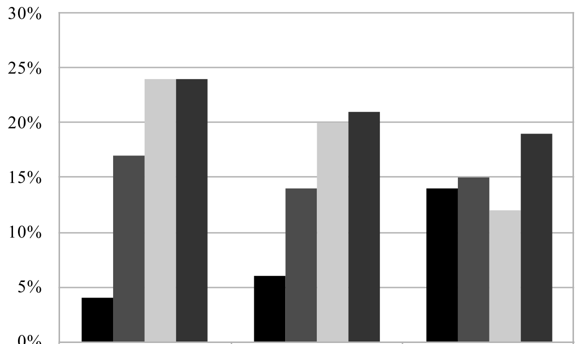
Merchandise Exports of Mercosur to Major Partners

Figure 1: Merchandise Exports of Mercosur to Major Partners (in US$ billion) *(Source: WTO Statistics Database)*



	2001	2006	2011
China	3.14	12.06	51.21
Intra-Mercosure	15.18	25.81	53.79
EU	20.72	40.04	68.81
North America	20.78	38.41	41.26

Figure 2: Merchandise Trade of Mercosur to Major Partners (in percentage terms) *(Source: WTO Statistics Database)*

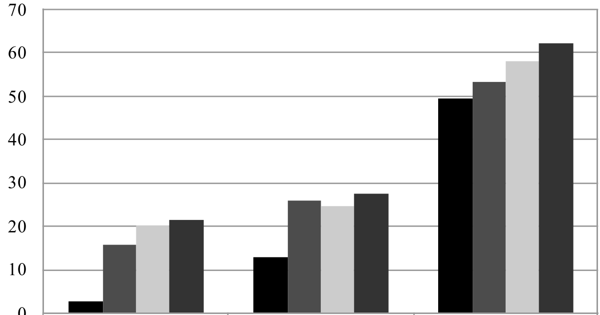


	2001	2006	2011
China	4%	6%	14%
Intra-Mercosure	17%	14%	15%
EU	24%	20%	12%
North America	24%	21%	19%

Annexure C

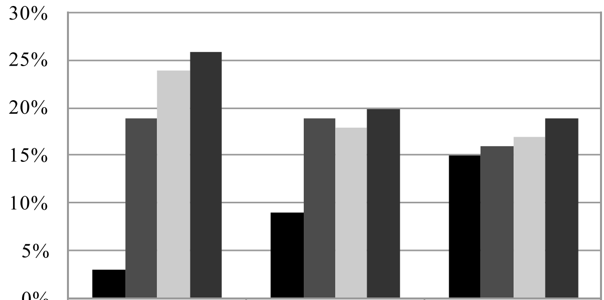
Merchandise Imports of Mercosur from Major Partners

Figure 3: Merchandise Imports of Mercosur from Major Partners (in US$ billion) *(Source: WTO Statistics Database)*



	2001	2006	2011
China	2.84	13.05	49.55
Intra-Mercosure	15.95	25.95	53.4
EU	20.38	24.72	58.13
North America	21.79	27.8	62.48

Figure 4: Merchandise Imports of Mercosur from Major Partners (in percentage terms) *(Source: WTO Statistics Database)*

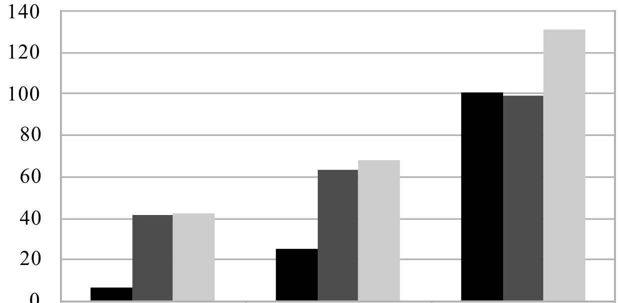


	2001	2006	2011
China	3%	9%	15%
Intra-Mercosure	19%	19%	16%
EU	24%	18%	17%
North America	26%	20%	19%

Annexure D

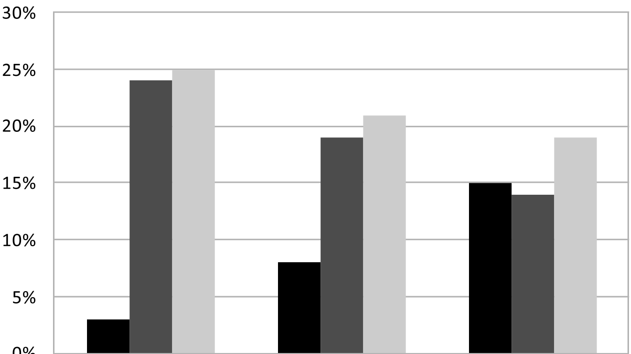
Total Merchandise Trade of Mercosur with Major Partners

Figure 5: Merchandise Trade (in USD billion) of Mercosur with Major Partners *(Source: WTO Statistics Database)*



	2001	2006	2011
China	5.98	25.1	100.67
EU	41.16	63.13	99.39
North America	42.5	67.84	131.29

Figure 6: Merchandise Trade of Mercosur with Major Partners (in percentage terms) *(Source: WTO Statistics Database)*



	2001	2006	2011
China	3%	8%	15%
EU	24%	19%	14%
North America	25%	21%	19%

Annexure E

Mercosur's Services Trade Figures

Table 5: Total Commercial Services Trade of Mercosur by Member State

Mercosur's Total Commercial Services Trade	In US$ Billion			Share of Member Country (in Percentage terms)		
Year	**2001**	**2006**	**2011**	**2001**	**2006**	**2011**
Argentina	13	16	30	32%	25%	20%
Brazil	25	45	110	61%	70%	74%
Paraguay	1	1	3	2.2%	1.7%	1.8%
Uruguay	2	2	5	5%	4%	4%
Total	**40**	**65**	**148**	**100%**	**100%**	**100%**

Source: WTO Statistics Database.

Table 6: Commercial Services Exports of Mercosur by Member State

Mercosur's Commercial Services Exports	In US$ Billion			Share of Member Country (in Percentage terms)		
Year	**2001**	**2006**	**2011**	**2001**	**2006**	**2011**
Argentina	4.5	7.9	14.0	30%	28%	25%
Brazil	8.7	17.9	36.7	59%	64%	66%
Paraguay	0.5	0.7	1.8	4%	3%	3%
Uruguay	1.1	1.4	3.4	7%	5%	6%
Total	**14.8**	**27.9**	**55.8**	**100%**	**100%**	**100%**

Source: WTO Statistics Database.

Table 7: Commercial Services Imports of Mercosur by Member State

Mercosur's Commercial Services Imports	In US$ Billion			Share of Member Country (in Percentage terms)		
Year	**2001**	**2006**	**2011**	**2001**	**2006**	**2011**
Argentina	8	8	16	33%	22%	17%
Brazil	16	27	73	63%	74%	80%
Paraguay	0.4	0.4	0.9	1.4%	1.0%	0.9%
Uruguay	1	1	2	3%	3%	2%
Total	**25**	**37**	**92**	**100%**	**100%**	**100%**

Source: WTO Statistics Database.

Annexure F

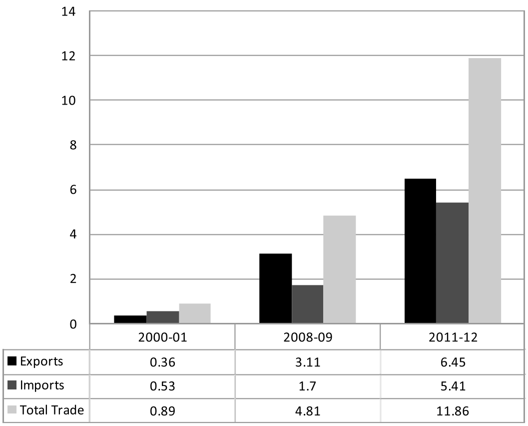
India's Merchandise Trade with Mercosur

Table 8: India's Merchandise Trade with Mercosur (in US$ Billion)

Year	2000-01	2008-09	2011-12
Exports	0.36	3.11	6.45
Imports	0.53	1.70	5.41
Total Trade	**0.89**	**4.81**	**11.86**

Source: Ministry of External Affairs, Government of India.

Figure 7: Capitalized Annual Growth Rate of India's Merchandise Trade with Mercosur and the World



Source: Ministry of External Affairs, Government of India

Table 9: India's Share in Mercosur's Merchandise Trade

Year	2001	2006	2011
Mercosur's Merchandise Exports to India/ Total Exports of Mercosur	0.86%	0.98%	1.23%
Mercosur's Merchandise Imports from India/ Total Imports of Mercosur	0.90%	1.36%	2.14%
India's Total Trade/ Total Trade of Mercosur	0.88%	1.14%	1.67%

Source: WTO Statistics Database

Table 10: India's Merchandise Exports to MERCOSUR Member Countries: Financial Year 2000-01 to 2011-12

Country	CAGR	CAGR	CAGR
Argentina	15.45	17.40	10.38
Brazil	34.41	36.27	29.58
Paraguay	21.01	21.50	19.71
Uruguay	13.32	7.95	28.99
Mercosur	29.86	30.73	27.56

Source: Ministry of External Affairs, Government of India.

Table 11: India's Merchandise Imports from MERCOSUR Member Countries: 2000-01 to 2011-12

Country	CAGR	CAGR	CAGR
Argentina	9.68	3.44	28.24
Brazil	36.36	30.34	53.81
Paraguay	31.98	0.90	170.11
Uruguay	23.91	22.58	27.53
Mercosur	23.59	15.78	47.08

Source: Ministry of External Affairs, Government of India.

Table 12: India's Merchandise Trade with MERCOSUR Member Countries: Financial Year 2000-01 to 2011-12

Country	CAGR-FY 2000-2001 to 2011-2012	CAGR-FY 2000-2001 to 2008-2009	CAGR-FY 2008-09 to 2011-2012
Argentina	11.12	7.47	21.49
Brazil	35.20	34.17	38.00
Paraguay	22.05	20.76	25.55
Uruguay	14.55	9.65	28.72
Mercosur	26.53	23.46	35.11

Source: Ministry of External Affairs, Government of India.

Endnotes

1. Linkages are the networks of economic relationships created with suppliers, distributors or customers (Source: www.businessdictionary.com)
2 The Effective Rate of Protection measures the percentage effect of the entire tariff structure on the value added per unit of output in each industry (Source: ux1.eiu.edu)
3. The source of the Parana River lies in Brazil. It marks the border between Brazil and Paraguay and downstream between Paraguay and Argentina.
4. There is no alternative (shortened as TINA) was a slogan which Margaret Thatcher, the conservative Prime Minister of Britain used often. In economics, politics, and political economy, "there is no alternative" is synonymous to economic liberalism i.e. free markets are trade are the best way to organize economic activity
5. Ibid.
6. Sources: IADB, IMF and CIA World Factbook
7. Ibid.
8. Ibid.
9. Ibid.
10. Canada, the USA and Mexico
11. (Source: WTO Statistics Database)
12 (Source: WTO Statistics Database)
13. Ibid.
14. Ibid.
15. Ibid.
16. Safeguard measures are aimed to protect a particular domestic industry when imports of certain products are causing or threaten to cause serious injury to that domestic industry which produces similar products.
17. Source: WTO Statistics Database
18. Ibid.

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