

MERCOSUR's Labyrinth and World Regionalism

Julio J. Nogues*
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Regional trade agreements are more likely to produce negative effects on nonmembers the larger and the more protected they are. Because MERCOSUR countries are efficient producers of the most protected products in the world –agricultural and agro-industrial products-, these countries suffer particularly from other countries regional agreements. Finally, these costs are likely to increase with the number of regional agreements in which they are not members. The arguments and estimates presented in this paper support these assertions.

The next section illustrates the negative effects on MERCOSUR coming from successive enlargements of the European Union (EU). After that, I discuss some evidence on trade diversion from the North American Free Trade Agreement (NAFTA). The picture is completed with references to findings reported in earlier literature. Based on the analysis, I conclude with some final remarks on why if MERCOSUR continues to remain in a protectionist labyrinth, member countries will suffer increasing costs from loss of export opportunities through trade diversion effects.

A. Impact of successive enlargements of the EU

Initially with the creation of the European Community (EC) and then with its deepening and enlargement policies, Western Europe has been the region of the world that has gone the furthest with regional trade strategies. These enlargements include: (i) Denmark, Ireland and the United Kingdom in 1973, (ii) Greece in 1981, (iii) Spain and Portugal in 1986 and, (iv) Austria, Finland and Sweden in 1995. In what follows, I review some of the literature showing the impact of successive enlargements on trade diversion in agricultural trade when Greece, Spain and Portugal joined the EC¹. In addition, for the enlargement of Austria, Finland and Sweden, I offer several new examples of negative export effects on Argentina and Brazil. I conclude that the upcoming enlargement of the EU to Central and East European Countries (CEECs) is also likely to produce additional trade diversion effects against the MERCOSUR countries.

1. Greece, Spain and Portugal.

Goto (1997) analyzed the accession of these countries to see whether there had been changing patterns of agricultural and manufactured trade flows before and after

* Professor, School of Government, Universidad Di Tella, and Universidad del CEMA. This note is an extension of Section IV of my paper on "Efficient Agricultural Exporters in a Protectionist World: Assessing Trade Strategies for MERCOSUR", prepared for the Inter American Development Bank, 2003. I am grateful to Maurice Schiff for comments made to a preliminary version. I also appreciate the very efficient assistance provided by Lic. Pablo Garcia in the preparation of some tables reported in this note, and to Ms. Maria Gondell for preparing the graph and editing the final version. Remaining errors are my sole responsibility.

¹ Researchers have also found trade diversion effects when Denmark, Ireland and the UK joined (Bayoumi and Eichengreen, 1997).

enlargement. He found that in all three cases, there was an important increase in regional agricultural trade but at best, minor changes in the patterns of manufactured trade flows. He concluded that these differences should be attributed to the EU's common agricultural policies (CAP) of high protection to agricultural and agro-based manufactures.

In the case of Greece for example, the EC9 share of agricultural imports from this country in total agricultural imports increases from 0.63% before, to 1% after enlargement. On the other hand, the EC9 share of Greece's agricultural imports increased steeply from 28% before enlargement, to 64% after. The same effects occurred when Portugal and Spain joined the EC. For example, the share of these countries' imports from the EC10 increased from 17% to 28% before and after enlargement respectively. The increased EC import shares from new partners were not concentrated in a few products but extended over many agricultural sectors. Who lost agricultural market shares in the EC and in the three acceding countries? The answer is that nearly all other regions lost shares in both groups of countries including Latin America (Goto, 1997).

2. Austria, Finland and Sweden.

In January of 1995, these countries became formal members of the EU. The statistics on growth rates of these countries' imports from the EU and Argentina before and after enlargement, shows striking differences. The extreme example is Finland where between 1990 and 2000 agricultural imports from the EU grew by 147%, while those coming from Argentina declined by 41%. An alternative hypothesis to explain these differences would point to loss of competitiveness in Argentina and/or exchange rate overvaluation experienced by this country. Nevertheless, differences in import growth occurred during a decade of significant structural reforms that between 1990 and 2000 led to a near doubling of agricultural exports. Therefore, the evidence strongly points in the direction of trade diversion having cost Argentina loss of market shares.

There are several examples that illustrate quite clearly important losses of market shares. The first example in Table 1 presents imports of apples by Sweden from Argentina declining by 67% between 1991 and 2000, while imports from the EU increased more than eleven times. This example is of particular interest as it illustrates the trade losses to non-members associated with countries' accession to the EU and adopting the very protectionist CAP's trade policies for fruits².

Figures 1, 2 and 3 illustrate clear negative effects on Brazil's exports following the EU's enlargement. The first two examples illustrate dramatic trade diversion effects away from Brazil and towards the EU on Finland and Sweden's imports of horsemeat. For example in 1990, 80% of Finland's imports came from Brazil but by 2000, this share had declined to only 7%. During these same years, the corresponding share of the EU increased from 15% to 79%. In the case of Sweden's imports of frozen orange juice, Figure 3 shows

² Protection of fruits in the EU is granted mainly through specific tariffs that vary by time of the year and import price. This implies that fruits and vegetables in the EU are protected by dozens of equivalent ad-valorem tariffs (WTO, 1999).

that in 1990 Brazil's share was 42% but by 2000 it had declined to 16%. During these same years, the EU's share went from zero to 83%.

3. Central and eastern European countries (CEECs)

The next step in the enlargement of the EU includes several CEECs and the question is what will be the effects of this enlargement on MERCOSUR's exports? While some results have been offered in the literature, in my view this question merits more analysis. One study concludes that this enlargement will have minor negative effects on Latin American because, in most of its exports to the EU where it has trade overlap with CEECs, the region has comparative advantage. More specifically: "for 78% of Latin American agricultural exports to the EU, there is no competitive threat from the CEEC countries" (IRELA, 1997).

There is an important reason why this issue merits further analysis. To a far greater extent than Western Europe, the CEECs are agricultural economies that are undergoing major economic transformations from planned to market-based economies. One of these transformations includes an important reduction of protection to manufacturing which is expected to result in less discrimination against agriculture. Under these conditions, it is risky to forecast from the finding that the CEECs did not show comparative advantage in the 90s, that this situation would continue to characterize the future. The experience of the MERCOSUR's countries during the 90s of rapidly expanding agricultural output and exports following structural reforms suggest that exactly the same could happen in the CEECs with negative effects on third countries.

B. NAFTA

NAFTA came into effect in January of 1994, and this is the date for the analysis of trade diversion effects before and after its formation. Here I concentrate attention on what happened to Argentina and Brazil's exports to Mexico who generally is known to be an uncompetitive agricultural producer. Looking at Argentina, the first thing to note is that between 1990 and 2001, Mexico's agricultural imports declined by 36.7% while its imports from Canada and the US increased by 216.2% and 169.7% respectively. These important differences point in the direction of trade diversions effects against Argentina (Nogues 2003).

One case of loss is that of sunflower oil exports from Argentina to Mexico. Table 2 presents Mexico's imports from Argentina and the US for the years from 1991 to 2000. By 1995, rapidly increasing imports from Argentina came to an end and thereafter declined from \$ 82.4 million dollars, to only \$3.6 millions dollars in 2000. The figures also show Mexico's imports from the US increasing fast to more than double the value registered in 1991.

Mexico's entry into NAFTA was accompanied by a regional discussion on how it should provide compensation in line with Article 44 of the Montevideo Treaty. This treaty establishes that trade preferences given by any member to other countries should be extended on an "unconditional" basis to all the other members. These discussions

concluded with the 1994 signing of the “Protocolo Interpretativo del Artículo 44 del Tratado de Montevideo 1980”. Argentina and Mexico negotiated compensation for loss of sunflower oil exports that took the form of a country specific import quota but the figures in Table 2 clearly indicate that this compensation had no significant effects³.

Summing-up, NAFTA has clearly had trade diversion effects on the MERCOSUR countries. These negative effects are likely to worsen in the next few years as sensitive agricultural products have been given long phasing-in periods for reaching regional free trade. One major example will be maize that Mexico has protected for decades and is soon coming up for liberalization under the NAFTA agreement (Cerro and Velez, 2000). When this occurs, Canada and the US will export more maize but most likely, the MERCOSUR countries will not.

C. Other examples

I want to add one last comment on how even small integration agreements damaged MERCOSUR’s exports. Gupta and Schiff (1997) studied one case of how Argentina’s exports declined as a consequence of the formation of the Andean Pact (AP). When this agreement was created in 1969, the member countries included Bolivia, Chile, Colombia, Ecuador and Peru. Later in 1973, Venezuela joined and in 1976, Chile withdrew. As was the case with several other Latin American integration schemes, during their early years, the AP was very protectionist (Nogués and Quintanilla, 1993). More recently however, the member countries introduced important liberalization policies and are working to achieve closer integration ties (Devlin and Esteveadordal, 2001). Nevertheless, for a relatively important number of agricultural products, protection remains very high and is implemented mainly through a system of price bands⁴.

Gupta and Schiff (1997) analyzed the effects on Argentina’s cattle exports to Peru during the early years of the AP and Table 3 summarize their results. Following the signing of the AP, Argentina’s cattle exports to Peru declined dramatically and was substituted by Colombia. These authors also document loss of price premiums associated with negative trade diversion effects.

D. Concluding Remarks

Since the implementation of the Tratado de Asunción in 1991, MERCOSUR has signed membership agreements with Bolivia and Chile. In the meantime, many other countries have continued to form new agreements and/or expand others. During the last ten years, the number of trade agreements notified to the WTO has more than doubled in relation to the first four decades of GATT and this dynamic trend, is not yet showing signs of deceleration. In addition to the enlargements of the EU, we now have to factor in

³ The reason is likely to be found in the fact that Mexico retained the administration of the quota.

⁴ An idea of just how protectionist these price bands can be taken from Ecuador’s schedule of commitments when it became a member of the WTO in 1995. This country binded the following maximum ad-valorem equivalents: poultry meat: 85%, skim milk powder: 72%, wheat: 45% sugar: 45%, etc. (Ecuador, 1995).

additional FTAs already signed by the US such as with Chile and Singapore and, the announcements that it is seeking further agreements associated with national security goals.

In much the same way as MERCOSUR had trade diversion effects on nonmembers and benefited from improvements in terms of trade (Chang and Winters 2002), the rapid expansion of FTAs around the world, is now having negative effects on the MERCOSUR countries. What is MERCOSUR's response? While member countries are in a serious crisis, their leaders have announced three goals: (i) extension to South America, (ii) deepening and institutionalization and, (iii) the creation of a common currency . As to the first goal, in spite of the political capital invested by former President Cardoso, MERCOSUR has failed to convince Chile and the Andean countries of the benefits of joining. As to the deepening and institutionalization objectives, they appear like putting the cart in front of the horses. Deepening and institutionalization are objectives that can only progress as fast as the goal of trade liberalization advances. On this front, the current MERCOSUR is full of NTBs many of which have to be attributed to the lack of macroeconomic convergence (Berlinski, 2001). Finally, the goal of creating a common regional currency among countries that have recently been battered by major devaluations, is clearly unattainable for the next few years.

In my view, this agenda diverts the attention away from the fundamental objective of opening markets for the region's agricultural exports. Why is this happening? One explanation is that MERCOSUR has been co-opted by the protectionist interests in the region to the detriment of exports and growth. MERCOSUR is in a labyrinth and while its leaders continue to insist on working first inside the agreement and then seeking regional pacts, the rest of the world is fast advancing with regional policies that will continue to divert trade away from the member countries and undermine export possibilities.

All this would not matter that much if the multilateral trading system was advancing with further liberalization agreements. But this is not the case and everything indicates that the Doha negotiations will fail to liberalize agricultural protectionism. MERCOSUR leaders must awake to this reality and ask why they are failing badly to open markets for their exports. If they don't do this and act accordingly, the member countries will find it increasingly difficult to export their products.

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Table 1: Sweden's Imports of Apples from Argentina and the EU

Year	Apples (millions of dollars)		
	Argentina	EU	Total
1991	10.1	3.6	46.3
1992	14.5	1.9	56.2
1993	5.1	0.0	50.9
1994	2.8	0.0	46.9
1995	5.3	23.5	63.5
1996	3.9	29.8	72.6
1997	3.8	38.4	66.2
1998	3.0	37.7	60.7
1999	2.9	34.6	55.7

2000	2.1	40.9	50.1
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Source: Author's elaboration based on Eurostat.

Table 2: Imports of Sunflower Oil by Mexico (millions of dollars)

Year	Argentina	US	Total
1991	13,0	42,6	55,6
1992	9,0	58,7	67,7
1993	27,5	69,9	97,4
1994	78,2	55,5	133,7
1995	82,4	98,6	181,0
1996	80,0	59,4	139,5
1997	48,4	73,5	121,9
1998	13,9	97,4	111,3
1999	6,8	98,3	105,2
2000	3,6	78,9	82,6

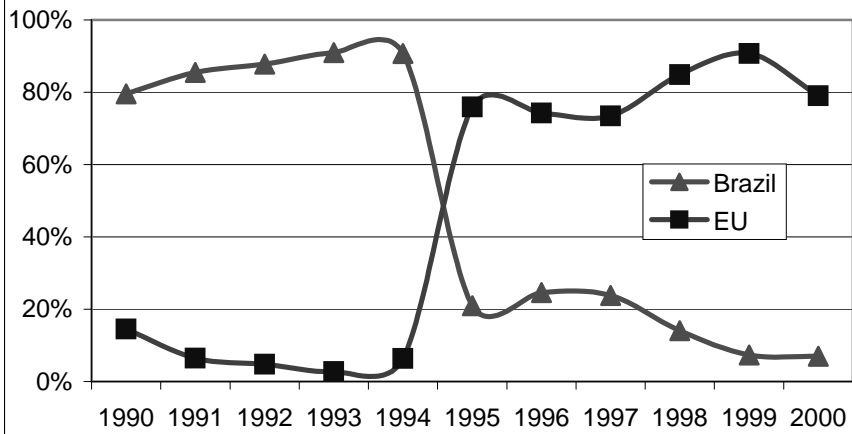
Source: Author's elaboration based on data from IADB-INTAL

Table 3: Cattle Exports of Argentina and Colombia (millions of dollars)

Period	Argentina				Colombia			
	World	Peru	Other LAC	ROW	World	Peru	Other LAC	ROW
66-68	31.9	10.4	21.2	0.3	3.05	2.4	0.2	0.5
70-72	16.7	0.4	16.2	0.06	15.8	13.0	0.6	2.2
% Change	-48%	-96%	-23%	-79%	417%	444%	302%	328%

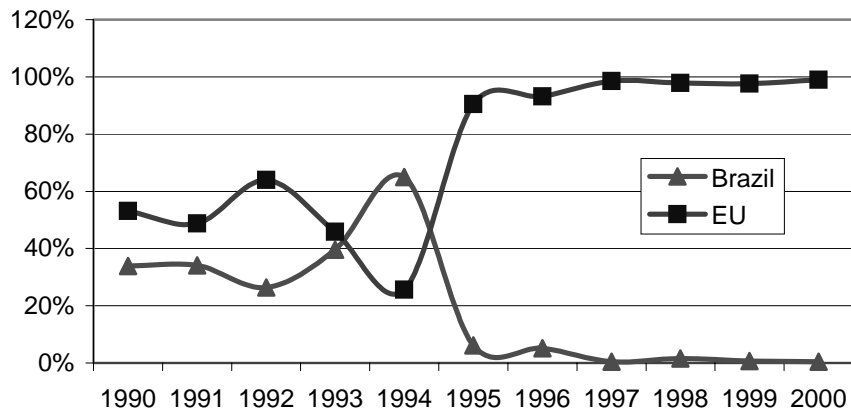
Source: Gupta and Schiff (1997).

Figure 1: Share of Brazil and EU in Finland's Imports of Horse Meat



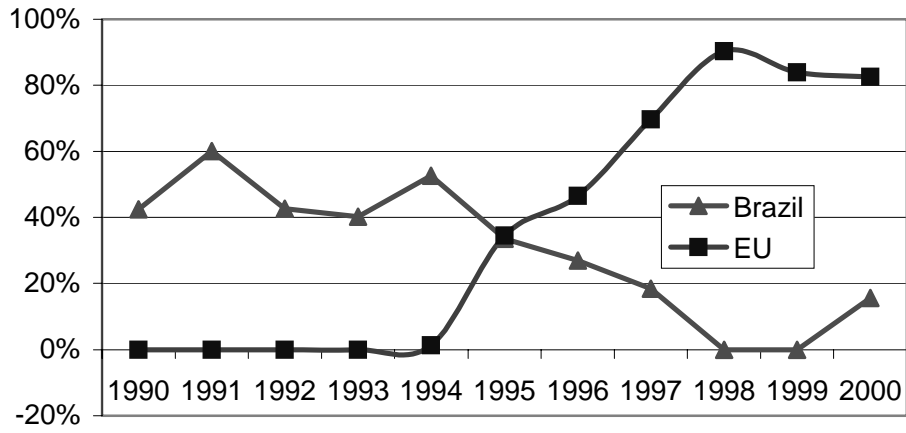
Source: Nogues 2003.

Figure 2: Share of Brazil and EU in Sweden's Imports of Horse Meat



Source: Nogues 2003.

Figure 3: Share of Brazil and EU in Sweden's Imports of Frozen Orange Juice



Source: Nogues 2003.