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**TRADE INTEGRATION AND INDUSTRIAL  
RESTRUCTURING:**

**THE CASE OF MERCOSUR**

This report was prepared by the Regional and Country Studies Branch,  
Industrial Policy and Perspectives Division.

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## INTRODUCTION

This is the first in a series of UNIDO documents on MERCOSUR. It is aimed at reviewing some key industrial policy issues involved in this specific trade integration initiative and at identifying industrial restructuring and related technical assistance requirements stemming from the respective timetable at the subsector level.

Against a backdrop of contradictory current trends towards trade liberalization, on the one hand, and the formation of regional blocs and growth of subtler forms of protectionism and managed trade practices, on the other, the Presidents of Argentina, Brazil, Paraguay and Uruguay signed on 26 March 1991 the Asuncion Treaty aimed at creating a common market by 1995.

The Treaty includes a commitment to reduce mutual tariffs to 0% by 31 December 1994 with automatic yearly reductions of one fifth. A common external tariff is to be established. Uruguay and Paraguay should have removed their trade restrictions by 1996, when capital, labour and services should be let to move freely within the area. Coordination of economic policies was agreed.

On 20 June 1991, the MERCOSUR countries and the USA agreed to establish a joint committee aimed at fostering trade and investment flows among the five countries. Additional agreements with the EC and Japan are underway.

The way has been left open for Chile and Bolivia to join MERCOSUR in the future. For the latter it involves resigning membership to the Andean Pact.

With a total population of 190 million and an annual GNP of US\$ 500 billion, MERCOSUR can be expected to become a sizable common market by international standards.

MERCOSUR follows a political decision to exploit important latent opportunities for efficiency gains and trade creation and to avoid running counter to trends towards increasing globalization and regional integration in the world economy.

Important medium-term implications follow from this regarding resource allocation and policies in the inter-related fields of industry, environment, human resources and science and technology. The ensuing economic and institutional adjustments are to be superimposed on those that are already part of the economic and social reform programmes underway at the national level. In the case of the industrial sector, a great potential for reaping economies of specialization and intra-industry trade exists, although a special effort is required to avoid waste of resources and unaffordable social costs and to create a conducive environment for the private initiative. The urgency with which this effort is required can hardly be exaggerated.

Although efficiency gains, trade creation and, ultimately, increased social welfare are the expected outcome, unavoidable adjustment costs are entailed. These are related to the execution of the needed industrial restructuring programmes whereby manufacturing enterprises streamline and focus their product lines, reap gains from economies of scale and specialization and upgrade their international competitiveness. Although some progress along these lines is already observed, the concretion of the common market will provide a powerful additional incentive within a much broader perspective.

Currently, UNIDO's work on MERCOSUR is focused on three main tasks within a medium-term outlook: (i) a review of the situation of specific industrial subsectors in order to identify the implications of the MERCOSUR schedule for industrial restructuring; (ii) an assessment of the past record and prospects of intra-industry MERCOSUR trade as a possible engine for trade creation and efficiency gains; and (iii) an evaluation of the experience of the EC from the MERCOSUR angle in three specific areas: a. manpower training b. investment incentive regimes; and c. competition policies.

Chapter I first presents an overview of the international policy and structural scenario within which MERCOSUR is taking shape, with emphasis on trade and investment flows as well as on trends in strategic partnering alliances. It then proceeds to focus on the conceptual underpinnings of intra-industry trade as well as on related empirical and policy dimensions and their implications for MERCOSUR.

Chapter II explores the conditions under which MERCOSUR may mold the pattern of economic relationships between the economies concerned. It submits a typology of impacts of economic integration on trade and industry and assesses them in the light of the MERCOSUR case.

Finally, Chapter III deals with cost and industry-specific factors bearing upon the development of inter- and intra-industry trade within MERCOSUR. It also assesses industrial restructuring implications and ensuing technical assistance needs by specific industrial subsectors.

This report has been prepared by the Regional and Country Studies Branch with contributions by consultants José Tavares and Elbio Baldinelli (chapters II and III, respectively).



## I. TRADE INTEGRATION AND INDUSTRIAL RESTRUCTURING: A REVIEW OF ISSUES

### A. THE GLOBAL ENVIRONMENT

Ambivalent signals stem from current tensions arising from the coexistence of generalized policy changes towards multilateral trade growth, liberalization, deregulation and privatization, on the one hand, and trends towards managed trade, on the other<sup>1</sup>.

At the same time, both on policy and theoretical grounds, trade issues and industrial policy issues are increasingly converging with each other.

International trade frictions arising from the implementation of subsidy schemes to domestic industry are an almost daily event. In addition, FDI and other non-market transactions are becoming as powerful a drive towards economic integration as trade itself.

International market structure and conduct are undergoing sharp changes. A clear thrust towards skill-based, more narrowly focused specialization coupled with an intensive strategic partnering activity and cross-border flows of skills and R&D outputs is observed. The frontiers between arms' length and non-arms' length transactions are becoming more blurred.

Liberalization trends notwithstanding, selective policy interventions are still pervasive, albeit under new labels (e.g., "market conforming", as opposed to "market-defying" interventions). Their all-out dismissal is being reassessed in light of concrete (successful) historical experiences [World Bank, 1991] and new theoretical developments [Baldwin, 1992]. Both in conceptual and practical ways, the blurring of the borderlines between "selective" and "functional" policy interventions does not make the ensuing policy debate any easier.

A new environment for trade and investment is clearly discernible. Most FDI, technology and trade flows take place between and within trade blocs (including their peripheries). The share of Intra-Triad stock on world-wide inward FDI went from 30% in 1980 up to 39% in 1988 [UNCTC, 1991]<sup>2</sup>. In 1989, fully 59% of world trade took place either *within* (36%) or *between* (23%) the three main trade blocs. Similarly, out of a total reported 4,192 strategic technology alliances undertaken during 1980-1989, 91.3 per cent were either *intra-* (49.0 per cent) or *inter-* (42.3 per cent) Triad members (see Table 1).

<sup>1</sup> The total value of trade affected by the so-called "grey-area measures", such as VERs and orderly marketing agreements, increased by over 60% in the 1980s, representing over half the overall growth in government trade intervention. There are currently some 250 VER agreements. The sectors most affected are semiconductors, automobiles, consumer electronics, steel and textiles [OECD, 1991].

<sup>2</sup> In 1989 US firms accounted for over 30% of all cross-border acquisitions in western Europe [Ibid].

Table 1. Regional composition of world trade and strategic technology alliances-STA

	Trade (1989, in US billion)		STA	
	Value	Percentage	Number	Percentage
1. <u>Intra-Triad</u>	<u>1.850</u>	<u>59</u>	<u>3.827</u>	<u>91.3</u>
Within blocs	1,125	36	2,054	49.0
Between blocs	725	23	1,773	42.3
2. <u>Triad-Rest of World</u>	<u>870</u>	<u>28</u>	<u>160</u>	<u>3.8</u>
3. <u>Intra Rest of World</u>	<u>400</u>	<u>13</u>	<u>205</u>	<u>4.9</u>
<u>Total</u>	<u>3.120</u>	<u>100</u>	<u>4.192</u>	<u>100.0</u>

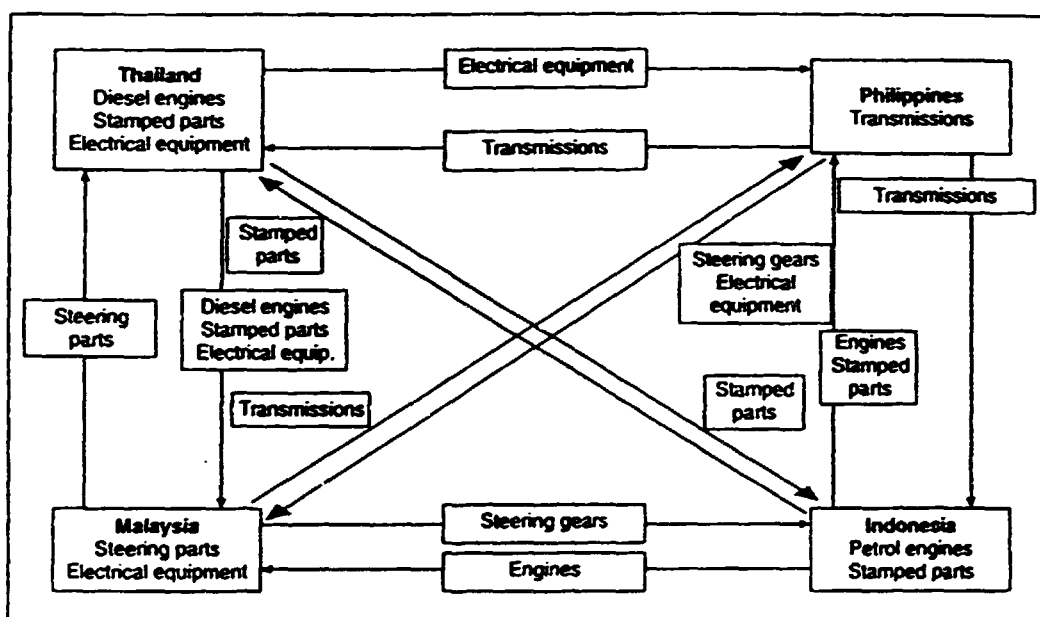
Source: GATT, MERIT, OECD and UNCTC.

Intensive relocation activity is taking place both within and between trade blocs. Take the S.E. Asean region. Industrial restructuring-IR in Japan and the last-tier NICs has opened up opportunities in resource-based and labour intensive activities in 2nd tier NICs such as Malaysia and Thailand, Indonesia and the Philippines. Many firms from Japan, Korea, Taiwan and Singapore are relocating unskilled labour intensive activities into those low wage cost economies giving rise to an emerging intra-firm, inter- and intra-industry network in which high-skill, critical component production and assembly segments are retained at home, particularly in Japan, while other segments and sub-assemblies are relocated within the region<sup>1</sup>. For an example see Figure 1.

Subject to the pressures ensuing from the ambivalent context depicted above, the Latin American countries are striving to enhance their capacity to create wealth through an in-depth policy-oriented reassessment of their competitive abilities within ever more open economies. Trade integration schemes such as MERCOSUR, CACM, CBI and the Andean Pact, are one of the avenues being sought, under completely new premises, to facilitate efficiency gains by acceding larger markets and thus reaping potential economies of scale and advantages from specialization.

<sup>1</sup> Compared to other developed market economies-DME, Japan keeps a relatively high ratio of inter-industry to intra-industry trade (see further below). Taiwan has become second only to Japan as source of FDI in the region. In the three fiscal years to 1990, FDI from Taiwan in the South East Asian economies amounted to about US\$7 billion. Out of 159 outward-investment projects by Taiwanese firms between January and June 1990, 52 went to the USA, 15 to Europe, 24 to Malaysia, 11 to Hong Kong, 21 to Thailand, 9 to Indonesia and 12 to the Philippines. Over three thirds of the projects were in the electrical and electronic fields. See Table 2.

Figure 1. Specialisation and intra-firm trade by South East Asian subsidiaries of Toyota



Source: *Far Eastern Economic Review* (1989, p. 73).

The potential for efficiency gains and trade creation in the context of trade integration schemes lies heavily, although by no means exclusively, in the development of two-way trade in manufacturing products (intra-industry trade-IIT). Both global and more specific regional trends point towards the development of IIT as the single fastest growing component of global trade in manufactures and one of the main engines of growth. Except for Japan, this kind of trade has become more important than inter-industry trade in the industrial world and it is on its way to do so in the developing world as well.

Table 2. Taiwan: main areas of manufacturing DEI in South East Asia

	THAILAND	MALAYSIA	PHILIPPINES	INDONESIA
Foods	/			/
Textiles	/	/	/	/
Garments			/	
Shoes				/
Timber processing		/		/
Wood Products		/		/
Paper				/
Plastics and Rubber	/	/		
Chemicals	/			
Basic Metallic Products		/		
Electrical and Electronics	/	/	/	

Source: Industrial Development and Investment, Taiwan, 1990

As far as efficiency gains are concerned, the key component of IIT is increasing returns from dynamic economies of scale (particularly those stemming from learning-by-doing and skill upgrading). However, the growth of IIT is by no means a safe indicator of improved resource allocation. It may also mean the opposite. What remains of this chapter will be devoted mainly to this issue and its implications for IR<sup>1</sup>.

<sup>1</sup> Two caveats should be borne in mind. First, because of very high minimum optimum scale of plant compared with market size, increasing returns to some activities may be reaped through inter- rather than intra-industry specialization. Second, a country may specialize even in activities not subject to increasing returns when economies of scale exists in activities that are situated either upstream or downstream of them or both.

By emphasizing the IIT and IR dimensions of trade integration at least two key factors accounting for the failure of past attempts (e.g., LAFTA) may be counteracted, i.e.: (i) too much focusing on the pure trade approach to integration; and (ii) the uneven distribution of the gains and costs of regional trade liberalization<sup>1</sup>.

There are a number of reasons why the joint approach to trade integration, IIT and IR issues is of particular relevance not just to leading DME, but to industrializing countries as well. These reasons have to do, among other things, with policy definitions relating to the scope and time-frame for an efficient application of infant industry criteria.

## B. INTRA-INDUSTRY TRADE

### 1. Overview

By 1985, 53% of the trade among the 6 largest DMEs consisted IIT. This contrasts with 14.9% for DMEs' IIT with developing countries (31% between OECD countries and NIEs). IIT among the latest, however, was higher (16.7%). See Tables 3 and 4. [Forstner and Ballance, 1990].

IIT among economies with similar resource endowments and demand patterns shows more dynamism than inter-industry trade among economies with differing resource endowments and demand patterns. This does not fit well the prognosis of received theory, which would have indicated otherwise. It does not follow from this, however, that factor endowments and ensuing cost differentials are no longer relevant, their influence on the pattern of international division of labour being shifted to the discretionary allocation of resources by firms and governments. There does seem, however, to be a broad gray area between both extremes. The conceptual and empirical search along these lines is far from exhausted.

### 2. Conceptual and Empirical Dimensions

IIT consists of the simultaneous import and export of products that are close substitutes in terms of either factor inputs or consumption, or both. Comparative advantages cannot easily explain this kind of trade. IIT is basically a symptom that additional explanatory ingredients are necessary.

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<sup>1</sup> Such emphasis has somehow been built-into the Integration and Economic Co-operation Programme between Argentina and Brazil signed in July 1986. Leaving aside the issue of whether achieving a balanced trade growth, overall and by sectors (with a focus on capital goods), should or should not have been left to the market to settle, such seems to be in some activities an unavoidable outcome to follow in the long run from a successful trade integration scheme among industrializing economies if a fair distribution of costs and benefits is to be sought.

Table 3. Average shares of IIT a/ in manufactured goods, by country group b/  
1985 (percentage)

Economic group/country (number of countries)	Trade with:								
	World	DMEs	Six major exporters	Other DMEs	CPEs	Developing countries	NIEs	Second- generation NIEs	Other developing countries
<u>DMEs (22)</u>	42.8	47.1	45.3	48.3	16.1	15.1	21.6	11.6	12.3
Six major exporters	47.8	54.4	52.8	55.6	20.8	19.9	30.8	19.1	14.3
France	60.1	70.2	69.6	71.3	33.5	13.7	28.2	13.5	10.8
Germany, Fed. Rep. of	56.0	63.9	63.9	62.9	23.4	17.0	27.6	17.9	13.6
Italy	48.0	55.1	55.7	54.0	23.4	19.1	35.7	12.3	16.5
Japan	17.8	22.4	24.0	16.3	6.4	10.3	22.0	7.0	4.2
United Kingdom	60.2	67.7	66.5	69.3	22.5	22.7	26.9	25.3	20.5
United States	44.6	47.6	37.3	59.6	15.2	36.5	44.3	38.7	20.0
Other DMEs (16)	40.9	44.4	42.5	45.5	14.4	13.3	18.2	8.7	11.5
<u>Developing countries and areas (25)</u>	16.3	14.9	15.3	12.5	2.5	16.7	15.8	14.0	18.8
NIEs (6)	29.3	29.8	30.4	26.4	2.7	29.6	32.7	29.0	24.0
Second-generation NIEs (9)	13.3	11.3	11.9	7.9	0.6	17.5	18.2	11.5	13.5
Other developing countries (10)	11.4	9.6	9.7	8.8	4.3	12.8	3.8	7.5	15.5

Source: UNIDO

a/ In general, the averages of the Grubel-Lloyd measure used in this table are based on data at the four-digit level of the SITC. Determination of these averages consisted of three steps. First, for each of the 47 countries in the sample and for each of the six 'basic' subgroups of trading partners (identified in columns 3, 4, 5, 7, 8 and 9) the IIT share of all manufactures was calculated as a weighted average where the sum of exports and imports was used as the weight. Second, IIT-shares for the 'broad' partner country groups (DMEs, developing countries and world) were derived from the foregoing figures as the same type of weighted average. Third, figures for the groupings of the 47 countries were obtained as unweighted averages of the indices derived in steps one and/or two.

b/ The composition of country groups is given in table 3.1.

Table 4. Industries *a/* with high IIT shares *b/* in trade of DMEs and developing countries and areas, 1985 (percentage)

Country group	SITC	Trade with DMEs	SITC	Trade with developing countries and areas
DMEs	581	Plastic materials (74.3)	714	Office machines (53.7)
	729	Other electrical machinery (66.2)	729	Other electric machinery (51.8)
	722	Electric power machinery (66.2)	512	Organic chemicals (41.7)
	734	Aircraft (64.8)	723	Equipment for distributing electricity (32.5)
	512	Organic chemicals (64.3)	722	Electric power machinery (32.3)
	711	Non-electric power generating machinery (64.0)	711	Power generating machinery (25.5)
	651	Textile yarn and thread (64.0)	653	Woven textile fabrics (25.3)
	719	Non-electric machinery and appliances (63.0)	894	Perambulators, toys, games (22.4)
	714	Office machines (62.3)	891	Musical instruments, etc. (22.0)
	541	Medicinal and pharmaceutical products (62.3)	861	Scientific, medical and optical instruments (20.6)
	Developing countries and areas <sup>c/</sup>			735
			864	Watches and clocks (69.1)
			894	Perambulators, toys, games (60.2)
			729	Other electrical machinery (59.6)
			722	Electric power machinery (50.4)
			714	Office machines (39.3)
			724	Telecommunications apparatus (35.7)
			652	Cotton, fabrics, woven (33.0)
			541	Medicinal and pharmaceutical products (31.8)
			891	Musical instruments (31.0)

Source: UNIDO

- a/* Only industries which accounted for at least one per cent of total trade between or within the respective country groups in 1985 are included.
- b/* IIT shares, given in parentheses, are weighted averages of four-digit SITC subgroups within each given three-digit group.
- c/* The figures in the lower right hand block refer to trade between the 25 developing countries included in the sample and all developing countries for which partner country data were available.

A distinction should be drawn between three kinds of IIT: (i) sporadic; (ii) sequential; and (iii) horizontal.

(i) Sporadic IIT (ITT): it consists of homogenous products involved in border, entrepôt or seasonal trade. Transport costs and seasonal differences in production may explain most IIT of this type.

(ii) Sequential IIT (ITT): comprises heterogeneous products made in the same industry along its vertical chain of production. Labour cost differentials often are the primary reason for this kind of IIT, which is common in DFI-intensive industries; and, finally:

(iii) Horizontal IIT (ITT): This (the most dynamic component of IIT) consists of heterogeneous or differentiated products that are close substitutes in production, consumption or both. Three sub-categories can be distinguished here:

(a) Products with different input requirements but high elasticities of substitution (e.g., furniture made from different materials such as steel, timber or cane, textile yarn from natural or man-made fibres, and footwear of leather or synthetic materials);

(b) Products from industries that transform identical inputs into a range of outputs with different end-uses (e.g., railways sleepers and heavy plates for shipbuilding turned out by the basic iron and steel industry; a wide range of petrochemical products supplied by the petroleum industry);

(c) Similar products made by similar processes from similar materials (e.g., processed food, beverages, textiles, clothing, shoes, cars, furniture, tobacco products, appliances, hand tools, boats, electronic and mechanical data processing equipment and communications equipment).

IIT, sub-categories (b) and (c), in particular, strain the explanatory powers of conventional theory. They relate to specific production conditions, increasing returns to scale associated with specialization and learning, product market imperfections and strategic considerations.

Some IIT subcategories, such as  $T_1$ ,  $T_2$ , and even  $T_3$ , may be explained at least to some extent in terms of consumer preferences even assuming identical production functions and instantaneous international diffusion of product and process innovations. However, the remainder IIT categories appear to require a greater doses of supply-side explanations, such as those related to differences in technology, and in innovative and imitative skills and capabilities across countries.

The development of IIT is by no means an indicator of increased efficiency, let alone social welfare. There is no lack of examples in Latin America where such a development has followed from duplication of capacity in inefficient plant sizes as well as from exploiting brand image and market segmentation techniques within a protected trade area (witness the case of the tire subsector in Central America in the late 1960s and early 1970s).

Another caveat is due to measurement distortions. As, unfortunately, formal trade categories often do not fit the economic definition of what an industry is, statistical measurements of IIT are sometimes deceiving. Thus, for instance, what may appear as IIT at a given level of aggregation may turn



out, on closer scrutiny at a more disaggregate level, to be inter-industry trade<sup>1</sup>. It has also been found that the variability in capital-labour ratios within SITC 3-digit "industries" is greater than the variability of those ratios between 3-digit groups [Finger, 1975; Rayment, 1976; see also Rayment 1986].

### C. POLICY DIMENSIONS

The scope and timing of IR-related policy dimensions are bound to be profoundly influenced by broader policy related-issues that arise within a trade area. One of them is: is there a need for a pace-setter? A given country may be called forth to play this role if it offers the best combination of competitive strength, economic dynamism, monetary stability and influence on world markets. Such is the case of Germany in the EC, the USA in NAFTA and Japan in East Asia.

If a country with a vocation for pace-setting falls into disarray (witness Germany today) and is therefore unable to perform as expected the immediate alternatives are: (i) another country may take its role; (ii) the trade area gets weakened and eventually breaks down and (iii) the weaker countries choose a third (extra-area) country or region or the world market as a whole as an "anchor".

When the differences in specific weight of the countries concerned is substantial, alternative (i) may not be viable. Therefore, alternative (iii) becomes the only viable if the trade area is to subsist. This, however, may weaken considerably the scope for policy convergence and, with it, for trade creation and efficiency gains to stem from the trade area.

One of the main challenges faced by MERCOSUR members is that the domestic content regulations and rules of origin to be set forth do so in such a way as to avoid the trade area becoming an exercise in extended import substitution. This is critical for those countries and subsectors with a lower degree of vertical integration and a higher relative weight of downstream activities. These countries will naturally favour relying on world market prices as much as possible, thus strengthening the external "anchor" resort, as is the case of Canada within NAFTA.

Progress towards freer intra-MERCOSUR trade will bring about strong adjustment pressures. (See further below, particularly chapter III.)

There are two types of IR needs pursuant to the removal of barriers to trade to be dealt with. First, those having to do with adjustment pressures on existing capacity. Second, those related to new industrial opportunities

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<sup>1</sup> Thus, for instance, the 3-digit level SITC category 775 ("household type equipment") shows a Grubel and Lloyd unadjusted index of 95.17 in 1985 in reciprocal trade between Argentina and Brazil. However, it turns out that, at the 4-digit level, Argentina was exporting only electric shavers and only importing refrigerators, domestic electrical and electro-thermic products, thus indicating nearly complete inter-industry specialization at the 4-digit level [Behar, 1991].

open by the enlarged market.

To await for protectionist lobbying by firms that are in need of restructuring once it is too late to do much about it instead of encouraging them to adjust when there is still time to do so would be a very shortsighted stand to take. The rationale behind it, as is sometimes argued, is that adjustment costs are simply the price society has to pay for change. However, those that have to afford such costs directly will find such a reasoning hardly persuasive and are most likely to pose strong cases for counteracting protectionist measures.

Faced with the impact of the elimination of restraints on trade on prices, firms may respond either by quickly adjusting or by resisting the price change, thus giving rise to an adjustment problem. The acuteness of this problem may be assessed by determining whether trade expansion leads to intra- or inter-industry specialization.

Adjustment costs associated with trade integration may be expected to be greater with inter-industry than with intra-industry specialization. Leaving aside risks stemming from too much exposure to highly price-sensitive and stagnant markets, no matter how efficient the first type of specialization may be in the long run, it is bound to give rise to serious dislocations in both production and employment in the short run. Other things given, changes in the scope and structure of the input/output mix are likely to be a much less disruptive way of gaining efficiency than moving resources across industries. Thus, for instance, transferability of labour may not be possible without complete retraining or geographical relocation of labour and facilities may be necessary (Greenaway and Hine, 1991). The impact on income distribution can also be expected to be less dramatic<sup>1</sup>.

It is worth recalling the experience of the EC in the steel sector in this regard. The prediction might have been made, along the lines of customs union theory, that sectoral specialization in accordance with comparative advantage would have taken place. However, the French and Italians did not feel comfortable with having Germany dominating the entire market. Instead of inter-industry specialization, a substantial expansion of intra-industry specialization and trade took place [Adler, 1970]. Similarly, Japan chose to adjust to expanding trade in textiles and clothing with its East Asian trade partners through intra- rather than inter-industry specialization [Fukorora, 1990]. Further evidence in this respect can be found in the literature [see, for instance, Cox and Harris, 1985 and Canada, 1988].

However, as pointed out above, inter-industry specialization may be inevitable where minimum efficient size is large relative to the total market. Then, significant inter-industry adjustments may take place with large numbers of firms exiting sectors.

Perhaps the key policy dilemma faced by MERCOSUR governments at the end of 1992 relates to a schism evolving between trade policies, on the one hand, and the realities of industrial adjustment, on the other.

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<sup>1</sup> This has been taken as the reason why GATT multilateral trade negotiations have tended to be focused on manufactured goods [Hofbauer and Chilas, 1974].

The governments have established the overall timetable for reciprocal trade liberalization (in addition to the accelerated schedules underway at the national level) and left it to the private sector to adjust quite by itself in a context that includes, among others, wildly diverging exchange rate policies (leading, for instance, to trade frictions stemming from a flooding of the Argentine market by Brazilian products).<sup>1</sup>

At the same time, encouraged by the governments, private industry is negotiating sectoral agreements that may eventually have built-in biases towards restrictive trade practices and trade diversion [Motta Veiga, 1992]. This would be in direct conflict with the Treaty of Asuncion which gave birth to the trade area. Therefore, the general guidelines set up in advance hardly suffice at this stage. Governments have been left now with little choice but to take a stand on the contents of the negotiations at the sub-sectoral level, including hotly debated issues such as local content requirements, rules of origin and the level of the common external tariff.

Clearly, this situation can only be sorted out in the medium-term [Berlinski, 1992]. Meanwhile, the ground must be prepared so that suitable policy instruments are in place when the time comes to take the most decisive steps towards a genuine common market - such issues as those relating to areas such as competition, investment incentives, environmental and quality management and skill formation, which are being focused by UNIDO's current work relating to MERCOSUR.

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<sup>1</sup> For a review of asymmetries see, for instance, Lavagna, 1991.

## II. THE OUTLOOK FOR MERCOSUR

### A. INTRODUCTORY REMARKS<sup>1</sup>

The prevalence of exchange rate instability and the fragility of economic ties between the member countries stand as two fundamental stumbling blocks to creation of MERCOSUR. History has as yet no record of successful experiences in economic integration involving economies with these particular characteristics.

The present chapter explores the conditions under which MERCOSUR could alter the pattern that has governed relationships between the region's economies in recent decades, *assuming that the monetary question has been resolved*. Section B submits a typology of effects that economic integration would in principle have on productive structures and trade flows. Section C qualifies this analytic approach for the MERCOSUR case. Section D discusses MERCOSUR's agenda. Lastly, section E provides a summary of the main conclusions.

### B. INDUSTRIAL CONFIGURATION, INDUSTRIAL LOCATION, AND TRADE PATTERNS

During the decade of the 1980s, the theories of international trade and of industrial organization moved together to form one unified area of knowledge, as the result of two converging processes. On the one hand, the long cycle of challenges to the Ricardo-Heckscher-Ohlin-Samuelson version of the theory of comparative advantages came to a close within the trade pattern debate. This controversy, inaugurated with Prebisch's theses and Leontief's paradox, produced invaluable new tools useful in analyzing contemporary international economics - for example, Linder's ideas, the product cycle theory, and intra-industry trade indexes. However, up until the beginning of the 1980s, these tools served only to subsidize partial criticisms of established theory. Since then, with the advent of Helpman and Krugman's approach (1985), it has become possible to incorporate these tools into a new theory that stresses economies of scale and imperfect competition as key factors in explaining international trade. This theory does not abandon the fundamental thesis of the previous theory - that trade is worthwhile as long as disparities between two economies' opportunity costs exists - but it adds two important observations: (a) labour costs and factor proportions not always explain opportunity costs and (b) it is not enough to identify the origin of comparative advantages; the rhythm of change must also be taken into account.

On the other hand, in the realm of the literature on industrial organization, the Schumpeterian competition and contestable market theories emphasized the importance of interactions between technical progress, competition, and market size and thereby encouraged research of topics related

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<sup>1</sup> Thanks are due to Francisco Sercovich and Ronald Sprcut for thoughtful comments, and to Honorio Kume and Lia Valls Pereira for information provided on the import policies currently enforced by Mercosur members and on the recent evolution of governmental talks concerning the Southern Common Market project.

to Helpman and Krugman's approach.<sup>1</sup> In view not only of the economies of scale and of scope inherent to contemporary technology but also of the business strategies that must be implemented to take advantage of these potential gains and of the dimensions of the final demand vector for goods and services produced by that technology, there is a growing number of sectors wherein only firms of a global scope can survive. Therefore, any current analysis of industrial dynamics must necessarily include an analysis of trade patterns, and visa versa.

In Geography and Trade (1991), Paul Krugman has contributed to this integrated vision of industrial dynamics. He argues that the topic of trade would still remain relevant even under the drastic hypothesis that the current trend toward formation of unified economic spaces were carried to its ultimate consequences and all national borders were to disappear. Goods and services would nevertheless continue to be produced in one location and consumed in another, due to the combined influence of three main factors: (a) the size and geographic distribution of consumer markets; (b) transportation costs; and (c) economies of scale.

This model does not consider the above factors as exogenous variables that explain trade volume but as products of historical events, technical progress, and economic policy. Central to the model is its return to classic themes from studies on regional economics. Once an industrial park has been established, locational economies begin to operate, attracting new investments as a direct function both of the size of the market already in place and the economies of scale inherent to the new ventures and as an inverse function of the relation between transport costs for productive inputs and final goods.

The ensuing process of industrial concentration will be governed by (a) the pace of technological innovations (which can affect either transport costs or economies of scale); (b) the performance of other existent industrial parks; and (c) public or private decisions to set up new parks in other regions.

Two applications of Krugman's model are particularly relevant to the present discussion. One has to do with the political economy of protection, and the other, with the theory of economic integration.

Krugman's model goes a long way towards conciliating protectionist and liberal views. Indeed, as long as prospects for growth on a local market and trends in technical progress lead to changes in opportunity costs, it is worth investing in the creation of new industrial parks, provided that the costs of temporary protection of infant industries do not surpass the present value of expected social benefits.

One worry that often haunts economic integration projects are the dissimilarities in the levels of efficiency displayed by the productive structures involved in the project. Common sense suggests that the dismantling of trade barriers means that only the most competitive industries in each nation will outlive like industries in the other nations. Although this may in fact be beneficial in the long run, the short-run costs of industrial

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<sup>1</sup> The Schumpeterian competition theory is described in Nelson and Winter (1982) and the contestable market theory, in Baumol et al. (1982).

relocation may be unbearable for certain countries.

It is interesting to note, however, that in the cases of the EC and EFTA this was not a major problem.<sup>1</sup> Krugman's model shows that these cases were not exceptional, since the formation of a unified economic space will have other effects that tend to override the problem of industrial relocation, or, at least, will make more amenable the costs of such a change.

In principle, three kinds of effects are foreseeable. The first is simple trade growth, with no change in existing industrial configurations. This would be the case with industries which, prior to integration, were already operating according to international standards of quality and efficiency in more than one member nation. After integration, intra-industry trade flow would appear, based essentially on product differentiation and market segmentation strategies - as exemplified by sales of Beaujolais in Venice and of Valpolicella in Lyon, of the Fiat Uno in London and the Rolls Royce in Rome, of sherry in Glasgow and Drambuie in Madrid, and so on.

Secondly, economic integration may produce changes in company product mixes, as a consequence of mergers, acquisitions, and partnership formation or of the restructuring of individual companies, so as to exploit the economies of scale and scope generated by the integration project. This kind of impact would be particularly relevant to those industries that, prior to integration, had low levels of international competitiveness, because it would mean that each country would begin to display industrial configurations better adjusted to the characteristics of available technologies and to market dimensions. In this case, the benefits of integration would result mainly from intra-industry specialization: type-X lathes would be produced in Argentina and type-B, in Brazil; colourings and pigments in Montevideo and paints in São Paulo.

The third kind of effect would be industrial relocation, something that would tend to occur where inequalities in competitiveness could not be corrected by means of the modifications described in the previous paragraph. This consequence obviously becomes an obstacle to integration in those cases in which the productive structures of member nations are so dissimilar that they do not generate opportunities for the other two types of effects to take hold.

Thus, from the point of view of each country, economic integration offers new growth opportunities to its industries that were already competitive, through the removal of trade barriers. The remaining industries will have to face the dilemma of choosing between restructuring or perishing. The advantage offered by integration in this case is to soften this dilemma, by generating an enlarged local market.

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<sup>1</sup> This does not mean that regional or sectoral impacts on employment and installed capacity have not occurred, but that European integration has generated investment opportunities that allowed partial absorption of those impacts.

### C. FORFSEEABLE REPERCUSSIONS

Given the peculiarities of the region's economic ties in recent decades, the typology of effects described above requires some preliminary qualifications in the case of MERCOSUR. We must first consider the geographic distribution of trade between MERCOSUR countries, as depicted in Table 5. On the one hand, over the past 30 years Paraguay and Uruguay have tended to concentrate their transactions within the area of the Latin American Integration Association (ALADI), destination of up to 40 per cent to 50 per cent of these two nations' foreign trade more recently. On the other hand, Brazil has diversified its trade partners while almost always channeling over 50 per cent of its foreign commerce to the EC and the US and only 10 to 15 per cent to Aladi. Argentina's behaviour has lain somewhere in the middle: at the beginning of the sixties, its trade with Latin America was slightly more than 10 per cent, whereas during the second half of the eighties the figure reached a peak of 25 per cent.

Table 5. Regional distribution of foreign trade by MERCOSUR nations

Period/Area	Argentina	Brazil	Paraguay	Uruguay
1961/1963				
Aladi	12.8	10.7	27.2	14.5
US	18.4	35.6	23.7	6.0
EEC	50.1	27.0	28.1	26.1
Others	18.7	26.7	21.0	53.4
Total	100.0	100.0	100.0	100.0
1970/1972				
Aladi	21.5	9.9	29.3	24.8
US	15.8	27.0	18.5	8.4
EEC	43.1	33.4	32.6	39.1
Others	19.6	29.7	19.6	27.7
Total	100.0	100.0	100.0	100.0
1980/1982				
Aladi	21.3	15.0	47.7	37.1
US	16.5	18.2	7.8	9.0
EEC	25.8	20.3	19.7	21.9
Others	36.4	46.5	24.8	32.0
Total	100.0	100.0	100.0	100.0
1986/1988				
Aladi	25.4	12.0	45.5	40.1
US	14.5	23.8	8.5	10.7
EEC	29.5	24.7	23.6	23.7
Others	30.6	39.5	22.4	25.5
Total	100.0	100.0	100.0	100.0

Source: Aladi.

This trade pattern is partly a natural result of disparities in both the size and the level of complexity of these economies' productive structures.

However, the influence of three additional factors must be noted: the style of industrial growth prevailing in the region through the end of the 1970s, the foreign debt crisis, and exchange rate instability.

The defining feature of an industrial policy aimed at import substitution is the restrictions it entails on the entry of foreign products that compete with local goods. In Brazil, where the creation of new branches of activity has systematically generated domestic market reserves for incumbent firms, this strategy was taken to its extreme. As a result, Brazilian trade policy has been unable to adequately fulfil the role that inherently falls to large economies participating in regional integration processes: promoting trade by creating purchasing power in neighbouring economies through imports from those neighbours.

The foreign debt crunch of the first half of the 1980s aggravated this perverse characteristic of the Brazilian economy, as reflected in Table 6. From 1980 through 1983, Brazilian imports from what now forms MERCOSUR dropped 46 per cent. In response, intra-regional trade fell in an equal proportion, and Brazil's own balance of payments problem was exacerbated as the nation's trade balance with the region plummeted from US \$816 million to US \$463 million.

Table 6. Brazilian trade with MERCOSUR nations, 1980/1990  
(in US \$ million)

Year	Exports (1)	Brazil Imports (2)	Balance (3)	Intra- MERCOSUR Trade (4)	Brazilian Share (1+2)/(4)
1980	1,812	996	816	3,434	0.82
1981	1,703	802	901	2,995	0.84
1982	1,112	797	315	2,353	0.81
1983	999	536	463	1,836	0.84
1984	1,322	646	676	2,289	0.86
1985	987	700	287	1,950	0.87
1986	1,215	1,089	126	2,636	0.87
1987	1,306	810	496	2,531	0.84
1988	1,637	954	683	3,003	0.86
1989	1,367	1,906	(539)	3,717	0.88
1990	1,197	2,237	(1,040)	4,036	0.85

Source: MERCOSUR Index.

In recent decades sharp exchange rate variations have become an endemic disease in all of Latin America. While exchange rate instability may not be an obstacle to trade growth, it does trammel the closing of long-term international contracts between independent firms. The consequences of this problem will be examined below in the light of the behaviour of intra-industry trade between Argentina and Brazil.

The recovery of regional commerce during the second half of the 1980s, shown in Table 6, was possible thanks to a set of bilateral agreements that were forerunners to the Treaty of Asuncion. From 1986 through 1988, the



governments of Argentina and Brazil signed twenty-two protocols meant to enforce the Programme for Economic Integration and Co-operation between the two countries, while Argentina and Uruguay worked to expand Cause (the Argentinean/Uruguayan Agreement on Economic Co-operation) and Brazil and Uruguay renegotiated PEC (Trade Expansion Programme).

Despite the success attained on the trade level, these bilateral agreements failed to erase two blemishes marring relations between these economies: the systematic generation of Brazilian superavits - a pattern broken only in 1989 and 1990, when the cruzeiro was highly overvalued [Araujo Jr., 1991a] - and the absence of stable intra-industry transactions. Accumulating trade surpluses while making no equivalent compensatory investment in neighbouring nations meant that, on the one hand, Brazil was under-utilizing trade potential by inadequately stimulating the region's buying power and that, on the other hand, the region's central banks were periodically forced to renegotiate debts. Before moving on to a discussion of possible solutions to this dilemma (section D), and in order to assess the probable impact on MERCOSUR, the final peculiarity of this project; i.e. intra-industry trade has to be dealt with.

The intra-industry transactions examined in the literature are regular trade flows that result from the exploration of economies of scale and of standards of competition based on product differentiation and market segmentation. Three kinds of flow may exist: (a) intra-company trade; (b) the import of goods that compete with local supplies; and (c) the purchase and sale of inputs between independent companies under long-term contracts. Intra-industry trade indicators measure the degree of integration between the economies and encompass not only the ties between productive structures but also the interactions between markets for final goods.

Opportunities for this kind of trade between MERCOSUR members have been scarce in recent decades due to Brazil's excessive protectionism and to exchange rate instability. Indeed, the only feasible modality has been intra-company trade and even then under quite restricted circumstances.

One reflection of these conditions is the behaviour of Argentine and Brazilian companies operating within both economies. According to Guia Inter-invest, in 1986 Argentine capital had participation in 130 companies in Brazil while, according to the Atlas Financeiro, only 15 Brazilian companies had subsidiaries in Argentina in 1989. But none of these firms appears on the list of the 300 largest exporters and importers responsible for bilateral trade over the past 5 years, contrary to what typically occurs in the case of headquarters and their branches.

Table 7 provides a more complete picture of the evolution of intra-country trade between Argentina and Brazil. Within a selected set of industries, data cover all branches that at least once in 1975, 1980, 1985 or 1987 reached intra-country trade indexes of no less than 40 per cent and total transactions of over US \$20 million simultaneously. Of the eight sectors achieving such performance, only two did so on more than one occasion: autoparts and products for photography, film, and other goods.

Table 7. Argentine/Brazilian Intra-industry Trade, 1975/1987

Industry	1975		1980		1985		1987	
	Bi	(X+M)	Bi	(X+M)	Bi	(X+M)	Bi	(X+M)
Petroleum products	2.8	1.3	6.3	22.8	6.4	10.4	76.9	36.1
Organic chem. prod.	72.5	2.9	92.0	9.1	29.2	9.3	45.8	21.5
Combustion engines	83.0	4.4	30.0	22.8	76.7	12.7	78.2	20.9
Office machines	99.2	20.2	16.9	20.7	4.7	3.9	0.5	3.8
Pumps and compressors	46.7	7.1	89.2	20.9	92.4	7.6	62.3	11.9
Electrical appliances	13.0	4.8	81.2	26.8	84.6	3.8	73.0	3.7
Car parts	39.2	7.6	68.2	54.5	90.0	62.7	79.2	91.8
Prod. for phot. and film etc.	67.9	1.3	89.3	19.3	66.6	28.9	85.5	25.9

Source: Banco do Brazil's Foreign Trade Office (CACEX).

Bi - Intra-industry trade index =  $1 - [X - M] / (X + M)$ .

X - Brazilian exports in millions of current US dollars.

M - Brazilian imports in millions of current US dollars.

Ever since the start of the 1980s, the car-parts industry has recorded high intra-industry trade indexes and a growing trade volume. Strictly speaking, this is perhaps the only effective example of intra-industry trade within MERCOSUR, albeit limited to the operations of just three multinational companies. The Argentinean and Brazilian subsidiaries of Autolatina, Fiat, and Saab-Scania boast sole responsibility for this feat [Fonseca, 1989].

The firms classified under "products for photography, film, and miscellaneous other goods" also presented high intra-industry trade indexes but a less substantial trade volume. This industry encompasses an extremely heterogeneous set of goods and distinct patterns of competition. Items range from scientific instrumentation and medical equipment to toys, and thus these indexes may, for instance, reflect exports of dolls and imports of lenses.

Despite the fragility of current ties between MERCOSUR economies, the data presented in Tables 6 and 7 suggests that the integration project may have a relevant impact not only at the trade expansion level but also at the level of company restructuring. In 1986, in response to a timid set of liberalizing measures, the rhythm of trade level recovery proved that there is still much trade potential left to be exploited. Furthermore, intra-industry trade indexes showed that, if exchange rate stability were the rule, Brazil and Argentina would enjoy symmetrical opportunities for specialization in important areas of the chemical and metal-mechanical industries and in final consumer goods. Thus, any possible relocation costs that might arise could be offset by gains coming from the other two kinds of integration effects.

#### D. INDUSTRIAL POLICY AND THE COMMON EXTERNAL TARIFF

If MERCOSUR is to realize its full potential, in terms of the above effects, exchange rate stability is not the only prerequisite to be met. Companies must also enjoy similar conditions of competition in all four nations. If this is not the case, strongholds of resistance to integration may take root in those industries where regional differences in profitability

are prompted by institutional asymmetries or asymmetries in economic policy.

The effort to harmonize governmental goals, legislation, and public agency conduct calls for an agenda of measures comprising three different timetables. Theoretically, all three of these went into effect on 26 March 1991, when the Treaty of Asunción was signed. The final deadline for the first timetable is 31 December 1994, the date by which trade barriers between the four economies are to have been abolished. The second timetable has no precise end date but will expire upon achievement of all the conditions that define a common market (i.e. identical policies - or at least less divergent ones - in the monetary, fiscal, exchange, trade, industrial, and agricultural areas). Although official discourse claims that this will be accomplished by 1994, that target date is known to be unrealistic. Fulfillment of the third timetable will be an even lengthier process because it entails enforcement of an industrial strategy capable of guaranteeing that MERCOSUR's productive system keeps pace with international technical progress.

Through December 1994, customs tariffs will suffer linear, automatic and across-the-board reductions at six-month intervals. Three matters will merit top-priority treatment in the interim: (a) taxes charged solely on local production - in the case of Brazil, this would include such workers' compensation funds as PIS and FINSOCIAL (as well as the proposed tax on drafted checks, should the Brazilian Congress go ahead with its current idea of creating this mechanism); (b) regulation of supplies of agricultural products; and (c) significant disparities between effective protection structures vis-à-vis third markets, which encourage the breaking of rules of origin, via triangular import schemes.

In integration projects, taxes on the value of production and other charges that do not affect imports can easily discourage local industry since calculations quickly disclose the ensuing bias in favour of goods produced in other nations within the project's economic community. When the government is unable to abolish this form of discrimination directly, simply by eliminating such taxes, countervailing duties must be imposed in order to forestall legitimate resistance to integration. However, enforcing this alternative, even transitorily, is not a simple matter since it exposes an apparent flaw in the integration project. In the case of MERCOSUR, a sensible solution would be to conduct a complete, precise survey of such taxes within the four member nations and to negotiate their effective revocation by 1994.

Due to its singular characteristics - seasonal variations and the possibilities of crop failure or over-production - the agricultural sector does not fit readily into automatic liberalization schemes. To keep these uncertainties from thwarting progress toward integration in other areas, it is advisable to separate agricultural sector talks by setting up a forum charged with regulating the regional supply of agricultural products. In its initial years of operation, this forum would merely be a co-ordinating and consultancy mechanism bringing together the four nations' agriculture ministers. Each semester, forecasts for regional production and supply would be evaluated and decisions made on any necessary adjustments in price policies, subsidies, intra-regional trade, and trade with third markets. As was the case in Europe, the region's agricultural policies would gradually be unified through these co-ordination and consultation activities.

According to the guidelines set out in the Treaty of Asunción, MERCOSUR will adopt a common foreign tariff by 1994. But the history of other

integration projects and the recent evolution of Brazilian trade policy suggest it is unlikely this goal will be met. Since 1987, customs tariff reform has been the topic of talks between the government and private business in Brazil. Under the Collor Administration, a timetable was defined for gradually reducing tariff rates through 1994. This means it will have taken nearly eight years to achieve what may be only a partial transition from one trade regime to another.

Indeed, the tariff structure that will go into effect in 1994 is only a first step toward a new and as yet incomplete structure. In the first place, no guidelines have yet been defined for determining further changes in the structure and, second, as it is, it contains distortions that will most likely demand correction prior to 1994.

Table 8 shows the levels of effective protection foreseen for 1994, according to Brazilian Government calculations (non-tariff taxes or subsidies have not been taken into account). Of the 64 total sectors, 7 will be unprotected<sup>1</sup> and two will have protection levels of over 30 per cent, that is, the car industry (62.5 per cent) and radio, TV, and sound equipment (36 per cent). These distortions may be prevented from provoking cries for changes in custom tariffs if they are offset by other taxes, subsidies, or variations in the real exchange rate.

Table 8. Levels of effective protection foreseen for Brazil in 1994

Level of protection	No. of sectors
Negative	7
0 to 10 per cent	10
10 to 20 per cent	17
20 to 30 per cent	28
Over 30 per cent	2

Source: Brazil, Ministry of the Economy, Coordenadoria Técnica de Tarifas (CTT).

To gain an idea of the exact dimension of the effort needed to establish a common foreign tariff within MERCOSUR, one would need to compare the effective protection structures existing in the four member nations. Since no information is available on effective protection, nominal indexes have been used.<sup>2</sup>

Tables 9 and 10, which show average and maximum import duties and the

<sup>1</sup> The unprotected sectors are: mining of non-metallic minerals, extraction of crude and natural gas, coal, cement, petroleum refining, pulp and wheat milling.

<sup>2</sup> Nominal protection indexes should be interpreted with caution, above all when referred to the averages for nomenclature chapters, since these chapters often encompass goods from various industries. In some cases, the information may be completely distorted. In Brazil, for example, the average tariff rate for chapter 87, which includes cars, tractors, bicycles, and other vehicles, will be 24.2 per cent in 1994 while effective protection of the car industry will be 62.5 per cent, as indicated earlier.

dispersion of nominal protection levels, provide initial subsidies for this question. As can be noted, current tariff structures<sup>1</sup> are a strong incentive to unfair trade practices in view of the profits to be made through triangular import schemes. In the 87 chapters of the nomenclature, differences of more than 10 percentage points can be found between average rates for the four nations within one same chapter.

Table 9. Customs tariffs in MERCOSUR nations

Country	Average	Maximum
Argentina	9.6	35.0
Brazil	14.2	40.0*
Paraguay	16.0	72.0
Uruguay	21.5	30.0

Source: CTT.

\* The maximum tariff to be established was lowered to 35%.

Table 10. MERCOSUR dispersion of nominal protection levels

Degree of dispersion	No. of chapters
0 to 10	8
10 to 20	62
20 to 30	20
Over 30	5

Source: CTT.

**Degree of dispersion:** Difference between the maximum values of average duties, by chapter of the customs nomenclature, in effect among MERCOSUR nations.

Therefore, harmonization of import policies will affect almost all sectors of these economies. Since it is impracticable to achieve harmonization in one single round of talks, an agenda of priorities must be defined, stipulating which goals are to be met by 1994 and which can be assigned longer deadlines. Tables 11 and 12 present data essential to these definitions.

Table 11 shows that some disparities are devoid of any economic significance or are confined to one single nation and can thus be easily corrected. An example of the first kind of disparity is the aircraft industry, which in this region exists in Argentina and Brazil, although the highest tariff rates are charged by Paraguay and Uruguay. The textile industry illustrates the second situation: levels of effective protection in Argentina, Brazil, and Uruguay are apparently similar when one looks at duties on cotton, synthetic fibres, fabrics, and wearing apparel. However, in Paraguay the cotton fabric industry can be considered unprotected since the

<sup>1</sup> In the case of Brazil, the tariffs used are those foreseen for 1994.

tariff on basic inputs is higher than that on the final product, while wearing apparel is overprotected.

Table 11. MERCOSUR: average import duties

Chapter	Argentina	Brazil	Paraguay	Uruguay
Live animals	0.0	0.0	11.6	22.3
Meat	1.1	10.0	35.5	25.4
Fish and shellfish	0.0	9.4	10.1	24.4
Milk and dairy product	0.0	19.4	31.2	23.3
Grains	0.0	9.6	11.2	14.8
Milling	0.0	10.4	14.6	28.4
Seeds	0.0	8.1	11.7	16.0
Misc. foodstuffs	3.3	20.0	13.1	25.9
Beverages and vinegar	11.3	19.7	26.7	26.8
Cotton	14.7	12.5	24.8	25.5
Synthetic fibres	20.1	19.3	13.3	22.7
Fabrics	22.0	20.0	20.2	28.6
Wearing apparel	22.0	20.0	34.9	29.8
Hides and leather	11.0	5.0	41.0	10.0
Footwear	22.0	20.0	34.7	26.7
Boilers and machinery	14.9	19.6	9.9	21.4
Electric machines	10.8	19.9	15.9	22.3
Rail vehicles	17.6	20.0	0.6	13.6
Cars and tractors	15.1	27.2	12.4	24.2
Aircraft	2.0	5.7	15.5	12.2
Inorganic chemical products	5.2	4.6	3.1	13.5
Organic chemical products	2.4	12.2	3.0	12.6
Pharmaceutical products	3.1	12.6	8.9	19.8
Natural and chemical fertilizer	3.2	3.7	0.0	22.5
Misc. chemical products	4.0	18.0	4.7	21.1
Pulp	0.0	0.0	4.4	16.4
Paper and cardboard	8.6	10.5	19.5	23.9

Source: CTT.

Table 12 reveals something else that may facilitate talks considerably: the similarities between MERCOSUR nations' structures of foreign trade with the rest of the world. All four MERCOSUR economies are net importers of chemical, mechanical, electric, and electronic products and net exporters of agricultural/food, textile and leather goods.

Table 12. MERCOSUR members' trade balance with rest of world, 1986/1988  
(Percentage over transaction in each sector, three-year ave.)

Sector	Argentina	Brazil	Paraguay	Uruguay
Energy	(1.5)	(10.3)	(11.4)	(6.4)
Agricultural/food	42.8	19.5	24.5	25.5
Textiles and leather products	5.7	5.8	1.0	32.7
Wood, paper, and others	(0.2)	2.7	0.2	(0.5)
Chemical products	(8.2)	(3.0)	(6.1)	(9.8)
Steel	1.6	9.7	(1.1)	(0.4)
Non-ferrous metals	1.2	2.3	(0.1)	(0.1)
Mechanics	(7.3)	(1.9)	(8.8)	(5.5)
Motor vehicles	(1.5)	3.9	(5.2)	(1.9)
Electric materials	(1.9)	(1.2)	(2.7)	(0.9)
Electronics	(6.1)	(1.7)	(12.7)	(5.0)

Source: Aladi.

It may thus be concluded that the list of priority items in implementation of a common foreign tariff is in fact quite short; it will consist basically of chemical products, capital goods, and mechanical and electro-electronic components, since these not only are relevant items in the four nation's import structures but also display technical characteristics that hamper strict application of rules of origin. As a way of streamlining the agenda for the talks and a lending credibility to the integration programme, the list could also include any merchandise whose tariff harmonization would be simple.

The remaining customs tariffs can be harmonized over time, as economic policies gradually converge. In the agricultural sector, the ministerial co-ordination and consultancy forum would manage imports over the next few years. A common external tariff would come into being gradually, in response to the unification of agricultural policies. In the case of products like cars and other durable consumer goods, any triangular import schemes could easily be discouraged by applying rules of origin. Lastly, in industries like pulp, where tariffs are nil in Argentina and Brazil because production is competitive, decreased protection in Paraguay and Uruguay can await the advent of a common industrial policy in the region.

Negotiations concerning a common external tariff would be simplified substantially if MERCOSUR adopted an industrial strategy along the lines of that announced by the EEC in November 1990 in the document entitled "Industrial Policy in an Open and Competitive Environment". Since Brazilian industry would be the main reference point for the strategy to be drawn up, its government would need to put forth a special effort toward that end.

As in the European case, the long-term goals of this strategy would be to guarantee the international competitiveness of MERCOSUR's productive system and to avert systematic imbalances in intra-regional economic relations, against a backdrop of growth, stable prices, and improved income distribution. The conditions required to achieve this would be similar to those employed by the EC and other developed nations: public investment in education, science, and technology; use of the state's buying power; and reliance on a finance system able to offer long-term credit. Theoretically, all of this is contained in the Treaty of Asunción. It only needs to be enforced.

## E. CONCLUSIONS

Despite the obstacles to be overcome, MERCOSUR is a viable project. The potential synergy of the participating economies should allow for the formation of a community open to international competition and capable of incorporating contemporary patterns of welfare.

As in all other integration experiences, the governments of MERCOSUR nations share a non-transferable duty: they must build the institutional frame of a new market. This will depend on a lengthy process of negotiations whose logic is not one of mercantile bargaining nor one of imperialist pressure but one of co-operation within the venturesome political exercise of shared national sovereignty. As shown in this paper, such an enterprise can be developed gradually, over the course of many years, as long as its intermediary goals are realistically defined - but thus far this has not been the road taken by MERCOSUR.



### III. COMPETITIVENESS AND INDUSTRIAL RESTRUCTURING

#### A. EFFECTS OF TRADE LIBERALIZATION

The MERCOSUR countries are committed to a process of economic integration characterized by the swift removal of limitations restraining the flow of products and services within the grouping. This transition from a protected local market environment to one subject to competition with neighbouring countries, within a few years, coincides with the opening of individual economies to the rest of the world. Both processes are to be implemented within the same period, thus complicating even more industry's adjustments to new market conditions.

The following two tables show the country trends towards the opening of the economy to international markets and in custom duties by product.

Table 13. Trends in nominal import tariffs:  
maximum and average rates

Countries	Maximum			Average		
	Previous	Present	Planned	Previous	Present	Planned
Argentina	53	22	-	29	10	-
Brazil	105	85	40*	38	25	14
Paraguay	-	72	35	-	16	15
Uruguay	40	30	-	-	28	-

Source: F. Porta, 1991.

Paraguay data: Statements by the Paraguayan Under-secretary of Commerce.

\* Lowered to 35 per cent.

Table 14. Customs duties at the end of 1991  
(in percentages)

Products	Argentina	Brazil	Paraguay	Uruguay
Raw materials	5	0	0 to 3	10
Intermediate products	13	-	5 to 20	20
Finished goods	22	85	21 to 72	30

Note: This breakdown is only approximate, since criteria used are not the same in all countries.

The reduction of custom duties impacts on the integration process in two different ways: First, it contributes in a significant way to the credibility of the success of Latin American integration. In the past, businessmen were reluctant to compete within the region because they used to enjoy exclusiveness in their respective of domestic markets. They now have to face an increasing number of raw materials and finished goods imported from the Taiwan Province of China, Japan or Germany. New circumstances make competition with the industries of neighbouring countries more easily acceptable, even though this competition will take place in the absence of customs barriers. The second effect is related to the projected common external tariff scheduled for approval at the end of 1991. Although these

countries are in the process of opening their economies, prevailing criteria in each of them are widely different.

In the sub-group discussing the "co-ordination of macroeconomic policies" Argentina proposed a system similar to the one used at present, e.g.: three different levels of customs duties. Brazil has already established a schedule to reduce the protection against non-MERCOSUR countries that sets a maximum customs duty of 35 per cent as of 1 January 1995. Nevertheless, Brazil emphasizes the objective of curbing domestic inflation, one of its main components being a substantial drop in customs duties for non-MERCOSUR countries. If this is actually enforced, it would exceed the scope of the present schedule.

As for Paraguay, the Government is trying to establish low and consistent barriers, both in the tariff and non-tariff fields [Burt, 1991]. Thus, there would be an average tariff of 15 per cent with a 35 per cent ceiling. One of the targets is to discourage smuggling, which is endemic within the country. Besides, both private and government sources believe that the opening of the domestic economy to the MERCOSUR countries and to the rest of the world will not bring about serious consequences for the Paraguayan industry, since smuggling has always been so wide and persistent that it has made most companies immune against foreign competition.

In Uruguay, sources closely related to the administration believe that the common external tariff should be established at around 15 per cent to 20 per cent. This country has recently stated that all imports of industrial equipment and machines are free from customs duties until June 30, 1992. Besides, it is well known that the economic team is considering the possibility of extending this measure to encourage the process of industrial reconversion that will enable the establishment of a regional market. All this indicates that Uruguay, as well as Paraguay, fear that the common external tariff will force local companies to buy their equipment from Brazil and Argentina.

However, while countries are reaching agreements on a common external tariff, there are still major differences on the treatment on imports affecting trade between the countries. ICI Duperial, an Argentine company exporting chemical products, has presently run into non-tariff-like measures that hamper trading with Brazil, i.e. while Argentine authorities take one month to approve the registration of an agro-chemical drug, the same procedure takes three years in Brazil [INTAL and Bank of Boston Foundation, 1991a]. Manufacture of fruit and vegetable by-products in Paraguay has been impaired by import restrictions systematically imposed by neighbouring countries, specially Argentina, and companies have been forced to focus their investments on similar or related activities [Hondara, Baldinelli & Fadlala, 1991].

On the other hand, some Paraguayan industries have profited from the opening of neighbouring markets [Hondara, Baldinelli & Fadlala, 1991]. Such is the case of cotton manufacture, an activity that has grown in the last two decades taking advantage of the non-official opening of markets due to the increase in smuggling activities. More cotton clothes are sold to the so-called "tourists" than to the local market.

The Treaty of Asuncion foresees a listing of exempt products that will be gradually reduced, until it is finally phased out in 1995. Uruguay has the longest list, including 960 items. They believe that the list is exaggeratedly long, as there was no need at all to include 40 per cent of the products [MERCOSUR, Claroscuro de una Integración, 1991]. Such is the case of bananas, which are imported, or rice, which Uruguay produces at a very low

cost. These and other similar products will surely be the first ones to vanish from the exemption list. Around 96 products (10 per cent of the list) should have disappeared by the end of November 1991, when the Treaty of Asuncion is meant to be effective; another 10 per cent was due to be deleted on 31 December 1991, and a new 20 per cent reduction was scheduled for the end of 1992. Only then the Uruguayan Government would have eliminated the superfluous 40 per cent. Therefore, Uruguayan products will not be subject to real competition with the MERCOSUR countries until 1993.

A problem which concerns Uruguayan economists is what the multinational companies presently located in Uruguay will do after the implementation of the common market. They believe that it would be almost impossible to prevent these companies from choosing Sao Paulo or Buenos Aires as the ideal location when scale economies become the decisive factor. On the other hand, they expect that in some cases companies may prefer Uruguay due to technological and commercial flexibility. It is also encouraging that several companies are now taking advantage of the removal of import duties in relation to capital assets, a measure that will be in force until June 1992, although it is well known that most imports made under this system consists of second-hand equipment.

#### B. DIFFERENCES IN FOREIGN EXCHANGE POLICIES

The most conflicting item in the process of implementing the MERCOSUR relates to foreign exchange policies. If exchange rates take opposite trends in each of the member countries, prices of products traded in the regional market may become widely different and damage the industry in countries where the currency is overvalued. Some "policy co-ordination" talks have been held but this would be hardly attainable unless the MERCOSUR countries succeed in curbing their respective inflationary processes.

In 1979 the European Economic Community (EEC) established the so called European Monetary System (EMS) as a means to co-ordinate and stabilize the exchange rates of its member countries. EMS is based on a mechanism of fixed exchange rates backed by a common reserve in foreign currency and gold that enables it to correct any balance of payment unbalance. A special currency, the ECU, has also been established to be used as measure of value. EMS has been only partially successful in maintaining the stability of exchange rates, since there have been nine adjustments from March 1979 through April 1986. Presently, the situation within MERCOSUR is not alarming because import tariffs have been reduced by 47 per cent. But in a few years time this level will be reduced to zero and the problem will arise in all its crudeness, unless some solution is found in the meantime. It will not be easy to repeat the European scheme. If the European countries, that have extremely low inflation rates, have met with so many difficulties, it is hardly probable that the same approach may prosper the MERCOSUR region. It does not seem advisable to wait until December 1994 to find a solution, because problems may well arise before that date. The lower import tariffs are, the stronger the impact of the different exchange parities will be, and this can happen as soon as next year.

Table 15 shows the values for each member country's currency with a 1985 base, adjusted by price indexes that measure domestic variation, and corrected by the United States wholesale price index. The Table shows exchange rate trends for the four countries up to 1989, and for three of them as far as July 1991.

Table 15. MERCOSUR: Adjusted real exchange rates  
Index 1985 = 100

Period	Argentina	Brazil	Paraguay	Uruguay
1985	100.0	100.0	100.0	100.0
1986	100.0	106.4	99.4	101.5
1987	103.6	106.4	123.9	101.4
1988	117.9	98.1	117.9	110.4
1989	128.2	74.2	152.0	104.1
1990				
January	100.0	57.1	--	78.1
February	113.1	54.0	--	77.0
March	88.3	47.2	--	74.8
April	84.5	54.3	--	75.8
May	79.9	53.2	--	77.3
June	77.5	52.1	--	74.4
July	75.5	53.8	--	73.9
August	74.1	52.7	--	74.0
September	66.3	49.4	--	68.5
October	64.1	51.0	--	68.4
November	59.1	61.5	--	69.3
December	56.5	62.3	--	68.8
1991				
January	65.2	61.4	--	67.6
February	67.4	62.0	--	67.4
March	67.2	57.1	--	65.6
April	68.6	59.5	--	66.1
May	68.4	60.6	--	62.7
June	68.0	59.5	--	62.1
July	67.6	58.5	--	61.5

**Source:** For years 1985/1989: BID, Progreso Económico y Social en América Latina. IMF, IFS. For years 1990/91: CEPAL, Panorama Económico de América Latina, Santiago de Chile, 1991.

**Notes:** Argentina: Nominal exchange rate deflated by wholesale price index and adjusted by USA wholesale price index. Exchange rate applicable to exports. Brazil: Nominal exchange rate deflated by wholesale price index and adjusted by USA wholesale price index. Uruguay: Nominal exchange rate deflated by wholesale price index and adjusted by USA wholesale price index.

At the end of 1989, actual exchange rates had suffered strong variations. Maximum recorded deviation is found between Brazil and Paraguay, because Brazilian currency was markedly overvalued, while the opposite trend prevailed in Paraguay. The result was a difference of no less than 78 percentage points. Differences recorded by other countries were not so broad, although they were always quite noticeable.

Table 16 of the Annex there is a comparison between the exchange rate trends of Argentina and Brazil, from January 1990 through July 1991. In February 1990 there is a 59 percentage points difference in favour of Argentina, but in December 1990 Brazil was ahead by 6 per cent. The whole year's variation was 65 percentage points between both extremes. July 1991

year-to-date variations have been less marked, with a difference of 10 percentage points in favour of Argentina.

Table 16. Argentina and Brazil - adjusted real exchange rates

Period	Argentina	Brazil	Difference in favour of Brazil
1990			
January	100.0	57.1	-42.9
February	113.1	54.0	-59.1
March	88.3	47.2	-41.1
April	84.5	54.3	-30.2
May	79.9	53.2	-26.7
June	77.5	52.1	-25.4
July	75.5	53.8	-21.7
August	74.1	52.7	-21.4
September	66.3	49.4	-16.9
October	64.1	51.0	-13.1
November	59.1	61.5	+2.4
December	56.5	62.3	+5.8
1991			
January	65.2	61.4	-3.8
February	67.4	62.0	-5.4
March	67.2	57.1	-10.1
April	68.6	59.5	-9.1
May	68.4	60.6	-7.8
June	68.0	59.5	-8.5
July	67.6	58.5	-9.1

Source: Table 15.

Table 17 compares Argentina's and Uruguay's indexes for the same period. Variations are even less apparent than in the above case. Anyway, in February 1990 the relationship shows 36 percentage points difference in detriment of Uruguay, while December 1990 figures show 12 points to Uruguay's advantage, e.g. variation between extremes was 48 points. As in the above case, during the first semester of 1991 variations were flattened, reaching a maximum of 6 percentage points.

Table 18 shows Brazil's and Uruguay's figures. Maximum differences appear in March 1990, when the real exchange rate was 28 percentage points in favour of Uruguay, compared to May 1991, when the difference was only two points, e.g. variation between extremes was 26 percentage points.

Two final considerations to the above comments: the first one is related to the base year. The selection of 1985 does not mean that in this period the parities of the four countries had reached a point of equilibrium. It would be erroneous to say, for example, that in 1991 the Argentine currency was less undervalued than the Brazilian currency, as it may be wrongly concluded from the figures in the chart. In fact, Brazilian prices and salaries were lower. It would also be false to conclude that mutual trade of manufactured products favoured Brazil. The relationships would be different by merely changing the base year, but it would not solve the problem by any means because there are no more or less recent dates when the exchange rate parities of the MERCOSUR countries reached an equilibrium.

Table 17. Argentina and Uruguay - adjusted real exchange rates

Period	Argentina	Uruguay	Difference in favour of Uruguay
1990			
January	100.0	78.1	-21.9
February	113.1	77.0	-36.1
March	88.3	74.8	-13.5
April	84.5	75.8	-8.7
May	79.9	77.3	-2.6
June	77.5	74.4	-3.1
July	75.5	73.9	-1.6
August	74.1	74.0	-0.1
September	66.3	68.5	+2.2
October	64.1	68.4	+4.2
November	59.1	69.3	+10.2
December	76.5	68.8	+12.3
1991			
January	65.2	67.6	-2.4
February	67.4	67.4	--
March	67.2	65.6	-1.6
April	68.6	66.1	-2.5
May	68.4	62.7	-5.7
June	68.0	62.1	-5.9
July	67.6	61.5	-6.1

Source: Table 15.

Table 18. Brazil and Uruguay - adjusted real exchange rates

Period	Brazil	Uruguay	Difference in favour of Uruguay
1990			
January	57.1	78.1	+21.0
February	54.0	77.0	+23.0
March	47.2	74.8	+27.6
April	54.3	75.8	+21.5
May	53.2	77.3	+24.1
June	52.1	74.4	+22.3
July	53.8	73.9	+20.1
August	52.7	74.0	+21.3
September	49.4	68.5	+19.1
October	51.0	68.4	+17.4
November	61.5	69.3	+7.8
December	62.3	68.8	+6.5
1991			
January	61.4	67.6	+6.2
February	62.0	67.4	+5.4
March	57.1	65.6	+8.5
April	59.5	66.1	+6.6
May	60.6	62.7	+2.1
June	59.5	62.1	+2.6
July	58.5	61.5	+3.0

Source: Table 15.

The second consideration is related to the relative stability shown by the 1991. Although it is true that since April 1991 there has been a steady exchange rate in Argentina, and inflation has been considerably curbed down, Brazilian inflation rate was 23 per cent in October 1991, and threatened to reach 27 per cent in November. This strong volatility of Brazilian and Argentine economies has a strong impact on the necessary process of industrial reconversion. This is a general belief in Uruguay [Crónicas Económicas, 1991a] where it is said that this inconsistency is a main factor taken into account by prospective investors when they assess the high risks of investing where returns are conditioned to permanent access to both Argentine and Brazilian markets.

### 1. A Possible Solution

To definitely solve this problem, the MERCOSUR should attain conditions of price stability comparable to those of the developed countries. In the meantime, other mechanisms that may, at least, mitigate these variations, may be resort to.

The member countries may agree on a theoretical parity of each of the four currencies in relation with the US dollar. These theoretical parities may differ from the real one. For example, the Uruguayan Peso that presently had a nominal parity of 2,300 for each US dollar in December 1991, may be assigned a theoretical parity of 2,650 for each US dollar, e.g. an overvaluation of 15 per cent.

It is also possible to establish a margin of tolerance in relation with this theoretical parity. Trading among the four member countries is not as important as it may be in Europe, to expect that government authorities should determine the exchange rate based on the MERCOSUR needs. Authorities are most likely to take into consideration trading relationships with the rest of the world, although in this respect the position of Uruguay may be quite different from that of the other countries.

A different kind of agreement may be reached considering the event when one currency is undervalued by more than 6 per cent with respect to the theoretical parity. In this case, the other three countries should automatically be authorized to apply an import duty to any product coming from this country. The additional duty would equal the percentage of undervaluation exceeding 6 per cent. For example, if the Uruguayan Peso reaches 6,000 for each US dollar, this currency is undervalued by 13.2 per cent as compared to a theoretical parity of 2,650. In this event, the other three countries may apply an additional tariff of 7.2 per cent, e.g. 13.1 per cent less 6 per cent to any Uruguayan product. In no event the resulting import tariff may exceed import tariffs applied to non-MERCOSUR countries. The additional duty will be suspended as soon as the parity falls within established limits.

These mechanisms would solve part of the problem. Although the difficulties for selling products to a country with undervalued currency would still subsist, the first and more acute problem arising from imports aided by any under-parity currency would disappear.

### 2. Theoretical Parity Calculation Method

One way of calculating theoretical parity may be the so-called "purchasing power parity" (PPP). As per this method, the balance between

exchange rates for two currencies is met when they have equal domestic purchasing power. For example, there is PPP between Argentina and Uruguay if 10 Argentinian pesos, which may be exchanged by 2,300 Uruguayan Pesos, are enough to buy the same amount of products in both countries.

The "purchasing power parity" theory states that exchange rates tend to gradually equal the price of trade products. The "relative" version maintains that exchange rate tends to follow relative inflations in each country included in the analysis. Actually, this does not happen because present financial flows have great impact on the determination of the exchange rate. This heavily restrains the applicability of the PPP when forecasting the future trends of currency prices, but does not impair its use as a method of calculation. Therefore, the MERCOSUR countries may use it as a basis to determine the theoretical parity of the respective currencies.

### C. COSTS AND PRODUCTIVITY

#### 1. Relative Prices

Tables 19 and 20 show prices for several manufactured products other than foods for the USA, Argentina and Brazil for May 1989, May 1990 and September 1991. If it is assumed that USA prices are representative of international levels, the comparison with the other two countries shows variations which are sometimes due to different levels of productivity and, in other cases, to currency variations.

After determining simple average figures for 13 products included in the analysis, Argentina is 43 percentage points lower than the USA, while Brazil is 5 points above. When the calculation was repeated in May 1990, the USA were exceeded by Argentina in 15 points and by Brazil in 20 points. In September 1991, Argentina and Brazil were once more above USA's figures, but this time by 19 and 9 points, respectively.

It is needless to say that such wide variations correspond to different levels of real exchange rates in both Latin American countries. It should not be forgotten that Argentina had two hyper-inflationary processes, while Brazilian general prices experienced rather marked increases. Nevertheless, in 1990 and 1991 Argentina overcame the strong undervaluation that affected its currency in 1989, and the price variations corresponding to that period were somehow flattened.

If the comparison is made at the product level, variations for six out of thirteen prices between Argentina and Brazil exceeded 40 per cent in 1989. Argentina was unfavourably positioned in aluminium, tin and zinc in ingots, slaked lime and automobiles, having advantage only in structural shapes.

Tables 21 and 22 show similar information concerning food products. Comparing USA's prices to Argentine and Brazilian ones for the ten products included in the analysis, Argentine simple average was no less than 69 percentage points below the USA in May 1989, while Brazilian average was 44 points below. Repeating the calculation in May 1990, Argentina and Brazil were still below the USA by 36 and 38 points, respectively. In September 1991, Argentina and Brazil were 38 and 41 points below the USA respectively.

Variations of food prices between Argentina and Brazil are equal or larger than in the case of manufactured products. In September 1991 there were six products with variation exceeding 40 per cent. Argentina shows advantages in bread and wine while Brazil is better positioned in rice, sugar, coffee and eggs.



Table 19. Argentina, Brazil and USA - comparative prices of manufactured products other than foods

Products		USA	Argentina	Brazil
Portland Cement (in bulk, in factory)	May 1989	64	45	139
	May 1990	64	79	132
	Sep 1991	68	85	100
Hydrated Lime (building type)	May 1989	75	36	34
	May 1990	80	113	82
	Sep 1991	128	117	76
Newsprint Paper (including taxes)	May 1989	564	436	688
	May 1990	521	589	913
	Sep 1991	578	711	902
Structural Profile (I10")	May 1989	564	279	591
	May 1990	466	345	435
	Sep 1991	(1) 470	362	(2) 750
Hot Rolled Plates (3 to 8 mm)	May 1989	571	286	316
	May 1990	675	408	380
	Sep 1991	663	610	404
Cold Rolled Plates (1.5 mm)	May 1989	698	304	414
	May 1990	675	536	640
	Sep 1991	663	610	696
Iron Bars (for building)	May 1989	441	184	365
	May 1990	417	340	345
	Sep 1991	420	440	385
Aluminium (in 99.5% ingots)	May 1989	0.88	1.02	1.08
	May 1990	0.74	1.82	2.20
	Sep 1991	1.37	1.72	1.23
Copper (electrolytic wire bars)	May 1989	3.03	1.43	2.34
	May 1990	2.00	3.00	2.64
	Sep 1991	2.57	3.20	2.61
Tin (in 99.9% ingots)	May 1989	9.9	4.6	4.3
	May 1989	10.6	10.5	6.0
	Sep 1991	8.0	8.9	5.9
Lead (in 99.9% ingots)	May 1989	0.80	0.29	0.89
	May 1990	1.01	0.92	1.23
	Sep 1991	0.73	0.85	0.78
Zinc (electrolytic in 99.9% ingots)	May 1989	1.39	0.48	1.15
	May 1990	1.35	1.08	1.48
	Sep 1991	1.23	1.70	1.11
Automobiles: Ford Escort (including taxes)	May 1989	9.0	6.8	11.2
	May 1990	9.3	14.1	12.0
	Sep 1991	11.0	17.6	11.2

**Source:** Fundación Mediterránea, Novedades Económicas, Numbers 105, 117 and 130, Córdoba.

(1) As of August 1991; (2) As of July 1991.

Table 20. Argentina, Brazil and USA - comparative prices of food products

Products		USA	Argentina	Brazil
Rice (long grain) US \$/kg	May 1989	1.20	0.46	0.48
	May 1990	1.21	1.12	0.72
	Sep 1991	1.71	1.71	0.70
Refined Sugar US \$/kg	May 1989	0.86	0.38	0.36
	May 1990	0.90	0.60	0.40
	Sep 1991	1.42	0.70	0.42
Ground Coffee US \$/kg	May 1989	6.8	4.6	3.3
	May 1990	6.4	7.1	5.0
	Sep 1991	6.4	4.7	3.2
Beef (First quality cuts) US \$/kg	May 1989	7.5	0.5	2.9
	May 1990	7.9	1.5	2.8
	Sep 1991	8.8	3.7	4.1
Eggs (big) US \$/dozen	May 1989	1.04	0.37	1.41
	May 1990	1.16	0.80	0.80
	Sep 1991	1.83	1.05	0.65
Milk (fluid) US \$/litre	May 1989	0.67	0.12	0.25
	May 1990	0.67	0.30	0.38
	Sep 1991	0.77	0.40	0.39
Butter US \$/200 grams	May 1989	0.59	0.27	0.50
	May 1990	0.59	0.70	0.90
	Sep 1991	0.90	0.83	1.03
Bread US \$/kg	May 1989	2.70	0.18	0.67
	May 1990	2.87	0.38	0.38
	Sep 1991	2.19	0.39	1.05
Dry noodles US \$/400 grams	May 1989	0.77	0.23	0.41
	May 1990	0.78	0.56	0.65
	Sep 1991	0.81	0.63	0.61
Table wine (common red) (1)	May 1989	1.23	0.22	0.67
	May 1990	1.92	0.53	0.60
	Sep 1991	1.70	0.97	1.61

Source: As in Table 19.

(1) As there is no USA price for ordinary table wine, this Table lists Italian price.

Table 21. Argentina, Brazil and USA - price ratios of manufactured products other than foods

Products		USA	Argentina	Brazil
Portland Cement (in bulk, in factory)	May 1989	100	70	217
	May 1990	100	123	206
	Sep 1991	100	125	147
Hydrated Lime (building type)	May 1989	100	48	45
	May 1990	100	141	103
	Sep 1991	100	91	59
Newsprint Paper (including taxes)	May 1989	100	77	122
	May 1990	100	113	175
	Sep 1991	100	123	156
Structural Profile (I10*)	May 1989	100	49	105
	May 1990	100	74	93
	Sep 1991	(1) 100	77	(2) 160
Hot Rolled Plates (3 to 8 mm)	May 1989	100	50	55
	May 1990	100	60	56
	Sep 1991	100	161	132
Cold Rolled Plates (1.5 mm)	May 1989	100	44	59
	May 1990	100	79	95
	Sep 1991	100	92	105
Iron Bars (for building)	May 1989	100	42	83
	May 1990	100	82	95
	Sep 1991	100	105	92
Aluminium (in 99.5% ingots)	May 1989	100	116	123
	May 1990	100	145	297
	Sep 1991	100	126	90
Copper (electrolytic wire bars)	May 1989	100	47	77
	May 1990	100	150	132
	Sep 1991	100	125	102
Tin (in 99.9% ingots)	May 1989	100	46	43
	May 1989	100	99	56
	Sep 1991	100	111	74
Lead (in 99.9% ingots)	May 1989	100	36	111
	May 1990	100	91	122
	Sep 1991	100	116	107
Zinc (electrolytic in 99.9% ingots)	May 1989	100	35	83
	May 1990	100	80	110
	Sep 1991	100	138	90
Automobiles: Ford Escort (including taxes)	May 1989	100	76	124
	May 1990	100	152	129
	Sep 1991	100	160	102

Source: As in Table 19.

(1) As of August 1991; (2) As of July 1991.

Table 22. Argentina, Brazil and USA - food price ratios

Products		USA	Argentina	Brazil
Rice (long grain) US \$/kg	May 1989	100	38	40
	May 1990	100	93	60
	Sep 1991	100	100	41
Refined Sugar US \$/kg	May 1989	100	44	42
	May 1990	100	67	44
	Sep 1991	100	49	30
Ground Coffee US \$/kg	May 1989	100	68	49
	May 1990	100	111	78
	Sep 1991	100	73	50
Beef (First quality cuts) US \$/kg	May 1989	100	7	39
	May 1990	100	19	35
	Sep 1991	100	42	46
Eggs (big) US \$/dozen	May 1989	100	36	136
	May 1990	100	69	69
	Sep 1991	100	57	36
Milk (fluid) US \$/litre	May 1989	100	18	37
	May 1990	100	45	57
	Sep 1991	100	52	51
Butter US \$/200 grams	May 1989	100	027	85
	May 1990	100	070	153
	Sep 1991	100	083	114
Bread US \$/kg	May 1989	100	7	25
	May 1990	100	13	13
	Sep 1991	100	18	48
Dry noodles US \$/400 grams	May 1989	100	30	51
	May 1990	100	72	83
	Sep 1991	100	78	75
Table wine (common red) (1)	May 1989	100	18	54
	May 1990	100	28	31
	Sep 1991	100	57	95

Source: As in Table 19.

(1) As there is no USA price for ordinary table wine, this Table lists Italian price.

## 2. Cost Variations

There are five factors that are frequently mentioned while examining the competitive position of these countries. Those are labour, power, technology, industrial raw materials, transportation and working capital.

### 3. Labour

Salaries paid in Argentina and Brazil under normal circumstances are similar, but this situation changes under hyper-inflationary scenarios. In 1989, salaries in Argentina measured in US dollars were ridiculously low. Something similar is happening in Brazil at the end of 1991. But leaving these problems aside (they have already been discussed in the previous chapter), available statistics show that non-specialized workers perceive a slightly lower compensation in Brazil than in Argentina, while the situation is reversed for specialized labour. Some time ago, additional compensation for health care, pensions and other social security contributions were higher in Argentina, but lately the situation has been almost equal in both countries. Delinquency in the compliance with social security contributions also exists on the part of the employers, being more frequent in the case of small companies, but it is quite difficult to assess its degree in any of these countries.

Therefore, variations in industrial wages are scarcely remarkable. This was already so by April 1986, when a group of Argentine companies carried out a comparative analysis of costs and prices with their peers in Brazil. The review was made within the framework of the agreement signed by both Governments in November 1985, starting the integration process. The results of this review were as follows:

Average cost of a normal man/hour in the metal industry, including additional compensation, overtime, premiums and social security contributions, was higher in Argentina (US \$5.30) than in Brazil (US \$4.00). But this difference was offset by the higher productivity of Argentine companies.

The information obtained concerning the electronic industry was as follows:

Table 23. Argentina-Brazil: direct labour cost - 1986  
(including social security contributions)

Item	US \$ Per month		Chapter in Brazil Percentage
	Argentina	Brazil	
Line operator	309	327	-6.0
Service technician (Junior)	330	458	-2.8
Service technician (Regular)	412	653	-3.7
Service technician (Senior)	515	980	-4.7
Department manager	2.062	2,350	-1.2
Working week: hours	44	44	

Source: La Industria Petroquímica ante la Integración Argentina Brasil - Asociación Petroquímica Latinamericana, 1990.

Table 24 supplies more information on labour cost in Argentina and Brazil.

Table 24. Argentina-Brazil: labour cost in the petrochemical industry, August 1990

Item	US \$ Per month		Chapter in Brazil Percentage
	Argentina	Brazil	
Process engineer	1,400	1,370	2
Semi-skilled mechanic	520	470	11
Bilingual secretary	960	803	20
Production supervisor	1,010	1,200	-19

Source: As in Table 23.

In November 1990 a new analysis was performed, deeper than the previous ones, at the request, once more, of Argentine companies interested in a comparison with Brazil, and this time limited to the metal industry [Nofal, 1990]. This review confirms that unit labour costs are similar in both countries.

Table 25. Argentina-Brazil: labour cost in the metal sector, November 1990  
(US \$ per hour)

Year	Argentina	Brazil	Cheaper in Brazil Percentage	Average	
				USA	The World
1986	4.30	4.25	1	---	
1987	4.06	4.78	-15	---	
1988	4.01	4.14	-3	---	
1989	3.32	3.60	-8	---	
1990*	6.36	4.00	59	18.40	18-24

\* September 1990.

Salaries collected by metal industry workers in Brazil were estimated at US \$3.00/hour in November 1991, a figure which reflects exchange rate levels. Another report [Principales Conclusiones Obtenidas en las Diversas Reuniones Mantenedas en Brasil, 1990] shows the following information on social security contributions.

Table 26. Argentina-Brazil: social security contributions, December 1990

Item	Argentina	Brazil	Chapter in Brazil Percentage
Deduction from worker's pay	17%	7 to 10%	143 to 70

A report prepared in 1988 on the possibility of complementing industrial activities between Brazil and Paraguay remarked that both labour productivity

and the raw materials/manufactured product ratio show very unfavourable conditions for Paraguay, which worsened during the 1980/87 period [ALADI, 1988a]. The same report states the added value/worker rate at 47.8 per cent for the Paraguayan manufacturing industry during 1980, while in 1988 it was only 28.4 per cent. During the same period, productivity measured in absolute values grew in Brazil and remained flat in Paraguay.

This analysis is confirmed by Industria Gráfica del Paraguay, a books and printed matter exporter, which states that comparative advantages are technological and not based on cheap labour [INTAL and Bank of Boston Foundation, 1991b]. The company adds that it pays higher salaries than those in Argentina and Brazil. On the other hand, Manufacturas del Pilar S.A., a Paraguayan textile exporting company states, for the same period and in the same report, that labour cost is approximately equal throughout the region, adding that, although minimum wages in Paraguay are remarkably higher than in neighbouring countries, the cost of skilled labour is similar. It goes on to say that social security contributions are also lower in Paraguay (approximately 42 per cent of salaries paid).

Regarding Uruguay, a company manufacturing gloves for industrial use states that in August 1991 the cost per man/hour was, in general terms, above neighbouring markets [Industrial Chamber of Uruguay, 1991b]. Other Uruguayan leather-manufacturers reported in July 1991 that wages in dollar terms had increased by 60 per cent in the last five years within this industrial sector, while there had not been an equal increase in productivity [Industrial Chamber of Uruguay, 1991a].

In general terms, the basic complaint of Paraguayan and Uruguayan businessmen is the difficulty in obtaining skilled workers. To this the frequency of labour conflicts and strikes carried on by the unions should be added in the case of Uruguay.

#### 4. Power

Historically, the cost of electric power, taxes included, has been lower in Brazil than in Argentina. This is confirmed by the following.

Table 27. Argentina-Brazil: prices of electric power

Year	US \$ Per MWH		Cost in Argentina (percentages)
	Argentina	Brazil	
1986	32.07	22.23	+ 44.3
1987	32.29	26.75	+ 24.4
1988	44.85	30.76	+ 45.8
1989 (September)	70.71*	30 to 35**	+ 135.7 to 102.0

Source: Nofal, 1990.

- \* It results from applying SEGBA's (Electric Power Utility) (high voltage) tariff charge for greater consumers in the Province of Buenos Aires.
- \*\* High voltage rate for greater consumers in the States of Mina Gerais and San Paulo, respectively.

The main cause of Argentine high costs is the heavy tax burden. Typically, in all countries around the world electricity is only taxed with value added tax and it is well known that this tax has no impact on production costs, but on the final price of manufactured products. It does not impair competition with foreign markets because it is returned at shipment. The high tax evasion existing in Argentina has forced fiscal authorities to look for unconventional revenues, i.e. to tax electric power and gas, among other utilities.

In Paraguay the price of electric power for greater consumers is presently around US \$60 to US \$80 per MWH. With the electricity generated by Itaipú power station (and, in a near future, Yacyretá) Paraguay has a remarkable electric power surplus. Tariffs, nevertheless, are far from low [ALADI, 1989].

The Uruguayan Industrial Chamber (Cámara de Industrias del Uruguay) reports in July 1991 that electric power costs in Uruguay averages three times the cost of electric industrial power in Argentina and Brazil [Industrial Chamber of Uruguay, 1991a]. Therefore, electric power price is a most serious hindrance for the companies to compete in industrial areas demanding greater electric power use.

#### 5. Technology

Manufacturas Pilar S.A., a Paraguayan textile exporter, reports that, since it buys machinery from far away foreign countries, it is forced to keep a large stock of spare parts [INTAL and Bank of Boston Foundation, 1991b]. The financial cost of keeping this capital in non-accrual status is a great disadvantage. To be able to compete, it should have more efficient and cheaper means of transport as well as continuity in research and development of new and improved fibres. The company had some wrong investment decisions, such as purchasing machines without taking into consideration the climatic factors. Maintenance of sophisticated machinery that is affected by high temperatures is a serious problem since electric parts have been designed for colder climates. As it is absolutely impossible to have all necessary spare parts in stock, these are frequently imported by air, which is most expensive.

More than 50 per cent of the Uruguayan leather products exporters stated in July 1991 that they only had access to inferior quality leather [Industrial Chamber of Uruguay, 1991a]. This seriously impaired their possibilities of competing in high-quality markets.

#### 6. Industrial Raw Materials

Information available shows that Brazilian metal companies specially government-owned ones, get iron ore at a lower cost than quoted on international markets (including Argentina). For example, prices for ore fines have been as follows [Nofal, 1990]:



Table 28. Argentina-Brazil: prices for ore fines  
(in US \$ per ton)

Year	FOB Brazilian Atlantic port*	In Brazilian Plant
1986	16-17	7-8
1987	15-16	6-8
1988	15-16	7-8
1989	16-18	11-12
1990	19-20	12-14

\* FOB prices at Brazilian Atlantic ports, including land transport, are the minimum prices for foreign buyers, including Argentine ones, while in Brazil these already include freight and transport to the freight yard.

The following Table compares fuel costs.

Table 29. Argentina-Brazil: fuel costs, December 1990

Item	Argentina	Brazil	Above Brazil's Percentage
Fuel oil in US \$ per ton	185.00	132.00	40
Natural gas in US \$ per MBTU	2.60	1.70	53

Source: Principales Conclusiones Obtenidas en las Diversas Reuniones Mantenedas en Brasil, 1990.

Manufacturas del Pilar S.A., a Paraguayan textile company reported at the beginning of 1991 that its raw material (cotton) is first quality, and plenty of it can be bought within the country at international prices [INTAL and Bank of Boston Foundation, 1991b]. It also states that only 5 per cent of the country's total production is processed in Paraguay.

Uruguay companies remark that the Government monopoly as supplier of several raw materials is most inconvenient for the industry [Industrial Chamber of Uruguay, 1991a]. This is the case of fuels, alcohols (used to manufacture beverages and perfumes) and solvents, which in Uruguay are offered well above international prices.

The Uruguayan fruit and vegetable industry finds that the regional common market will increase the supply of such necessary inputs as containers, cartons and crates, at international prices and of high quality, which will allow them to compete on international markets. Thus, the problem presently affecting this industry will disappear. There may be also a possibility of obtaining raw materials at regional levels, which would help to reduce the strong fluctuations that presently affect local prices and stocks.

For all the above reasons, it is not possible to plan a competitive production schedule based on domestic supply of raw materials. One example of this are tomatoes, a key item for the food processing industry. During the past two years Uruguay imported tomatoes from Mendoza, Argentina, and Chile.

at US \$0.06/kg. The range of domestic prices for the same period was US \$0.20-0.30/kg.

#### 7. Cost of Working Capital

Several Paraguayan companies have voiced their concern on the lack of credit lines to buy capital assets [INTAL and Bank of Boston Foundation, 1991b]. For example, shoe manufacturers are highly skilled businessmen who have gradually incorporated state-of-the-art machinery, but presently lack adequate financial support to market a product with so much added value. Similar complaints were also expressed by Uruguayan businessmen [Hondara, Baldinelli and Fadlala, 1991].

#### D. CASES OF SENSITIVITY TO COMPETITION

The integration process between Argentina and Brazil started already one year before the MERCOSUR Treaty was signed. In the meantime, governments and companies in Paraguay and Uruguay were concerned about the future. Therefore, it is now possible to analyze some of the most outstanding cases of sensitivity to industrial competition recorded so far.

FATE S.A., a tire producing Argentine company, filed a presentation before the Argentine Government in December 1990 stating its opinion on the projected common market [El Tránsito hacia el Mercado Común con Brasil, 1990]. The company maintained that macroeconomic policies were not yet compatible, that many asymmetries subsisted, that exchange parities were still a disturbing factor to the commercial flow and profitability of companies, that local capital market was scarce and expensive, and that recession had not been abated. The presentation added that in such a scenario FATE S.A. was planning with absolute responsibility its transition into the common market, although the company was conscious that, without reorganizing its production lines and enlarging its commercial focus to include Brazilian markets, its probabilities of surviving even the transition period were almost nil. To avoid this, the company should reconvert its production lines, increase present production volumes and also launch its trademark within Brazil. The presentation ended with a request that, to be able to adjust this scheme FATE S.A. should be declared "sensitive" and included with the protection measures established in the Buenos Aires Minutes. This document states that "For those sectors that meet the qualification of 'sensitive' .... there may be special agreements taking into account their special circumstances." As far as it is known, the Government has not approved this request. It is also rumoured that the company is up for sale, and that negotiations with Brazilian company Michelin S.A. have already started.

In July 1991, the Association of Pulp and Paper Manufacturers expressed its concern on the increasing imports from Brazil, remarking that during the first semester of the year they almost quadruplicated figures for the same period of 1990 [La Nación, 1991a]. The Association filed a request with the Argentine Government attempting to control this situation. During the meeting of the Argentina/Brazil Common Market Group held on 27 June 1991 [MERCOSUR Bulletin, 1991b] Argentine Government officials stressed the need to apply protective measures.

Without assessing the grounds for this request, the Brazilian team expressed that adopting such an extreme resource at this early stage of the integration process might unleash a chain reaction in other sectors,

endangering the common market project. Based on this reasoning, the Common Market Group decided to summon the pulp and paper manufacturers from both countries with the recommendation that, in a peremptory term of 30 days, they should reach an agreement to solve the problem. As a consequence of this recommendation, an Argentine-Brazilian business meeting was held in Sao Paulo, Brazil, on 29 July 1991. This meeting concluded with the signing of an Agreement establishing voluntary export quotas that will restrain Brazilian exports.

In Brazil, there have also been cases of sensitivity to competition. On 7 January 1991 the Foreign Trade Board, an entity reporting to the Brazilian Secretary of Economy, Finance and Planning, started a research on the imports of disposable diapers from Argentina. The claim was basically related to the Brazilian tax return system that benefits exporters. On that date, the Argentine product was sold on the Brazilian market at half the price of the domestic product.

In the beginning, Brazilian authorities insisted on defining the tax return as a subsidy, due to the manner in which the calculation and tax reimbursement were made. Nevertheless, according to GATT regulations on this matter and the provisions of the Tax Code, a subsidy is considered as such only when the amount reimbursed is higher than taxes paid in the production process, with total independence of the calculation and payment modes. In October 1991 the case was closed by Brazilian courts with a judgement in favour of the Argentine company. This decision is far reaching, since dozens of Argentine industrial sectors are in the same position as the diaper manufacturers.

In August 1991 a survey was conducted in Paraguay on the prospects of the domestic industry facing competition from Brazilian and Argentine products. Hundreds of workshops of different sizes were identified and approximately ten well organized factories with state-of-the-art technology. A few of them were exporting and could surely stand the challenge of an open market [Hondara, Baldinelli and Fadlala, 1991].

Doubt subsists on the future of the many workshops, factories and medium-sized companies. The situation of the textile industry is also a source of concern. Cotton should be spined, weaved, produced and later exported from Paraguay. But there is some concern because, given the present conditions of the textile industry, the clothing industry will not improve nor diversify unless it can buy fabrics in neighbouring countries again. This dependency is the direct consequence of the mediterranean condition of Paraguay, a country that has always been subject to high freight costs. It may always be possible to profit from the neighbouring markets of the Argentine provinces and Brazilian states, and this would suffice to fulfil Paraguayan expectations about the regional market.

Most of the sixty companies surveyed expected to be able to profit from the opening of the common market. It was also reported that 75 per cent of them are planning to export, but 61 per cent fear foreign competition. Out of a group of 35 companies, 28 reported that smuggling activities affect them. From this information it seems that the initial hypothesis that smuggling had already swept away the inefficient companies is false, as is the belief that Paraguay is well positioned for competition since borders were open, although unofficially, long before the process of establishing the common market had been initiated.

In a round of conferences held in Montevideo, Uruguay, to discuss the subject of the common market, the question was raised as to the most appealing location for multinational companies already established in the region after the integration process is concluded [MERCOSUR, *Claroscuro de una Integración*, 1991]. And the answer supplied by an expert was Sao Paulo or Buenos Aires. He added that the decisive factors in the companies' assessment are consumer demand, easy access to essential services and, finally, supply of raw materials. In general terms, Uruguay seems to be the country with less advantages to compete, but it should be remembered that some corporations may decide to continue operating in more than one location. This depends upon the transportation costs, on whether the companies produced durable or non-durable goods, and several other hardships that may arise in the flow of products.

On the other hand, multinational corporations are already benefitting from the possibility of efficient production scales and new markets [América Economía, 1991]. Du Pont produces nylon filaments for tires in Argentina, something that the Brazilian subsidiary does not. After the fall of the Brazilian customs barriers in 1990, even before the integration process started, the Argentine branch started to export and presently supplies 15 per cent of the Brazilian market, equalling the domestic production volume and covering overall demand.

This is only one of the many developments of multinational corporations in the region. Needless to say, these are the corporations that have already designed complete plans for the regional market. Some of them, as the case of Du Pont, have already started ordering their trade and investments bearing the new scenario in mind, but hardly any have not made plans on how to take advantage of it.

#### **E. MANUFACTURING TRADE RELATED MATTERS**

To analyze the development of trade among the MERCOSUR countries aided by privileges established under the Treaty of Asuncion is not an easy task. It is worth recalling that there was a previous agreement signed in Iguazú, Argentina by President Alfonsín, from Argentina, and President Sarney, from Brazil, in November 1985. Also, and even more important, the regulations eliminating customs tariff within the MERCOSUR have already been in effect between those countries since 1 January 1991. This only consisted of an initial reduction of customs tariff and an elimination of items from the exemption list, but these measures, plus the movement towards the common market, was what encouraged regional businessmen to plan new businesses or to develop already existing ones. Circumstances are different for Paraguay and Uruguay, countries that initiated the process by the end of 1991.

Table 30 shows the influence of MERCOSUR over trade between Argentina and Brazil during the first semester of 1991.

Exports of Argentina manufactured products to Brazil in the first semester of 1991 are 9.9 per cent lower than in the same semester of the previous year. But exports to the rest of the world for the same periods decreased by 15.1 per cent, allowing to assume a positive influence of the Treaty in what the development of the foreign trade is concerned.

Table 30. Argentina: trade of manufactured goods with Brazil and the rest of the world

Item	US \$ million		Percentage difference
	First Semester		
	1990	1991	
<b>Exports</b>			
To the world, except Brazil	1,201.1	1,019.4	-15.1
To Brazil	190.5	171.6	-9.9
<b>Total</b>	<b>1,391.6</b>	<b>1,191.0</b>	<b>-14.4</b>
<b>Imports</b>			
From the world, except Brazil	1,198.7	2,021.5	68.6
From Brazil	200.5	372.1	85.6
<b>Total</b>	<b>1,399.2</b>	<b>2,393.6</b>	<b>71.1</b>

Source: Argentine Institute of Statistics and Census.

Note: This Table includes the following manufactured products: chemicals, plastic and artificial materials, paper, shoes, hats and umbrellas, stone production, cement and glass, common metals, machinery and electric parts, transport materials, optical instruments and photographic cameras.

Figures for Argentina's imports of Brazilian manufactured products imported show an amazing 85.6 per cent increase for the above periods. Imports from the rest of the world were also high, but nearing 71.1 per cent, which allows to assume that there is a preference for purchasing Brazilian products. This may be considered a positive effect of the reduction of customs tariff between these countries.

Undoubtedly, figures show that at present economic circumstances prevailing in each country overcome the effect of tax reductions. If in Argentina the volume of exported manufactures exceed imports, it is due to the direct consequence of domestic policies. The same happens in Brazil, but variations in figures with the rest of the world mark the impact of the advantages established by the Treaty.

Tables 31 and 32 show manufacturing exports and imports at the by sub-item level. In the first Table, which shows Argentine exports to Brazil in early 1990 and 1991, it is clear that, in spite of a general decrease in sales volume, some important items follow a rather different trend. Exports of common metals, for example, which amounted to US \$8.8 millions in the first semester of 1990, increased to US \$19.3 millions for the same period of 1991, i.e. by 119.3 per cent. Equal trends have followed exports of machinery and electric appliances, which increased by 20 per cent, and automobiles, by 22 per cent.

Table 31. Argentina exports to Brazil - first semester 1990/91

Table 31. Argentina exports to Brazil - first semester 1990/91

Products	First semester 1990	1991	Percentage variation
Livestock and animal by-products	54.5	58.1	6.6
Vegetables	208.0	240.3	19.4
Fats and oils	13.8	18.3	32.6
Foodstuff	40.4	23.5	-41.8
Cocoa and by-products	0.1	0.1	0.0
Vegetables preserves	26.8	20.9	-22.0
Beverages and vinegars	9.8	0.3	-96.9
Other	3.8	2.2	-42.1
Minerals	8.3	7.6	-8.4
Salt, sulphur, eartns and stones	3.1	1.8	-41.9
Metal minerals	4.5	0.5	-88.9
Mineral fuels	0.8	5.4	575.0
Chemical products	48.1	44.5	-7.5
Inorganic	17.7	10.8	-39.0
Organic	18.0	20.2	12.2
Chemical industry by-products	2.8	4.0	42.9
Other	9.7	9.5	-2.1
Plastics and man-made materials	16.3	14.2	-12.9
Furs, leather goods	3.7	36.3	881.1
Furs and leather	3.7	35.7	864.9
Others	0.0	0.6	100.0
Paper	22.6	10.2	-54.9
Textile materials and fabrics	19.2	21.6	12.5
Stone manufacture, glass, ceramics & similar	10.0	4.0	-60.0
Common metals	8.8	19.3	119.3
Iron and steel casting	3.5	10.4	197.1
Other	5.3	8.9	67.9
Machines and electric components	56.4	49.5	-12.2
Boilers and mechanic devices	50.9	42.9	-15.7
Electric machines and devices	5.5	6.6	20.0
Transportation	28.3	29.9	5.7
Automobiles	19.3	23.7	22.0
Others	9.0	6.2	-31.1
Rest	8.3	6.8	-18.1
Total	546.9	592.1	8.3

Source: Instituto Nacional de Estadísticas y Censos (INDEC).

Table 32. Argentina imports to Brazil - first semester 1990/91

Products	First semester 1990	1991	Percentage variation
Livestock and animal by-products	0.9	4.1	355.6
Vegetables	9.1	25.0	183.5
Fats and oils	0.5	0.9	0.0
Foodstuff	9.5	23.0	142.1
Cocoa and by-products	8.2	17.6	114.6
Vegetables preserves	0.1	0.3	200.0
Beverages and vinegars	0.3	0.8	166.7
Other	0.9	4.2	366.7
Minerals	61.7	38.7	-36.7
Salt, sulphur, earths and stones	2.8	4.0	42.9
Metal minerals	56.7	32.1	-43.4
Mineral fuels	1.6	2.6	62.5
Chemical products	58.6	69.3	18.3
Inorganic	5.5	9.4	70.9
Organic	39.0	41.0	5.1
Chemical industry by-products	10.1	8.9	-11.9
Other	4.0	10.1	152.5
Plastics and man-made materials	15.6	51.7	231.4
Furs, leather goods	0.2	0.1	-50.0
Furs and leather	0.2	0.1	-50.0
Others	0.0	0.0	0.0
Paper	6.3	37.0	487.3
Textile materials and fabrics	5.9	20.4	245.0
Stone manufacture, glass, ceramics & similar	3.6	6.4	77.8
Common metals	36.6	65.9	80.1
Iron and steel casting	28.5	50.2	76.1
Other	8.1	15.7	93.8
Machines and electric components	54.7	90.4	65.3
Boilers and mechanic devices	39.4	60.2	52.8
Electric machines and devices	15.3	30.3	98.0
Transportation	25.1	51.0	103.2
Automobiles	25.1	51.0	103.2
Others	0.0	0.0	0.0
Rest	3.4	8.7	155.9
Total	291.2	493.3	69.4

Source: Instituto Nacional de Estadísticas y Censos (INDEC).

Some Brazilian exports items to Argentina have also exceeded average volumes. Such is the case of plastics, which have increased by 231 per cent, paper by 487 per cent, textiles by 245 per cent and automobiles by 103 per cent.

A group of Argentine bankers sponsored a survey among businessmen of the MERCOSUR countries [D'Alessio & Asociados S.A., Coopers & Lybrand, 1991]. Results were as follows:

Table 33. Businessmen's perceptions of the impact of MERCOSUR

Opinion	Percentage points			
	Argentina	Brazil	Paraguay	Uruguay
They win	45	82	41	19
Neutral	40	10	14	56
They lose	15	8	45	25
Totals	100	100	100	100

This Table allows to conclude that Argentine businessmen believe that present activity will increase after the implementation of the MERCOSUR, generating risks for many sectors. Brazilian companies are far more optimistic. In Paraguay, general belief is that the common market will have a negative impact on the domestic activity due to Argentine and Brazilian larger scale economies. Uruguayan companies fear that, although through some necessary adjustments they will be able to meet competitive requirements, the final result will be negative due to the greater scope of Argentine and Brazilian economies.

## F. INDUSTRIAL RESTRUCTURING

### 1. Overview

A well known international accounting audit firm conducted a survey of the companies' attitude in relation with MERCOSUR [Indicadores Económico-Financieros, 1991]. One of the questions was about the present attitude toward the foreseeable effect of the Treaty. Answers were as follows:<sup>1/</sup>

Table 34. Impact on industrialists' decision-making

State	Argentina	Brazil	Paraguay
Analyzing subject and searching info.	37	30	61
Preparing strategic planning	26	12	11
Implementing selected alternatives	21	9	11
Issue was not analyzed	7	24	0
Issue does not impact the company	9	18	17
The Treaty has no implementation conditions	0	1	0
Answers	99	94	100
Refused to answer	1	6	0
Total	100	100	100

<sup>1/</sup> This item was unavailable in the Uruguayan survey.



The most different attitude corresponds to Brazil, where 42 per cent of the companies either had not yet analyzed the issue or had found no known effects. In relation with these two points, the position is similar in Argentina (16 per cent) and Paraguay (17 per cent).

The companies that seem to be more involved, those already implementing the alternatives, are 21 per cent in Argentina, 11 per cent in Paraguay and 9 per cent in Brazil.

Another question was whether 1991 investments for expanding or diversifying the production take into account domestic market or foreign markets. Answers were as follows:

Table 35. Impact on investment decisions

Investments by area	Argentina	Brazil
Foreign markets - MERCOSUR	11	3
Foreign markets - Other	12	15
Domestic market	77	82
Total	100	100

Once more, Brazilian businessmen seem to be rather unconcerned with the MERCOSUR possibilities.

We now proceed to review the perspective on industrial restructuring at the country level.

## 2. Argentina

A survey shows a great number of Argentine companies with export-related investments, although not always linked to MERCOSUR markets [INTAL and Bank of Boston Foundation, 1991a]. Some of them are: Agroandina S.A. (fresh and dried fruits, vegetables), ICI DUPERIAL S.A.I.C. (chemical products), Peñaflor S.A. (wines, concentrated must, mineral water and fruit juices) and Promeco S.R.L. (tool-machines).

Nevertheless, in Argentina there is not a systematic and general concern towards the MERCOSUR, as it is the case in Uruguay. Probably this is so because businessmen are already facing reduction of customs tariff in relation to non-MERCOSUR countries. The economic opening established by the Argentine Government on 1 April 1991 has originated a growing import activity affecting all type of raw materials and finished products from different countries.

Companies are now engaged in an effort to increase their productivity level to meet this challenge. It is difficult to separate the efforts made as a consequence of MERCOSUR from those related to third countries. Besides, a substantial reactivation of domestic demand is helping to disguise the effects of the invasion of imported products at the same time that it discourages exports. This determines a rather defensive approach to the reconversion process.

Yet, there is hardly any company where productivity is not increasing. This is as much the result of labour shedding as of increases in demand. Re-equipment does not seem to be a very crucial issue.

Many companies find that, in an open economy, manufacturing goods for which there is little domestic demand are not profitable. Several production processes have been stopped. The most frequent solution is to import the product from Brazil.

Present circumstances do not encourage Argentine exports to Brazil. There is the double obstacle of a slightly over-valued Argentine currency and a strongly undervalued Brazilian currency. Besides, domestic demand in Argentina is steadily growing while in Brazil the situation is the reverse. The growing demand in Argentina prevents Brazilian imports to become a great hindrance on domestic industry. A change of this scenario may arise from either side. It is possible that the increase of efficiency will allow Argentina to overcome the present overvaluation of the Austral, while Brazil may finally control its inflation rate thereby increasing consumer purchasing power and bringing the exchange rate closer to parity.

Meanwhile, some Argentine companies are surveying the Brazilian market. Most frequent conclusions seem to be that, although it will be rather difficult to compete in Brazil with mass consumption products, there is nevertheless the chance of selling first-quality goods to selected consumer segments. The most propitious ones seem to be textiles, clothing, ceramics and iron products.

A final remark: When, in 1985, Presidents Alfonsín and Sarney established free trade for almost all industrial goods, Argentine businessmen stated that there were poor conditions for competing. Shortly thereafter, it was a fact that the possibility of exporting to Brazil was saving Argentine tool-machine manufacturers from bankruptcy, due to a severe recession that lasted many years and had reduced the domestic market almost to nil.

### 3. Brazil

At the beginning of 1987, a specialist made a qualified assertion: Brazil, as opposed to Argentina, had not only entered the international industrial commodities markets successfully but was also making inroads in sophisticated, high value added product markets [Sercovich, 1987]. However, the opinion disclosed in November 1991 by a Director of Anderson Consulting was only partially true when he stated that Brazilian companies were ahead of their Argentine peers in their search for efficiency through cost reduction and internal restructuring, a direct consequence of their experience in international competition [Kuperman, 1991]. Since these companies, as well as those in most of Latin America, have been protected for many decades by a closed domestic market, they will have to adjust their production methods if they want to keep their ground in MERCOSUR.

At the end of 1991 Brazilian businessmen were worried about the strong recession in domestic markets. The customs tariff reduction enforced by the Government seemed to be a minor concern, partly because it is a long-term objective, and partly because it is only a moderate reduction. Confronted by these problems, MERCOSUR seems to be not so relevant a challenge, both as a new market to be conquered and as a competition threat. This explains the lack of interest reflected in the above mentioned surveys. It also gives

grounds to conclude that few Brazilian companies are presently implementing changes to enter the common market.

#### 4. Paraguay

Paraguay is well positioned to produce and export leather shoes [ALADI, 1988a]. Brazil is the fourth shoe manufacturer in the world, and Brazilian companies will probably be interested in joint-ventures with Paraguayan companies oriented to export or, possibly, sell the products in the Brazilian market. Prospects for production and export of leather clothes are also good.

Although these and other possibilities are presently being considered, private and government interest in the industry's restructuring are low. Both sectors believe that smuggling has already opened the country's economy to international competition, and believe that the consequences of the customs duty reduction will be immaterial. On the other hand, they find most appealing the possibility of introducing Paraguayan products to Argentina and Brazil, and are willing to make any necessary adjustments to compete in those markets.

#### 5. Uruguay

Although Uruguay entered the MERCOSUR a few months ago, local companies have already started actions to position themselves advantageously within the future enlarged market [Maderni, 1991]. Previous agreements with Argentina and Brazil, such as CAUCE and PEC, did not threaten domestic industries since these basically meant importing manufactured goods not produced in the country at the same time that it opened export opportunities. The MERCOSUR has changed this scenario. Even though export opportunities are most attractive due to elimination of quotas in Brazil and Argentina, the opening of domestic markets to competitive products poses a risk for local industries. Businessmen are swiftly changing from a passive to an active attitude.

Changes are perceived in many sectors [Maderni, 1991]. The milk industry, which is said to have competitive advantages in the region, is planning investments over US \$35 million to enlarge production capacity, manufacture new products and improve the industrial processes, which will enable the expansion of exports within the MERCOSUR.

Something similar happened in the printing industry. Five medium-sized companies with limited export capacity but with a state-of-the-art technology and competitive quality products, decided to establish a consortium that will qualify them exclusively for export sales. This will foster their participation in the MERCOSUR.

According to a survey carried out by the Uruguayan Industrial Chamber in the second semester of 1990, 23 paint and by-products manufacturers, out of a total of 35, had planned overall investments totalling US \$10 million in 1990/91. In 1987/89, major companies within this sector had already invested US \$15 million.

The main iron work and steel companies are planning, with the support of the Uruguayan Industrial Chamber, an overall reconversion through mergers in order to compete within the MERCOSUR. These companies have so far produced only for the domestic market.

Tires and tubes manufacturers are making substantial investments to adjust to a new open and consolidated economy. FUNSA, a local company, started a rationalization process that included 200 workers under unemployment insurance.

Automobile spare parts companies are meeting with their peers in Argentina and Brazil. Several agreements are under way which involve production areas, technology, marketing, joint ventures or equity participations.

Adjustments are also being made in the paper manufacturing sector. One of the companies, Fábrica Nacional de Papel, dismissed 116 employees in December 1990.

Other industrial segments, such as meat cold-storage plants, clothes and textiles, have requested technical support from the Uruguayan Industrial Chamber to implement adjustments, and are ready to make the necessary investments. The Chamber has summoned the private sector to assist in the reconversion, and will take the maximum advantage of available resources and technical assistance offered by international organizations.

If we position MERCOSUR countries by degree of commitment to industrial restructuring, Uruguay is at the top, greatly concerned with the issue, followed by Argentina where the interest is mixed with the compulsory need of adequacy to international competition. Paraguay occupies the third position, confident that a certain amount of effort concentrated on exports will suffice, and at the bottom is Brazil, where concern is not yet apparent.

#### G. TECHNICAL ASSISTANCE

As mentioned above, the involvement of businessmen in industrial restructuring to make economic integration feasible within MERCOSUR is widely different in each one of the four countries. Uruguay is where this need is perceived most clearly. This country will benefit from the possibility of free access to Argentine and Brazilian markets, and will also stand competition of products from both countries. The benefit is here now, risks will appear in 1993, once the Uruguayan Government had consumed the "reserve" items in the exemption list attached to the Treaty. Nonetheless, three years will barely suffice to make the adjustments. The most important plans related to industrial reconversion are as follows:

Leather goods exporters need better raw materials to manufacture first-quality products. Adequate technical assistance to cattle raisers and meat cold-storage plants will help to improve matters.

The milk industry is quite competitive and its products are marketable in Brazil and even in Argentina. Support in the planning of new investments and more efficient production processes would help considerably.

The printing industry needs aid to overcome scale problems. Technical assistance should be given not only to establish consortiums, mergers and other types of partnerships, but also to increase production volumes and standards.

Several iron casting and steel companies are merging to achieve their reconversion goals. They need similar technical support as the printing industry.

Substantial investments are being made in the paint and paint by-products industry sector. Technical audits should help to avoid mistakes.

Tire manufacturers are facing serious problems in their reconversion process. Four are multinational companies and the issue is a relatively easy one for them. But the other two companies established with local capital, FUNSA from Uruguay and FATE from Argentina, are in great need of an impartial and comprehensive vision, which an international agency may be able to provide.

A similar problem exists for the automobile and spare parts industries. Both Argentine and Uruguayan companies will undergo a deep transformation after commercial constraints are eliminated. Timely and comprehensive analysis of the new scenario would be most helpful for both governments and industries.

The paper industry is undergoing a streamlining process in Uruguay. This is another case where both Argentine and Uruguayan companies could face trouble in matching Brazilian competition due to different production scales. As they are hardly able to compete in the area of mass consumer products, some help should be provided to identify special products where some competition is possible.

Meat cold-storage, clothes and textile industries are undergoing their restructuring process and are willing to make investments. They also count on UNIDO's help to achieve their goals.

Argentina is following Uruguay in its concern with industrial reconversion in relation with MERCOSUR. Both countries share some worrisome issue such as tires, automobiles, and paper. In the case of Argentina, metals, fabrics, clothes and ceramics should be added. Some people believe that Argentine shoe makers should improve some details, such as the resistance of the thread used for sewing, to be able to compete with Brazilian industry which is used to the USA market requirements. It is necessary to help all these troublesome sectors to find "niches" in the Brazilian market that may compensate lower sales of mass consumer products.

Paraguay is confident that no industrial reconversion is required to stand up to foreign competition. They think that they already have an open economy, due to the impact of smuggling. But they surely would appreciate any assistance that may foster their industries' capabilities to take advantage of the opening of their partners's markets.

Some Paraguayan companies have already acquired equipment which is not tough enough to resist tropical climates. This increases maintenance costs, and the situation is aggravated by transport deficiencies. An adequate technical assistance may avoid repetition of such errors, frequently promoted by supplies too anxious to sell their machines.

Paraguay has plenty of first quality cotton at international prices. Only 5 per cent of national production is manufactured within the country. This leaves an ample field for textile development, which could be encouraged through an adequate technical assistance.

There are also favourable conditions to export leather shoes. Joint ventures with Brazilian companies with expertise in their own market as well as in the USA's, should improve prospects. The same analysis is valid for leather clothes, but the association should in this case be with Uruguayan

companies. An international organization may give technical advice on merging processes.

For the reasons discussed above, possibilities of Brazil welcoming any offer of technical assistance are scarce, although Porto Alegre's food industry may constitute an exception, due both to geographic location and production characteristics. However, Brazil is not entirely out of the scope of international assistance. As discussed above, this country is considered by businessmen of the other three countries as the most dangerous competitor due to production volumes and industrial diversification. Consequently, there is hardly any issue concerning industrial reconversion that is not approached either in confrontation with, or focusing on, this country.

## ANNEX I

Treaty establishing a common market between the Argentine Republic,  
The Federative Republic of Brazil, the Republic of Paraguay and  
the Eastern Republic of Uruguay

The Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, hereinafter referred to as "States Parties".

Considering that the expansion of their domestic markets, through integration, is a vital prerequisite for accelerating their processes of economic development with social justice.

Believing that this objective must be achieved by making optimum use of available resources, preserving the environment, improving physical links, coordinating macroeconomic policies and ensuring complementarity between the different sectors of the economy, based on the principles of gradualism, flexibility and balance.

Bearing in mind international trends, particularly the integration of large economic areas, and the importance of securing their countries a proper place in the international economy.

Believing that this integration process is an appropriate response to such trends.

Aware that this Treaty must be viewed as a further step in efforts gradually to bring about Latin American integration, in keeping with the objectives of the Montevideo Treaty of 1980.

Convinced of the need to promote the scientific and technological development of the State Parties and to modernize their economies in order to expand the supply and improve the quality of available goods and services, with a view to enhancing the living conditions of their populations.

Reaffirming their political will to lay the bases for increasingly close ties between their peoples, with a view to achieving the above-mentioned objectives.

Hereby agree as follows:

## CHAPTER I

PURPOSES, PRINCIPLES AND INSTRUMENTS

## Article 1

The State Parties hereby decide to establish a common market, which shall be in place by 31 December 1994 and shall be called the "common market of the southern cone" (MERCOSUR).

This common market shall involve:

The free movement of goods, services and factors of production between countries through, inter alia, the elimination of customs duties and non-tariff restrictions on the movement of goods, and any other equivalent measures:

The establishment of a common external tariff and the adoption of a common trade policy in relation to third State or groups of States, and the co-ordination of positions in regional and international economic and commercial forums;

The co-ordination of macroeconomic and sectoral policies between the States Parties in the areas of foreign trade, agriculture, industry, fiscal and monetary matters, foreign exchange and capital, services, customs, transport and communications and any other areas that may be agreed upon, in order to ensure proper competition between the State Parties;

The commitment by State Parties to harmonize their legislation in the relevant areas in order to strengthen the integration process.

#### Article 2

The common market shall be based on reciprocity of rights and obligations between the State Parties.

#### Article 3

During the transition period, which shall last from the entry into force of this Treaty until 31 December 1994, and in order to facilitate the formation of the common market, the State Parties shall adopt general rules of origin, a system for the settlement of disputes and safeguard clauses, as contained in annex II, III and IV respectively to this Treaty.

#### Article 4

The State Parties shall ensure equitable trade terms in their relations with third countries. To that end, they shall apply their domestic legislation to restrict imports whose prices are influenced by subsidies, dumping or any other unfair practice. At the same time, State Parties shall co-ordinate their respective domestic policies with a view to drafting common rules for trade competition.

#### Article 5

During the transition period, the main instruments for putting in place the common market shall be:

- (a) A trade liberalization programme, which shall consist of progressive, linear and automatic tariff reductions accompanied by the elimination of non-tariff restrictions or equivalent measures, as well as any other restrictions on trade between the State Parties, with a view to arriving at a zero tariff and no non-tariff restrictions for the entire tariff area by 31 December 1994 (annex I);



- (b) The co-ordination of macroeconomic policies, which shall be carried out gradually and in parallel with the programmes for the reduction of tariffs and the elimination of non-tariff restrictions referred to in the preceding paragraph;
- (c) A common external tariff which encourages the foreign competitiveness of the States Parties;
- (d) The adoption of sectoral agreements in order to optimize the use and mobility of factors of production and to achieve efficient scales of operation.

#### Article 6

The State Parties recognize certain differentials in the rate at which the Republic of Paraguay and the Eastern Republic of Uruguay will make the transition. These differentials are indicated in the trade liberalization programme (annex I).

#### Article 7

In the area of taxes, charges and other internal duties, products originating in the territory of one State Party shall enjoy, in the other State Parties, the same treatment as domestically produced products.

#### Article 8

The State Parties undertake to abide by commitments made prior to the date of signing of this Treaty, including agreements signed in the framework of the Latin American Integration Association (ALADI), and to co-ordinate their positions in any external trade negotiations they may undertake during the transition period. To that end:

- (a) They shall avoid affecting the interests of the State Parties in any trade negotiations they may conduct among themselves up to 31 December 1994;
- (b) They shall avoid affecting the interests of the other State Parties or the aims of the common market in any agreements they may conclude with other countries members of the Latin American Integration Association during the transition period;
- (c) They shall consult among themselves whenever negotiating comprehensive tariff reduction schemes for the formation of free trade areas with other countries members of the Latin American Integration Association;
- (d) They shall extend automatically to the other State Parties any advantage, favour, exemption, immunity or privilege granted to a product originating in or destined for third countries which are not members of the Latin American Integration Association.

## CHAPTER II

ORGANIZATIONAL STRUCTURE

## Article 9

The administration and implementation of this Treaty, and of any specific agreements or decisions adopted during the transition period within the legal framework established thereby, shall be entrusted to the following organs:

- (a) The Council of the common market
- (b) The Common Market Group

## Article 10

The Council shall be the highest organ of the common market, with responsibility for its political leadership and for decision-making to ensure compliance with the objectives and time-limits set for the final establishment of the common market.

## Article 11

The Council shall consist of the Ministers for Foreign Affairs and the Ministers of the Economy of the State Parties.

It shall meet whenever its members deem appropriate, and at least once a year with the participation of the Presidents of the State Parties.

## Article 12

The presidency of the Council shall rotate among the State Parties, in alphabetical order, for periods of six months.

Meetings of the Council shall be co-ordinated by the Ministers for Foreign Affairs, and other ministers or ministerial authorities may be invited to participate in them.

## Article 13

The Common Market Group shall be the executive organ of the common market and shall be co-ordinated by the Ministries of Foreign Affairs.

The Common Market Group shall have powers of initiative. Its duties shall be the following:

- to monitor compliance with the Treaty;
- to take the necessary steps to enforce decisions adopted by the Council;
- to propose specific measures for applying the trade liberalization programme, co-ordinating macroeconomic policies and negotiating

agreements with third parties:

- to draw up programmes of work to ensure progress towards the formation of the common market.

The Common Market Group may set up whatever working groups are needed for it to perform its duties. To start with, it shall have the working groups mentioned in annex V.

The Common Market Group shall draw up its own rules of procedure within 60 days of its establishment.

#### Article 14

The Common Market Group shall consist of four members and four alternates for each country, representing the following public bodies;

- Ministry of Foreign Affairs;
- Ministry of the Economy or its equivalent (areas of industry, foreign trade and/or economic co-ordination);
- Central Bank.

In drafting and proposing specific measures as part of its work up to 31 December 1994, the Common Market Group may, whenever it deems appropriate, call on representatives of other government agencies or the private sector.

#### Article 15

The Common Market Group shall have an administrative secretariat whose main functions shall be to keep the Group's documents and report on its activities. It shall be headquartered in the city of Montevideo.

#### Article 16

During the transition period, decisions of the Council of the common market and the Common Market Group shall be taken by consensus, with all State Parties present.

#### Article 17

The official languages of the common market shall be Spanish and Portuguese, and the official version of its working documents shall be that drafted in the language of the country in which each meeting takes place.

#### Article 18

Prior to the establishment of the common market on 31 December 1994, the State Parties shall convene a special meeting to determine the final institutional structure of the administrative organs of the common market, as well as the specific powers of each organ and its decision-making procedures.

## CHAPTER III

PERIOD OF APPLICATION

## Article 19

This Treaty shall be of unlimited duration and shall enter into force 30 days after the date of deposit of the third instrument of ratification. The instruments of ratification shall be deposited with the Government of the Republic of Paraguay, which shall notify the Governments of the other State Parties of the date of deposit.

The Government of the Republic of Paraguay shall notify the Governments of each of the other State Parties of the date of entry into force of this Treaty.

## CHAPTER IV

ACCESSION

## Article 20

This Treaty shall be open to accession, through negotiation, by other countries members of the Latin American Integration Association; their applications may be considered by the State Parties once this Treaty has been in force for five years.

Notwithstanding the above, applications made by countries members of the Latin American Integration Association who do not belong to subregional integration schemes or an extraregional association may be considered before the date specified.

Approval of applications shall require the unanimous decision of the State Parties.

## CHAPTER V

DENUNCIATION

## Article 21

Any State Party wishing to withdraw from this Treaty shall inform the other State Parties of its intention expressly and formally and shall submit the document of denunciation within 60 days to the Ministry of Foreign Affairs of the Republic of Paraguay, which shall distribute it to the other State Parties.

## Article 22

Once the denunciation has been formalized, those rights and obligations of the denouncing State deriving from its status as a State Party shall cease, while those relating to the liberalization programme under this Treaty and any other aspects to which the State Parties, together with the denouncing State, may agree within the 60 days following the formalization of the denunciation

shall continue. The latter rights and obligations of the denouncing Party shall remain in force for a period of two years from the date of the above-mentioned formalization.

## CHAPTER VI

### GENERAL PROVISIONS

#### Article 23

This Treaty shall be called the "Treaty of Asuncion".

#### Article 24

In order to facilitate progress towards the formation of the common market, a Joint Parliamentary Commission of MERCOSUR shall be established. The executive branches of the State Parties shall keep their respective legislative branches informed of the progress of the common market established by this Treaty.

Done at the city of Asuncion, on 26 March 1991, in one original in the Spanish and Portuguese languages, both texts being equally authentic. The Government of the Republic of Paraguay shall be the depositary of this Treaty and shall send a duly authenticated copy thereof to the Governments of signatory and acceding State Parties.

For the Government of the Argentine Republic:

Carlos Saul Meném

Guido di Tella

For the Government of the Federative Republic of Brazil:

Fernando Collor

Francisco Rezek

For the Government of the Republic of Paraguay:

Andrés Rodríguez

Alexis Frutos Vaesken

For the Government of the Eastern Republic of Uruguay:

Luis Alberto Lacalle Herrera

Héctor Gros Espiell

#### Annex I

### Trade Liberalization Programme

#### Article 1

The State Parties hereby agree to eliminate, by 31 December 1994 at the latest, any duties, charges and other restrictions applied in their reciprocal trade.

With regard to the schedules of exceptions submitted by the Republic of Paraguay and the Eastern Republic of Uruguay, the period for their elimination

shall extend to 31 December 1995, on the terms of article 7 of this annex.

#### Article 2

For the purposes of the preceding articles:

- (a) "Duties and charges" shall mean customs duties and any other charges of equivalent effect, whether related to fiscal, monetary, foreign exchange or other matters, levied on foreign trade. This concept does not cover fees and similar charges corresponding to the approximate cost of services rendered; and
- (b) "Restrictions" shall mean any administrative, financial, foreign exchange or other measures by which a State Party unilaterally prevents or impedes reciprocal trade. This concept does not cover measures taken in the situations envisaged in article 50 of the Montevideo Treaty of 1980.

#### Article 3

As of the date of entry into force of the Treaty, the State Parties shall begin a programme of gradual, linear and automatic tariff reductions, which shall benefit products classified according to the tariff nomenclature used by the Latin American Integration Association, observing the following timetable:

##### Date/Percentage tariff reduction

30 June 1991	31 Dec. 1991	30 June 1992	31 Dec. 1992	30 June 1993	31 Dec. 1993	30 June 1994	31 Dec. 1994
47	54	61	68	75	82	89	100

Preferences shall apply to the tariff in force at the time of their application and shall consist of a percentage reduction in the most favourable duties and charges applied to imports of products coming from third countries not members of the Latin American Integration Association.

If one of the State Parties increases this tariff for imports from third countries, the established timetable shall continue to apply at the tariff level in force on 1 January 1991.

If tariffs are reduced, the corresponding preference shall apply automatically to the new tariff on the date on which that new tariff enters into force.

For the above purposes, the State Parties shall exchange among themselves and shall transmit to the Latin American Integration Association, within 30 days of the entry into force of the Treaty, updated copies of their customs tariffs and of those in force on 1 January 1991.

#### Article 4

Preferences agreed to in partial scope agreements concluded by the State Parties among themselves in the framework of the Latin American Integration Association shall be expanded, under the present tariff reduction programme, according to the following timetable:

**Date/Percentage tariff reduction**

31 Dec. 1990	30 June 1991	31 Dec. 1991	30 June 1992	31 Dec. 1992	30 June 1993	31 Dec. 1993	30 June 1994	31 Dec. 1994
00 to 40	47	54	61	68	75	82	89	100
41 to 45	52	59	66	73	80	87	94	100
46 to 50	57	64	71	78	85	92	100	
51 to 55	61	67	73	79	86	93	100	
56 to 60	67	74	81	88	95	100		
61 to 65	71	77	83	89	96	100		
66 to 70	75	80	85	90	95	100		
71 to 75	80	85	90	95	100			
76 to 80	85	90	95	100				
81 to 85	89	93	97	100				
86 to 90	95	100						
91 to 95	100							
96 to 100								

These reductions shall apply only in the context of the corresponding partial scope agreements and shall not benefit other members of the common market; nor shall they apply to products included in the respective schedules of exceptions.

**Article 5**

Without prejudice to the mechanism described in articles 3 and 4, State Parties may also expand preferences by means of negotiations conducted in the framework of the agreements envisaged in the Montevideo Treaty of 1980.

**Article 6**

The tariff reduction timetable referred to in articles 3 and 4 of this annex shall not apply to products included in the schedules of exceptions submitted by each of the State Parties with the following quantities of ALADI nomenclature items:

Argentine Republic:	394
Federative Republic of Brazil:	324
Republic of Paraguay:	439
Eastern Republic of Uruguay:	960

**Article 7**

The schedules of exceptions shall be reduced at the end of each calendar year in accordance with the following timetable:

- (a) For the Argentine Republic and the Federative Republic of Brazil, by 20 per cent per year of the component items; this reduction applies from 31 December 1990;
- (b) For the Republic of Paraguay and the Eastern Republic of Uruguay, the reduction shall be at the following rates:

10 per cent on the date of entry into force of the Treaty
10 per cent on 31 December 1991
20 per cent on 31 December 1992
20 per cent on 31 December 1993

20 per cent on 31 December 1994  
20 per cent on 31 December 1995

#### Article 8

The schedules of exceptions contained in appendices I, II, III and IV include the first reduction envisaged in the preceding article.

#### Article 9

Products which are removed from schedules of exceptions on the terms set forth in article 7 shall automatically benefit from the preferences resulting from the tariff reduction programme established in article 3 of this annex. They shall benefit, at the least, from the minimum percentage reduction provided on the date on which they are removed from the schedules.

#### Article 10

States Parties may apply up to 31 December 1994, to products included in the tariff reduction programme, only the non-tariff restrictions expressly mentioned in the notes supplementing the complementarity agreement to be concluded by the State Parties in the framework of the Montevideo Treaty of 1980.

As of 31 December 1994, all non-tariff restrictions shall be eliminated from the common market area.

#### Article 11

In order to ensure observance of the tariff reduction timetable established in articles 3 and 4, and also the formation of the common market, the State Parties shall co-ordinate any macroeconomic and sectoral policies which may be agreed upon and to which the Treaty establishing the common market refers, beginning with those connected with trade flows and the composition of the State Parties' productive sectors.

#### Article 12

The provision of this annex shall not apply to the partial scope agreements Nos. 1, 2, 13 and 14 or trade and agricultural agreements signed in the framework of the Montevideo Treaty of 1980, such agreements being governed exclusively by their own provisions.



ANNEX IIMERCOSUR TIMETABLE<sup>1</sup>

<u>Measures</u>	<u>Deadline</u>
<b>1. TRADE MATTERS</b>	
- Defense against imports encouraged by dumping or subsidies	October 1992
- Agreements on exchange of statistical information on foreign trade	October 1992
- Assessment of Incidence of non-tariff restrictions with a view to their elimination	December 1992
- Assessment of the bilateral agreements signed with third countries	April 1993
- System and instruments for export promotion	October 1993
- Free zones and special custom areas	December 1993
- Common nomenclature	December 1993
- Safeguards policy	June 1994
- Compatibilization of special customs regimes	September 1994
- Administrative norms on imports and exports	July 1994
<b>2. CUSTOM MATTERS</b>	
- Elaboration of a MERCOSUR glossary	December 1992
- Simplification of border transactions	March 1993
- Customs-related training	June 1993
- Unified sanitary inspection service	June 1993
- Coordination of commodity codes	December 1993
- Harmonization a the custom, migrations and sanitary legislation	June 1994
- Migration control: creation of a common ID	June 1994
- Informatized customs control	December 1994

<sup>1</sup> Agreed upon by the member countries in Las Leñas, Argentina, 27 June 1992.

Measures	Deadline
- Implementation of a common system of custom valuation of imports	September 1994
<b>3. TECHNICAL NORMS</b>	
- Toys	September 1992
- Information procedures	April 1993
- Net weight and tolerances of packaged products	June 1993
- Food ingredients and additives	June 1993
- Food registry	June 1993
- Pollutants	June 1993
- Microbiological and microscopic standards	June 1993
- Packaging and materials in contact with food	1992-1993
- Motor-vehicles industry: harmonization of technical regulations	1992-1993-1994
- Legal metrology: tools	November 1993
- Telecommunications	November 1993
- Health products	December 1993
- Identity and quality patterns	June 1994
- Labelling of nutrient and/or dietetic foods	October 1994
- Industrial quality	November 1994
- Scientific and industrial metrology	November 1994
<b>4. FISCAL AND MONETARY POLICY</b>	
- Exchange regime	Dec. '92-Dec. '93-Jun '94
- Promotion and reciprocal protection of investments	June 1993
- Capital markets	December 1993
- Financial system	June 1994
- Insurance	June 1994
- Management and quality of information	June 1994

Measures	Deadline
<b>5. SURFACE TRANSPORTATION</b>	
- Harmonization of regulations on surface transportation hazardous materials	March 1993
- Labour regime of road transportation and requisites for licenses	March 1993
- Measures for the integration of road transportation of passengers	September 1993
- Railway transportation	1992-1993
- Multimodal transportation	September 1993
<b>6. MARITIME TRANSPORTATION</b>	
- Labour regime	March 1993
- Common registry of boats and vessels	June 1993
- Multimodal transportation	September 1993
- Transport security regulations	October 1993
- Multilateral agreement on maritime transportation	December 1993
<b>7. INDUSTRIAL AND TECHNOLOGICAL POLICY</b>	
- Harmonization of industrial, regional or sectoral promotion and reconversion measures	November 1993
- Harmonization of quality and productivity policies	December 1993
- Policy for micro-, small and middle-sized enterprises	December 1993
- Sectoral competitiveness diagnoses	December 1993
- Common technological policy	June 1994
- Harmonization of national and provincial environmental legislation	November 1994
<b>8. AGRICULTURAL POLICIES</b>	
- Registry of agrochemicals	December 1993
- Barriers to the free circulation of agricultural products	April 1993
- Articulation of small and middle-sized producers to the integration process	October 1993

<u>Measures</u>	<u>Deadline</u>
- Agricultural and agroindustrial harmonization, restructuring and reconversion	November 1993
- Harmonization of agricultural policy	November 1993
- Diagnostic of sectoral competitiveness	November 1993
- Harmonization of technological policy	March 1994
- Sustainability of natural resources and environmental protection	June 1994
<b>9. ENERGY POLICY</b>	
- Energy legislation; organizational and institutional aspects	December 1993
- Technological development	December 1993
- Absolute and relative energy prices	December 1993
- Fiscal aspects: tax burden	December 1993
- Electric standards and specification of fuels	September 1993
- Environmental legislation and framework	December 1993
- Rationalization, quality and productivity	June 1993
- Guidelines for energy policies	June 1994
<b>10. COORDINATION OF MACROECONOMIC POLICIES</b>	
- Policy towards state monopolies	June 1993
- Harmonization of legislation in defense of the consumer	September 1993
- Harmonization of legislation on competition	November 1993
- Policy towards services	December 1993
- Creation of data bank and economic documentation	December 1993
- Monitoring and harmonization of macroeconomic policy	December 1993
- Common external tariff	July 1994
- National, provincial, state and municipal tax systems	September 1994

Measures	Deadline
<b>11. LABOUR RELATIONS, EMPLOYMENT AND SOCIAL SECURITY</b>	
- Labour costs in the transportation sector	December 1992
- Agreements with ILO	December 1992
- Individual labour relations	December 1993
- Professional training	December 1993
- Collective labour relations	December 1993
- Health and work security	May 1994
- Social security	May 1994
- Employment	December 1994
<b>12. INSTITUTIONAL ASPECTS</b>	
- Definitive structure of the MERCOSUR institutions	May 1994
- Specific prerogatives of the MERCOSUR institutions	May 1994
- Decision-making mechanisms	May 1994

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