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REGIONAL INTEGRATION IN LATIN AMERICA: IS MERCOSUR A NEW APPROACH?

Douglas Zormelo

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1 Introduction

The history of regional integration among developing countries is one which leaves observers wondering why they continue to be formed despite their low level of achievement in the past. The pessimism with which such schemes are viewed has been matched by a stagnation of theorising particularly by international relations scholars who view it as an unfashionable area of specialisation to be engaged in and as a waste of time. However the few who continue to study the phenomena have recognized that theory has lagged far behind practice.

In Latin America and the Caribbean despite the failure of integration over the past two decades old groups are being revitalised and new ones being formed. They include; the Andean Pact, the Central American Common Market (CACM), the Caribbean Community (CARICOM), and MERCOSUR. Most of these groups have fairly specific timetables with the mid-1990s being targeted as the time for the consolidation of collective structures.¹

The objective of this study is to use MERCOSUR as a case study in order to determine whether the background conditions that are normally postulated as necessary for successful integration exist. The paper is divided into four main parts. The introduction which forms the first part, apart from introducing MERCOSUR also looks at integration among developing countries and the theoretical assumptions underlying earlier attempts at regional integration. It then assigns reasons for the failure of those earlier attempts. The introduction then moves on to compare MERCOSUR with these earlier attempts in terms of theoretical assumptions and the institutional structure of the organisation. Part two of the paper looks at the political and economic conditions that are necessary for successful integration in the context of the organisation. Part three attempts to measure the extent of MERCOSUR integration since 1991. This is done by looking at the level of collective decision making, and various measurements of trade flows. The conclusion which forms the final part attempts to assess the prospects for MERCOSUR within the context of the conditions for economic integration and the level of integration achieved since the inception of the organisation. The study will not concentrate on a specific functional area such as economic, or political. Instead a multidimensional perspective will be adopted which looks at economic, political and social aspects of regional integration in order to gauge potential for success.

1.1 MERCOSUR and regional integration

The Treaty establishing MERCOSUR was signed in Asuncion, Paraguay on 26

¹ Baumann, R., 'Integration and Trade Diversion' in *Cepal Review*, United Nations, No. 51, December 1993.

March 1991. It envisaged the establishment of a common market among the members by 1 January 1995. The aims of the organisation as stated in the preamble to the Treaty, are that it will be a means of: expanding the domestic markets of member countries in order to facilitate their economic development; countervailing integration in other areas, particularly the integration of large economic areas; furthering the gradual integration of Latin America in keeping with the Montevideo Treaty of 1980; and the promoting of scientific and technological development, modernizing their economies and increasing the competitiveness of goods through improving the quality of their goods and services.

MERCOSUR—*Mercado Comun del Sur*—is an expansion of bilateral integration between Argentina and Brazil to include Paraguay and Uruguay.² The Treaty of Asuncion which established MERCOSUR (Southern Common Market) was therefore predated by the Iguazu Act which was signed in 1985 to launch a stepping up of bilateral trade relations, industrial complementarity and technological cooperation between Argentina and Brazil. Subsequent to the signing of this Act twenty-four protocols were signed between 1986 and 1989. In 1989 a treaty of Integration and Cooperation was signed followed in July 1990 by the Act of Buenos Aires to form a common market as from 1 January 1995 between the two countries. The timetable which is being followed by the four member states was therefore essentially that which had been set by Argentina and Brazil. Though, as stated above, the Treaty envisaged the formation of a common market by January 1995, such a timetable was found to be too tight and a customs union has been formed instead with a common market following in 2001. Thus even though the Financial Times has reported the setting up of the customs union as what had been planned,³ the customs union is actually a reduction in the level of economic integration that had been planned for that date.

1.2 Integration among developing countries and their theoretical assumptions

Integration among developing countries is usually rationalised, by theoreticians, on the basis of the so-called dynamic impact that it will have on the economies of the participating members. This is because the static gains which form the basis of traditional assessments of the desirability of such schemes on the welfare and trade impact are regarded to be of low theoretical significance to the process among developing countries. The reason for this is the low level of industrialisation and trade of developing countries and therefore the low level of potential reallocation of resources that can take place after integration. As Robson pointed out, in

² Argentina, *Trade Policy Review*, GATT, Vol. II, May, 1992.

³ *The Financial Times*, 17/18 December 1994.

evaluating the merits of integration among developing countries what is relevant is not so much what its impact on existing patterns of trade will be but rather its impact on the patterns that are likely to emerge.⁴ Integration among developing countries is therefore expected to derive its benefits from the rationalization of the emergent structures of production.

As Axline also noted, the differences in the economics and politics between industrial countries and developing countries means regional integration follow different dynamics. As he saw it, integration among developing countries does not aim at 'the intensification of present economic patterns through the elimination of artificial barriers but at their restructuring through the adoption of regional policies.' He goes on to point out that this implies 'a dirigiste rather than a *laissez-faire* approach to integration that requires a high degree of political cooperation.'⁵

These views underlie theorising on integration among developing countries. They also imply substantial state involvement not only in collective decision-making but in the location of industries. It therefore involves determining the appropriate scope for regional specialisation, and how benefits that accrue from regional joint ventures are to be distributed. All of these imply a level of cosmopolitanism which downgrades the existence of economic nationalism considerably and elevates the desirability of increased regional welfare over national industrial development aspirations.

1.3 Failure of integration among developing countries and reasons

Though the rationalization of prospective industries is essentially an argument for collective import substitution industrialisation and is based on a recognition of the importance which developing countries attach to industrialisation,⁶ the method however contains the seeds that caused the failure of earlier integration schemes among developing countries from the late 1950s through to the 1980s.

The failure of integration schemes among developing countries over the past three decades was to a large extent a result of the assumptions that underlie both the

⁴ Robson, P., *The Economics of International Integration* (3rd ed.), Allen and Unwin, London, 1987, p. 195.

⁵ Axline, W.A., 'Integration and Development in the Commonwealth Caribbean: The politics of Regional Negotiations', in *International Organization*, vol. 32, part 4, 1978, p. 954.

⁶ Cooper, C.A., and Massell, B.F., 'Towards a General Theory of Customs Unions for Developing Countries', in *Journal of Political Economy*, 1965, pp. 461-476.

dirigiste approach to regional industrial planning and the underestimation of the desire for national industrial development rather than regional industrial development *per se*. The hope of better prospects for industrialisation are a major consideration for common markets among developing countries both for welfare as well as for status reasons. At the same time there was the tendency for industry to cluster in the more developed areas of the region to take advantage of existing external economies of scale. In regions where there is little industrialisation or few poles of growth, imbalances tend to occur in the distribution of industries.⁷ This tends to be the case in most developing regions. The situation is exacerbated in instances where the larger or more developed economies within the region become more attractive to investors thus creating polarization within the region.⁸

In addition to the tendency for private investment to cluster in the more developed areas, the strong desire of the individual member states for industrial development frequently resulted in disagreement over where regional joint ventures should be sited and on incentive schemes that would allow the less attractive areas within the region to benefit from foreign investment, regardless of the actual distribution of comparative advantage within the region. Time has shown that excessively high expectation of goodwill and of government involvement in planning and structuring of industries are both unrealistic and ineffective. The difficulties UNCTAD has faced in resolving various national interests, and the failure of state planning in the former Soviet Union and eastern Europe, as well as in the developing countries are both clear examples of the spuriousness of such assumptions.

From the above it can be hypothesized that where industrialisation remains a policy goal of the members of an integration scheme among developing countries, the distribution of benefits features prominently in continued commitment to the process.

As a result of the failure of dirigisme, recent trends in development theory and practice have advocated the reduction of the role of the state to one that creates an enabling environment for private enterprise. Many developing countries have consequently adopted structural adjustment programmes which include the sell off of state owned industries and the liberalisation of trade. Both sets of policies contradict regional collective ownership of industries which was a basic rationale for integration among developing countries.

⁷ Nye, J.S., 'Comparing Common Markets', in *Integration Theory and Research*, Lindberg, L. and Scheingold, S., (eds.), Harvard Univ. Press, 1971.

⁸ Brown, A.J., 'Economic separatism versus a Common Market in Developing Countries' in *Yorkshire Bulletin of Economic and Social Research*, May 1961, vol. 13, no. 1.

1.4 Differences between MERCOSUR and earlier integration schemes

The Treaty of Asuncion establishing MERCOSUR reflects the new trend in development planning. As has been mentioned above, the emphasis among the members of the organisation is to expand their '...domestic markets, through integration....' The members;

believe that this objective must be achieved by making optimum use of available resources, preserving the environment, improving physical links, coordinating macroeconomic policies, ensuring complementarity between the different sectors of the⁹ economy, based on the principle of gradualism, flexibility and balance.¹⁰

The above quotation shows the underlying philosophy of MERCOSUR integration. It reflects the downgrading of the states' involvement in industrial planning to one of creating an enabling environment and deviates from previous schemes in its emphasis on market integration¹¹ rather than rationalizing prospective emergent industries. What this means is that the success of integration will be determined by the changes that will occur in their *existing* patterns of production. The benefits of regional integration will depend very much on the extent to which market forces can result in more efficient allocation of resources within the region to take advantage of economies of scale and thus improve competitiveness.

Thus even though MERCOSUR is an integration group among developing countries, the processes that are expected to bring about the achievement of the aims set out in the Treaty differ very much from earlier models and the process mechanisms that they suggest. The process envisaged reverts to the orthodox model which depends on neo-liberal perspectives and abandons the rationalized trade diversion model with its assumptions of high government intervention that had been in vogue since the 1950s. Thus even though the Treaty sets out aims that are similar to earlier attempts the modalities differ in important ways from what theoretical postulations for developing countries would suggest.

First, most developing country schemes formed in the 1960s and 1970s saw integration as a means of overcoming the limits imposed by market size and

⁹ Note that the definite article here refers to the individual constituent economies rather than complementarity at the regional level through a deliberate regional industrial planning.

¹⁰ Preamble to the Treaty of Asuncion.

¹¹ UNCTAD, *The Outcome of the Uruguay Round: An Initial Assessment*, UNCTAD/TDR/14 (Supplement), 1994, pp. 29-34.

capital.¹² However, instead of just integrating markets, the rationale was to combine resources and build joint industrial concerns. Such enterprises were then to take advantage of the enlarged market made available by integration. The members of MERCOSUR, on the other hand view integration more as a means of increasing their competitiveness through market integration and not through industrial integration. Though market integration may result in a reallocation of resources, it is to be as a result of market forces and the private sector and not by dirigiste policies.

The scheme and what it is supposed to achieve indicate that the member states see it as a means of improving their competitiveness rather than as a method of collective regional import substitution industrialisation. This is a major departure from the theoretical justification of integration among developing countries in the preceding decades. Whereas such theories sought to justify trade diversion on the basis of the infant industry argument, the aim here is to set up external tariffs that do not protect inefficient industries. Indeed the radical nature of this proposal has created difficulties for the member states. Uruguay and Paraguay have since the beginning of the scheme been in favour of the lowest possible tariffs whilst Argentina and Brazil have been in favour of tariffs that are high enough 'to continue providing protection to some industries'.¹³ The *laissez-faire* method that MERCOSUR integration implies makes static efficiency allocation an important criterion for the welfare benefits that will accrue to members collectively and individually. The *laissez-faire* method that is being employed by the process among MERCOSUR members can be gleaned from what the Uruguayan president, for example, said in May 1991. To him the organisation '...would herald a new, creative phase in the continent, in which private initiative will be the engine-room....'¹⁴

Secondly, the process initially sought to create a common market without going through the intervening stages of economic integration, that is, free trade area and customs union. This deviates from all known integration schemes and also from economic and political theoretical paradigms.

Thirdly, the Treaty does not refer to redistributive or compensatory mechanisms as a means of redistributing the unequal gains from integration or the loss that some members might suffer as a result of the implementation of collective policies. The demise of various integration schemes among developing countries have been

¹² Linder, S., 'Custom Unions and Economic Development, in *Latin American Integration: Experience and Prospects*, Wionczek, M.S., (ed.), Praeger, 1964.

¹³ *Southern Cone Report*, 24 December 1992, RS-92-10, p. 1.

¹⁴ *Latin American Regional Report: Southern Cone Report*, 4 July 1991, RS-91-05, p. 1. Emphasis ours.

attributed to the unequal gains that accrued to the members. The East African Community, which was regarded as one of the most developed regional integration schemes among developing countries, was in part dismantled as a result of what came to be seen as the disproportionate benefits to Kenya at the expense of Tanzania and Uganda.

The lack of a compensation or redistributive mechanism further points to the assertion made earlier about the essentially free market orientation underlying the scheme. The basic attitude would seem to be that integration is for improving competitiveness through a redistribution of production. Such redistribution of production and rationalisation of prospective ones will however be done by market forces rather than by dirigiste methods.

Another way in which MERCOSUR differs from earlier attempts at integration is in the institutional structure of the organisation. Whereas most integration schemes in the past started with an attempt to establish fairly elaborate institutions with supranational powers, the Treaty of Asuncion does not envisage one.

1.5 Institutional structure and integration process

During the transitional period leading to the establishment of the common market, the process was being overseen by a transitional institutions made up of the Council, the Common Market Group, and an administrative secretariat.¹⁵

The Council, which is the highest organ of the common market is responsible for its political leadership and decision-making. It is also responsible for ensuring compliance with the 'objectives and time-limits set for the establishment of the common market'.¹⁶ It is made up of the Ministers of Foreign Affairs and Ministers of the Economy of the member states. The Council meets whenever it is deemed necessary and at least once a year with the Presidents of the member states. It has a rotating presidency lasting six months each in alphabetical order.

The Common Market Group (CMG) is the executive organ of the common market.¹⁷ It is coordinated by the Ministers of Foreign Affairs. It has powers of initiative, and has duties that include: monitoring compliance with the Treaty; enforcing decisions taken by the Council; proposing ways of implementing the trade liberalisation programme, coordinating macroeconomic policies of the member states, and negotiating agreements with third parties; to ensure progress toward the

¹⁵ Article 9-18, Treaty of Asuncion.

¹⁶ Article 10, Treaty of Asuncion.

¹⁷ Article 13, *ibid*.

formation of the common market. It is composed of four members and four alternates representing the Ministries of Foreign Affairs, Economy and the Central Bank of the members and in its deliberations leading to the establishment of the common market the CMG can call on any representatives of government or the private sector. Decision of both the Council and the CMG are taken by consensus with all member states present.¹⁸ The CMG has an administrative secretariat which keeps the Group's documents and report on its activities.¹⁹ The Treaty also provides for the CMG to set up working groups that are needed to enable it to perform its duties.

Even though the organisational structure is interim, and the member states were supposed to meet specially prior to 31 December 1994 to announce a final structure and administrative organs of the organization, the delay in the timetable for forming a common market means that the structure that has been described above will continue to run affairs for some time. Indeed the fear that supranational institutions will encroach on sovereignty has resulted in Argentina and Brazil opposing a Uruguayan proposal for a supranational court to rule on trade disputes.²⁰ As the common market is not expected to be formed, according to the economic adviser at the Brazilian Ministry of Foreign Affairs, until 2006,²¹ it is unlikely that any supranational institution will be set up till then. This means that a definitive organisational structure may not be in place for quite a while yet.

From the above, MERCOSUR differs in several ways from earlier integration schemes both in Latin America and other parts of the developing world. The question that springs to mind with the poor record of schemes among developing countries is whether there are any reasons why the mechanisms, structure and aims of MERCOSUR can be expected to facilitate development, and particularly industrial competitiveness, where earlier attempts have failed. It will also be interesting to examine how departing from the theoretical framework usually postulated for developing countries will impact on the achievement of the goals. Below we will examine the economic, political and social conditions that are seen as prerequisites for successful integration.

¹⁸ Article 16, *ibid.*

¹⁹ Article 15, *ibid.*

²⁰ *Financial Times*, 16 Dec. 1994.

²¹ Seminar held at the Institute of Latin American Studies on Brazil and the MERCOSUR, October 1994.

2 Conditions for Economic Integration

2.1 Economic conditions and regional allocation of resources

Orthodox integration theory assesses the effectiveness of reallocating resources within an economic bloc on the trade creation or diversion that will occur as a result of the adoption of a common external tariff which forms a customs union. 'Trade creation refers to a union induced shift from the consumption of higher-cost domestic products in favour of lower-cost products of a partner country.'²² The shift has two effects; a production effect, and a consumption effect. The production effect results from the savings in real cost of goods that were previously produced domestically inefficiently and the more efficient production of alternative goods. The consumption effect also results from the consumer surplus that is a consequence of substituting lower priced goods for high priced ones for satisfying wants.

Trade diversion on the other hand results from a union induced shift in the consumption of a good from lower-cost external sources to higher-cost partner sources. It results from the reduced tariff of the member countries on each others goods. Thus the free trade or highly reduced internal tariffs of the member countries *vis-à-vis* non-members results in a shift of competitiveness to partner countries. It is therefore not necessarily the common external tariff that makes the partner goods more competitive but rather the removal of internal trade. Trade diversion is also seen as having two aspects; the production effect and the consumption effect. The first is an increase in the cost of the goods previously imported from abroad. The second is the reduction in consumer surplus as a result of higher priced goods.²³

The potential benefits of a customs union are then assessed on whether on balance the economic bloc will be a trade creating one or a trade diverting one. A trade creating one will, it is supposed, increase welfare whilst the trade diverting one will reduce welfare.

The literature identifies certain circumstances as being conducive to trade creation. These include: the size of the economic area of the custom union; the pre- and post-integration tariff levels; level of competitiveness of the economies of the member countries; the difference in the unit cost for protected industries of the same kind; and the level of pre-integration trade. It is assumed that the larger the economic area the higher the probability that the least cost producer will be a

²² *ibid*, p. 15.

²³ *ibid*.

member of the process.

2.1.1 Trade creation and trade diversion in MERCOSUR

Even though multilateral tariff reductions in GATT are making the trade creation and trade diversion method of calculating the potential benefits of a custom union obsolescent, they still remain quite useful to the extent that tariffs remain as an important trade policy instruments at the present time. It also remains useful to the extent that tariff regimes in potential member countries differ from each other so that harmonization will produce changes in the tariff structure of member countries and thus impact on the competitive advantage of member *vis-à-vis* each other and with non-members. Among the members of MERCOSUR tariffs differ substantially. The simple average pre-Uruguay tariff rates in Argentina and Brazil, for example, were 23.3 per cent²⁴ and 14.2 per cent²⁵ respectively. This could be used as a pointer to the existence of potential sources of reallocation.

Whether reallocation will indeed result from MERCOSUR will depend on several factors.

Table 1 Population and average incomes in MERCOSUR countries, 1990

	<i>Argentina</i>	<i>Brazil</i>	<i>Paraguay</i>	<i>Uruguay</i>	Total
Population	32.3	150.4	4.3	3.1	190.1
GNP per capita	2,370	2,680	1,110	2,560	2,086

As Table 1 shows MERCOSUR will result in an economic bloc of about 190 million people with an average per capita income of US\$2,086.²⁶ The population is made up of Argentina's 32.3 million, Brazil's 150.4 million, Paraguay's 4.3 million, and Uruguay's 3.1 million. The disparities in GNP per capita of the individual countries are not as high as they are for the population. The smallest

²⁴ GATT, *Trade Policy Review, Argentina*, Vol. 1, 1993, p. 93.

²⁵ GATT, *Trade Policy Review, Brazil*, Vol. 1, 1993, p. 103.

²⁶ Calculated from World Development Report 1991, pp. 204-205.

population, Uruguay has the second highest level of GNP per capita of US\$2,560. Brazil, with the highest population also has the highest GNP per capita of US\$ 2,680. Argentina's is US\$2,370, with Paraguay's being the lowest at US\$1,110. Brazil is the dominant economy in the sub-region. It is therefore of crucial importance to the organisation. Paraguay and Uruguay stand to gain the most in terms of market enlargement. MERCOSUR will provide Paraguay with an extra market of about 182 million people, and Uruguay with about 183 million people. The increases are colossal and, if successful, may prove catalytic to the industrial development of the two countries. Despite having a fairly large population Argentina will also gain substantially from market integration. Brazil's internal market is very large making market integration of marginal significance to its own internal market. The total market size is of sufficient size to act as an important incentive to producers of the member countries. However, as a criterion for trade creation, MERCOSUR is more likely to be a trade diverting one than a trade creation one because as a group of developing countries, it is unlikely that the members will include the least cost producers of the goods they import from third countries.

The other factors that are used to gauge whether a bloc will be a trade diverting or creating one indicate that MERCOSUR will be a trade diverting one. This is because their external pre-integration tariffs are high except for Paraguay and Uruguay (with small economies), and their economies do not have the competitiveness that results in efficient reallocation of industries and hence the complementarity that will make the economies fuse together adequately. Even though orthodox theory will suggest that MERCOSUR will be a trade diverting organisation, such trade diversion, because of the level of development of the member states, will be minimal and be limited to mainly primary and basic manufactures which constitute the greater proportion of their exports, as Table 2 below shows. Thus because most of their manufactured imports come from non-member countries and are not produced by MERCOSUR countries, and therefore continue to be imported, the extent of trade diversion will, in the near future, be low.

Even though on balance the organisation, according to the trade creation and trade diversion criteria, will be a trade diverting one, the analysis is static. Hence it does not look at the potential benefits for countries such as Uruguay and Paraguay whose markets will be expanded several times over by the formation of the group.

Besides, as Srinivasan et al. have noted, even though trade creation and trade diversion may be a useful description of custom unions they are an inappropriate basis for measuring their welfare effects. As they pointed out trade diversion might, from a global standpoint, 'represent a shift in the trade pattern counter to comparative advantage; but the importing country may benefit from trade diversion

as domestic prices of goods fall.²⁷

It is also the case that trade creation and trade diversion measures look at the desirability of customs unions from a world welfare perspective. Thus even though trade diversion may result in the purchase of goods from a relatively high-cost partner country, it may nevertheless lead to increased consumer surplus as a result of the removal of internal tariffs thus making goods imported from partner countries cheaper to consumers than those that were imported from non-members. As a whole intra-regional welfare will increase if intra-regional trade rises. The increase in intra-regional trade need not be at the expense of world trade. Theory has so far been unable to provide rules that determine the suitability on welfare grounds of particular countries as partners of integration schemes.²⁸ The potential for intra-regional trade is however an important criterion for successful integration, especially where that does not occur at the expense of world trade and thus result in trade diversion.

However, whether the members are able to increase trade depends substantially on the nature of their export mix and whether they have the necessary extra capacity to expand trade.

Table 2 **Structure of merchandise exports for 1991**

	<i>Fuel, mineral and metals</i>	<i>Other primary commodities</i>	<i>Machinery and transport equipment</i>	<i>Other manufacture s</i>	<i>Textiles and clothing</i>
Argentina	8	64	7	21	2
Brazil	16	28	18	38	4
Paraguay	0	89	0	11	1
Uruguay	1	59	2	38	16

Source: World Development Report 1993.

²⁷ Srinivasan, T.N. et al., 'Measuring the effects of regionalism on trade and welfare', in *Regional Integration and the Global Trading System*, Anderson, K., and Blackhurst, R., (ed.), Harvester Wheatsheaf, 1993, p. 55.

²⁸ *ibid*, p. 57.

As Table 2 indicates, Paraguay, which is the least developed of the member countries of MERCOSUR, is also the least industrialised. 89 per cent of her exports are made up of non-fuel primary commodities. Thus even though it exported 35.2 per cent of its products to the members of the group in 1991 most of it was primary commodities. It is therefore unlikely to gain very much from the initial reallocation of resources because of the inflexibility of the primary sector. There is, however, the potential to industrialise because whereas her small internal market of 4.2 million people and per capita income of US\$1,030 imposed severe difficulties on her ability to set up viable industries, the market provided by her partners may reverse all that.

Uruguay, on the other hand has a fairly high proportion of export being made up of manufactures. It is indeed equal to that of Brazil in percentage terms. It therefore stands to gain more immediately from integration than Paraguay. It will also gain substantially in the long run from the expansion of the potential market for its manufactured products. Indeed the explosion of the potential market is phenomenal in terms of its own population of 3.1 million.

Whether industrialisation is encouraged in the smaller member countries depends on the extent to which Argentinean and Brazilian manufacturers exploit the Paraguayan and Uruguayan markets after integration. However, even if manufactures from the larger members should swamp the markets, the elimination of tariffs will nevertheless open up huge markets for them. In any case, considering that they already had lower tariffs than Argentina and Brazil, if their markets were to be flooded by Brazilian and Argentinean goods, it would have happened before MERCOSUR was formed. Thus it can be assumed that the situation will not be substantially different from what it was prior to the formation of the organisation. From a purely logical perspective both Uruguay and Paraguay stand to gain from the enlargement of the market. The larger countries, *prima-facie*, have less to gain in terms of the increased potential market for manufactures. The main source of potential benefit is that they will be forced to become more competitive because of the liberalisation of their markets through lower import tariffs.

The issue of how low external tariffs should be has indeed been a thorny one for the members of the group, particularly Brazil. The problem has always been the Brazilian insistence on a high tariff to protect 'strategic' sectors, such as capital goods, computers and telecommunication equipment. The eventual tariff which was agreed in Montevideo in December 1993 allowed a ceiling of 20 per cent for all but a list of products for which 35 per cent tariff will be set. The 35 per cent tariffs will then be reduced gradually between 1995, when the CET comes into force and 2001, the revised scheduled year for the common market.²⁹ These levels of tariffs

²⁹ *Latin American Regional Reports: Southern Cone Report*, 4 February 1994, RS-93-01.

are much higher than the zero rate that Paraguay and Uruguay had been demanding.³⁰

The net effect of market enlargement from the above will therefore be positive for the region as a whole, and particularly so for Argentina, Paraguay and Uruguay who would have the advantage of having access to the huge Brazilian market. Brazil will also gain by having 40 million people added to its potential market.

Another possible source of gain will be the discipline that will be imposed by the attempts to harmonize macroeconomic policies of the individual members. The importance of this issue to the integration effort cannot be overestimated, especially since MERCOSUR is intended to be a common market. As a result of the *laissez-faire* approach to integration in MERCOSUR exchange rates and inflation would be important variables determining competitiveness of member countries. There is therefore a need for them to be managed adequately if they are not to cause problems for the process. Brazil's chronic macroeconomic instability, as Table 3 indicates, need to be corrected.

Table 3 Inflation in MERCOSUR over two years

	1992	1993
Argentina	24.6	10.6
Brazil	1,200.0	2,246.7
Paraguay	15.1	18.5
Uruguay	68.3	54.1

Source: IMF, International Financial Statistics Yearbook, 1994

The method being adopted so far has been through national policies rather than through coordination of national policies which, according to some, is the best method due to the high degree of macroeconomic instability in Argentina and Brazil.³¹

³⁰ *Latin American Regional Reports: Southern Cone Report*, 23 December 1993, RS-93-10.

³¹ Schwidrowski, A., 'Macroeconomic policy coordination and integration', *Cepal Review*, No. 45, December 1991.

Other sources of benefit will be the increased bargaining power in international relations. Such a potential has indeed been recognised by developed country members of GATT who have asked for the organisation to be examined 'in the light of the Enabling Clause of the General Agreement including Article XXIV....'³² The movement of capital and labour may also result in added benefits, as industries are established to take advantage of disparities in marginal productivity.

From the above we can conclude that even though the trade creation and trade diversion criteria indicate a potentially negative outcome to MERCOSUR, because of the level of industrialisation of the members, various effects of a custom union, such as enlarged market, and of the common market, such as the free movement of factors of production, might make it potentially instrumental in the development of the member countries. How far such benefits will accrue will depend on the willingness of the member countries to bear the immediate costs of integration and the loss of individual economic policy decision making autonomy, in order to benefit from the long run dynamic effects. It will also depend on the political dynamics of the process. In the final analysis all potential outcomes have to be made to happen because they are unlikely to be a result fortuitously. Below we look at the political factors that determine whether the mainly a priori postulations of economic theory, will become reality in MERCOSUR and help in the development of the competitiveness of member countries.

2.2 Political conditions

Regional economic integration takes place within a political context which determines the integrative potential of a scheme. The factors affecting the political context of a regional integration scheme have been categorised into structural and perceptual conditions.³³ The conditions that were listed by Nye as important for integration are based on a synthesis of various studies carried out by various students of the international integration. Structural conditions include symmetry of units, capacity of members to respond and adapt, pluralism, and elite value complementarity. The perceptual conditions are: perceived equity of the distribution of benefits, perceived external cogency, and low visible costs. We would add to the perceptual conditions, predictability of each other's behaviour. These conditions respond positively to the pressures generated by integrative mechanisms, and also affect the initial commitment and hence the process mechanisms. The reverse of these conditions are seen as implying low integration potential.

Though not a condition as such, the initial commitment to integration by the

³² UNCTAD, *The Outcome of the Uruguay Round*, op. cit., p. 30, Box 2.

³³ Nye, J.S., 'Comparing Common Market', op. cit., p. 217.

prospective member of the scheme is seen as very important and therefore deserves comment. As Nye has pointed out, they remain important throughout the process.³⁴ We might add that they indeed determine whether the process will progress, stagnate or regress. Such commitments are reflected in the institutions and treaty obligations and are important because they determine the strength of the treaty as a working document and shape the environment and the capabilities of the organisation. The treaty, for example, determines the latitude that is allowed, national interpretation and also the penalties for noncompliance. The amount of escape clauses and exemptions found in the treaty also determines, to a large extent, the usefulness of the treaty as a guide to integration. What is in the treaty also has a direct impact on the conditions that have been listed above. Responsiveness of members to each other's needs and difficulties, and how the presence or absence of symmetry between members affects the process are, for example, determined by the escape clauses and exemptions. If member countries, for example, demand too many exemptions the process is likely to be affected adversely. On the other hand judicious exemptions may reflect a capability by the members to respond to each other's domestic difficulties in a manner which does not jeopardize the process.

The treaty setting up MERCOSUR, for example shows a high level of commitment among the member countries when safeguard clauses are considered. Annex IV of the Treaty of Asuncion provides for safeguards that may be used only in exceptional cases by the member countries. The main trends that can result in their use relate to 'the existence of damage or threat of serious damage: production level and capacity used; employment level; share of the market; level of trade between the parties concerned or participating in consultations; performance of imports and exports in relation to third countries. However none of the factors is on its own sufficient or decisive in determining the existence of damage or threat of serious damage.'³⁵ An important aspect of the safeguards clauses is that they do not extend beyond 31 December 1994.³⁶ Presumably this date was to coincide with the coming into effect of the common market as it was originally scheduled. Given that the dates have changed it is probable that the date will be extended. The significant thing though is that it makes it difficult, once the common market is operational, for the process to be unduly disrupted by the use of such measures. Below we examine each of the political conditions listed above in the context of MERCOSUR to determine the extent to which they reflect how high the integration potential of

³⁴ *ibid.* Many of the variables used as political and social determinants are based on this article and Lindberg's *animators* of political integration found in 'Political Integration as a Multidimensional Phenomenon...', in *Integration Theory and Research*, Lindberg, L., and Scheingold, S.,(eds.), Harvard Univ. Press, 1970.

³⁵ Annex IV, Article 3, Treaty of Asuncion.

³⁶ Annex IV, Article 4, Treaty of Asuncion.

the organization is.

2.2.1 *Structural conditions*

Responsiveness. The first condition that we consider is the level of responsiveness of member countries to each other. Responsiveness³⁷ of governments and political elite of member countries to each other's need and desires is seen as being important to sustaining integration. Such responsiveness according to the model requires increased attention, fuller and more accurate understanding of each other, and more rapid and effective action. Increased responsiveness is itself facilitated by increased capabilities of the governments concerned in the area of administration, policy formulation, decision making and action. It is also facilitated by a greater and wider range, and volume of communications and other transactions between the members. Communications and transactions increase interdependence and hence make it essential for members to be responsive because not doing so affects them adversely. A third and final element in increased responsiveness is the strengthening of social groups, institutions, and organisations which will provide links of social communication between the member countries.

Responsiveness is important in our assessment of MERCOSUR because the involvement of governments in economic integration makes a certain amount of political integration inevitable and indeed necessary. This is because political integration provides the crucible within which economic processes take place. Our use of political integration conforms to Lindberg's view that the sure sign of political integration is that a system has the authority to make decisions for the entire community regardless of whether these are military, economic, or social welfare decisions.³⁸ The extent of the willingness of member governments to allow collective institutions to take decisions on their behalf is therefore what, in our view, constitutes political integration. The extent of legitimacy and authority accorded to collective institutions can be gauged from the demands emanating from member countries to the collective arena. They form part of the capabilities that the institutions are endowed with by the member countries.

The setting up of various transmission mechanisms by MERCOSUR countries may increase the capacity of the members to respond to each other's needs and for effective action. The mechanisms include: Integration Ministries; regular meetings and summits; and an institutional framework. The Integration Ministries are

³⁷ The concept of responsiveness comes mainly from historical studies by Deutsch, K.W., et. al., in *Political Community and the North Atlantic Area*, Princeton University Press, 1957.

³⁸ Lindberg, N.L., and Schneingold, S., *Europe's Would-Be Polity*, Prentice-Hall, New Jersey, 1970, p. 32.

supposed to give impetus to the integration process, inform and mobilise the private sector, and help develop favourable national attitudes toward integration. The various national ministries are also expected to keep in close contact in order to coordinate the implementation of measures agreed by the CMG.³⁹ A regional parliament which will 'institutionalise the participation of representatives of the people'⁴⁰ will also ensure that there is adequate feedback from the constituent member states.

The capabilities that the political environment provide also include the recognition that certain problems must be solved at the regional rather than at the state level. That is, the recognition of the authority and legitimacy of collective decision making organs to take decisions on behalf of the members. Without such recognition decisions that should appropriately be taken at the regional level will be taken by national governments solely with the national interest in mind. Without such recognition of the legitimacy and authority of collective decision making organs, policies they formulate will not be recognised as binding.

An example of the recognition of the collective decision making arena as the one which should legitimately decide on certain issues was when in March 1994, the Paraguayan Minister for Industry and Trade stated that MERCOSUR members should negotiate their relationship with NAFTA as a group rather than as individuals. This was later reiterated to President Bill Clinton by President Lacalle of Uruguay⁴¹. In addition to exemplifying recognition of the organisation, the fact that both a Minister of Trade and a President voiced such an opinion is significant because of the authority they have in determining national policy. As gatekeepers of the national interest, governments determine the flow of demands to the regional organisation. The attitude of governments as gate keepers of the national interest tend to be important in deciding whether state authority should be delegated. The willingness to delegate such authority indicates how relevant the members perceive integration to be.

The various organs created by the members of MERCOSUR have also been given the authority they need in the Treaty of Asuncion. The CMG, for example, has been given the task to enforce decisions adopted by the Council. It has also been given the authority to determine that the trade liberalisation programme is adhered to. It has as a consequence set up various working groups to shape policy proposals

³⁹ Latin American Regional Reports: Southern Cone Report, 17 October 1991, RS-91-08.

⁴⁰ *Latin American Regional Reports: Southern Cone Report*, 17 October 1991, RS-91-08, P.1

⁴¹ *Latin American Regional Reports: Southern Cone Report*, 28 April 1994, RS-94-03.

pertaining to the achievements of the Treaty. This recognition of the CMG means it can follow up the progress of various programmes to ensure that they are being followed. With a membership that is made up of representatives from the Ministries of Foreign Affairs, Economy and the Central Bank of the member countries, and being coordinated by the Ministers of Foreign Affairs, there is an appropriate mix of political, economic, and monetary authorities in charge of the process.

Pluralism and predictability of behaviour. The character of politics in the region is an important measure of predictability. A region characterised by frequent political change, especially of a revolutionary kind, can be sited as one that will not be conducive to integration because of the tendency of the high level of uncertainties that accompany such frequent political change. A situation which is characterised by military take-overs are even less predictable. However institutionalised politics and regularised political change reduce uncertainties and make countries less nervous of committing their futures to joint ventures with partners whose behaviour cannot be predicted. A common market which involves a high level of joint decision making, coordination of macroeconomic policies and harmonisation of fiscal policies can only be successful where there is mutual predictability of behaviour. Member countries should be able to expect that collective decisions will be adhered to. Where either the political structure or past behaviour of partners make such expectations uncertain, regional decisions will not be implemented.

Since the middle of the 1980s the member countries of MERCOSUR have all adopted democracy with elections as the mode of political transition. After a breakdown of democracy in 1973 it was restored in 1984. Argentina has also held elections since 1983. Since 1989 both Paraguay and Brazil have also had presidential election. This means politics has moved from the highly authoritarian regimes to more open forms of rule; for MERCOSUR this reduces the amount of uncertainties. However it must be noted that the origins of the organisation date back to periods of military rule in both Brazil and Argentina. Nevertheless uncertainties that would have resulted from the possibility of military coups have been lessened and therefore the unpredictability that would have resulted from the political structure of member countries has also subsequently been reduced. All the countries have had changes in leaders since the organisation was formed but none of the new leaders has been against the organisation as a vehicle for economic development. Additionally treaty provisions, protocols and agreements have already been translated into national laws, thus making them difficult to undo.

From the above it can be suggested that the political environment is more conducive to integration than it used to be when authoritarian regimes and personalised politics was the order of the day. However certain decisions and utterances by member countries have produced feelings of uncertainty among members of the organisation. Argentina was reported to be giving serious thought to joining NAFTA and abandoning MERCOSUR because of the obstacles to

MERCOSUR integration caused by Brazil's political and economic crisis.⁴² A year earlier in mid-November 1991, the Brazilian President hinted that he was unable to attend a scheduled summit. This led to doubts about his commitment to integration. Despite changing his mind and saying that he would attend the meeting if it were held in Brasilia instead of in Punta del Este, the doubts persisted. This speculation lay the foundation for uncertainty and hence unpredictability of behaviour and tended to have a negative impact on the process.

Apart from these, Argentina's decision to raise her 'statistical levy' on imports from 3 per cent to 10 per cent 'temporarily'⁴³ in November 1992 on all imports⁴⁴, caused friction with other members who saw it as being in direct conflict with the objectives of MERCOSUR. Though it was supposed to be a temporary measure aimed at correcting 'imbalances', such a unilateral decision undermines confidence in integration. As the Paraguayan pointed out 'Argentina should have discussed its need to curb imports with its MERCOSUR partners.'⁴⁵ It actually resulted in industrialists in Brazil asking their government to slow down the pace of tariff reductions and those of Paraguay pressuring their government to make an energetic protest to the Brazilian government.⁴⁶ Later on, the Paraguayan government itself threatened to pull out of MERCOSUR unless a satisfactory solution was found. They estimated that the measure had cost Paraguay US\$40 million between November 1992 and March 1993.⁴⁷ Uruguayan industrialists, who had not been affected by the increased levy because of a previous bilateral agreement, also urged their government to follow Argentina's example.

Despite the fact that the levy was not illegal, it was based on a technicality which went against the spirit of the Treaty of Asuncion. It undermined confidence in the treaty as the definitive document of the community. But above all the unilateral way in which the action was taken meant an undesirable precedent for integration *vis-à-vis* domestic problems was set. A possible offshoot of such action also reduces the willingness of foreign investors to invest in the region to take

⁴² *Latin American Regional Reports: Southern Cone Report*, 15 October 1992, RS-92-08.

⁴³ Even though this measure was supposed to be temporary, it has remained in force till now.

⁴⁴ *Latin American Regional Reports: Southern Cone Report*, 19 November 1992, RS-92-09.

⁴⁵ *Latin American Regional Reports: Southern Cone Report*, 15 April 1993, p. 6.

⁴⁶ *Latin American Regional Reports: Southern Cone Report*, 19 November 1992.

⁴⁷ *Latin American Regional Reports: Southern Cone Report*, 15 April 1993.

advantage of the increased market because of the uncertainty that such a market will continue to be available.

From the above we can conclude that though changes in the political structure has reduced the level of uncertainty in the region but that certain actions have raised questions about the level of commitment of members and the willingness of members to adhere to collective decisions.

Elite value complementarity. However whether the treaty and its provisions will propel the process over time will depend on how the political and economic elite of the member countries perceive integration, and whether elite values across national boundaries complement each other. Different politicians might perceive the desirability of integration differently. Thus even though treaty obligations are binding on succeeding governments, new politicians may sometimes muddle about with the process through various means such as the such of escape clauses, exemptions and special pleas if they do not perceive their interests as converging with those of the other members.

The success of an integration scheme is also seen as depending on the level of complementarity of values relevant to economic decision making. This means those responsible for formulating economic policies must agree that integration and the policies they embody as the way solving certain problems that are common to them. The coordination of the domestic policies of the member countries can only take place if those responsible agree, in broad terms, on the methods that should be used. It does not only depend on whether they see integration as the most effective way of solving the problems they face as a group, but their economic philosophy must also be compatible. It is unlikely that people with socialist perspectives will work well with those who are capitalist oriented. Thus 'in general the greater the complementarity of elites with effective power in economic and policy as reflected in similar statements and policies toward the most salient political-economic issues in their region, the better the conditions for positive or integrative response to the pressure for decisions arising from the process mechanisms'.⁴⁸

MERCOSUR countries have adopted liberalisation policies and have become more market oriented. This means that the broad framework for policy formulation is compatible. Various utterances by Ministers of Finance and Foreign Affairs, as well as Presidents of Central Banks point to the common belief that integration is the way to achieve growth and competitiveness. Similar political and economic systems of the member countries will therefore have positive effects on the process.

It must be noted that it is not the compatibility of values that is emphasized, but

⁴⁸ Nye, J., 'Comparing Common Markets', op. cit.

rather their complementarity. The assumption here is that once there is complementarity, member governments may be able trade-off benefits in the bargaining process. It makes it possible for various national parties with different ideologies to be involved in an integration process as the European Union shows.

Elite complementarity is, however, not enough for effective and adequate economic policies. It is believed that for integration to be sustainable it must involve both the business community and the population. The business sector's involvement is important because they are directly involved in trade. They are also important because of the influence they can sometimes exert on government policy. Not least, the business sector also, it is also expected that the involvement of the population will create a psycho-social community⁴⁹ that induces goodwill among the populations of the member countries of an integration scheme. The attitude of the business sector is therefore of major significance to integration. The more supportive they are the more likely the scheme is to succeed. If the population does not support integration, they may tend to vote governments who support such schemes out of office and bring those opposed to it. Thus a supportive population determines to a large extent the willingness of a government either to join a scheme or to withdraw its membership.

In the initial stages of MERCOSUR, entrepreneurs from member countries were seen as not being very enthusiastic about integration. This was put down to the fact that they were failing to appreciate the immense opportunities offered by the organisation. For Paraguayan and Uruguayan businessmen the reason was the fear that they would be overwhelmed by the competition from Argentina and Brazil. Brazilian businesses were also of the opinion that they would be at a disadvantage with their Argentinean counterparts because of the high inflation in Brazil. Thus while in October 1991 a survey by Price Waterhouse indicated only 25 per cent of 550 large Brazilian businesses were planning to increase their business with their MERCOSUR partners, the figure had changed to 36 per cent by the end of the year. A year after its formation however attitudes had changed.

Symmetry of units. The relative size of the members forming an integration scheme is another factor that can affect its outcome. A big disparity in the political importance and economic size of members may have either negative or positive consequences for the group. Where economic size and political importance coincide, as is the case with Brazil's preponderance in MERCOSUR, problems may arise. The lack of symmetry between the member countries, but especially between Brazil and the others may result in skewed negotiating modalities. Unless Brazil decides to go along with certain measures, the process will find it difficult to progress. This is especially so because of its high level of trade with non-member

⁴⁹ Taylor, P., 'The Concept of Community and the European Integration Process', *Journal Of Common Market Studies*, vol. 7, no. 2, 1968.

countries, such as the US which reduces the salience of its partners in its international trade. However, the importance of Argentina as a trading partner reduces the possibility.

The lack of symmetry may also result in the perceptions of possible unequal distribution of benefits, a factor which has been categorised under perceptual conditions and is looked at in the next section. However the existence of a preponderant country or group of countries in an integration scheme may also have advantages. This is because such a country may act as the core area which initiates the process. It/they may also underwrite the initial costs of integration by supporting collective institutions financially and administratively. The size of their markets and the political spin-offs of associating with such large countries may also offset misgivings that smaller potential members may have about being swamped by products from the larger countries or any loss of autonomy that they might suffer.

MERCOSUR integration is a classic case where two large countries formed a core area around which an integration scheme has developed. Despite the size of Brazil and Argentina, Paraguay and Uruguay have nevertheless decided to become members of an integration scheme between the two larger ones. As has been pointed out earlier, despite the fear expressed by manufacturers and labour leaders of the smaller countries, the governments believe the venture is worth the cost and that the benefits outweigh such costs.

Whether the existence of a core area advances the process and ensures its success is a more debatable issue. But it can be hypothesized that as long as the perceived benefits continue to be positive the scheme is unlikely to disintegrate. However, because various issues determine cost and benefit calculations once an integration scheme is underway, it is difficult to separate the possible impact of a lack of symmetry.

2.2.2 *Perceptual conditions*

Even though most of the structural conditions are favourable to integration, certain issues remain problematic and influence the perceptions about the distribution of benefits among members. As was pointed out above, the business sectors and labour in Paraguay and Uruguay see competition from Argentina and Brazil as detrimental to them. Even though such attitudes are changing the fact still remains that only 36 per cent of manufacturers responded positively to integration.

Secondly the lack of a compensatory mechanism may pose problems for the process despite the fact that there will be a mechanism for the settlement of

disputes.⁵⁰ The raising of Argentina's statistical levy from 3 per cent to 10 per cent, which is threatening to disrupt the process, was seen as a response to what they perceived as unequal distribution of benefits - the growing trade imbalance with Brazil. As Srinivasan et al. noted, a country will only join a regional integration scheme if the removal of trade barriers by its partners is sufficiently large enough to offset any losses from concessions it might make to them. Since this may not always be guaranteed, it is possible to come to some agreement about international transfers that will ensure that all members benefit. Once a formula can be found for such a transfer mechanism it is possible for any group of countries to form an integration scheme.⁵¹

Though this may be the case, it is the difficulty of finding an appropriate formulae for such an international transfer that has been a problem among developing countries. Such a mechanism also implies a very capable administrative setup at the regional level. The mainly ad-hoc institutional structure of the organization suggests that such a mechanism will be difficult to formulate because of resources that the administrative office has.

From the above examination of the conditions for integrative potential of MERCOSUR we can see that they are mainly favourable. However various issues have the potential disrupt the process. To the extent that no regional group is problem free, how the scheme progresses depends on the continuing dominance of benefits over cost to all the members of the group.

Below we consider how far integration has progressed within the environment that has been described above.

3 MERCOSUR since 1991

As has been mentioned above, the period between the signing of the MERCOSUR Treaty and 31 December 1994 was to be a transitional period⁵² during which members were expected to: liberalise trade through the elimination of customs duties and non tariff barriers together with any measures of equivalent effect,⁵³ the

⁵⁰ Annex III, Treaty of Asuncion.

⁵¹ Srinivasan, T.N., et al, 'Measuring the effects of regionalism on trade and welfare' in Anderson and Blackhurst, op. cit.

⁵² Article 3, Treaty of Asuncion.

⁵³ Tariff reductions was to follow 'a progressive, linear and automatic' formula which would result in a 'zero tariff and no non-tariff restrictions for the entire area by the 31 December'. Article 5(a) *Treaty of Asuncion*.

coordination of macroeconomic policies,⁵⁴ adopt a common external tariff (CET),⁵⁵ and adopt sectoral agreements that will enable the members to 'optimise the use and mobility of factors of production and to achieve efficient scales of operation.'⁵⁶ The actual details of the achieving of the zero tariff position are annexed to the Treaty.⁵⁷ In addition to the various policy objectives listed above, the members were also able to adopt rules of origin, and safeguard clauses.⁵⁸ To attempt to measure the extent of integration achieved so far, we will use data that is mainly for the transitional period. These will give an indication of what can be expected from integration among the members of the organization.

3.0.1 *Measuring integration*

To measure the extent of integration since the inception of the organisation we will use two main measures; collective decision making and direction of trade.

Collective decision making. As was mentioned earlier, political integration is a necessary aspect of economic integration because it provides the crucible within which the various activities take place. Political integration therefore describes the institutionalization of decision making at the regional level. It constitutes both the institutional framework and/or process that is involved in joint endeavours by a group of countries. It therefore lays the framework within which joint economic, social, political, or a combination of these are taken for the mutual benefit of the members.⁵⁹ It involves the decisional process which enables problems to be recognized and discussed as needing collective action, decisions taken, and implemented collectively. Thus a conceptualization of collective decision making would be as shown in the continuum below:

Problem recognition - - - - - Decision - - - - - Implementation

⁵⁴ The coordination of policies were to be done in parallel to the tariff reduction programme. Article 5(b), *ibid*.

⁵⁵ The CET was to be set in such a way that 'encourages the foreign competitiveness' of the members. Article 5(c), *ibid*.

⁵⁶ Article 5(d), *ibid*.

⁵⁷ Annex 1, Treaty of Asuncion.

⁵⁸ Article 3, Treaty of Asuncion.

⁵⁹ Zormelo, D., *Integration theories and economic development: A case study of the political and social dynamics of ECOWAS*, unpublished Ph.D thesis presented to the London School of Economics and Political Science, University of London, 1994, p. 265.

Any of the three levels of decision making could be used as the threshold for inclusion for counting purposes once the variables that would be counted have been specified.

The continuum is derived from one devised by Lindberg,⁶⁰ and constitutes a range of six stages of decision making. They are: collective problem recognition; specific action alternatives defined collectively; collective decisions on policy guidelines; detailed collective goal-setting and implementation by national governments; decisions on policies and rules directly binding on individuals; and collective implementation and enforcement. A movement along the stages implies higher and higher levels of supranationalism and loss of autonomy.

The scope⁶¹ of collective decision making among the member countries will be operationalised according to a modified form of a heuristic paradigm suggested by Lindberg, which was used by the author in analysing decision making among the members of the Economic Community of West African States (ECOWAS).⁶² Lindberg identified four functional areas; external relations, political constitutional, social and cultural, and economic, as the main areas of decision making activities. Under each of these are listed issue areas which together amount to 22. In our analysis we will narrow the list of issue areas to those that pertain to the formation of a common market and other aims in the Treaty.

For external relations we will include commercial relations with other polities, and

⁶⁰ Lindberg, L, *Integration as a multidimensional phenomenon*, in Lindberg, L., and Scheingold, S., (ed.) *Regional Integration: Theory and Research*, Harvard Univ. Press, Cambridge, 1971.

⁶¹ Collective decision making, according to Lindberg, has three aspects; scope, range of decision making stage, and consequences. Scope involves the breadth of issue areas involved. Range includes a movement from problem recognition to collective implementation.

Consequences is the impact of decisions on members. Decisions could impact directly on citizens of member countries or only on governments depending on the level of supranationality of collective institutions.

To determine the scope of decision making one may decide on any part of the range of decision making stages, i.e., problem recognition, decision or implementation, as the threshold from which to count.

⁶² Zormelo, D., *Integration Theories and Economic Development: A Case Study of the Political and Social Dynamics of ECOWAS*, unpublished Ph.D thesis presented at the London School of Economics, University of London, 1994.

diplomatic influence and participation in world affairs.⁶³ No issues will be listed under political-constitutional functions because MERCOSUR does not aim to take decisions on or pursue a common political system within the region. Social and cultural functions will include educational and research, and social welfare policies, as well as public health and safety which was originally included under political constitutional functions in Lindberg's list.⁶⁴ Finally economic functions will include all those policies that facilitate free and competitive trade, common commercial policy, and the free movement of the factors of production. They include: counter-cyclical policy (government expenditures, prices and wage controls, budgetary policies); regulation of economic competition and other government controls on prices and investment, agricultural protection, economic development and planning (including regional policies, aid to depressed industries, public finance, guarantees of investments etc.); exploitation and protection of natural resources; regulation and support for transportation; regulation and support of mass media and communication (including post-office, television, radio, etc.); labour management relations; fiscal policies; balance of payment stability (exchange rate, lending and borrowing abroad, capital movement); domestic monetary policy, banking and finance, money supply and; assurance of free movement of goods, services and other factors of production. Together, the issue areas amount to 17 as opposed to the 22 suggested by Lindberg. The reason for the difference between the number of issue areas is because of the mainly economic aims of MERCOSUR as compared to the EEC which informed the original list.

Counting the issue areas over the life of the organisation will give us a rough indication of the extent to which the regional organisation is seen as the appropriate forum for decision making on those decisions rather than the individual state. The threshold that we will use in counting the issue areas will be problem recognition. This low level of collective decision making is used because of the relatively short time the organization has been in existence, and thus the non-availability of information concerning more detailed aspects of the integration process.

Collective decision making among the members of an organisation will be determined by the aims of the member countries as expressed in the Treaty establishing it. As has been pointed out earlier the desire was to create a common market among the members by the beginning of 1995. They have failed in achieving this goal and have formed a custom union. The reasons for this failure

⁶³ These correspond to aims detailed in Article 1 of the Treaty of Asuncion.

⁶⁴ The Treaty considered in the Preamble, called an annex in the treaty of Asuncion, that '...integration, is a vital prerequisite for accelerating their processes of economic development *with social justice*,' and conviction of the 'need to promote the *scientific and technological development* of the states Parties ... 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 population'.

and its implications will be examined later. But what the original goal means to our study is that the members would have taken certain decisions that are geared toward achieving this aim. The scope of decision making will be reflected in the annexes attached to the Treaty, the working groups created to work with the CMG, and on other decisions that bear on the creation of a common market and have been reported either in the media or official documents. Since the treaty and annexes are fairly specific in what should actually have been done, they can be taken as a working document rather than as a legal document that is referred to occasionally for guidance. To see the extent to which collective decision making has progressed we will compare collective decision making in 1990, and 1994.

Trade. The second set of measures that we will use in gauging the extent of integration achieved so far will be trade flows between the member countries and also with the rest of the world. These will show the response of trade to policies that seek to promote intra-regional trade. Even though the common market has not yet come into existence, the liberalisation of policies that have been implemented since the Treaty was signed should begin to have a discernible impact on the trade figures of the member states with each other, and with the rest of the world, especially those of the two original members, Argentina and Brazil. We will be particularly interested in comparing the trade flows prior to the signing of the Treaty of Asuncion. As has been mentioned above, figures from 1986 will be relevant for Argentina and Brazil whilst figures from 1991 should be relevant to all four members. If there is a discernible change in the direction of trade of the exports and imports of member states then we can conclude, tentatively, that integration policies are having an impact.

It has always been difficult to trace causality between integration policies and trade increases. The suggested method here is to compare the rate of growth of trade with partner countries with the rate of growth of trade with the world. As a result of the trade liberalisation policies going on in the member countries of the organization, it will be difficult to attribute a general increase in trade to integration. However if there is a change in the share of goods traded with member countries or if intra-gap trade grows faster than trade with the rest of the world, then we can assume it is partly due to regional integration.

It should be noted that growth in regional trade need not be at the expense of growth in world trade. The change in both can be in a positive direction. But to distinguish between the general growth and the impact of integration, the growth in regional trade must be greater than growth in world trade. The extra growth above world averages will be attributed to policies that are impacting on trade with member countries only.

Since the process has not been in existence for very long, substantial changes in the direction of trade cannot be expected except between Argentina and Brazil between whom it started since 1985.

The composition of trade with the rest of the world will also be used as an indication of the extent to which integration has resulted in higher competitiveness of the manufactured products of the members of MERCOSUR. This goal has been postulated as the stated aim for adopting a common external tariff.⁶⁵

Based on the result of the level of collective decision making and on trade flows we will then be in a position to speculate on the future prospects of regional integration among the four.

3.1 Scope of MERCOSUR decision making

The preliminary counting of issue areas indicates a very rapid increase in the scope of collective decision making among the members of MERCOSUR. In 1990 the four states were not a decision making group. However within a period of four years they have moved to a position where 13 issue areas have been recognized as needing collective action. What is meant by saying the four were not taking decisions together in 1990 is that even though they may have participated in other collective decision making schemes such as ALADI and LAIA they had not done so as an exclusive group of four countries attempting to form a common market-MERCOSUR.

External relations functions. The organisation has covered both issue areas of external relations functions that pertain to the forming of a common market, and also as a bargaining bloc in international relations. One of the working groups that was set up under the CMG and annexed to the treaty of the organisation was Subgroup 1: Commercial issues. This group would advise on matters relating to the coordination of commercial issues.

Various joint activities such as the informing of GATT in April 1992 of their intention to keep their external tariff below 35 per cent subject to a successful conclusion of the Uruguay Round is an example of joint decision making on commercial policy.⁶⁶ The members have also acted together in relation to establishing trade relations with third countries. In June 1991, MERCOSUR members signed a joint framework treaty with the United States of America to encourage trade and investment in the region.⁶⁷ The resulting consultative council on trade and investment sets out a programme that seeks to reduce trade and investment barriers in the Americas and agricultural subsidies. It also seeks to look at intellectual property rights, access to technology, sanitary and phytosanitary

⁶⁵ Article 5(c), Treaty of Asuncion.

⁶⁶ Perez del Castillo, S., 'MERCOSUR: History and aims', *International Labour Review*, Vol. 132, No. 5-6, 1993, pp. 639-654.

⁶⁷ GATT, *Trade Policy Review: Argentina*, Vol. 1, May, 1992, p. 62.

regulations in agriculture and access to markets of goods and services. Even though President Bush's Enterprise for the Americas Initiative was a proposal for the formation of a hemispheric venture, the MERCOSUR countries acted as a group in discussions with the Bush administration rather than as individual countries thus indicating the beginnings of coalition formation activities among the members in international economic relations.⁶⁸ It was interesting in this regard that Argentina's Under-Secretary for Industry and Trade had to reassure non-members that the formation of MERCOSUR would not conflict with the hemispheric initiative.⁶⁹

Apart from coordinating their activities in GATT and with other states, they have also acted jointly in their relations with other regional organisations. They have entered discussions with the North American Free Trade Area (NAFTA),⁷⁰ and also with the European Union (EU) on trade issues.⁷¹ They have also signed an Inter-Institutional Cooperation Agreement with the EU in 1992 in which the EU is providing MERCOSUR with institutional support, technical assistance and personnel training.⁷²

An interesting issue that MERCOSUR members also cooperated in is the joint condemnation, in June 1992, of a US Supreme Court ruling that endorsed the US government's claim of the 'right to abduct' a suspect from another country to take him to the US to stand trial.⁷³ Despite the fact that the ruling involved a Mexican, the MERCOSUR members, nevertheless, acted jointly in condemning it as a dangerous precedent and an abuse of the sovereignty of an independent state. This action, as far as our study of the organisation is concerned, is indicative of just how much the members are willing to coordinate their actions and to do so even beyond the issues of international economic cooperation.

The extent to which the member states are willing to work together on issue areas

⁶⁸ *Latin American Regional Reports: Southern Cone Report*, 14 March 1991, p. 4.

⁶⁹ *ibid.*

⁷⁰ Perez del Castillo, S., 'Mercosur: History and Aims' in *International Labour Review*, Vol. 132, No. 5-6, 1993, p. 642.

⁷¹ *The European Community and MERCOSUR, Background Report*, ISEC/B22/94, December 1994.

⁷² *Latin American Regional Reports: Southern Cone Report*, 11 March 1993.

⁷³ The ruling was in the case of a Mexican gynaecologist, Humberto Alverz Machin, who was abducted by the US Drug Enforcement Administration because of his alleged complicity in the murder of DEA agent Enrique Camarena. *Latin American Regional Reports; Southern Cone Report*, 6 August 1992, RS-92-06.

that are not directly involved with economic integration, was exemplified by an earlier decision that year to adopt a common position at the UN Conference on Environment and Development (UNCED) in Rio de Janeiro the following year. Their position differed from one taken 10 days earlier by the Presidents of Brazil, Bolivia, Colombia, Ecuador, Guyana, Peru, Surinam and Venezuela.⁷⁴ At that meeting the eight countries had hinted at the hypocrisy of the developed countries in dictating what developing countries should be doing. The MERCOSUR countries, on the other hand, stated the pointlessness of confrontation and instead sought cooperation with the developed countries in finding solutions to environmental problems. The fact that Brazil belonged to both camps and agreed to the MERCOSUR position soon after a far different position had been adopted 10 days earlier is, it could be suggested, indicative of the importance the country gives to the views of its fellow members of MERCOSUR.

From the above we can conclude that the members of MERCOSUR have taken joint decisions in both commercial relations with other polities and also in diplomatic influence and participation in world affairs. This compares very well with the expectations of the member countries as they stated in the Preamble to the treaty and in utterances of the officials.⁷⁵

Social and cultural functions. For social and cultural functions three issue areas were identified as having been covered. This again means the members have covered all the issues listed under this functional area. In the treaty itself states social justice as an important goal of the integration process.⁷⁶ To further this aim and to ensure that there is real improvement and equality in the conditions of work in the member countries, a new working group, Subgroup 11 (The Labour Relations, Employment and Social Security Subgroup), was created in December 1991 in addition to the ten listed in Annex 10 of the Treaty.

In research and educational issues the member countries have at a 11-12 March 1993 meeting agreed to set up three commissions to research and analyse resources

⁷⁴ *Latin American Regional Report: Southern Cone Report*, 12 March 1992, RS-92-02.

⁷⁵ Carlos Menem of Argentina for example rationalised the formation of the organisation on the basis of the need to 'improve the members' bargaining power in a world in which powerful blocs have emerged', and also because of other world trends, such as, the dissolution of the Soviet Union and its repercussions. *Latin American regional Report: Southern Cone Report*, 6 August 1992.

⁷⁶ Preamble to the Asuncion Treaty.

and obstacles to technological integration.⁷⁷ It was also agreed to identify all the researchers from the member countries who are working abroad to urge them to return to the sub-region to participate in the effort of integration or at least contribute through collaboration. Whether that is a feasible strategy or not, it nevertheless points to joint decision making among the members of the regional group. In addition to research, education has also been identified as needing joint effort. Thus in the Ministers of Labour of the four member countries decided, in a declaration after a meeting in Montevideo on 9 March 1991 to '...provide all the necessary cooperation for ... vocational training....'⁷⁸ Other achievements of Subgroup 11 are the setting up of subcommittees that have been looking at issues relevant to the other issue areas listed under social and cultural functions such as: occupational safety and health, and social security. Other joint deliberations have been on establishing common guaranteed minimum social provisions.⁷⁹

Again we can conclude that collective decision making in social and cultural issues is extensive and covers all the issue areas listed under the functional area.

Economic functions. Economic issues have, as would be expected, had the most decisions taken on them. All the Subgroups listed in Annex V of the Treaty are to do with the coordination of economic issues. Various decisions have been taken to facilitate free trade and competition. A detailed tariff reduction programme has been in operation since the Treaty was signed. This expects the member countries to reduce their tariffs and non-tariff barriers linearly and automatically over the transition period.⁸⁰ Rules of origin⁸¹ have also been adopted together with unfair trade practices, organs for dispute settlement,⁸² and antitrust legislation.⁸³

A common commercial policy including a common external tariff (CET) is also expected to come into force at the beginning of 1995. Though it was originally expected to cover all products imported into the region, differences among the

⁷⁷ *Latin American Regional Report: Southern Cone Report*, 15 April 1993, RS-93-03.

⁷⁸ Cited Perez del Castillo, S., op. cit., footnote 5, p. 643.

⁷⁹ *ibid*, pp. 644-645.

⁸⁰ Annex I, Articles 3 and 4 of the Treaty of Asuncion.

⁸¹ Annex II, Treaty of Asuncion.

⁸² Annex III, Treaty of Asuncion.

⁸³ Talk by Rubens Barbosa, Ambassador of Brazil, entitled 'MERCOSUR and NAFTA: What They Mean For Your Business', organised by the Brazilian and American Chambers of Commerce on the 12 May 1994.

member countries means about 85 per cent rather than 100 per cent of goods will be covered by that date. The remaining 15 per cent will be those goods that are regarded as sensitive by some of the member countries and include products such as computers, capital equipment and the chemical industry.⁸⁴ The year 2006 is being suggested as the time when full convergence of national tariffs might take place. In May 1993 a 20 per cent CET was expected to be set with a range of 20 to 35 per cent for strategic goods, however the issue has remained controversial for the member countries. As late as December 1993, Brazil was at loggerheads with Argentina, who is proposing a 5 per cent rate, and Paraguay and Uruguay who are proposing a zero tariff.⁸⁵

In addition to the above policies to facilitate free movement, the factors of production are being taken. The movement of the factors of production is indeed an integral part of forming a common market. Various meetings have been held between Economy Ministers and Presidents of Central Banks of the member countries with the intention of harmonising macroeconomic policies, particularly, reducing fiscal deficits, liberalising foreign trade, and fighting inflation.⁸⁶ Fears expressed by other members of the organisation, especially Argentine companies about incentives in Brazil that make competition difficult, such as, government export incentives, subsidised trade finance and artificially low prices for inputs such as steel, gas and electricity,⁸⁷ while benefiting from an undervalued currency remain issues that have to be ironed out before the common market becomes operational. These issues are nevertheless being discussed collectively with the hope of identifying the necessary variables that will enable convergence to be achieved. The Brazilian position has been that such advantages are temporary and will disappear once the common market comes into being.⁸⁸ Whether that implies that market forces will cause convergence to occur is not clear but the Brazilian economy remains one of the main obstacles to convergence of macroeconomic policies.

⁸⁴ *ibid*, cp *Latin American Regional Report; Southern Cone Report*, 27 May 1993, RS-93-04, p. 6.

⁸⁵ *Latin American Regional Report: Southern Cone Report*, 27 May 1993 and 23 Dec. 1993 respectively.

⁸⁶ At a mid-November 1991, for example, the Economy Ministers and Presidents of the Central Banks discussed convergence. Brazil's economy was the one which was of most concern. It was therefore suggested at that meeting that convergence can only occur with the Brazilian economy's liberalisation, freeing of the exchange market, opening up of its market to external competition, eliminating subsidies, and curbing inflation.

⁸⁷ *Latin American Regional Reports: Southern Cone Report*, 15 October 1992.

⁸⁸ *ibid*.

In addition to the various decisions mentioned above, MERCOSUR members have also adopted a series of financial regulations such as regulations for stock market operations within MERCOSUR, and approval of a quadrilateral Investment Protection Agreement which will act as a mechanism for the promotion and protection of investment carried out within the region by member country investors.⁸⁹ Support for transportation is also being done with the member countries together with Bolivia deciding to build a waterway on the Paraguay-Parana river network.⁹⁰ Initial finance for consultants was to come from the UN, the European Union, and the Inter-American Development Bank. Part of the initial engineering work estimated at about US\$240m which would be borne by the members' governments will make the waterway navigable. The final US\$749m which will be needed to upgrade the ports is expected to come from the private sector. The whole project would be expected to take about 10 years.⁹¹ Certain regulations suggested by Argentina have however been turned down. These include the liberalisation and deregulation of maritime transport, and the charging of tolls, from 1994, from vessels using the Parana leg of the waterway made of the Paraguay and Parana rivers used by Paraguay as an outlet for parts of its exports.⁹²

Again an extensive number of issue areas have been covered. Most of them fall under the responsibilities of the Subgroups listed in Annex V of the Treaty. Again the conclusion is that collective decision making in the issue areas listed under economic functions have all been covered by the member countries.

Almost all of the decisions taken by collective institutions are expected to be binding on all the members of the organisations. The Council has indeed been charged with the task of ensuring 'compliance with the objectives and time-limits set for the final establishment of the common market'.⁹³ Since all the decisions that have been taken are geared toward the final establishment of the common market, they fall within those that the Council is to ensure compliance on. However, because the organisation is not supranational yet, individual governments rather than collective institutions are left with the task of actual implementation and enforcement of decisions. In certain instances, such as tariff reductions, governments are not at liberty to interpret the rules. National governments are

⁸⁹ Barbosa, R., op. cit.

⁹⁰ *Latin American Regional Report: Southern Cone Report*, 6 August 1992, RS-92-06.

⁹¹ *Latin American Regional Report: Southern Cone Report*, 15 April 1993, RS-93-03.

⁹² *ibid.*

⁹³ Article 10, Chapter II, Treaty of Asuncion.

limited to passing legislation implementing detailed collective decision. In other areas such as macroeconomic convergence, choices are suggested but national governments are left to translate them into policy.

Overall the conclusion that can be drawn from this preliminary gauging of collective decision making indicates an impressive collective desire to work together. Whether this desire is feasible, given the trade relations between the member countries, as well as the background conditions that facilitate economic integration, will be our next concern in this paper.

3.2 Trade flows

Even though collective decision making is a good indicator of the extent to which member countries are willing to work together, what it actually facilitates is the achievement of the goals by the members. One such goal is the increased trade that is expected to result from the liberalisation of trade through tariff reductions and the removal of non tariff barriers. Despite the fact that liberalisation policies would take time to affect the direction of trade there will, nevertheless, be discernible reactions to such liberalisation. Additionally, because the framework of MERCOSUR trade liberalisation has been going on between Argentina and Brazil since 1985 it can be expected that their foreign trade sectors would show some response to the measures. Thus even if Paraguay and Uruguay do not show any significant changes in their trade with their partner countries we can assume that changes between Argentina and Brazil can be used as proxy indicators of what can be expected to be the impact of integration among the members of the organisation.

The difficulty with attributing increases in trade to integration policies is that other policies may be responsible for such increases in trade. Trade figures are, nevertheless, indicative of how trade shares are changing among a group of countries.

Below are the trade figures of the MERCOSUR member countries. They show both the imports and exports figures of each member in relation to the other members. From the figures we can see the pre-integration level of trade that existed between the partners and how these have changed over the years as a result of regional trade liberalisation. As pointed out above, the relatively short time that MERCOSUR has been in existence makes meaningful judgement of the impact of the organisation premature. However, because Argentina and Brazil have been involved in the process since 1986, it makes it possible to gauge the possible impact that integration will have from changes that have occurred in their direction of trade statistics.

Argentina's direction of trade

Figures 5 and 6 show that though Argentina's exports to Brazil have increased from

the 1985 start year, the increase has not been steady. Even though trade over the whole period has risen from 5.9 per cent in 1985 to 12.9 per cent in 1992, the share of exports fell in both 1987 and 1988. Over the same period her trade with Paraguay rose from 0.9 per cent in 1985 to 1.6 per cent in 1992. Apart from a fall in 1988, the share of Argentina's trade with Paraguay has not experienced any rapid growth. A similar picture emerges for Uruguay whose share of Argentina's total exports amounted to 1.2 per cent in 1985 and to 2.1 per cent in 1991. It also experienced up and down movement with 1988, 1990, and 1992 experiencing falls from the preceding years. Overall, the share of Argentina's trade going to its partner countries in MERCOSUR is low.

	Share of Argentina's exports going to partner countries							
	<i>(% of total exports)</i>							
	1985	1986	1987	1988	1989	1990	1991	1992
Brazil	5.9	10.2	8.5	6.6	11.8	11.5	12.4	12.9
Paraguay	0.9	1.0	1.0	0.9	1.0	1.2	1.4	1.6
Uruguay	1.2	1.9	2.6	2.1	2.2	2.1	2.6	2.5
Total	8.0	13.1	12.1	9.6	15.0	14.8	16.4	17.0

Brazil is the main regional export market for Argentina and accounts for the bulk of the share of exports that Argentina trades within the region.

In addition to being the most important market for Argentinean exports, Brazil is also the member country from whom Argentina imports the largest quantity of goods. Compared to the 21.7 per cent of its imports from Brazil in 1992, it imported only 0.3 from Paraguay and 1.8 per cent from Uruguay.

The amount of imports from her partner countries has been fairly stable. In recent years imports from Paraguay have decreased.

The figures from Tables 5 and 6 indicate that Paraguay and Uruguay are more important to Argentina as export markets, in percentage terms, than as sources of

Table 6 **Share of Argentina's imports coming from partner countries**

(% of total imports)

	1985	1986	1987	1988	1989	1990	1991	1992
Brazil	16.0	14.6	14.1	17.2	17.2	17.6	18.5	21.7
Paraguay	0.5	1.0	1.2	1.3	1.2	1.0	0.5	0.3
Uruguay	1.7	2.0	2.0	2.5	2.4	2.8	2.0	1.8
Total	18.2	17.6	17.3	21.0	20.8	21.4	21.0	23.8

imports. The reverse is, however, the case for her trade relations with Brazil where it imports more than it exports to it.

Table 7 **Share of Brazil's exports trade going to partners**

(% of total exports)

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	2.1	3.0	3.2	2.9	2.2	2.1	4.7	8.5
Paraguay	1.2	1.3	1.1	1.0	1.0	0.9	1.6	1.5
Uruguay	0.5	0.9	1.0	1.0	1.0	1.0	1.1	1.4
Total	3.8	5.2	5.3	4.9	4.2	4.0	7.4	11.4

Brazil's direction of trade. The export figures in the table above show that the partner countries are not very significant markets for Brazilian exports. The figures however suggest that Argentina is the main export market for Brazilian goods among the member countries. The figures for all three partner countries have oscillated over the years and have risen and fallen without any discernible pattern.

Table 8 **Share of Brazil's imports trade coming from partners***(% of total imports)*

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	3.4	5.0	3.7	4.6	6.5	6.7	7.5	7.9
Paraguay	0.5	1.0	0.4	0.1	1.8	1.5	1.0	0.8
Uruguay	1.0	2.0	1.5	2.0	3.0	2.7	1.9	0.5
Total	4.9	8.0	5.6	6.7	11.3	10.9	10.4	9.2

Import figures show that Argentina is also the partner country from whom it imports the most. The difference between it and the other partner countries are however not as significant as they were for Argentinean exports to Brazil.

Between 1985 and 1991 Brazil's imports from Argentina doubled in per centage terms. However, the same could be said for both Paraguay and Uruguay if 1992 figures are omitted. Thus no conclusions can be drawn about changing share of trade going to any of the member countries.

Paraguay's Direction of Trade

Among the partner countries Brazil is the most important export destination for Paraguay's exports. Argentina comes second with Uruguay coming a poor third. The total amount of trade with partner countries have gone up and down over the period 1985 to 1992. It therefore shows the same pattern as Argentina in the regional direction of trade.

In relative terms Brazil is also the most important source of imports for Paraguay among the member countries as the table indicates. It has, however, decreased in importance over the years under consideration. From 36.1 per cent in 1985, imports have since been falling and experienced a low of 17.4 per cent in 1990 before beginning to rise again.

Uruguay's direction of trade. As with Paraguay, Brazil is the most important export

Table 9**Share of Paraguay's exports going to partner countries***(% of total exports)*

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	5.2	15.1	14.3	6.1	4.9	5.8	6.1	7.6
Brazil	19.8	39.5	16.6	21.3	32.5	32.6	27.6	28.3
Uruguay	2.1	2.8	3.0	0.8	1.0	1.2	1.5	1.5
Total	27.1	57.4	33.9	28.2	38.4	39.6	35.2	37.4

Table 10**Share of Paraguay's imports coming from partner countries***(% of total imports)*

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	16.9	13.6	8.7	11.6	10.2	12.7	11.9	16.2
Brazil	36.1	31.6	32.0	30.0	26.7	17.4	18.3	21.3
Uruguay	1.3	0.9	1.4	1.1	0.9	0.7	0.8	0.9
Total	54.3	46.1	42.1	42.7	47.8	30.8	31.0	38.4

market among the partner countries of MERCOSUR. The regional market therefore constitutes a fairly important one for Uruguayan exports. The figures, as with those examined so far, show rises and falls over the period under consideration. Retaining and increasing trade with its partner countries is therefore important for trade development Uruguay.

Imports also follow the same pattern as exports. Of the three countries, Uruguay imports more from Brazil than the other two.

Table 11**Share of Uruguay's exports
going to partner countries***(% of total exports)*

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	7.4	8.8	9.5	7.2	4.8	4.8	10.3	15.7
Brazil	16.7	29.4	9.5	16.5	27.6	29.6	24.2	17.5
Paraguay	0.7	0.5	0.6	0.5	0.4	0.9	0.7	0.6
Total	24.8	38.7	19.6	24.2	32.8	34.3	45.2	33.8

Table 12**Share of Uruguay's imports coming
from partner countries***(% of total imports)*

	1985	1986	1987	1988	1989	1990	1991	1992
Argentina	12.2	14.2	13.7	15.2	15.7	16.8	17.5	17.2
Brazil	17.8	24.4	24.4	26.1	26.8	23.0	24.0	23.6
Paraguay	1.2	1.4	1.0	1.2	1.0	1.1	0.7	0.5
Total	31.2	40.0	39.1	42.5	43.5	40.9	42.2	41.3

The trade figures we have considered so far indicate that regional trade among the members of MERCOSUR is significant. The significance, however, varies for each member country. The two smaller countries, Paraguay and Uruguay, depend very highly on their trade with the members of the group. Argentina and Brazil, on the other hand, have less share of their goods going to the other members of the group. This should not be too surprising given the differences in the size of the economies involved.

Thus even though Brazil, for example, exported more in value terms to Paraguay

in 1992 than Paraguay exported to Brazil, the share of Paraguayan exports to Brazil exceeded that of Brazilian exports to Paraguay as the table below shows.

Table 13 **Value of exports to partners in 1992**
(million US\$)

<i>To</i>	<i>From</i>			
	<i>Argentina</i>	<i>Brazil</i>	<i>Paraguay</i>	<i>Uruguay</i>
Argentina		3070	45.23	249.7
Brazil	1598.1		167.80	284.3
Paraguay	200.7	541		10.3
Uruguay	314.4	517	8.90	

Source: UN Direction of Trade Statistics Yearbook 1993.

One thing that the share of trade figures shows clearly is the importance of Brazil to the other members of the scheme, especially to the two smaller members, Paraguay and Uruguay. Compared to the other members Brazil depends very little on intra-regional trade, despite its high value figures. The same applies to Argentina.

The figures also show that trade between Paraguay and Uruguay is low compared with their trade with the larger Argentina and Brazil. This further underlines the importance of the two larger countries to the economic development of both Uruguay and Paraguay.

It is, however, difficult to link the level of trade between the members of MERCOSUR to liberalisation policies, particularly between Paraguay and Uruguay and the other members. In the first instance it will be premature to do so except for that between Argentina and Brazil between whom the trade liberalisation started in 1986. Secondly, trade liberalisation between the members of LAIA of which MERCOSUR members are also involved may be responsible for the high level of trade especially of the two smaller members.

As has indeed been pointed out by Anderson and Norheim, 'intra-regional trade in a region's total trade is a very inadequate indicator of preferential policy-induced

regional trade bias.⁹⁴ This is, as they pointed out, because factors such as history and geography play an important role in determining a country's direction of trade. As they also pointed out, all things being equal, the larger the number of countries in a regional group the higher will be the share of intra-regional trade in total trade.

To overcome the difficulty of drawing causality between increased and regional trade bias, Anderson and Norheim suggested using an index of intensity to trade intra- or extra-regionally. The method disaggregates the change in geographical distribution of a country's or region's trade into component parts. The intensity is defined, in the case of extra-regional trade, as 'the share of a region's trade with the rest of the world's share of global trade.'⁹⁵ The index of intensity of country i's export trade with country (or country group) j's is expressed as:

$$I_{ij} = x_{ij}/m_j \\ = x_{ij}/(q_j.r_i)$$

where

x_{ij} = the share of country i's exports going to country j,

m_j = the share of country j in world imports (net of country i's imports since i cannot export to itself),⁹⁶

q_j = the share of country j in world (net of country i's) GDP,
and

r_j = the 'relative openness' of country j, defined as j's import-to-GDP ratio divided by the world's (net of country i's) import-to-GDP ratio.

The reasoning underlying the formula is that 'if trade is not geographically biased in the sense of i's trade going to j equals j's importance in world trade, then it will have a value of unity for all j.'⁹⁷ Since figures for imports and exports are available, the calculation will be done using the first part of the formula instead of using the m_j the denominator and not $q_j.r_i$. The formula supplements the direction of trade statistics of the preceding tables in indicating the extent to which the share of trade

⁹⁴ Anderson, K. and Norheim, H., 'History, geography and regional economic integration' in *Regional integration and the global trading system*, Anderson and Blackhurst, op cit., p. 22.

⁹⁵ *ibid.*, p. 20.

⁹⁶ 'If j is a country group and country i is part of country group j, it is necessary to subtract country i's imports from country j's imports not only in the denominator but also in the numerator of the m_j ratio, and likewise to subtract country i's GDP from j's GDP in the numerator of q_j ratio.' *ibid.*, footnote 6, p. 47.

⁹⁷ *ibid.*, p. 23.

going to partner countries can indeed be attributed to integration policies to the extent that it makes it possible to remove geographical and historical bias that influence the direction of trade flows.

Below is a table showing the values of the intensity index for the member countries of MERCOSUR.

Table 14	Argentina's intensity index with countries in the Southern Cone region						
	<i>1965</i>	<i>1970</i>	<i>1975</i>	<i>1980</i>	<i>1985</i>	<i>1990</i>	<i>1993</i>
Brazil	6.99	7.41	6.14	6.68	3.72	11.13	17.79
Paraguay	17.59	34.18	42.62	66.52	33.97	35.84	96.27
Uruguay	4.42	21.30	26.85	39.71	16.17	34.17	65.28

Table 15	Brazil's intensity index with countries in the Southern Cone region						
	<i>1965</i>	<i>1970</i>	<i>1975</i>	<i>1980</i>	<i>1985</i>	<i>1990</i>	<i>1993</i>
Argentina	9.57	9.36	9.84	11.95	4.20	5.17	25.83
Paraguay	3.56	16.43	46.16	57.46	47.73	36.55	111.29
Uruguay	5.77	15.21	19.82	26.66	7.68	15.12	38.81

Integration and intensification of trade in MERCOSUR. The intensity index indicates that Argentina's trade with the other members of MERCOSUR has in general increased over the years that we have chosen as benchmarks. The increase over the years has been highest for the smaller countries, Paraguay and Uruguay. That with Brazil has not shown the same increases. Thus even though Argentina trades a higher share of goods with Brazil, trade ties have not intensified as much as it has with the two smaller countries. The figures also show that the level of

Table 16 Paraguay's intensity index with countries in the Southern Cone region

	1965	1970	1975	1980	1985	1990	1993
Argentina	22.05	37.89	62.92	52.70	9.95	13.25	20.47
Brazil	0	0	2.98	11.85	12.4	28.89	14.99
Uruguay	41.8	55.56	25.19	56.52	29.16	18.46	20.75

Table 17 Uruguay's intensity index with countries in the Southern Cone region

	1965	1970	1975	1980	1985	1990	1993
Argentina	1.75	3.77	17.28	29.65	14.46	11.95	12.97
Brazil	2.74	5.06	14.56	16.50	10.77	28.36	28.44
Paraguay	2.58	27.28	32.77	39.04	28.79	10.48	15.57

trade with all three members were lower in 1985. From then on the intensity has again picked up with a dramatic increase in 1993.

The increasing intensity of trade between Argentina and the other three predate the formation of MERCOSUR, and therefore cannot be attributed to discriminatory policies. However the increase that occurred between 1990 and 1993 is much higher than any other that has been experienced. The preliminary suggestion can therefore be made, as a result of the more than normal change in the trend, that MERCOSUR has had an impact on the level of trade between Argentina and its partner countries.

Brazil's trade with the three countries it is now a partner with in MERCOSUR shows the same trend as that of Argentina. The index of trade with Argentina, for example, remained at around 9 between 1965 and 1975 then rose to 11 in 1980. It then fell between 1985 and 1990 but then rose dramatically from 5 in 1990 to 25 in 1993. The same trend holds for Paraguay, except that the index increases by

larger margins over the 1965 to 1980 period. There is then a fall in 1985 and 1990. The falling trend is reversed by a remarkable rise from 36 to 111 in 1993. Again the very abnormally large increase is replicated.

The largest increases in the trade indexes of Argentina and Brazil occurred with Paraguay.

Paraguay's indexes with the three partner countries shows a rapid increase for Argentina up to 1975. It then drops by about 10 points in 1980. This is followed by a very sharp fall from 52 in 1980 to about 9 in 1985. It makes a relatively small recovery in 1990 and continues rising in 1993. In the case of trade with Brazil, the index starts from zero up to 1970. It then rises consistently to 28 and then falls to 14 in 1993. Trade with Uruguay fluctuates over the period. The 1993 index is about half 1990's.

The figures for Paraguay do not show the same extraordinary increase that occurred between 1990 and 1993 that both Argentina and Brazil show. This suggests that trade with the two large countries has not become more intensive as a result of MERCOSUR.

The indexes for Uruguay's trade with the other three countries show the same trend; a steady increase up to 1980. It then falls for 1985 and 1990 before starting to rise again in 1993. The recovery begins earlier for trade with Brazil.

Other interesting conclusions can be drawn from the figures above, but the ones that are most relevant are that the two largest countries; Argentina and Brazil, have intensified their trade with the two smaller countries, Paraguay and Uruguay, more than the smaller countries have with the larger ones. It suggests that both Argentina and Brazil are responding to integration more than Paraguay and Uruguay are. This is contrary to what the percentage share of trade figures seem to suggest. This conclusion implies, among other things, that Argentina and Brazil are more capable of responding to trade policy changes at the international level than Paraguay and Uruguay are. Another conclusion which could also be drawn is that it justifies, to a certain extent, the fear that is expressed by producers in Paraguay and Uruguay. Such a conclusion only holds, however, if things remain as they are. The resources reallocation assumptions that underlie a *laissez-faire* MERCOSUR integration would suggest that unless the two smaller countries are able to intensify their trade with Argentina and Brazil, the enlarged market will not benefit to any great extent. At the same time, despite the very high intensification of trade by both Argentina and Brazil with Paraguay and Uruguay, the smallness of the size of the markets of these two smaller countries make the potential scope of expansion modest. The overall effect would then be that the impact of regional discriminatory practices on trade will be low.

The above qualifies the conclusion which was drawn earlier further by adding that

the literal explosion of the market size of Paraguay and Uruguay can help with industrial development efforts of these two countries if they devise the means to become competitive in the region.

4 Conclusions

From the study we saw that the method of achieving integration among MERCOSUR countries differ from those which were used in earlier attempts at regional integration. Whereas a mainly dirigiste approach was used in the earlier attempts, the private sector is now seen as the one which will determine the outcome of the process. This has the advantage of focusing governmental attention on policies that will create an enabling environment for business and reduces the need for difficult and intractable decisions such as the siting of collectively owned enterprises.

However the emphasis on a *laissez-faire* approach heightens the difficulties that may arise from the lack of a mechanism that ensures a fair distribution of benefits. It also makes it difficult for logrolling in negotiations since the process does not include joint ventures that could be traded in negotiation. The level and structure of intra-regional trade also pose questions about the efficacy of trade liberalisation as a method of stimulating regional trade among the members of the organisation. The intensity index also indicates potential difficulties for sustainability as the smaller countries reap less and less of the benefits of MERCOSUR integration.

The structure of trade, unless it changes, does not make for viability of MERCOSUR as a mechanism for 'modernising [the] economies' of the member countries, or as a method for 'expand[ing] the supply and improv[ing] the quality of available goods and services. This is, as was pointed out, because of the low level of competitiveness between the member countries.

Thus because MERCOSUR is placing such premium on the private sector and free trade as the mechanism by which integration will be pushed forward, a lot depends on the response of businesses to integration policies. It also depends on the attitudes of businesses to integration in general, which in turn depends on how they see their interests as being affected. Apart from these, it depends crucially on the efficacy of integration to the goals of the member countries.

As the study has shown, the private sector's initial response was lukewarm. Though this is changing gradually certain policies, especially the unilateral increase of tariffs by Argentina, may have reversed the trend as response from the other members' business communities indicated. Secondly, the level of trade of manufactured goods is low. This means that the reallocation of resources will be minimal. It also means that the initial static gains that result from competition and

intra-industry trade, on which future dynamic gains will be built, will be mainly absent. That means the process, far from being propelled by the private sector, will have to be pushed along by governments in the early stages. Whether this results in stagnation or progress of the process depends on just how necessary the governments view integration among the four to be for their industrial development, and whether such aims cannot be realised as members of ALADI. Commitment is therefore of the essence among the members of the organisation. Such commitment as we have shown has been tested and found wanting when regional goals compete with national goals. Additionally, the fact that all members belong to other arrangements, such as ALADI, that aim to liberalise trade means that there are other competing options to MERCOSUR. Commitment might therefore not be as high when things become difficult as Argentina's overtures to NAFTA indicate.

So far the member countries have done quite well in the number of collective decisions taken together and the institutional framework that facilitated them. The involvement of business and labour, and the dissemination of information by the Ministries of Integration are all positive signs for success. However when the common market becomes operational, the organisation will need a more elaborate institution. Such an international institution will, as the many examples of such organisations indicate, pose serious difficulties in terms of resources, personnel, coordination and supranationality.

The timetable, which has been found to be unrealistic has been shifted forward with the common market expected to be formed in 2001. Given the high level of macroeconomic instability in Brazil and the distortions produced by support for so-called strategic products, the initial timetable was too ambitious anyway. The attempt to create a common market within four years has also proved impossible with the members settling for a customs union as an interim stage instead, implying that though the various levels of economic integration overlook the policy overlaps that exist throughout the process, an incremental process that moves gradually toward a common market is more realistic.

So far macroeconomic policy coordination has proved intractable, especially as a result of the largest member's domestic instabilities. Since this is of crucial importance to the formation of a common market, success in this area will determine whether MERCOSUR will achieve its full institutional potential. The period between the formation of a custom union, at the beginning of 1995, and the new date for the common market, 2001, will prove decisive in determining how much commitment the members have.

The point can also be made that there is an uncomfortable fit between the *laissez-faire* method being adopted by MERCOSUR countries and their levels of development. This has resulted partly because of the changing attitudes to the role of governments in economic activity. The belief that market oriented methods

should be the driving force behind development efforts is being tested and the outcome of the scheme will contribute to the validation of that view. The one thing that is certain is that, for the organisation to fulfil the purposes for which it was embarked upon, it would need a lot of commitment on the part of the member countries. It also depends on whether the organisation does not become redundant in view of the hemispheric trade bloc that is being formed in the Americas. The low initial advantages of the scheme and the high level of politicisation of economic activity in the member countries, may also severely limit the usefulness of the organisation as it is overtaken by more relevant international trading arrangements.

The organization has achieved an active role in international negotiations. This may remain the main achievement till the harmonisation of instruments in the member countries together with mutually beneficial trade, make MERCOSUR the engine for creating the competitive modern industrial development that the members have stated in the preamble to the Treaty of Asuncion.

In terms of the wider lessons that can be learnt from the case study, integration between the four has shown that the unequal distribution of benefits, whether perceived or actual, determine the extent to which member countries will be willing to continue with a scheme. Thus, whether a scheme will progress, stagnate or regress will depend on how the benefits of integration are distributed. To the extent that member states of an integration scheme remain separate sovereign entities, collective increases in welfare are not as important an incentive as actual or perceived individual gains. In other words the national interest, as it is defined by the elite of the member countries, must be served if the gate keeping role of member governments are not to disrupt the process. This is particularly so among developing countries where economic development planning tends to be highly politicised very early on in the process.

Secondly, the attempt by the members of MERCOSUR to bypass the intervening stages of economic integration and to form a common market without giving adequate time for a free trade area and customs, and the failure that resulted from that attempt seems to suggest that a gradualist approach to integration is a more realistic method. This is because adequate time ought to be allowed for the learning process that enables both governments and citizens to know how the system works and for economies to adjust. Adequate time also enables governments to be able to learn how to respond to each other's internal difficulties and also to educate their citizens. Despite the essentially *laissez-faire* approach being adopted by the scheme, the member governments assumed that once they had taken decisions to form a common market the rest of society would follow. This top-down approach to collective decision making among members of integration schemes tends to make governments and public opinion move at different paces. This often results in governments failing to gauge correctly the attitude of the general public toward further integration. The referenda in Denmark and France in 1994 are examples of

where the results about whether or not to integrate further, produced results that were contrary to the path that was generally being taken by governments.

The predictability of behaviour is also an important element in successful integration. The action of Argentina in introducing tariffs was against the spirit of the scheme. In other instances where there is unpredictability, such as that of the french speaking members of the Economic Community of West African States (ECOWAS), commitment tends to be low.

The overall conclusion can be drawn that the conditions listed in part two of this paper are important for successful regional integration. The structural and perceptual conditions create the environment within which trade and other collective decisions take place. The conditions for the benefits of trade to accrue to the members of a scheme will also be determined by the extent to which discrimination among members of an integration scheme results in a level of trade that is above that which would normally have resulted from changes in economic development and changes in global patterns of trade.

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