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# Asymmetries Among the Members of Mercosur

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UNIVERSITY OF MIAMI

ASYMMETRIES AMONG THE MEMBERS OF MERCOSUR

By

Hadi Hijazi

A THESIS

Submitted to the Faculty  
of the University of Miami  
in partial fulfillment of the requirements for  
the degree of Master of Arts

Coral Gables, Florida

May 2012

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ASYMMETRIES AMONG THE MEMBERS OF MERCOSUR

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The Mercosur countries are very different in terms of their economic size and dimension, their level of development, their population, and the size of their market. Taking into account GDP, population and territory, Uruguay and Paraguay are clearly the smaller Mercosur members and they do not represent even 5% of any of these variables, while Brazil accounts for 70%. At the same time, there are other political and regulatory differences, such as a lack of coordinated macroeconomic policies and incentive policies, in particular. Each member has its own investment promotion policies, as well as policies to support the productive sectors and exports, which alters the conditions for competition between firms even more depending on their country of origin. This combination of structural and policies asymmetries can be considered an obstacle to deeper integration within Mercosur. This paper addresses considerations on asymmetries and growth, and then moves onto asymmetries and integration and the different ways of addressing and treating this problem in the European Union and in Mercosur. Finally, it considers possible policy impacts.

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## EXECUTIVE SUMMARY

This paper examines the European experience in treatment of structural and regulatory asymmetries and seeks to draw conclusions relevant to the MERCOSUR. Their goal is not to take the European experience as a model to replicate, but to identify the basics, the building process and methodology of implementation of policies in these fields with the purpose of extracting useful inferences for the formulation of policies in the MERCOSUR. According to the design, the foremost step is to establish the basis for the institutional Mercosur structure. Initially two bodies would be formed. These bodies are Common Market Council and the Common Market Group. The function of both these bodies is to ensure that a smooth and steady transition towards a union should take place. The second step in integration of Mercosur countries in formation of a Common Market Group. Common Market Group is formed of four permanent members. Under Common Market Group, three other bodies are found. But a multilateral trade liberalization results in a higher stage of exchange from the time of the channel substantially improve access to northern markets for goods from the South.

The size of the economy for each country is different, their level of economic development varies, the population figure for these countries widely differs, and the size of their markets is diverse. Taking into account GDP, population and territory, Uruguay and Paraguay are clearly the smaller Mercosur members and they do not represent even 5% of any of these variables, while Brazil accounts for 70%. The objective of integration is to overcome the above mentioned differences in growth, population, markets and

economic structure to create a level playing field for all countries which are part of Mercosur. The paper intends to identify the differences in growth levels and development between countries and regions, and the resulting inequalities. It also analyzes the asymmetries and their consequences on the distribution of the benefits of integration.

It is found that European policies to reduce asymmetries have been successful only when they have been directed to strengthen the comparative advantages of regions and countries. The study concludes that small countries have a comparative advantage can increase the proportion of regional industrial production based on intensive use of labor and skilled labor, and the proof of this translates into forces industrial agglomeration weakened as a result of intra-regional liberalization.

## BACKGROUND

INTRODUCTION Mercosur is the name of an agreement among countries of Argentina, Brazil, Paraguay and Uruguay. The agreement has both economic and political implications. The origin of the formation of the body dates back to the year 1999 when the Treaty of Asunción was signed by leaders of the member countries. The key objective for the formation of Mercosur is to bring about freedom in trade between countries which comprise of Mercosur and to enhance the exchange of goods, people, and currency between them. There are major cultural differences between Mercosur countries (Camarero, Flôres & Tamarit, 2006). The official languages of countries are Portuguese, Guaraní and Spanish. The constitution for the formation of Mercosur has been subjected to frequent changes. The treaty has been updated, amended, and altered several times after the initial formation. With the development which has taken place over the years, Mercosur is said to have achieved the status of a full customs union. Gradually, Mercosur has taken South American Countries towards formation of a customs union which is in the process of creating between Union of South American Nations.

The outlook of the program is quite ambitious. It has been proposed several times that a single currency, termed as Gaucho, should be formed as a currency for regional trade. Gradually, Bolivia, Chile, Colombia, Ecuador, Venezuela and Peru sought to become part of the group and signed formal membership agreements respectively. After the inculcation of the seven member nations, formation of a Mercosur Parliament was agreed in the year 2004. Even though, there are major differences are found between each

country's population and size of the economy, yet it was decided that Mercosur Parliament would comprise of eighteen representatives from each member country.

## PROPOSED STRUCTURE OF REGIONAL INTEGRATION

Formation of a regional integration is a highly difficult venture because each nation wants its vested interest to be safeguarded. In the initial stage of integration, some countries might face increasing levels of unemployment or high inflation due to free movement of workers and commodities. For this reason, a gradual process of integration has been put for Mercosur. According to the design, the foremost step is to establish the basis for the institutional Mercosur structure. Initially two bodies would be formed. These bodies are Common Market Council and the Common Market Group. The function of both these bodies is to ensure that a smooth and steady transition towards a union should take place. The Council is given the highest-level status in the agency of Mercosur. These bodies are endowed with the authority to review the policy which governs the formation of the Union. The bodies are also responsible for compliance of the body with the objects and time frames of each step. The members of these councils are highest level ministers of the respective governments. Members of these councils are the Ministers of Foreign Affairs and Finance Ministers of the member countries (Giannetti, Almeida & Bonilla, 2010). The responsibility of ministers is to preside over the Council. Each member is assigned with the responsibility of presiding over the sessions in a rotating alphabetical order. The charter of Mercosur also entails that session of these governing bodies should be held after every 6-month period. If the requirement of once-in-six-months meeting is not fulfilled, then a meeting should be held at least once a year (Camarero, Flôres & Tamarit, 2006). Most important element of these bodies is decision making. According to

the charter of Mercosur, Council decisions are to be made by consensus, with representation of all member states.

The second step in integration of Mercosur countries in formation of a Common Market Group. Common Market Group is formed of four permanent members. Under Common Market Group, three other bodies are found. The name of the bodies is Ministry of Foreign Affairs; Ministry of Economy, and the Central Bank. Each one of the bodies is important because the vision of Mercosur is to operate as a single market. As far as the language barriers are concerned, it is decided that there will be two official Mercosur languages. These chosen languages are Portuguese and Spanish. For official work papers, it is decided that these paper will be prepared in the language of the country hosting the meeting.

## POTENTIAL BENEFITS OF MERCOSUR INTEGRATION TO MEMBER COUNTRIES

There are a number of potential benefits of regional integration for member countries of Mercosur. Regional integration is a fairly old and established concept in economics and politics. Regional integration is motivated partially by economic benefits and regional integration. The ratio for national integration as put forwarded by various economists is that national markets are not large enough to generate economies of scale for businesses and let them to engage in lowest cost production. Baer, Cavalcanti & Silva (2002) are of the opinion that without national integration, “domestic monopolies and trade protection contributed to powerful rent seeking and “nationalistic” lobbies biased and organized against regional as well as global trade. Nationalistic governments with spoken interest in regional cooperation gave token support to regional organizations, broke their regional commitments and implementation lapsed; and there was excessive emphasis on joint public investments as opposed to creating a truly unified markets for private operators”. The above mentioned arguments were expressed regarding observation of African national countries. For the above mentioned reason, there is a trend towards formation of regional blocks in various geographical regions of the world. Most prominent amongst them is European Union which was formed after European countries came together to form a single currency, open borders and free movement of labor.

In the opinion of several economists, unilateral trade liberalization can bring down import costs, thus promoting the industrialization of developing countries (Camarero, Flôres & Tamarit, 2006). But a multilateral trade liberalization results in a higher stage of

exchange from the time of the channel substantially improve access to northern markets for goods from the South. The relationship of demand and cost go together and allow in turn, rapidly industrializing countries. In this case the demand relationships become relevant, since intra-regional demand becomes engine of industrialization in these countries. Combining the notions of comparative advantage (VCs) and trade diversion, the effects of a Customs Union (AU) on industrial development in integration agreements symmetric and asymmetric nations is highly beneficial for growth prospects. The main conclusion of this analysis is that a customs union consists of countries that share similar comparative advantages. Rest of the world also benefits through integration of these countries because it combines comparative advantage in extreme or highly concentrated certain sectors of production (Hira & Amaya Libardo , 2003). Therefore, the presence of preferential tariffs may affect local production, enhancing the role of regional comparative advantages in determining patterns of production, *ceteris paribus*, countries that, for example, have a greater amount of labor skilled workers relative to their partners will increase their proportions in the regional production of goods intensive in skilled labor, after the formation of the customs union, while those countries with a higher proportion of arable land, pass to increasing specialization in agricultural commodities.

The advantages of regional integration are numerous and multifarious. Regional integration enables those countries which are disadvantaged to attain economies of scale by engaging in mass scale production. Mass scale production is possible because barriers to trade are eliminated or lowered by integration and opens up borders for international trade. Manufacturers in small countries then produce for a large market rather than a



small one. Secondly, regional integration is also good for the consumers because countries compete on a broader platform and offer lower prices. Both consumers and firms benefit because there is an increased overall economic efficiency (Camarero, Flôres & Tamarit, 2006). Experience from European Union has shown that regional integration enables member countries to group their resources and benefit from combined use of institutional and human resources. The degree of technical and administrative competence reached in this manner could not have been possible on an individual basis. It must be noted that regional integration does call for compromise on the part of nation states; however, the net outcome is that it enhances the general quality of life.

Unilateral trade liberalization can bring down import costs, thus promoting the industrialization of developing countries. But a multilateral trade liberalization results in a higher stage of exchange from the time of the channel substantially improve access to northern markets for goods from the South: the relationship of demand and cost go together and allow in turn, rapidly industrializing countries (Giordano, 2003). PTAs South-South, however, results in reciprocal tariff reductions among members, with tariffs for the rest of the world and access to third markets remain unchanged. In this case the demand relationships become relevant, since intra-regional demand becomes engine of industrialization in these countries. However, this process of industrialization in South-South agreement occurs slowly, according to the authors, and the benefits derived from regional liberalization are lower than those obtained from a multilateral liberalization agreement (Camarero, Flôres & Tamarit, 2006). After defining the different sizes of the economies of South-South agreement, the model used by the authors suggests a slow

process of transfer and diffusion of the industrial activities of the larger countries to smaller, after a strong first step agglomeration or geographic concentration of these activities in the former.

## PROGRESS OF MERCOSUR INTEGRATION

According to the opinion of several experts, the progress of Mercosur integration is termed as quite slow. During last sixteen years of formation of Mercosur peace and stability has been promoted. The initial member countries, namely Argentina, Brazil, Paraguay and Uruguay have created a high-level political dialogue with each other. Nevertheless, progress has been considerably slow in terms of economic integration. Since the last Regional Strategy Paper in the year 2002, very limited progress has taken place towards the realization of a tangible customs union (Camarero, Flôres & Tamarit, 2006). So far the objective of formation of a structured common market is quite distinct from being realized. Mercosur has not reached any substantial achievement towards attainment of its primary goals; namely formation of a common market.

The reason for stagnancy in achievement of the Mercosur's primary objective is that the decision making process of the body has been quite slow. It takes very long time for implementation and enforcement of certain common legislation within the body. It has been quite troublesome for Mercosur to reach a common market. The major hurdle has been faced in increasing the awareness and involvement of civil societies in the regional integration project. Busse, Hefeker & Koopmann (2006) states, "an overall low level of ownership of projects and the absence of a centralized Mercosur institution responsible for managing and implementing cooperation with third countries. Moreover, it draws attention to Mercosur's difficulties in finding counterpart funding and the technical complications linked to the requirements of the EC's Financial Regulation (Camarero, Flôres & Tamarit, 2006). The EC has also drawn several key conclusions from its own

perspective. In the past, our cooperation was entirely project-based, with a multiplicity of projects responding to requests from different stakeholders, thus often lacking an overall strategic vision”.

It has also been said that Mercosur cooperation has also been thwarted to a certain extent from a lack of political involvement rather than economic reasons. During last ten years, there has been a trend of changing political priorities for Brazil, Argentina and Venezuela. Such change in political priorities resulted in disparate projects of Mercosur. It must not be thought that the acknowledged shortcomings have not been addressed by Mercosur bodies. The General Council of Mercosur tried to address the above mentioned shortcomings by drafting an action plan. The new action plan has replaced the original Plan of Cooperation 2007-2013. It is decided that the plan will no longer be centered on a usual list of projects rather it will be based on scheduled action plan. This action plan has also been referred to as Mercosur’s Integration Work Program (Edwards & Susmel, 2001). The action plan will mainly deal with the achievement of Mercosur’s Common Market. Once Mercosur’s Common Market is established, the next step will focus on the segments which facilitate implementation of larger integration between European Union and Mercosur.

Financial contribution is one of the key measures of the seriousness of the member countries. As of now, there is an agreed upon allocation of fifty million Euros announced for Mercosur integration to be spent during the period 2007-2013. The body which will look after allocation of this fund is Mercosur Development Cooperation. Of the fifty million Euros, ten million Euros are assigned to finance the chief project, namely,

“regional strategy papers”. Adjoining issues of social inclusion, good governance and sustainable development are planned to be made part of Regional Strategy Paper whenever appropriate.

## PROBLEM STATEMENT

The information discussed above shows that Mercosur countries vary widely in several respects. The size of the economy for each country is different, their level of economic development varies, the population figure for these countries widely differs, and the size of their markets is diverse. Taking into account GDP, population and territory, Uruguay and Paraguay are clearly the smaller Mercosur members and they do not represent even 5% of any of these variables, while Brazil accounts for 70%. At the same time, there are other political and regulatory differences, such as a lack of coordinated macroeconomic policies and incentive policies. Each member country is characterized by its own investment promotion policies, as well as policies to support the productive sectors and exports. These facts alter the conditions for competition between firms even more because their competitive positioning is contingent on their country of origin. This combination of structural and political asymmetries can be considered an obstacle to deeper integration within Mercosur.

The objective of integration is to overcome the above mentioned differences in growth, population, markets and economic structure to create a level playing field for all countries which are part of Mercosur. The paper aims to evaluate the impact of these differences on prospects for formation of regional integration within Mercosur countries. Economic theories and precepts from European Union are employed to gauge the feasibility of integration.

## RESEARCH OBJECTIVES

The objective of the report is to assess the potential impacts of MERCOSUR's integration process on prosperity of the member nations. Potential of prosperity is measured in terms of economic growth and social development, particularly for smaller partners. The main aim of the report is to identify asymmetries within member countries of Mercosur. To evaluate the asymmetries within Mercosur, the paper intends to identify the differences in growth levels and development between countries and regions, and the resulting inequalities (Maya & Bonilla, 1997). It also analyzes the asymmetries and their consequences on the distribution of the benefits of integration. The impact and importance of these asymmetries are analyzed by the member countries with the objective to analyze the alternative policies which have been adopted to compensate for these differences among member countries.

The paper also examines the outcomes of alternative policies which were directed at compensating the existing asymmetries. Most importantly, the paper attempts to analyze likely growth and welfare effects of those policies which were adopted to compensate for regional asymmetries. A secondary objective of the paper is to analyze the degree of economic convergence that has existed between MERCOSUR countries and regions. The regional integration process is studied in relation to economic growth. The fundamental question in the discussion of the hypothesis of convergence (or divergence) is whether it has existed or not in terms of levels of income or product per capita of less developed regions or countries within Mercosur structure. Another aim of this paper is to analyze the impact of the creation of a regional integration agreement such as MERCOSUR on

the behavior and distribution of industrial activities among member countries (Canen & Oliveira, 2000). More specifically, the work is aimed at finding asymmetries in the industrial development of these countries. The interest in addressing this topic is based on the recent emergence of regional integration agreements South-South, and therefore the need to understand the consequences of these agreements on welfare and opportunities for growth and development of the countries that are part of them. Thus, the processes of cumulative causation cause an uneven distribution of economic activities without considering the initial differences of the same composition in terms of factor of production (Camarero, Flôres & Tamarit, 2006). Similarly, the reduction in transport costs can lead to different patterns of economic location, according to the degree of mobilization of factors and resources, according to the degree of influence of agglomeration and dispersion forces.

Towards the end, the paper presents recommendations on methods to confront the structural and regulatory asymmetries. Furthermore, it addresses considerations on asymmetries and growth, and move onto analyzing the asymmetries and integration's and the different ways of addressing and treating this problem in Mercosur. Eventually, the objective is to study possible policy impacts on the region and the countries within the organization.



## RESEARCH QUESTIONS

How the differences in economic and social variables among Mercosur countries compares to those among European Union countries?

What is the likely impact of the asymmetries and their consequences on the distribution of the benefits of integration?

What are the possible ways to overcome the differences in the benefits of integration caused by structural and regulatory asymmetries?

What the different ways of addressing and treating the problems caused by regional asymmetries?

What are the possible policy impacts on the region and the countries within the organization?

## RESEARCH HYPOTHESIS

1. Mercosur countries are characterized by significantly higher level of regional asymmetry than European Union Countries
2. Asymmetry among Mercosur countries tilts the benefits of integration significantly towards larger economies like Brazil
3. Differences in the benefits of integration can be overcome by incorporating certain policy features within Mercosur structure

## RESEARCH DESIGN

The research design followed in the report is methodical and holistic. Various elements of research design are discussed in this section. Secondary data is used for the analysis in this paper. There are various highly reliable sources of secondary data because subject of Mercosur integration has roots in economic theory. Economic data for each country is published at regular interval. Government of each country publishes qualitative and quantitative information regarding its economic performance on a regular basis. This information is also verified by independent auditors and is highly reliable as compared to any primary information which we could have gathered for this analysis. The rationale for using secondary information rather than primary information is that secondary information is both readily available and highly reliable in this case. When reliable and valid secondary information is available for the analysis, it does not make sense to incur cost and spend time on collection of primary information for the purpose of this analysis.

The sources of data and information for this analysis are multifarious. The yearly economic data of Mercosur countries are the most important source of information. These reports are a public domain, verified by independent auditors and available on the official website of the country, as well (Busse, Hefeker & Koopmann, 2006). The information present in these reports is far beyond mere economic statistics of the respective countries. Yearly reports of a country contain information about the growth rate of the country, recent foreign investments made within the country, income distribution, respective values of the currencies, and degree of similarity to make integration feasible.

Data sources also contain spreadsheets and functional area analysis by economic analysts. Reports published by various independent organizations possess detailed quarter-by-quarter information regarding economic performance of the country. This information is highly valuable with regards to analysis of our study because this is tabulated information and very accurate. Economic attractiveness reports are another source of verified information for this research project. Economic attractiveness reports are important for competitive analysis and evaluation of performance of various Mercosur countries from an independent perspective. Public statements released by the economic ministries of the respective countries and articles published about feasibility of economic integration are also important for the purpose of this study.

Secondary data analysis method is deemed appropriate for the analysis in this report because the scope of the study pertains to those functional areas which are most appropriate measured through qualitative methods (Hira, Amaya & Libardo, 2003). Theoretical models of economic integration, formation of single currency, cross-country employments and free trade all pertain to qualitative analysis of data. For the current study, tools of economic integration, trade restrictions and control of employment levels are almost entirely based on qualitative analysis of data.

Reliability of the data is contingent on the source from which data is taken for the purpose of the study (Camarero, Flôres & Tamarit, 2006). This element of research design is taken care of by selecting only credible sources for secondary data. Among article sources, only those sources are considered which are peer-reviewed and

comparatively recent ones. For news sources, only information from credible news sources is made part of the analysis.

# Chapter 1

## PROGRESS IN THE INTEGRATION OF MERCOSUR SO FAR

The regional integration process of MERCOSUR began in 1991 with the signing of the Asuncion Treaty. The treaty defined a schedule for tariff dismantling convergence or so to reach a free trade area and customs union beginning from 1995. Despite a dramatic decrease of tariffs for intra-regional trade, the liberalization process has not proven to be symmetric across countries and industries. Definitely, the intra-regional liberalization process for high-tech products has proven to be deeper compared to low-tech goods or processing of natural resources. On the other hand, tariff reductions have contributed largely to the smaller countries, although the tariff liberalization process in Argentina has been less and slower in all industry categories, compared to the other MERCOSUR countries. The flow of intra and extra regional trade of manufactured goods has been particularly dynamic and very important during the nineties, to experience then a general decline in the last reporting period.

At the time, trade liberalization is accompanied by an increase in intra-regional trade flows. As a result of this increase, the regional bloc became an important market for exports of industrial goods, technology, high and average larger partners (Hochreiter et al, 2002). The creation of MERCOSUR with the resulting tariff reduction process is definitely related to the growing importance of this expanded market for the export trade of member countries, although not necessarily direct evidence of the block formation and changes in patterns trade of the countries that comprise it. The goal of this paper is

precisely to analyze whether the formation of MERCOSUR and the impact thereof on trade flows and specialization of exports of the countries have really come to affect the industrial development of individual members as reduce initial asymmetries between them. So far progress has been made only to the first step, which is to describe the evolution of tariffs and trade flows within the block (Camarero, Flôres & Tamarit, 2006). The next section will address the route taken by the countries in terms of their structures and export specialization.

MERCOSUR has been able to achieve significant diversion of trade in the early years of its formation. For example, the property most dynamic and fastest growing intra-regional trade has proved capital goods where MERCOSUR countries have not shown strong export markets of extra area. Furthermore, the rates of revealed comparative advantage (RCA) and other trade statistics have shown that the MERCOSUR countries have comparative advantages in this type of product (Urquidi, 2005). Argentina and Brazil experienced the strongest trend of reorientation of exports to the bloc in those industrial sectors that enjoy preferential margins higher. The evidence points to characterize the Mercosur as a regional bloc trade diversion generated, thus favoring the larger countries in terms of exports of certain types of manufactured exports whose natural vocation has not any country in the regional bloc. By comparing the behavior of the total exports of MERCOSUR countries with the same behavior in intra regional industrial categories, it is assumed that trade diversions should have caused a change in patterns of specialization, especially in categories and countries that are net beneficiaries of this trade diversion. The category of general or horizontal support includes all those who cannot be classified as regional or sectoral. In recent decades, the Commission established various protocols

and codes aimed at disciplining the use of such instruments (Hallwood, Marsh and Scheibe, 2006). The subjects received the most attention were the state aid for R & D, environmental protection, small and medium enterprises. In the case of the latter the most important feature of Community discipline was the establishment of a de minimize rule that exempts aid to a certain amount of the notification procedure to the Commission. These grants are considered implicitly allowed.

However, in recent years it has been shown that the benefits of integration have accrued to only to a few countries within the union like Brazil. Brazil's expertise in sectors of low and medium technology sectors where there is a marked improvement in regional exports, and to lesser extent high-tech products. Brazil is the only MERCOSUR country that has VCRs indexes in relevant sectors such as chemicals, transport equipment and machinery, as well as scientific and professional equipment. On the other hand, this country appears to be less specialized in exports of textiles, leather, wood, food and drink. On the other hand, Argentina, despite its natural vocation to manufactured products based on natural resources, shows significant improvements in high-tech products such as chemicals and transport equipment. More specifically in relation to the regional bloc, Argentina specializes in the export of leather, plastics, rubber and glass exports experienced an improvement in beverages, chemicals, petroleum and derivatives, and a reduction in export specialization in foods, leather, printing industry and glass products. With regard to small countries, Paraguay shows an improvement in their export specialization in natural resource-based manufactures such as snuff and low-tech products such as textiles, garments, leather and footwear, and to a lesser extent, plastic products. Like Paraguay, Uruguay continues to show VCRs in the manufacturing sector



based on natural resources such as food and snuff, but also some medium technology industries such as paper and printing industry, plastics and ceramics (Urquidi, 2005).

In short, the findings of previous studies suggesting the existence of trade diversion in MERCOSUR are confirmed in this work to observe the evolution of export specialization in intra-regional trade, large countries, especially Brazil, have competitive improvements in many industrial sectors and especially in high technology sectors, while small countries progressively competitive in low-tech industries and natural resource-based manufactures. However, the large countries also show improvements in their positions of exporters of manufactures based on natural resources in the region (Argentina) and low technology sectors (Brazil), while small show a slight improvement in a few products medium and high technology. So even when the evidence and generally cast as the main outcome of the larger countries of MERCOSUR as the only winners from trade liberalization, there are also some exceptions. Therefore, to accurately understand the role of export specialization within the MERCOSUR as acceleration factors or reduction of asymmetries in the next section will discuss the evolution of production patterns between the regional blocs.

### 1.1-PATTERNS OF SPECIALIZATION ACHIEVED THROUGH MERCOSUR UNION

The trade liberalization process has increased flows MERCOSUR exporters of medium and high technology in intra-regional trade but without changing the pattern of export specialization of member countries (Camarero, Flôres & Tamarit, 2006). In any case, what has occurred in almost all member countries is that as we advanced the tariff reduction process deepened the traditional specialization. In addressing the issue of evolution of the distribution of economic activities within MERCOSUR, the first

question to solve is whether the different production lines are more or less localized in the same areas or countries were concentrated before the Treaty Asuncion, and therefore if the countries are more or less specialized in those lines of production in relation to the period prior to RIA. In the event that the preliminary results of analysis demonstrate increasing degrees of geographic concentration of production and specialization, therefore, the next question is whether to clear this form of industrial polarization has taken place in the MERCOSUR countries relatively more advanced, and if, therefore, these countries have experienced an improvement in productive sectors relatively more advanced in relation to small countries that would focus on the production of natural resource processing industries, suffering, therefore, technological backwardness in relation to the larger economies the regional bloc (Domínguez, 2004).

Before considering the degree of industrial specialization of the countries of MERCOSUR as well as the degree of geographic concentration of these sectors or industry categories shows the evolution of regional production structure within the block. Within it, the major and growing proportion is represented by high-tech industries, while those low-tech sectors and natural resource-based experience a decline in regional output, while the share of assets medium-tech sector's remains unchanged. Smaller countries reduce their participation in all industry sectors with the exception of Uruguay, which does not in the manufacturing sector based on natural resources in the nineties. By contrast, Brazil makes a profit and increased participation in all sectors from the creation of MERCOSUR (Urquidi, 2005). Argentina increases the share of industries with low technology until the late nineties and the participation of their industries and HT, but only

until 1994, only to see decreased participation of these sectors, while from the end of nineties, Argentina lost, definitely ground in natural resource-based manufactures.

An important outcome of specialization within Mercosur union is specialization by Argentina. Argentina is gaining ground in the production of beverages, snuff, leather, footwear, furniture, chemicals, plastics and glass and non-ferrous metal manufacturing. But there are also many other industrial sectors where Argentina increased its share in regional production between 1985 and 1994, but reduced this participation in the second half of the period. For its part, Brazil, as has been said, is gaining ground in virtually every sector of medium and high technology, and within the low-tech sectors and manufactures of natural resources, increase their productive participation, particularly in textiles and clothing and food (Giannetti, Almeida and Bonilla, 2010). Paraguay experienced a slight increase in beverage production, leather and footwear, ceramics and professional and scientific equipment, while Uruguay increased their productive participation in food and drink, snuff, furniture, and to a lesser extent in sectors such as manufacturing of nonferrous metals, machinery non-electrical and professional and scientific equipment.

With the exception of Brazil, the other bloc countries increased strongly their specialization in manufacturing of natural resources. Brazil appears to be specialized in high technology goods, while Argentina in medium-technology goods and small countries mainly in natural resource-based products, although in the case of Paraguay, also increased its specialization in low technology products. As a result of growing location of economic activities in the Mercosur member countries are also in a process of increasing specialization from 1985, meaning thereby, and industrial production

structures mainly concentrated in a few sectors. Only Brazil shows a more diversified production structure and dispersed within its territory, compared to their partners. Brazil has the greatest degree of specialization in high technology products in relation to other countries, which, however, deepen their expertise in industries processing natural resources and low technology sectors.

Historically, smaller countries have not been specialized in producing medium and high technology, and this trend has deepened with the onset of MERCOSUR. Argentina, on the other hand, has been characterized by reduced levels of specialization in high technology sectors and a half, has seen, however, progress in certain types of medium-technology products (Cadot, Melo & Olarreaga, 2003). Anyway, clearly seen in terms of geographic concentration patterns and specialization, is a polarization of the latter between Brazil and the small countries of MERCOSUR, with only some exceptions in certain sectors and products, and an intermediate position specialization in the Argentine case.

The MERCOSUR countries have a long tradition of promoting productive activity. In the period of ISI mechanisms to stimulate investment and production aimed at import substitution and fill the "empty box" in the input-output matrix. Later, the menu is complemented by policies to stimulate exports and diversification. During the nineties this policy regime went through a stage of reforms "liberal." Although horizontal instruments gained weight in relation to sectoral policies, they did not disappear and in some countries were strengthened with specific incentives, as well as systems for the automotive industry in Argentina and Brazil and the scheme for computer and telecommunications equipment in Brazil. Activism in this area was deepened by the

granting of incentives, mainly in Brazil, by sub-national entities (states and municipalities). As a result, the structure of incentives and protection (generated by the combination of instruments to promote industrial and trade policy) has retained a high degree of discretionary sectors. The overlap of successive generations of industrial policy instruments designed to radically different policy environments was complemented by the action of sectoral lobbies and bureaucratic interests, which limited the consistency and negatively affected the effectiveness of the instruments used (Camarero, Flôres and Tamarit, 2006). One area where national policies were especially active was related to the treatment of foreign direct investment (FDI). During the nineties for FDI regimes became less restrictive, but maintained their goal of attracting foreign direct investment flows. Competition for attracting investment among countries in the region and affect the domestic investment location among federal units of the same country led to conflicts among member countries discouraged the elimination of barriers to trade flows and put the issue policy asymmetries in MERCOSUR's agenda. The devaluation of the Real in 1999 and Argentina's economic crisis of the new century, with the poor economic performance of Uruguay and Paraguay, gave new impetus to the issue of asymmetries, which in the case of small countries was expressed in demands for differential treatment.

## Chapter 2

### ASSYMETRIES AMONG MERCOSUR MEMBERS

There are significant asymmetries among countries which are member of Mercosur. The Mercosur countries are very different in terms of their economic size and dimension, their level of development, their population, and the size of their market. There is wide inequality between Mercosur countries in terms of economic might and social indicators. Economies of Brazil and Argentina comprise of a very large proportion of Mercosur economy as compared to Uruguay and Paraguay (Cadot, Melo & Olarreaga, 2003). Taking into account GDP, population and territory, Uruguay and Paraguay are clearly the smaller Mercosur members and they do not represent even 5% of any of these variable. Brazil accounts for 70%. At the same time, there are other political and regulatory differences, such as a lack of coordinated macroeconomic policies and incentive policies, in particular. Each member has its own investment promotion policies, as well as policies to support the productive sectors and exports, which alters the conditions for competition between firms even more depending on their country of origin.

These asymmetries are quoted as one the key reasons that integration among Mercosur countries has been rather slow in recent years. Domingues, Haddad and Hewings (2008) points out that during nineties MERCOSUR had progressed rather quickly towards formation of a customs union. Interestingly, during the initial years of the formation of the union, integration process appeared to go forward quite successfully. However, with the passage of time some key hurdles began to appear in the post 2000 era.

Some of the visible signs of the slowing process of integration were stagnancy in achievement of the Mercosur's primary objective for formation of a common market; an overall low level of ownership of projects was observed, as well as, a change in political priorities on member nations. The changing priorities of member nations led them to seek other options to increase trade in place of Mercosur regional integration. It should also be noted that during the initial years of the union, asymmetries caused little hurdles because those issues were dealt foremost which had little pertinence to regional asymmetries (Baer, Cavalcanti and Silva, 2000). Also, during the initial phase the smallest countries of Mercosur union had not proposed removal of tariff barriers. Also, at the start the focus of Mercosur's regional integration was be an adjunct to by unilateral liberalization policies.

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## 2.1-IMPORTANCE OF ASYMMETRIES AMONG MERCOSUR'S MEMBERS

There is very high importance of asymmetries among Mercosur's members because of their implication on the prospects of regional integration. The significance of asymmetries is that they have a decisive role towards eventual success or failure of the union. Firstly, asymmetries among member countries have cast a doubt on the potential of South-South integration. Asymmetries have caused changes in the regionalism mindset. Due to asymmetries little progress has been made in services and investments sector of Mercosur integration. According to economic theory, both the size and wealth of the countries hinder their ability to appropriate the benefits of the integration process. The theoretical developments of "geography and trade" emphasize the role of market size because it generates agglomeration processes around the larger markets. The degree of development is another dimension to consider. The poorest regions are being left behind and are less able to exploit opportunities offered by the agreements (Bouët et al,2011). In the case of MERCOSUR, both the poorest and the richest are found within larger countries. Several of negotiation rounds have been thwarted because member countries expressed serious reservations based on regional asymmetry. For instance, smaller countries wanted greater protection of their manufacturing sectors and agriculture rather than coming on a level platform.

Regional asymmetries have also become key issues of Mercosur integration of because majority of the problems faced by Mercosur so far stems from the tensions between the smaller member countries about safeguards for their industry and employment.

Asymmetries are the core reason that a definite institutional structure for the bloc has been increasingly hard to attain for Mercosur. The impact of asymmetries is so significant that certain decisions were not internalized after joint approval (Baer, Cavalcanti & Silva, 2000). This directly impacts the questions about the credibility of the union. Reservations stemming from asymmetries lead to multiplication of sectoral disagreements. There has been very modest progress in trade-related business disciplines, for instance services and investments. The eventual outcome of regional asymmetries within Mercosur has been loss of steam in South American Integration process.

Bouët, Berisha-Krasniqi and Estrades (2008) suggests that there is a need to address regional asymmetries within Mercosur members through a planned intervention. The invention is justified, “to create better structural conditions in the small partners to take advantage of the benefits of the integration process, and when policy asymmetries generate negative externalities to members. These policies should aim to create favorable conditions for the small partners to accept a greater commitment with the integration process. From the beginning the MERCOSUR was reluctant to confer differential treatment to the smaller members and demanded similar commitments on their part”.

The importances of cultural asymmetries within a union structure have been known to economists for a long time. Diao & Somwaru (2000) highlights the lack in coordination of macroeconomic policies in a context of strong instability of the partners. The uncertainty regarding the conditions of competition within the region is another serious obstacle to deepening the integration process. In an unstable region there is evidence that the effects on small economies such macroeconomic shocks can have much larger impacts on welfare than any changes in tariffs or other policies. Faced with this

uncertainty, targeted investments in the region tend to be concentrated around major markets.

The importance of regional asymmetries has only increased in recent years. Since the economic crisis 2007-08, the predicament of asymmetries has materialized as an impediment to the integration process. All associated benefit of regional integration has been thwarted due to lack of harmony caused by asymmetries within member countries. The smaller member countries of the union assert that the current agreements do not contemplate disparities in members' size and economic development. This implies that gains of integration are unevenly disseminated to the disadvantage of smaller countries (Baer, Cavalcanti & Silva, 2000). Cases in points are those of Paraguay and Uruguay. These two countries have not attained the promised benefits of integration, even though they share the willingness to access largest markets. As a result, these two countries have become reluctant to move toward consolidation of a customs union.

## 2.2-STRUCTURAL ASYMMETRIES

There are key structural asymmetries among countries which are part of Mercosur union. Majority of these differences originate from them member countries' differences in macroeconomic and competition policies. This results in lack of coordination between these countries. There is an inconsistency among these countries in terms of the application of incentives to production, investment and exports.

In the case of MERCOSUR, the differences are striking partners in several aspects, such as geographic size, population and economic activity. Brazil has 2 / 3 of the surface and holds more than 3 / 4 of the population and the regional product. While, taken Overall,

Paraguay and Uruguay represent just over 4% of the territory and the MERCOSUR's population and less than 3% of aggregate GDP of MERCOSUR. For its part, Argentina accounts for 29% of the territory, 17% of the population and just under 20% of the total aggregate. In terms of per capita income have also been discrepancies among the members of MERCOSUR. They have not been small and have remained rigid over the years. In addition, Brazil has not necessarily been the senior partner of the block, who has shown a higher per capita income to others. Within a general trend, Argentina and Uruguay are the countries higher income per capita, while Brazil and Paraguay the lowest income. Furthermore, this discrepancy, rather than reduced, has been extended over the years, despite the values of the indicator of growth economic growth have increased in each country. Growth has been more noticeable in Argentina and Uruguay, where GDP per capita in 2003 is almost double of that in the year 1985. This growth was more moderate in Brazil. Paraguay's situation was different, from the time GDP growth per capita has not been very significant, even to stagnate after the second half of the nineties. It is clear that considerable differences remain in levels of GDP per capita of the main partners of Mercosur, and that these differences are have increased during the study period, showing a significant stiffness in the gap.

The MERCOSUR union is characterized by prominent asymmetries in size and level of development among its member countries. In some cases, these differences have reached the level of extreme variations. For instance, Brazil possesses more than seventy percent of geographical territory of Mercosur as a whole. Also, the country contains more than eighty percent of Mercosur's population and is characterized by more than seventy

percent the total GDP of the region. On the other end of spectrum are countries like Paraguay and Uruguay. These countries combine to form only four percent of land mass, five percent of total population and 3.5 percent of the cumulative Gross Domestic Products of the Mercosur region. The differences between GDP and population of the countries are also not proportional. There are marked diversities in per capita GDP among Mercosur countries, as well. Interestingly, these are not the smallest countries of the union which have the lowest per capita GDP.

MERCOSUR has marked disparities in size and degree of development among countries and regions that comprise it. At one extreme, Brazil accounts for more than 70% of the territory, is home to nearly 80% of the population and generates 73% of GDP in the region (see Table 1). In contrast, Uruguay and Paraguay barely exceed 4% of the territory, 5% of the population of the region and 3.5% of GDP. These differences also become evident in the GDP per capita. Argentina is the country with higher GDP per capita, followed by Uruguay, Brazil and Paraguay.

It is important to understand the variation and extend of differences between the member countries. Argentina is the region which has the highest per capita income in the Mercosur union. Uruguay, which is among the smallest nations by population and geographical size, ranks second in terms of per capita income. Brazil and Paraguay are the next countries in the order of income earning capacity (Baer, Cavalcanti & Silva, 2000). The trend for these differences is also on the growing path. Originally, the differences in per capita income were no that wide between these countries. Disparity in per capita income tended to grow between the years 1985 and 2004. The major contributor to increasing income differences between countries is that certain regions

have been more proactive in responding to developments in technological improvements. For instance, Argentina and Uruguay has exhibited a highly dynamic performance than Brazil and Paraguay during the last six years. The table below exhibits the extent of structural differences between Mercosur members.

Country	Population		Area		Per capita real GDP	Real GDP
	Thousands of people	%	Thousands of Km <sup>2</sup>	%	Current US dollars (PPP)	Share in MERCOSUR
	2004		2004		Average 2000-2003	
Argentina	39,114	16.8	2,767	23.4	11,126	23.5
Brazil	184,546	79.1	8,457	71.6	7,377	73.1
Paraguay	6,180	2.6	407	3.4	4,912	1.6
Uruguay	3,437	1.5	176	1.5	9,965	1.9

**FIGURE 1 - STRUCTURAL ASYMMETRIES WITHIN MERCOSUR**

**(SOURCE: WORLD BANK)**

The structural differences between these countries do only relate to present differences, rather they can be assumed to grow in future because divergence in per capita income is taking place. Structural differences between countries also include policy differences in various matters of state. For instance, the governmental policies adopted to deal with competition conditions, exchange rate policies of the federal government, investment incentives given to foreign investors and local business and degree of liberalization of imports. Structural differences



**FIGURE 2 – GEOGRAPHICAL ASYMMETRIES WITH MERCOSUR (SOURCE: OFFICIAL WEBSITE MERCOSUR TRADE CENTRE)**

between Mercosur states also pertain to divergent policies regarding establishment of free-zone within the countries.

Several people regard differences in the size of the economies as also a major integration issue. However, a disparity in economic sizes is generally not a problem for integration according to the perspective adopted by contemporary economists. Economists say that integration does produce inequitable benefits for the member states. Inequitable benefits only mean that some countries benefit to a greater degree than the others; however, both countries are a net winner. Benefits of integration are accrued to all partners only by different margins (Bouët et al, 2011). But, it is not the case that any partner is worse off after integration. The ailments associated with integration like increase in unemployment rates or decrease in general wages are only short term impacts. These short term disadvantages are experienced due to structural adjustments of the economies. In the long run, all economies experience greater growth due to regional integration.

Diao & Somwaru (2000) on the other hand, state that the net benefit of integration process in Mercosur are reduced by asymmetries within the union. According to Diao and Somwaru (2000) within Mercosur union, “differences in market size give rise to agglomeration processes around largest markets. To ensure the political viability of an integration process it is necessary that it contribute to its members’ economic growth or, at least, that it is not an obstacle. The recognition of the need to promote special conditions for smaller and least developed economies has been present in the General Agreement on Tariff and Trade (GATT), the World Trade Organization (WTO), the European Union (EU) and throughout the history of Latin American integration through the principle of special and differential treatment. However, by the time the MERCOSUR

was created there was a skeptical view about the results of the policies applied in Latin America". The skepticism which was created with reference to integration process in Mercosur had caused member countries to step carefully. It was no wonder that there was a need felt to establish the equality of rights and obligations through the Asuncion Treaty. The treaty was formulated among the block members to safeguard the rights of smaller nations from being impinged by larger ones. This was also the step towards creation of a customs union.

It is also known that the bodies which were created under Mercosur have not yet designed a sustained long-term vision to take care of asymmetries. Initial attempts to take care of policy asymmetries had not yielded particularly positive results. Structural asymmetries of Mercosur have been taken care of through only a few instruments. These instruments were created under the code of differential treatment. For elongated periods of time, a significant number of exceptions for convergence have been created towards intra-regional free trade. Once the step of intra-regional trade has been established, then the second step towards formation of customs union is created. This is quite a workable approach because the drawbacks of asymmetries which are caused by initial free trade will be taken care of. After these side effects are taken care of, then the smaller countries will feel free to move towards a union.

Asymmetries which are part of Mercosur union not only pertain to the entire macro-environment only, rather they are also industry specific. Some key industrial sectors, for instance automotive and sugar sectors have different status in different Mercosur countries. In some countries, they are exempted from taxation while in others there is considerable level of tax on these industries. When Mercosur union reaches its goal for



formation of a single market, then all countries would have to adopt a single approach towards each of the industrial sectors (Baer, Cavalcanti & Silva, 2000). This means that the macro-economic policies of the region would have been completely aligned on every single sector of the economy for the union to work.

Furthermore, Paraguay and Uruguay have been awarded concession of longer periods for the removal of the disadvantaged and fleeting permit regimes. While the above mentioned advantage was also extended to the larger partners, the purpose of offering the favor to larger partners was to deter from adopting a discriminatory instrument in favor of smaller economies. Structural asymmetries within Mercosur also included the problem of selecting a CET. The issue of selecting a CET is quite an old within Mercosur structure. Ever since the inception of Mercosur, there were strong disagreements about the level of CET's, as well as, its structure. It is worth a mention that even though Brazil is the largest country in union by far (it comprises of seventy percent of population of Mercosur), still it was interested in defending its capital goods industries. These industries included computing and telecommunications industries which contain comparatively higher levels of tariff charges.

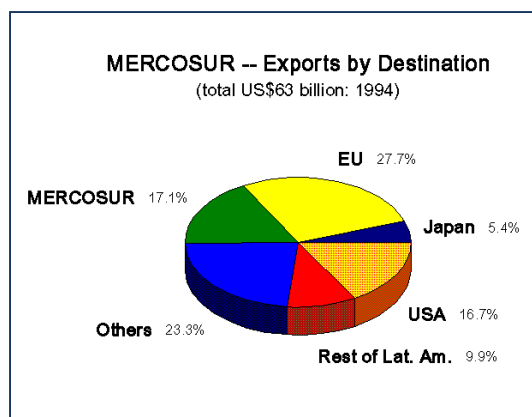
On the other hand, those countries which have smaller sized economies within the union have demanded low tariffs for the capital goods and products because they serve as inputs for their industries. The rationale for this demand for smaller sized trade partners is that these countries are dependent on a few industrial sectors. While, larger economies like Brazil possess a number of industries to support its economy, smaller countries do not have much of a choice in relying on alternate industries. Therefore, smaller nations are dependent on the import of certain goods. It is in the benefit of these nations that a

comparatively higher tariff on the products and services will ensure soaring trade-deviation costs (Bouët et al, 2011). The drawback of this approach is also present. The approach will slow down growth of these economies by discouraging investment – both foreign investment and indigenous investment.

The apparent anomaly was resolved through the approach of implementation of a tariff structure which was very similar to the tariff structure adopted within Brazil itself. The downside of this resolution is that a very slow pace of convergence is established in the region because of it. The small countries of the union anticipated that during the phase of convergence, Mercosur union as a whole would be able to enter into preferential agreements with Northern countries. Trade discussions with countries outside the union are important too. Structural asymmetries among Mercosur countries can be overcome through trade negotiations with third parties.

Structural asymmetries have taken a new turn over the previous decade and seriousness of member countries for dealing with these structural asymmetries have gained pace. Firstly, top leadership of all countries has openly acknowledged the presence of these asymmetries. Along with an explicit admission of the significance of structural asymmetries and decision has been made to devise a strategy to decrease structural asymmetries. Following the above mentioned decision in the year 2003, there were several studies carried to create a fund called FOCEM. The purpose of the fund is to improve the competitiveness of smaller sized partners in the union. Secondly, the fund will also be utilized to invest in growth of less developed regions. The bloc's governing bodies also mentioned the intention to create a provision of differential treatment in acknowledgement of structural asymmetries. For instance, it was decided that a

differential treatment for Paraguay will be given during the process of negotiations with trade partners outside the union. There are several other areas of structural asymmetries within Mercosur. The countries which are part of Mercosur differ widely amongst themselves in the way of special import regimes pertaining to raw materials (even in the case of temporary



**FIGURE 3 - COUNTRYWISE DISTRIBUTION OF MERCOSUR TRADE (SOURCE: INTER AMERICAN BANK DEVELOPMENT)**

admission for being exported later for reprocessing) and in telecommunication product category. An important aspect in the economic integration processes are asymmetries between countries and regions that make these processes. At the same time may increase or decrease the general welfare members, as do the costs and benefits of integration unevenly distributed across countries or regions, depending on the degree of disparities and the possibility that these inequalities acquire a persistent and incremental nature.

Asymmetries have also lead to creation of disagreement regarding use of Mercosur funds for regional development. The normative framework which was created for the allocation and utilization of combined-pool fund will be utilized to bring lesser competitive nations of Mercosur at par with more developed counterparts (Bouët, Berisha-Krasniqi and Estrades, 2011). The fund was initially aimed at financing programs for promotion of structural convergence and enhancement of competitiveness so that symmetries can be minimized. The areas chosen for the funds to be spent included those regions which pertained to development of trans-border infrastructure, improvement of production chains, and growth in adaption of technology in manufacturing process.

Social cohesion is also difficult to achieve due to structural asymmetries. Social indicators are quite different for Mercosur members. These countries vary widely in terms of provision of health, percentage of population living under poverty and degree of unemployment in the region. Especially, in smaller countries of the union, there is a need to improve the standards of living before opening up the borders for free movement of labor between these countries. Productivity and technological development is also an important part of the solidarity process between these nations. The way to deal with this form of structural asymmetry is to sustain the institutional structure operation and the escalation of the integration process between larger and smaller nations of the union.

### 2.3-STRATEGIES FOR MANAGEMENT OF ASSYMETRIES

Significant work has been done in contemporary research areas regarding management of asymmetries between nations. Baer, Cavalcanti & Silva (2002) lays down a framework which entails an analysis of the differences between countries to assess the feasibility of integration. The framework first discusses as to what extent there has been convergence or divergence in the levels of GDP per capita between regions and countries. Growth theory distinguishes between absolute convergence and conditional convergence or relative. There is absolute convergence when poorer countries grow at higher rates than the rich and converge to the same steady state (per capita GDP level of equilibrium) in the long term. In contrast, there is conditional convergence when the relationship between growth of income per capita and its initial level is negative after controlling for factors that lead to different steady states. In this case, it is necessary that the poorer economies grow at higher rates, what matters is the speed of convergence to steady state.

There are numerical frameworks too which deal with the degree of dispersion in per capita GDP to evaluate the feasibility of integration. The numerical models uses econometric models like cross-sectional analysis to test the hypothesis of absolute convergence; and fixed-effects panel to test the hypothesis of conditional convergence (Baer, Cavalcanti and Silva, 2000). The objective is to calculate the dispersion of the logarithm of per capita and estimates a function. Application of the model to Mercosur showed that the rate of convergence was very high for the regions where the predominant drivers of growth as it was much slower for the regions dominated retarding factors. By separating the sample into two periods, it is noted that since 1995 the rate of convergence for the regions fell sharply in the retarding effects were found for convergence, and increased in regions reinforcing effects were found. In the opinion of some theorists, not only the differences between the nations is important rather the differences of income levels and living standards within countries is also important for analysis of structural asymmetries within a group of countries.

## Chapter 3

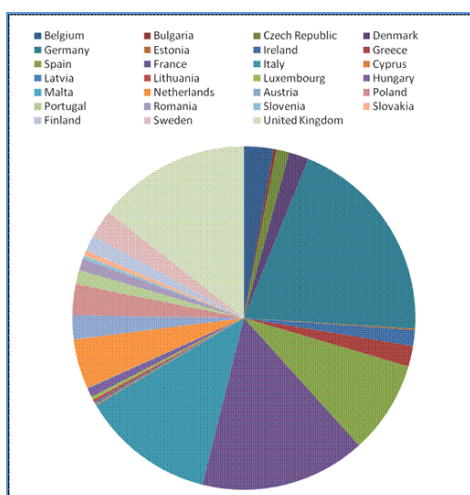
### INTEGRATION WITHIN EUROPEAN UNION

An important component of the paper is learning from the example of European Union to overcome structural asymmetries to create a cohesive and successful union. The treatment of asymmetries in the EU is often seen as an example of policies that promote cohesion and growth of the less developed partners (Diao & Somwaru, 2000). EU regional policy has been an integral part of the European approach to integration. Its basic objectives are to promote harmonious development and economic and social cohesion. Although the EU is one of the areas of per capita income highest in the world, its members always showed imbalances in income per capita. These disparities are even greater when compared to its more than two hundred fifty regions. This heterogeneity has been a permanent fact, deepened by successive expansions that incorporated relatively less developed countries. Throughout the history of European integration, the implementation of policies to address these disparities has had economic and social rationality (promote convergence), but also a political purpose. In fact, at key moments such as the establishment of the Single Market cohesion policy became a vehicle to promote consensus on deepening the integration process (Poja, 1998).

Mayes & Viren (2005) present a review of the policies adopted by the European Union to tackle the problem of asymmetries. The authors argue that the European experience should not be taken as a model to replicate, but that his account provides a set of useful items to discuss policies for MERCOSUR. These policies can be traced back to the foundation stage of the European Economic Community (Baer, Cavalcanti and Silva,

2000). The current model was built over several decades in response to the specific challenges that arose. The design responded to pressures and needs that arose as he moved the integration process was a source of conflict between national and EU authorities, was subject to ongoing review and there was a continuous learning process in its implementation.

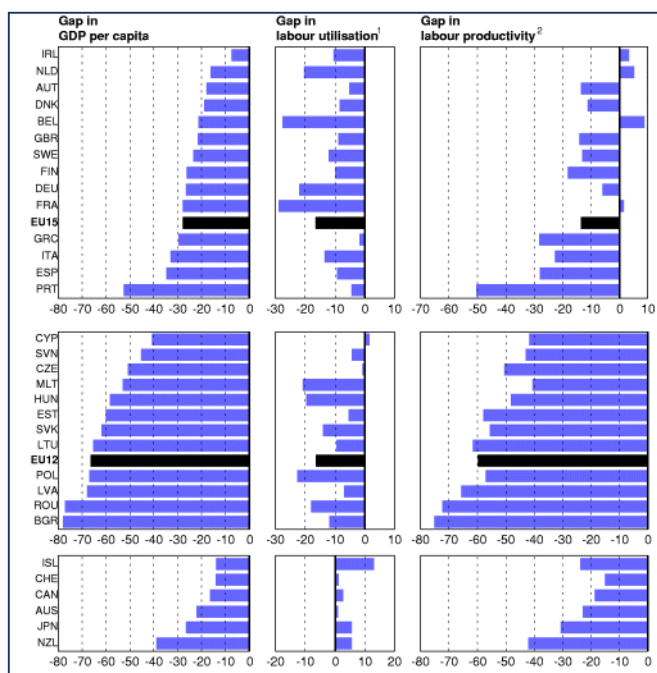
It must be known there were two ideological engines were key to the success of the process: the liberal approach adopted by the European Economic Community from the beginning and the vision of cohesion as a primary objective. This liberal view was sustained over time and is reflected in the fact that the Treaty of Rome there is no provision regarding industrial policy but there are express provisions to regulate the granting of state aid, which are within a section on competition policy. The latter were an essential element in the process of European integration. The policies implemented can be arranged around two main lines of action: control of state aid and cohesion policies. Mercosur Union can learn from the same set of practices to improve the process of integration within the Union despite presence of structural asymmetries.



**FIGURE 4- GRAPHICAL REPRESENTATION OF ECONOMIC DIFFERENCES  
BETWEEN EUROPEAN UNION COUNTRIES (HEATH, 2004)**

### 3.1 POLICIES ADOPTED BY EUROPEAN UNION FOR AID CONTROL TO OVERCOME ASYMMETRIES

Similar to Mercosur, the politics of state aid control faced severe difficulties for its implementation, mainly in the first decades of the integration process within European Union. The conflicts were dominated by the confrontation between the Commission, which wanted aid-discipline and nation states-those who give aid. These conflicts were most acute in difficult economic times. There was a continuous learning process but it is understood that there was a common view held by the Commission contributed to the successes that have been observed in recent years. Indeed, in the early years the Commission had limited capacity to impose their vision. Only in the eighties policies gained strength prevailed discipline and vision to create conditions for the competitiveness of EU industry. In the nineties discipline policies were seen as a necessary counterpart to policies to reduce structural asymmetries.



**FIGURE 5 - COMPARISON ON ECONOMIC INDICATORS**

**(CRAWFORD, 2011)**



One major difference which can be observed between Mercosur bodies and the Commission of European Union was decisiveness of action. There was a continuing concern of the European Commission and a bid consistent with nation-states over the first attempts to impose disciplines on sectoral support and other domestic support. The most contentious issues were the support for sectors with excess capacity and activities considered strategic by governments. State aid identified by the European Union as a source of distortion equivalent to anti-competitive practices of private companies. The Commission encourages horizontal policies (promotion of productive and technological capabilities or "horizontal competition" and competition policy), disciplines on aid and the opening of domestic markets in government procurement. The same policies can also be adopted by Mercosur to overcome concerns of smaller nations.

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In the year 2001, the commission of European Union initiated a review of aid programs in order to reduce the amount and increase your focus. The plan is based in four core

elements: market failures are the reason for their existence, the Commission carries out an economic analysis of the motivations, costs and benefits, efficiency and effectiveness of aid, and simplify, modernize and clarify the rules . There is concrete evidence of the elimination of certain types of aid and the reduction of government spending in this type of support in most countries. However, this success can be attributed not only to the action of the Commission since these states were more inclined towards horizontal policies and fiscal constraints faced limited their ability to provide aid. With regard to cohesion policy, the achievements seem more questionable given that state aid is highly concentrated in the more advanced countries.

It should be noted that the problems of integration and structural asymmetries within European Union would certainly have been greater cohesion if there had been no discipline policy. There are also difficulties associated with the development of interventions less transparent and the appearance of new instruments not specified in the legislation or its location in the local government level.

### 3.2 KEY LEARNING FROM METHODS ADOPTED BY EUROPEAN UNION TO DEAL WITH STRUCTURAL ASYMMETRIES

The implementation of policies to address disparities between EU countries responded both to economic reasons and social as political reasons. In fact, at key moments of the integration process of cohesion policy was a vehicle to promote consensus and the richest countries made concessions to the poorest countries to achieve membership. The increasing importance assigned to the cohesion policy is reflected in the growth of the

budget for cohesion funds from the EU. The Treaty on European Union, which entered into force in 2003, established the cohesion as a key objective of the Union.

**CREATION OF A POOL OF FUNDS** The instrument used to implement policies for treatment of asymmetries has been the creation of a pool of funds with clearly defined objectives and procedures. The main funds were the Structural Funds and the Cohesion Fund. The Structural Funds consist of four funds that finance actions aimed at the labor market, agricultural support, financial support to disadvantaged regions and fisheries. The Cohesion Fund was established with the objective of strengthening the Community's structural policy. It was assigned to countries with a GDP per capita below 90% of EU average. The fund co-finances infrastructure projects (environment and transport). In 2004 new funds are allocated for regional development to facilitate the convergence of new members who join the process. There are precise rules for the allocation and assessment of the resources of these funds.

**FORMATION OF POLITICAL WILL:** The analysis shows that the political conditions that led to the introduction of mechanisms to discipline regulatory asymmetries in the Treaty establishing the EC (especially in state aid) and institutional and legal framework that manages the scheme make the European experience is not liable direct transposition to other historical contexts, such as MERCOSUR. Something similar occurs in relation to policies to address the structural imbalances and promote economic and social cohesion, which were also heavily influenced by political, legal and institutional and structural characteristics of the participating countries. These findings, therefore, review the European experience not as an "ideal" model to be replicated, but as a general source of

inferences that may be of relevance for the treatment of the subject in the MERCOSUR. From the beginning the treatment of state aid in the EU was deeply rooted in a liberal view of the integration model. This was the result of certain basic consensus around key objectives (building a common market) and the most appropriate mechanisms to achieve them (the role of market and political competition). The control system of state aid was also firmly established supranational institutions and procedures implemented by the Commission and the European Court of Justice (Baer, Cavalcanti & Silva, 2000). This dual focus was a key figure in the design and implementation of this policy, which occurred in an environment characterized by ongoing friction between EU and national authorities and by strong resistance from some of the most influential players. In this sense, the treatment of State aid in the EU is an exemplary chapter in the history of taxation (business) of a community vision for the policies implemented under the logic of national and sub-national interests. "Armored" political and institutional action against local authorities, the control system of state aid was not only able to survive over time, but become increasingly sophisticated and adapt to the structural and conceptual changes and the process of deepening and widening of the EU. The evaluation of horizontal policies, review of guidelines for regional aid and the development of the State Aid Action Plan are examples of this evolutionary process.

ADOPT A STRATEGIC OUTLOOK: The EU experience also shows that the implementation of successive generations of cohesion policy has been associated with the launch of operations of deepening and / or expansion of the integration process. This policy acted as a strategic compensation mechanism for poorer members, in conjunction with initiatives like the establishment of the single market, EMU and, more recently, expanded

to twenty-seven members with strong disparities. A key requirement for these policies was the existence of conditions which enable the redistribution of resources from richer countries and regions to the most backward. Cohesion policy and financial instruments associated with it also became a tool available to the Community institutions, particularly the Commission, to "install" or "promote" strategic policy guidance in areas in which these instruments had or limited competition.

The events to which has been under the Technical Secretariat of MERCOSUR in recent years encourage skepticism about the possibility of this scenario to materialize, while emphasizing the primitive character of the challenges facing Mercosur. In short, the institutional and political context in which the European system was implemented for the treatment of structural and regulatory asymmetries is important to keep a distance of MERCOSUR. Political and institutional requirements for the adoption and implementation of Community policies that limit the autonomy of national policies or redistribute budgetary resources are too high and are not present in the case of MERCOSUR. On the one hand, and despite the use of the term "common market", in the case of MERCOSUR consensus on the objectives of the regional integration process (or more general framework of strategic policies) is fragile and does not seem to have influenced decisively the content of national policies or "community". The MERCOSUR not only lacks the supranational institutions that characterized the European process, but also there is a lack of common objectives and well-defined instrumental procedures. Intergovernmental bodies' own decision-making function with low efficiency and its decisions are often not implemented by the Member States. This gap between the level of political and institutional requirements of European system for the treatment of structural

and policy asymmetries and current characteristics of MERCOSUR does not imply that any effort to address the topic in the MERCOSUR should carefully examine the European experience. The analysis of this experience allows us to conclude that the treatment of asymmetries (especially political) is a necessary tool for the progress of integration, especially when it comes to promoting the integration process "deeper".

In the case of MERCOSUR, the potential distorting asymmetries policy has been affected not only by the disparity of economic and institutional resources of its members (data structure), but has been amplified by the very incomplete integration of markets. Indeed, the progressive removal of trade barriers and the adoption of a customs union model that keeps the fragmented national markets have magnified the potential distorting policies (in particular state aid) on trade and investment flows (Diao & Somwaru, 2000). This effect has operated through the strengthening of the attractiveness of the locations that face less uncertainty about the conditions of access to larger markets, at the expense of peripheral regions. In the European case, the competence of national and local organizations by attracting investment in the origin of the Community rules on aid policies to businesses.

## Chapter 4

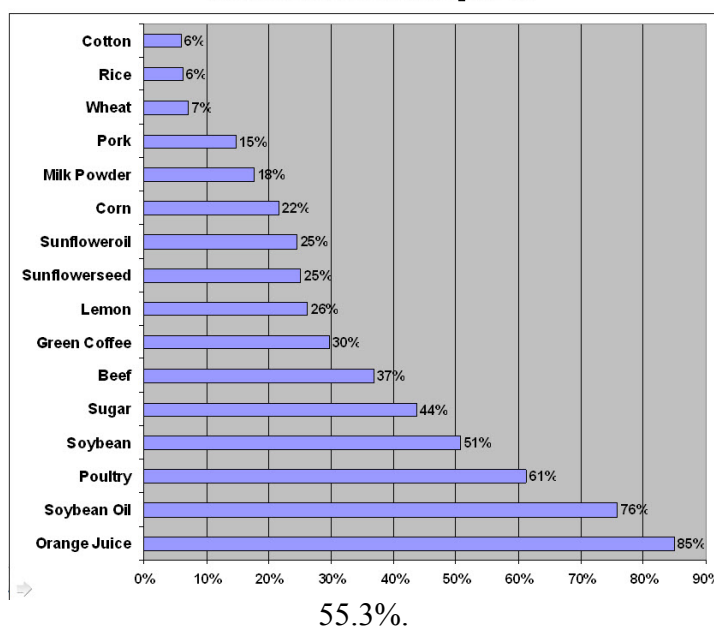
### REASONS MERCOSUR HAS NOT BEEN ABLE TO OVERCOME STRUCTURAL ASYMMETRIES

In the light of the above mentioned analysis, several problem areas have been identified to explain the key reason why Mercosur has not been able to overcome structural asymmetries within its structure. These asymmetries can be an obstacle for all partners benefit from an integration process even though this process can have benefits for the region as a whole. If any partner perceives that it can seize its benefits, the spirit of cohesion diluted jeopardizing the political viability of the process. In the case of MERCOSUR, the design of policies to address this problem is not easy because large countries are not necessarily the richest and very large differences in levels of development of regions within countries. Some of the poorest regions are found in richer countries. This is an important factor when designing policies to address the problem.

MERCOSUR has not had a vision sustained in the long term regarding the treatment of this problem. Since its formation adopted very different visions for the treatment of structural asymmetries and policy. The first were virtually absent from the negotiating agenda until 2003, while the latter were considered even though from the beginning, no significant progress was made for treatment. The Treaty of Asuncion is an explicit recognition of the risks policy asymmetries but not anticipated policy instruments to correct them. In subsequent instances programs were agreed for treatment but with little impact in terms of discipline members. For instance, in the year 1994 a technical

committee was formed with the objective of making a diagnosis and develops a proposal to address public policies affecting competitiveness. However, this approach did not have concrete achievements. Nor did the arrangements for the promotion and protection of investments or the Protocol signed Competition in 1996. The latter created an ad hoc group made an inventory of policies that distort competitiveness without other consequences (Baer, Cavalcanti & Silva, 2000). Another example is that of conflict emanating from loss of competitiveness of Argentina. Since 1999, the conflicts arising from the loss of competitiveness by Argentina, guided the negotiating agenda for resolving disputes arising from successive defensive measures imposed by this country. The process culminated in the adoption of mechanisms to address bilateral disputes between Argentina and Brazil. The approval of a bilateral safeguard mechanism and reversal of loss of competitiveness in Argentina decreased pressure.

### **Mercosur (Brazil, Argentina, Uruguay, Paraguay) share of world exports**



**FIGURE 6 - SHARE OF EXPORTS OF MERCOSUR COUNTRIES (CRAWFORD, 2001)**



#### 4.1-STRATEGIES ADOPTED SO FAR BY MERCOSUR TO TREAT ASYMMETRIES WITHIN THE UNION

Mercosur committees have so far adopted a number of measures to treat symmetries within the group. Since 2003 the treatment of structural asymmetries in MERCOSUR adopts a different character, you begin to consider the possibility of using instruments that seek to overcome discriminatory. Among the most important decisions in this area is the CMC decision to establish a High Level Group. This group made a proposal to establish and regulate a Structural Convergence Fund – the one similar to European Union Committee fund mentioned above - MERCOSUR (FOCEM). The same was created in 2006 with contributions from the four countries, in ten years to reach USD 100 million. The contributions and the benefits to the countries of this fund are determined by their size. Brazil contributes 70% of the funds, with 27% Argentina, Uruguay, Paraguay 2% to 1%. In contrast, Paraguay would receive 48% of resources, Uruguay 32% while the larger members would capture 10% each. The fate of these resources is regulated. At first be allocated to the Structural Convergence Programme which aims to contribute to the development and structural adjustment of smaller economies and less developed regions.

In the year 2003, Mercosur committee also adopted a series of decisions by CMC that address the demands of smaller partners. Such decisions accept new terms and exceptions in the convergence to the AU. It reaches an agreement to promote differential treatment for Paraguay in negotiations with third parties. It takes less stringent rules of origin for imports from that partner. Extensions are granted in special import regimes (raw

materials, draw-back and temporary admission) and AEC convergence of computer and telecommunications goods and capital goods. However, only the activities aimed at establishing structural funds are a novelty in the treatment of asymmetries. The other policies tend to delay a state of deep integration.

Moreover, in the year 2006 there is a new step in the incorporation of this item on the agenda of MERCOSUR. The decision proposes guidelines for a plan to overcome the asymmetries and create a group decision to formulate a proposal. On the other hand, the decision establishes a mechanism (Diao & Somwaru, 2000). The mechanism was aimed eliminating non-tariff barriers on intra-regional trade. However, when one closes this paper the negotiations seemed deadlocked. The interests of Paraguay and Uruguay are different: while Paraguay claims that are respected pillars of the plan to overcome asymmetries and broadening the FOCEM, Uruguay asks disciplines of policy incentives and flexibility to negotiate with third parties. In short, the positions of Paraguay at the negotiating table have sought to promote policies that address the structural imbalances while Uruguay positions are aimed at a reduction plan or policy regulatory asymmetries. Uruguay has placed emphasis on improving access to markets and competitive conditions while Paraguay has promoted the special and differential treatment.

#### 4.2-RECOMMENDED POLICIES FOR MERCOSUR TO OVERCOME STRUCTURAL ASYMMETRIES FOR THE FORMATION OF UNION

This study raises a number of elements to evaluate the policies adopted by MERCOSUR to address the problem of asymmetries. There are two types of policies which can be

adopted by Mercosur which can overcome structural asymmetries. The first type of policies are those that provide longer periods and exceptions to the small partners, while the second type of policies were those which point to the transfer of income through the creation of FOCEM. The first scenario in which there is no special and differential treatment for small partners, the four countries immediately eliminated all exceptions to the intra-regional free trade and the CET, against a scenario which assumes that small partners make this convergence within ten years. It concludes that both Uruguay and Paraguay are favored by the slow convergence to the CET. Exceptions to the same point to minimize the diversion of trade in products with greater weight in the basket importing countries (Baer, Cavalcanti & Silva, 2000). The postponement of these commitments is welfare enhancing and improving investment performance because it reduces the diversion of trade and improved access to large regional markets. However, in terms of welfare gains and growth are relatively modest. This policy favors Paraguay to Uruguay.

The rationale for recommending the above mentioned proposition is that mere postponement of commitments if not accompanied by other measures to reduce adjustment costs or improve the conditions of competition in the enlarged market would have little impact to reduce asymmetries. At the same time these policies generate other undesirable results such as the need for rules of origin and other restrictions on free trade within the region that limit the integration of markets. According to the new developments in geography and trade integration could strengthen weak agglomeration effects to Brazil hurting the smaller partners (Diao & Somwaru, 2000). It must be noted that a policy in which mere transfer of income to another, leads to infrastructure investments 10% decreases in transportation costs in trade with the region of the two

smaller partners. The creation of FOCEM is likely to have a positive effect on welfare. This effect is much more important for countries like Paraguay and Uruguay. Nevertheless, the magnitude of the background appears to be insufficient to address effectively the problem of asymmetries. Domingues, Haddad & Hewings (2008) argue that in practice the approved projects and resource scarcity question the ability of the fund to help strengthen cohesion in the region. The authors also consider that the region lacks a strategic framework of priorities for allocating funds and argue that it is likely that this instrument will become a mechanism for redistribution of resources rather than an instrument to encourage deeper integration. The findings of the analysis given above points in the same direction: the creation of a fund has a positive effect on welfare but the effect is small and the magnitude of the background appears to be insufficient to effectively address the problem of asymmetries in MERCOSUR.

The results of the empirical model estimates indicate that regional integration affects in a fundamental way in increasing the localization of production based on natural resources in countries rich in these resources and the reduction of the specialization of countries with abundance of skilled labor in the industrial sectors that make intensive use of this factor (Diao & Somwaru, 2000). At the same time, these results do not change when considering only the natural agricultural products or commodities, in the case of countries with comparative advantages in natural resources. By contrast, the effect is even greater integration in this case is reinforced specialization and location of such activities. Nor alter the results if the abundance of natural resources is measured by the proportion of arable land in each of the MERCOSUR countries. The decrease in the location of the most intensive use of skilled labor can be interpreted in light of the evidence resulting, as

favorable to an increase in the location of these activities in Brazil, which is the country that appears less endowment of skilled labor.

It must be recognized that economic aid should be needed to promote the desired development, which does not occur in the absence. Also, there must be proportionality between the support features (duration, intensity, impact on competition. The subsidy should be oriented to eliminate specific handicaps (e.g. regional) or help support a time-limited effort and goal-oriented and business functions, and not to create additional benefits or to reduce operating costs. The granting of aid should be evaluated in light of community interests and cannot be justified solely on the basis of national interests (Venables, 2003). Aid to sectors with excess capacity is permitted only under stringent conditions and usually involves a reduction in the overall capacity of the beneficiary. Help prohibits the operation of companies and any assistance for the re-structuring or "rescue" companies should be limited to recovering its competitiveness.

During the implementation of Mercosur agreement, rescue aid must be granted for six months to address liquidity problems in the short term and aims to enable smaller countries to prepare its restructuring plan. Support for restructuring, in turn, may be granted based on a plan that is intended to restore the long-term viability of the union. The measures provided for in the plan must provide for the operational restructuring, industrial and financial firm. The granting of aid for restructuring requires the participation of private financial resources and implies the adoption of "compensatory measures" to prevent or minimize distortions in competition caused by the aid (reduction capacity, de-investment in certain types of assets, etc.). Furthermore, these two types of

aid on implementing the principle of "one time, last time", under which the firm has received such aid in the last ten years will not be eligible for a new aid. Guidelines for Rescue and Restructuring adopted by the Commission in 2004 to more accurately intended to limit the distortions caused by this type of aid, reinforcing the principle "one time, last time", and demanding a minimum amount of private contribution to the restructuring effort.

Most importantly, procedures and concentrate assistance are required in three key areas, namely: a) the promotion of development and structural adjustment in regions whose GDP per capita was less than 75% of the average of the Mercosur union, b) assist the economic and social conversion of areas facing structural difficulties other than those covered by first objective and c) the development of human resources and modernization of policies and national systems of education, training and employment in regions other than those that qualified for second objective (Venables, 2003). As is clear from this analysis, the management of structural funds has been more ambitious than the mere redistribution of resources, developed in the framework of priorities and broader goals.

## CONCLUSION

In the work presented in this thesis there is a diagnosis of the nature and evolution of structural and policy asymmetries in the region, an assessment of the role of these asymmetries on growth, an evaluation of the policies adopted to deal with MERCOSUR asymmetries and a series of policy recommendations.

The paper found evidence of the presence of significant disparities between countries and regions within MERCOSUR, both in size and degree of development. These disparities have persisted over time. The asymmetries in the degree of development, measured by GDP per capita, have tended to increase especially after 1995 when the AU was formed. In MERCOSUR, the richest regions are not the biggest or the largest countries are the richest. Given these findings, raises the question of which indicator is more relevant when discussing the ability of regions or countries to appropriate the benefits of the integration process.

Using a macroeconomic approach it is found that countries with higher GDP per capita (Argentina & Uruguay) had a better economic performance. In contrast, Brazil had a greater ability to drive growth in its industrial sector, diversifying their production structure and attracting intensive industries skilled labor even when there is a country abundant in that resource. The size of this country played an important role to exploit economies of scale in an environment of shallow integration. These results are consistent with the predictions of the literature on geography and trade.

Review of work by other researchers clearly shows that the problems caused by the asymmetries on the smaller members, Uruguay and Paraguay, are very different.

Paraguay is among the poorest regions, smaller and poorer economic performance in the last twenty years while Uruguay, despite being the smallest country, is located at an intermediate level in their level of development and has performed economic than the regional average. In Paraguay, growth retardant factors predominate, while in Uruguay dominant drivers of it, so that the former converges to a GDP per capita long-run equilibrium is much lower than the second and the average of the region.

One can expect that if policies are not designed to address the factors driving the growth retardants or accentuation of disparities over time. MERCOSUR held a significant trade liberalization process; in particular, the process was more profound in high-tech goods. Trade liberalization was accompanied by increased trade flows and increased participation of the region as a destination for exports. The changes in productive specialization were not significant but there are indications that large countries, especially Brazil, improved their position in many industrial sectors, many high-tech, while small countries increase their specialization in low-technology goods and natural resource processing industries.

The role of regulatory asymmetries is also important since they lead to unfair competition between regions, countries and sectors to hamper progress in the integration process. The MERCOSUR agreement has failed to address them properly. There are some potentially damaging instruments because they go against the goals of deep integration. Among these are: the investment promotion policies as they affect the location of investments between the partners, the special import of intermediate inputs for export because they are against complementary production processes, and free zones regimes. In contrast, did not identify policy instruments that contribute to deeper integration. The design of



incentive policies made at the national level, regardless of the integration process and no basic agreements were reached to harmonize potentially distorting policies. In particular, the inability to formulate regional competition policy constitutes a serious obstacle to the progress of the integration process. Furthermore, Terra argues that the lack of coordination of macroeconomic policies had very negative consequences for the smaller economies.

A second aspect of this study is an exploration of the relationship between the asymmetries and the integration process. There is evidence that preferential liberalization deepened the comparative advantages of countries rich in natural resources (mainly Paraguay and Uruguay but also to some extent Argentina) and encouraged other forces of agglomeration of industries with economies of scale, more technology-intensive and hand qualified workers around Brazil. On the other hand, asymmetries played an important role in the design of key policies for regional integration such as the AEC. The response of the small partner is claiming exemptions that undermine the goals of deep integration. However, according to estimates with a CGE model tariff policies have little impact on growth and welfare of its members.

A third issue addressed in this paper is to examine the European experience in treatment of asymmetries in order to derive lessons that could be useful for the MERCOSUR. The European experience, like that of MERCOSUR, shows that these policies have been a source of conflict, showed progress and setbacks and were subject to ongoing review. They are the result of a process of continuous learning. However, the European experience in designing policies was carried out on two pillars that remained over time: the liberal approach of the Commission and the vision of cohesion as a primary objective.

From the beginning there are provisions for regular state aid but there are no forecasts of industrial policy. Competition policy is an essential element in the process of European integration. Moreover, it should be noted the role played by the supranational institutions to discipline the interests of national states.

State aid control was a primary objective in the treatment of asymmetries in the EU. Cohesion policy took shape much later because in the early years had few resources. It was common for cohesion policies were used as a compensatory mechanism for the richest to the poorest when they were required to make new commitments to deepen the integration process.

In the case of Mercosur, it can be expected that the agenda for the treatment of asymmetries is more difficult to resolve than the one in EU. Nevertheless, there are political and institutional mechanisms to make it effective. In the EU a clash between Community, national and sub national was present throughout the story but the Commission played a key role in enhancing the process. However, at the MERCOSUR level prospects have supranational institutional arrangements are virtually nil in the short or medium term. One recommendation is establishment of a vociferous mechanism that reflects regional interests and independent view of national interests. However, this is not easy, an institution as the Secretariat of MERCOSUR seems too weak to play this role. Also, the consensus regarding the strategic direction for the integration process also seems weak. No common objectives and well-defined instrumental procedures which effectively removes the decisions taken by the same makers.

The European integration experience shows that treatment of asymmetries is essential to promote deeper integration. In the case of the EU played a key role in the treatment of regulatory asymmetries, in the case of MERCOSUR seems even more important to address these asymmetries since there are many policy instruments that distort competition and undermine the goals of deep integration. Moreover, the ability to distort market performance of these policies was amplified by removing progressively barriers to intra-regional trade, especially in the case of investment promotion policies. Another key highlight is consistency between the treatment of asymmetries and structural policy. The European experience shows that there is coherence between cohesion policy and the politics of state aid control. In contrast, in MERCOSUR structural asymmetries were addressed using a series of instruments (temporary exceptions) that limit deep integration.

It is concluded that the treatment of asymmetries agenda should be realistic. One cannot address all disparities simultaneously making it necessary to prioritize and identify those whose treatment is essential at every point in time. MERCOSUR's agenda should focus on those policies with a greater capacity to produce distortions taking into account the objectives of the integration process. Not required to eliminate these policies. The European experience shows that common policies can go but there are alternatives such as mutual recognition, the progressive convergence and coordination. In contrast to the EU, policies that MERCOSUR has adopted in recent years have tended to address the structural imbalances. The exemptions granted to the junior partners, although they may have a positive effect on the welfare of the region, have limited range and generate pressures and interests that threaten their deep integration.

Another conclusion of the thesis is that European policies to reduce asymmetries have been successful only when they have been directed to strengthen the comparative advantages of regions and countries. Preferential trade liberalization has been favorable to a restructuring of the manufacturing industry according to regional comparative advantages in terms of both intensive labors, as skilled labor. In addition to intra-regional tariff reduction has weakened the forces of industrial agglomeration in terms of size distribution markets. The study concludes that small countries have a comparative advantage "right" can increase the proportion of regional industrial production based on intensive use of labor and skilled labor, and the proof of this translates into forces industrial agglomeration weakened as a result of intra-regional liberalization.

Moreover, the European structural funds have not been able to avoid regional bias within the EU, but rather have supported improvements in specialization, mainly in regions with higher production yields and growth. For its part, the FOCEM is an instrument that has a more symbolic than practical, except in the case of Paraguay. Has a positive effect on the welfare of small partners but this effect is relatively small on Uruguay. In the case of Paraguay, the impact could be much more important for its own geographical position as a continental country. This is true but not for Paraguay Uruguay, because for the latter, trade with the rest of the world is channeled through its MERCOSUR partners, therefore, improved infrastructure, reduce transportation costs of all its trade. In any event, becomes important as an instrument FOCEM palliative and as an expression of political will to address the problem but cannot be expected to solve the problem. In an integration agreement among countries of low and middle income, such as MERCOSUR, the resources can be allocated to these funds are limited. Therefore, the future is required to

put much emphasis on their effective use even a small increase in funding can have a positive impact on Paraguay.

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