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An Analysis of the Mercosur Economic Integration Project from a Legal Perspective

The original goal of Mercosur (or Mercosul in Portuguese) when it was announced in July of 1990 was the creation of a common market between Argentina and Brazil by 1995.[1] The broad, general guidelines for the establishment of Mercosur were included in ALADI Economic Complementation Accord No. 14 (ACE No. 14), signed in December of 1990.[2] Paraguayan and Uruguayan fears that they would be shut out of a common market between two of their largest trading partners caused both countries to ask to be included in the Mercosur process. The end result of this request was the Treaty of Asuncion, signed by Argentina, Brazil, Paraguay, and Uruguay in the Paraguayan capital on March 26, 1991.[3] The Treaty of Asuncion (the Treaty) was later incorporated into the

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1. Acta de Buenos Aires, 6 de Julio de 1990, 15 INTEGRACIÓN LATINOAMERICANA 67 (Agosto de 1990).

2. ALADI is the Spanish and Portuguese acronym for the Latin American Integration Association, which was formed in 1980 (Treaty of Montevideo Establishing the Latin American Integration Association, Aug. 12, 1980, 20 I.L.M. 672 (1981)) to replace the by then moribund ALALC or Latin American Free Trade Association founded in 1960 (Treaty of Montevideo Establishing the Latin American Free Trade Association, Feb. 18, 1960, 2 M.I.G.O. 1575). All the Spanish-speaking countries of South America, plus Brazil and Mexico, are members of ALADI. *See generally* Bevery M. Carl, *The New Approach to Latin American Integration and Its Significance to Private Investors*, 2 ICSID (WORLD BANK): FOREIGN INV. L.J. 335 (1987).

3. Arg.-Braz.-Para.-Uru., Treaty Establishing a Common Market, Mar. 26, 1991, 30 I.L.M. 1041 [hereinafter The Treaty of Asuncion].

ALADI framework as ACE No. 18 in November of 1991, following the Treaty's near unanimous ratification in the legislatures of all four signatory states.[4]

Since the signing of the Treaty, the common market aspect of the Mercosur project appears increasingly elusive. For one thing, Brazil's continuing economic instability makes it impossible to implement a goal considered crucial by the Treaty itself, namely coordinated macroeconomic policies among the four member states. What is likely to emerge by mid-decade, however, is a Mercosur free trade zone.[5] Many of the necessary steps for establishing such a free trade zone have already been taken, and the positive results that this process has already engendered ensure that progress in this area will continue.[6]

This article examines the current, multilateral Mercosur integration project from a legal perspective. Accordingly, the focus is on the Treaty and its effectiveness for creating an economically integrated Southern Cone by 1995. The earlier ACE No. 14 is touched upon only insofar as it adds new elements to the Mercosur process. As it is, the Treaty is superior in most respects to ACE No. 14 in that it flushes out many undeveloped areas in the earlier, bilateral ACE No. 14, and the Treaty establishes the institutional bodies intended to oversee implementation of Mercosur. The provisions of ACE No. 18, in turn, are virtually identical to the Treaty. Accordingly, all references to the Treaty encompass ACE No. 18, unless stated otherwise.[7]

Despite its superiority and the fact that the current Mercosur integration project is proceeding pursuant to the multilateral Treaty, it is important to emphasize that the Treaty does not supersede ACE No. 14. Under article 8 of the Treaty the signatory states specifically preserve their obligations under any previous ALADI agreement. As a result, Argentina and Brazil retain the right to continue with the Mercosur process under ACE No. 14 should the multilateral Treaty prove unworkable. This two-track option has the potential of reducing article 2 of the Treaty, which states that Mercosur is founded upon the mutual reciprocity

4. ALADI-Acuerdo No. 18, 23 de Enero de 1992, 2 PUBLICACIONES 71 (La Plata: Instituto de Relaciones Internacionales, Diciembre 1992).

5. A free trade zone is the least complicated form of economic integration and involves the elimination of tariffs and quantitative restrictions on trade between participating countries. A customs union adds a common external tariff (CET) on imports from nonunion members, while a common market also adds a CET and lifts restrictions on the free movement of labor, capital, and services between the member states and requires some degree of harmonization of national economic policies.

6. These positive results include dramatic increases of intraregional trade. For example, figures obtained from ALADI show that between 1990 and 1992 total Argentine-Brazilian bilateral trade, which accounts for 85% of intra-Mercosur trade, went from an already historically high $2.1 billion to $4.7 billion. The projection for 1993 is that Argentine-Brazilian bilateral trade will exceed $6 billion.

7. The only substantive difference between the Treaty of Asuncion and ACE No. 18 is that the latter includes preexisting legal obligations of each Mercosur state to which the Mercosur agreement is subject. Usually these preexisting obligations are minor (i.e., prohibition on importation of military hardware), but they also include Argentina's 3% statistical tax (10% since November 1992) levied on all imports regardless of origin (except Uruguay and, since April 1993, for most items imported from Paraguay).

of rights and obligations, to mere rhetorical window dressing. This two-track option could also conceivably be used to effectively undermine Paraguayan and Uruguayan veto power in Mercosur's institutional bodies, despite the requirement of article 16 of the Treaty that all decisions in these bodies must be unanimous. Paraguayan or Uruguayan intransigence could be countered by an Argentine and Brazilian decision to proceed with the Mercosur project under ACE No. 14.[8]

I. The Mercosur Process and Institutions

Pursuant to article 1 of the Treaty, Argentina, Brazil, Paraguay, and Uruguay propose to allow the free movement of goods, services, and factors of production (that is, capital and workers) between them by the end of a transition period on December 31, 1994. Such a goal will be accomplished, inter alia, through the complete elimination of tariff and nontariff barriers. In addition, the Treaty signatories propose to have a common external tariff (CET) in place by the end of the transition period, as well as coordinated macroeconomic policies. Finally, article 1 foresees the harmonization of conflicting national legislation by December 31, 1994.

The timetable for gradually eliminating intraregional tariffs to zero by the end of the transition period are found in Annex No. 1 to the Treaty. Certain goods exempt from this general tariff reduction schedule are included in special lists that must be annually reduced by 20 percent so as to be completely eliminated by December 31, 1994. Because Paraguay and Uruguay joined Mercosur approximately one year after ACE No. 14 took effect, those nations are given another year to totally eliminate their lists. The original Argentine list of exempt goods included 394 items, the Brazilian 324, the Paraguayan 439, and the Uruguayan list 960.

Annex No. II to the Treaty of Asuncion contains the provisions for determining the origin of a product, which, in turn, determines whether a good can take advantage of Mercosur's preferential tariff provisions. In order to receive preferential treatment a good must be native to or sufficiently transformed within the Mercosur region so as to achieve a new identity as found in the ALADI tariff classification system. Extraregional goods that are merely assembled in a Mercosur country in a Mexican *maquiladora*-style operation would not receive preferential tariff treatment. However, if no more than 50 percent of a finished good's F.O.B. value does not reflect the C.I.F. price of extraregional components, then the good will also be entitled to preferential tariff treatment.[9]

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8. Paraguayan or Uruguayan intransigence is unlikely so long as both countries continue to view the Mercosur project as necessary for encouraging economic growth, foreign investment, and international competitiveness.

9. F.O.B. means "Freight on Board" and reflects the price of a good the moment it is placed on the carrier to be shipped to the buyer. C.I.F. equals "Cost, Insurance, Freight" and reflects the cost of the good plus insurance and freight charges.

The Mercosur rules of origin are rather liberal when compared to other regional integration schemes. For example, in the North American Free Trade Agreement (NAFTA), passenger automobiles and light trucks will need 62.5 percent North American content in order to qualify for preferential tariff treatment when the NAFTA's rules of origin are fully phased in.[10] In addition, the Mercosur states are allowed to mutually agree on even more liberal content requirements in the event of a shortage of regionally produced inputs at internationally competitive prices or when regionally made inputs do not meet specific technical or quality specifications.

During the transition period Annex No. IV to the Treaty permits a member to impose a quantitative restriction on the continued importation of a good from another Mercosur country when a sudden surge in imports substantially harms or threatens to harm the importing country's economy.[11] The language in Annex No. IV makes clear, however, that a quota cannot be imposed when the import surge is due to the exporter's use of better technology or is a result of a shift in consumer preference. Instead, the sudden increase must be due to disloyal trading practices such as subsidized exports or dumping.

The country wishing to impose a quota must first petition the appropriate Mercosur institutional body. If after twenty days no action is taken on the petition, then the requesting country can unilaterally impose a quota that can only exclude the excess above the average amount imported during the preceding three years. Furthermore, the quota can only be imposed for a maximum of one year, although it may be extended continuously but not intermittently (that is, a country may not apply the quota in year one, skip year two, and reapply it in year three).

The inclusion of such a strict safeguard mechanism in the Mercosur process is intended to avoid the situation that occurred in past Latin American economic integration schemes where more lax rules were frequently imposed by governments bowing to powerful local industrialists wishing to protect domestic monopolies from outside competition. The abuse of these clauses was a significant factor contributing to the eventual stagnation of all these past integration schemes.[12]

In conjunction with article 1 of the Treaty's call for a CET, article 5(c) emphasizes that the CET has to be low enough so as to encourage the competitiveness of the Mercosur countries on the international market. At a meeting held in Montevideo in December of 1992, the presidents of all four Mercosur countries

10. E. Robert Lewis, *Negotiation of NAFTA Text Completed*, 21 INT'L LAW NEWS, Fall 1992, at 5.

11. After December 31, 1994, it is anticipated that fluctuations in trade flows will be handled by alternative methods that do not require the imposition of quantitative restrictions.

12. The three previous most important prior Latin American economic integration projects included the Central American Common Market (CACM) begun in 1960, General Treaty on Central American Economic Integration (with Annexes), *signed at* Managua on December 13, 1960, 455 U.N.T.S. 3 (1963); ALALC begun in 1960, which was replaced with ALADI in 1980; and the Andean Pact started in 1969, Agreement on Andean Subregional Integration, May 26, 1969, 8 I.L.M. 910 (1969). Each of these three projects stagnated far short of the lofty goals initially set for them.

agreed to establish a flexible, pseudo-CET whereby each member state's individual external tariff would be no higher than 20 percent by June of 1993. The presidents agreed to exempt from this 20 percent ceiling a special list of goods on which higher tariffs of up to 35 percent could be charged, but only through January 2001. At a presidential summit meeting held in Colonia, Uruguay, in January 1994, a final agreement on what items will be included in the special list of exempt items was postponed until the middle of 1994. The difficulty in establishing this special list has been occasioned by Brazil's desire to protect its capital goods, computer, and telecommunications industries with tariffs of 35 percent, while Paraguay and Uruguay want zero percent tariffs, and Argentina will compromise with a 15 percent tariff for such goods.

Article 5(d) calls for the implementation of sectoral complementation agreements affecting the various industrial sectors of each member state. The idea is to bring similar industries in the different countries together so that they either pool their talents and resources in the production of a given good, or specialize in some aspect of its production. The goal is to produce regional goods that are competitive on the international market. To date the only sectoral agreement of importance that has been signed and implemented affects the steelmaking industry. Under article 7 products of one Mercosur country are entitled to the same type of tax or internal duty treatment accorded to the domestically produced goods in the other Mercosur countries.

Article 9 of the Treaty establishes the Common Market Council and the Common Market Group to oversee the administration and implementation of the Mercosur process during the transition period. The Council is the highest of the two bodies and is made up of the Ministers of Foreign Relations and Economics of each member state. The Council issues decisions designed to ensure that the Mercosur project is implemented on schedule. Article 11 requires that all four presidents of the Mercosur countries must participate in at least one of the Council's meetings every year.

The Common Market Group, the second institutional body, proposes measures designed to, inter alia, strengthen the integration process and ensure the implementation of the Council's decisions. The Group is also the Mercosur body to which a country petitions for authorization to impose a temporary import restriction. The Group is made up of four representatives representing each member state's respective Ministries of Foreign Relations, Economy (or its equivalent responsible for Industrial Policy, Foreign Commerce, or economic coordination), and Central Bank. The Group is assisted by ten working subgroups that strive to coordinate policies dealing with commercial matters; customs; technical norms; fiscal and monetary policy as they relate to commerce; surface transport; maritime transport; industrial and technological policy; agriculture; energy policy; and the coordination of specific macroeconomic policies. Three new working subgroups were added in December of 1991 dealing with labor relations, education, and tourism.

The fact that the Common Market Council and Group are made up of the same individuals involved in setting foreign and economic policy in each country helps to insure that Mercosur will remain an important vehicle for the achievement of wider policy goals. This is an important difference from previous Latin American economic integration projects whose institutional bodies were staffed by bureaucrats whose work soon became irrelevant to the policies actually being pursued by their home countries.

Another important difference between the institutional bodies of Mercosur and those of previous Latin American economic integration projects is the emphasis placed on private sector participation. Article 14 of the Treaty specifically authorizes the Common Market Group to invite private sector representatives to devise and propose concrete measures to further the integration process. In addition, specific national sections of the Common Market Group exist, meet frequently, and include private sector participation as a matter of course. The Argentine section, for example, meets once a week and maintains close contacts with private sector groups interested in the progress of Mercosur.[13] The fact that the input of the private sector is actively sought in Mercosur is recognition of the crucial role it plays in insuring the success of any type of integration project—particularly one like Mercosur that depends so much on market forces. This situation is a far cry from the one that existed in all the previous Latin American economic integration schemes where the private sector was either excluded from the process or simply ignored.[14]

One of the negative features of the Common Market Council and Group, however, is their lack of supranational authority. Thus, any decision adopted by the Council or Group must be ratified by each member state's respective legislature. This procedure is time consuming and prevents quick resolution of the many asymmetries that currently exist in the laws of the Mercosur countries. These asymmetries include such things as subsidized electricity or labor regulations that serve to give a nonmarket competitive advantage to one country over the others. As mentioned earlier, article 1 called for the harmonization of these differences before the end of December 31, 1994. The current lack of supranational authority in Mercosur's institutional bodies makes it impossible to achieve the harmonization and, therefore, Mercosur's common market goal before 1995.[15]

13. F. Peña, Paper Presented at the International Conference entitled "Latin America's Future in World Trade: Regional vs. World Market Integration" celebrated in Frankfurt, Germany (Mar. 24 & 25, 1992) (unpublished manuscript).

14. *See, e.g.*, ALICIA PUYANA DE PALACIOS, ECONOMIC INTEGRATION AMONG UNEQUAL PARTNERS: THE CASE OF THE ANDEAN GROUP (1982).

15. Important factors limiting the ability to give supranational authority to Mercosur's institutional bodies are the present constitutional impediments in three of the Mercosur states. Only Paraguay's constitution accepts the idea of a supranational legal order. Although Brazil and Uruguay's constitutions promote the goal of an integrated Latin America, neither currently provides for the acceptance of a Mercosur community law. For its part, Argentina's present constitution recognizes only the distribution of law-making powers between the federal government in Buenos Aires and the provinces.

Article 15 of the Treaty of Asuncion sets up an administrative secretariat in Montevideo to coordinate meetings, issue press releases, and handle public relations. In this regard it should be pointed out that, by falling within the ALADI framework, the Mercosur process has at its disposal the ALADI administrative and bureaucratic organs, which are also headquartered in the Uruguayan capital. To date, the Mercosur countries have preferred to use their own institutional framework.[16] The one major exception to this avoidance of ALADI institutions is in the utilization of the ALADI central clearing house mechanism. By this mechanism private sector transactions are channelled through the main clearing agent, Peru's Central Reserve Bank in Lima, and dollar payments are only required to cancel balances remaining at the end of every four month period. Daily gaps between credits and debits are financed by bilateral credit lines, also settled at the end of every four months. All eleven members of ALADI plus the Dominican Republic participate in this clearing house mechanism.

Annex No. III to the Treaty established a temporary system for the resolution of controversies that might arise among the member states concerning their obligations under the Treaty. In December of 1991 the four Mercosur presidents signed the Protocol of Brasilia.[17] The Protocol spells out the definitive rules for resolving disputes among the member states with respect to interpretation of, application of, and failure to adhere to obligations arising under the Treaty of Asuncion and decisions and resolutions of the Common Market Council and Group. The Protocol was subsequently ratified by the legislatures of all four Mercosur countries and entered into force in April of 1993.

The Protocol of Brasilia requires that the state parties to a dispute first try to resolve their differences among themselves through direct negotiations. If a solution cannot be obtained, then the matter is to be referred to the Common Market Group, which may seek outside expert advice in rendering a decision. If the Group is unable to make a decision within thirty days, then the matter is referred to a three-member arbitration panel. The arbitrators have a maximum of ninety days within which to render a judgment, and their decision is not appealable. The vote is confidential, and no dissenting opinions to a judgment are permitted. The losing party has thirty days within which to obey the arbitrators' judgment.

See, e.g., Beltran Gambier, *El Mercosur Frente a Su Asignatura Pendiente: La Constitución Nacional*, COMMUNITAS 16 (1993); Diego Carlos Sanchez, El Derecho Ambiental en el Desarollo y Medio Ambiente en las Americas 4-6 (Feb. 2, 1993) (unpublished manuscript prepared for the XXX Conference of the Inter-American Bar Association, Santiago, Chile, April 1993). Accordingly, amendments to the present constitutions of Argentina, Brazil, and Uruguay would be required in order to give Mercosur's institutional bodies supranational authority.

16. Many have pointed out that the only reason why the Treaty was incorporated into the ALADI framework in the first place was to avoid the reporting requirements of article 24 of the GATT. All the Mercosur countries are GATT members.

17. Protocolo de Brasilia Para la Solución de Controversias, Dec. 17, 1991, 6 INTER-AMERICAN LEGAL MATERIALS 1 (1992).

Failure to comply permits the other parties to the dispute to temporarily adopt appropriate compensatory measures.

Individuals detrimentally affected by a law adopted by a member state violative of its Mercosur obligations can file a complaint with the National Section of the Common Market Group wherein they reside or are headquartered. If the complaint cannot be resolved within fifteen days, it is then referred to the full Common Market Group, which has thirty days within which to resolve the complaint. Unlike a state party, however, an individual has no further recourse beyond the Common Market Group unless a state party adopts the individual's complaint and requests arbitration. In addition, an individual may not directly challenge a state's failure to adhere to its Mercosur obligations. This specific limitation contrasts with the situation in the EEC, for example, where individuals who meet the standing requirements can directly challenge a state's failure to adhere to obligations arising under the Treaty of Rome. Interestingly, individuals enjoyed a similar right in the Andean Pact. Many legal scholars in the Mercosur countries have criticized the fact that an individual cannot challenge the decisions of the Common Market Group or Council, even if these decisions directly affect that individual.[18] At present this problem is more academic than real considering the Mercosur institutional bodies' current lack of supranational authority. However, should this situation ever change, this limitation is a serious infringement on individual rights, particularly if a state's national courts are without jurisdiction to hear cases challenging international legal obligations.

Other criticisms that have been levelled at Mercosur's conflict resolution mechanism are that the decisions are confidential and that no dissenting opinions are permitted. In particular, the confidentiality requirement prevents the establishment of a body of Mercosur law that can provide a helpful, interpretive guide for others who might find themselves in similar predicaments in the future.[19] The rule against dissenting opinions is criticized because it goes against the standard practice of arbitration clauses found in other international treaties.[20]

Pursuant to article 20 of the Treaty of Asuncion, any ALADI member wishing to join Mercosur will be permitted to do so after 1995. If that ALADI member is not already a member of a subregional group such as the Andean Pact, for example, then a request for membership may be considered beforehand. Interestingly, the accession provision in ACE No. 18 is much more permissive than article 20 of the Treaty in that the former permits any other ALADI members to join Mercosur subject only to prior negotiations among Mercosur's original member states.

Under article 21 of the Treaty any state wishing to withdraw from Mercosur

18. *See, e.g.*, Rodolfo R. Geneyro, *El Mercosur: Una Transición Jurídica Compleja*, 2 PUBLICACIONES 11, 19 (La Plata: Instituto de Relaciones Internacionales, Diciembre 1992).
19. *Id.* at 18.
20. *Id.* at 19.

may do so upon sixty days' written notice to the remaining members. However, article 22 requires the withdrawing state to adhere to the Treaty's trade liberalization program for another two years after the withdrawal request becomes effective.

Finally, article 24 of the Treaty imposes an obligation on the executive branch in each Mercosur country to keep their legislative branches abreast of progress in the Mercosur project.

Although no mention is made to them in either the Treaty or ACE No. 18, four programs that originated in the Argentine-Brazilian Program for Integration and Economic Cooperation (better known by its Spanish and Portuguese acronym PICAB) are carried over into the Mercosur project through ACE No. 14. The PICAB was started by then Presidents Raul Alfonsin of Argentina and Jose Sarney of Brazil in 1986 and gradually opened up specific sectors in Argentina and Brazil to bilateral free trade.[21] These four programs affect the capital goods, processed foods, automobile, and nuclear power industries. In the case of capital goods, processed foods, and products intended for use in each country's nuclear power plants, specific items are included in specially negotiated "common" lists which are traded between Argentina and Brazil free of tariffs. In the case of the automobile industries, Argentina and Brazil committed themselves to purchasing a specified number of cars, trucks, and spare parts from each other every year. In 1991, for example, each country was supposed to buy 10,000 passenger vehicles (including jeeps and small trucks) from the other and a maximum of $600 million worth of autoparts included in a common list. A new agreement signed by Argentina and Brazil on August 23, 1991, increased the automobile quota to 18,000 vehicles for each country, and in 1992 the goal was set at 25,000 vehicles each. At a meeting between the Argentine-Brazilian heads of state in Buenos Aires on May 24-25, 1993, the quota for 1993 was reduced to 20,000 passenger vehicles in recognition of Argentina's inability to meet either its 1991 or 1992 quotas. Much of Argentina's export problem has been attributed to sharply increasing domestic demand, which leaves the Argentine automobile industry with few surplus vehicles to export.[22]

II. Conclusion

Brazil's continuing economic instability makes it impossible to coordinate macroeconomic policies among the four Mercosur countries and therefore sharply diminishes the chances for a common market in South America's Southern Cone by 1995. In addition, the Common Market Council and Group's present lack of supranational authority makes it impossible to resolve before 1995 the many

21. Agreement on Argentine-Brazilian Integration, July 29, 1986, 27 I.L.M. 901 (1988).

22. *Argentina: Trade & Industry*, LATIN AM. WKLY. REP., Mar. 4, 1993, at 99. Less kind commentators have attributed Argentina's inability to meet its automobile quotas to the fact that Argentine cars tend to be more expensive and of poorer quality than comparable Brazilian models.

differences in the domestic laws of each member state, which must be done in order to establish a common market.

Although a common market will not emerge by mid-decade, what will appear by Mercosur's original target date of 1995 is a fully functioning free trade zone with a modified CET. In that regard, Mercosur's present legal and institutional framework appears adequate to sustain the formation of a viable free trade zone by 1995.

That there will be a Mercosur free trade zone by 1995 is facilitated by a number of factors. First, the tariff reduction schedule and accompanying reduction in the number of exempt items have been implemented according to schedule. The positive results these measures have already brought in terms of dramatic increases in intraregional trade flows, new jobs, and new business opportunities helps to insure that future tariff reductions will be enacted according to the timetable. Secondly, the free market oriented policies being pursued in each Mercosur country support and complement the overall goals being sought through a regional free trade zone. Finally, the creation of strong regional trading blocs in other parts of the world require the Mercosur countries to form their own negotiating bloc if they are to escape economic marginalization in this new world order.

A Mercosur free trade zone by 1995, although falling short of the original common market goal, would be a huge success in view of Latin America's previous dismal track record at economic integration. Such a free trade zone would provide both regional and extraregional investors with a wealth of new opportunities.[23] Once a free trade zone is established in South America's Southern Cone, it will then make Mercosur's original common market goal imminently more attainable sometime early in the next century.

23. For multinational companies already operating in the region, the Mercosur free trade zone allows them to streamline operations and redirect production to the most cost-efficient plants that can serve the entire 200 million person regional market from one location. Companies new to the region can, in turn, select the Mercosur country that provides them with the most comparative advantages to set up a manufacturing plant or service facility and then use it as a spring board into the other Mercosur members.