

MERCOSUR-ANDEAN COMMUNITY AGREEMENT: OPPORTUNITIES AND THREATS FOR ARGENTINA AND BRASIL

EXECUTIVE SUMMARY

Trade between the countries of the Andean Community (AC) and Mercosur showed a positive trend throughout the nineties, although it slowed down in the second half of the decade and beginning of this decade. It can also be seen that if trade flows between the AC and Mercosur are adjusted according to the share of their respective countries in world trade, the trade exchange level between both blocks has not shown any significant changes during the last ten years. This means that integration did not go beyond the change in the share of these countries in the world's economy.

Recent history shows that Argentina stands out in the trade relationship between Mercosur and CAN as the only Mercosur member shifting away from the Andean countries, which throughout the nineties lost their share both in Argentine exports as well as imports. In the other Mercosur countries the opposite is found to be the case.

As a section of the Harmonized System, Mercosur exports to the AC show much higher diversification than AC sales to Mercosur, which even show greater concentration than is found in its sales to the rest of the world, as is the case with mineral fuels.

Although the AC accounts for 7% of Argentine exports outside Mercosur, the Andean countries are an important destination for several product groups. As far as Argentina is concerned, the AC accounts for 14-17% of Argentina's extra-Mercosur sales of Chemicals, Plastics and rubber, Machinery and Equipment and Base metals and their manufactures. A similar development is found in Brazil for the first three as well as in Textiles and their manufactures.

Since the tariff liberalization process in both blocs is far from being complete (except in the case of Bolivia, which signed a broad liberalization

agreement with the countries of Mercosur), the question arises as to how the elimination of tariffs between the two large blocs of South America could lead to deeper trade integration.

A look at the degree of trade complementarity and at the existing tariff barriers, suggests that there is potential for more trade between both blocs. The countries of Mercosur, particularly Argentina and Brazil, are specialized in the export of products which the AC countries buy, and although the reverse relationship is not quite as significant, it should be added that the AC countries are also specialized in a number of products imported by Mercosur. The Andean countries therefore appear to be able to compete in a number of products that currently have a very low share in sales to Mercosur, even below the share in world sales. This is the case with Plastic and articles thereof.

The analysis of opportunities and threats suggests that both Argentina and Brazil would have a significant trade potential in the AC countries. Argentina would be more interested in elimination of barriers to agricultural products, whereas in Brazil more relative weight would be attached to manufactures of industrial origin.

The potential market that Argentina would be in a position to compete for in the AC if the bloc were to eliminate all import tariffs would be close to US\$10 billion. 27% of that amount would consist of "strong" opportunities, i.e. relating to sectors (at subheading level) in which tariffs are higher (as a result of which the impact of their elimination would be higher) and in which Argentina has a high level of competitiveness (its competitive advantages are independent of its preferential access to Mercosur).

Argentina's "strong" opportunities basically focus on Manufactures of Agricultural Origin (MAO), such as

Dairy products, Miscellaneous edible preparations, Residues, wastes of food industry) and Primary products (Cereals) although certain Manufactures of Industrial Origin (MIO) are also represented, such as Articles of iron or steel).

On the other hand, “weak” opportunities, which account for a little more than US\$7 billion, are diversified in the sense that Primary products, Fuels, MIO and MAO are all represented.

An important part of the opportunities Argentina would have in the AC would be shared with Brazil, as Brazilian exporters would be in a position to compete for 54% of the US\$10 billion market relating to Argentina’s opportunities. If “strong” opportunities are taken into account, Brazilian competition would be lower (39%), mainly focusing on Iron and steel, Articles of iron or steel, Cotton, Sugars and sugar confectionery and Residues, wastes of food industry. At the other end of the scale, the sectors that would virtually share no opportunities with Brazil are Cereals, Dairy products, Beverages and spirits and Miscellaneous edible preparations.

Brazil, on the other hand, would be able to access a market slightly over US\$10 billion, in the event of a tariff liberalization with the Andean Community. 20% of that amount relates to “strong” opportunities and focuses mainly on MIO, such as Vehicles and their parts, Rubber and articles thereof, Articles of iron or steel, Plastics, etc. The rest represents “weak” opportunities, concentrating on MIO (such as Vehicles and their parts, Machinery and equipment) but also includes Fuel, Primary products and some MAO.

As in the Argentine case, approximately 57% of the opportunities Brazil would have in the AC would be competed by Argentine exporters. Within the “strong” opportunities (in which Argentine competition would be 43%), the sectors with the highest level of Argentine competition would be Articles of iron or steel, Fats and oils, Residues, wastes of food industry, Sugars and sugar confectionery and Cotton. Among the sectors with “exclusive” opportunities for Brazil are Rubber and articles thereof, Machinery and mechanical

devices, Vehicles and their parts and Aluminium and articles thereof.

The price band system, one of the most restrictive tariff protection mechanisms of the AC, mainly affects Argentina, as it would apply to an amount of US\$1.4 billion, i.e. over 50% of the “strong” opportunities Argentina would have in the AC. In Brazil, on the other hand, the price band system only affects one fifth of the “strong” opportunities.

As to the threats to Mercosur bilateral trade arising from the Andean countries, the two largest Mercosur partners would suffer higher competitive pressure in certain products classified within MIO, particularly within the “strong” threats. Brazilian exports to Argentina would be more affected than Argentine sales to the Brazilian market, both in absolute as well as relative terms.

The opening of the Brazilian market to the AC countries would expose Argentine exports to Brazil to higher competition (US\$750 million, i.e. one tenth of the average value exported between 1998 and 2002). Approximately US\$220 million would relate to “strong” threats (sectors in which the AC countries currently face relatively high tariff barriers in Brazil and, at the same time, Argentina has no competitive advantages beyond Mercosur) and affect MIO sectors, such as Plastic and articles thereof, Pharmaceutical products, Synthetic fibres. Competitive pressure would be greater on the first of these two sectors, in which some AC countries have a high degree of international competitiveness.

The threats to Brazilian exports to Argentina would involve a market of US\$1.4 billion. As in the Argentine case, the “strong” threats would concentrate on MIO (in addition to plastics there would be products in the sectors of Vehicles and their parts, Machinery and equipment, Textiles), involving exports of around US\$500 million.

For the AC, the agreement would bring major advantages, mainly because AC countries could achieve greater diversification in their exports to Mercosur, which are currently concentrated on a few products.

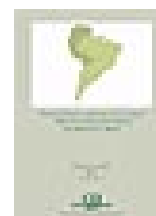
The estimates based on the Computable General Equilibrium (CGE) model of the CEI also give insight into the effects on more aggregated variables. In this regard, simulations show that Argentina's GDP would increase by 0.5% and Brazil's 0.9%, following tariff elimination between the AC and Mercosur countries. Exports from Argentina would grow by 2.2% and exports from Brazil by 3.2%. Sectorial results of the CGE model, although at a more aggregated level, seem to be consistent with

estimations made on the basis of an analysis at subheading level. The growth in Argentine exports to the Andean Community would relate mainly to Products of the food industry, Cereals, Petrochemical industry and Metal products, i.e. both agricultural products and industrial manufactures. In the Brazilian case, on the other hand, the increase in exports to the AC would include mainly MIO (Machinery and equipment, Vehicles and their parts, Petrochemicals and Metal products).



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