

The Common External Tariff of MERCOSUR. Is it a tool for stimulate the competitiveness of its members?¹

Introduction

One issue that has been debated in the political and economic world is “¿which policy applies to achieve a better life standard in the countries? The answer to this question had created large academics discussions and multiple policy applications trying to take the crucial step to take off in developing economies. In contrast, there is a large empirical evidence of growth that did not occurred with the recipes proposed by organizations such as the World Bank, the Interamerican Development Bank, International Monetary Fund or other multilateral agencies or from the neoclassical growth model focused on the accumulation of capital or in improving the state of technology, investment in R & D or other more sophisticated.

The only concrete result is that most developing countries remain in that position for over 3 decades. On the other hand, developing economies that have emerged in the globalizing world have had the common feature that the growth was accompanied by a growing involvement in international trade. So much so that recent talk of growth is almost similar to talk about international trade.

In this context, the challenges of developing economies, to become dynamic players in the globalized world is no minor, especially because the market size is very important

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for those small and open economies. In this sense, the evidence shows that these economies have tended to choose as natural partners to their neighbors. This is the case in Latin America, Africa and South Asia. This entails certain advantages from proximity: i) direct extension of the market, ii) lower cost of transport because of the distance and, iii) similar development in the region.

Empirical evidence has shown that the neighborhood is not necessarily the best club to participate in the global market. Given these, countries have moved deeper into patterns in order to generate a *membership* that has more influence on the global stage, this is to create common markets that by the synergy of common policies, become attractive from imports and exports point of view respectively. The starting point of common policies lies in the establishment of a common external tariff that promotes efficient business relationship between the region and the world.

The present study is to explain the pattern of incentives generated behind the establishment of the Common External Tariff (CET) of the MERCOSUR. In 1991, the governments of Argentina, Brazil, Paraguay and Uruguay agreed to create a common market allowing the benefits of free trade among its members. To this end, they decided to sign the Treaty of Asuncion (TA), which included a transition period in order to develop the tools necessary to build the common market. One such tool is the CET to be applied to the imports from countries not members of the bloc.

The governments from the four countries agreed that the guiding principle for the construction of the CET in MERCOSUR is that it stimulates the foreign competitiveness of its members. This principle is contained in the Article 5 of the TA.

However, in the negotiation process for the construction of the CET, the countries members had divergent positions on the tariff levels that should be applied to imports from countries not members.

The smaller economies of the bloc, Paraguay and Uruguay, were in favor of maintaining a structure with low rates of CET and minimal dispersion. On the other side were Brazil and Argentina, who showed preference for high level tariffs, which serve as protection of local manufacturing output.

Finally, in December 1994, the MERCOSUR countries approved the CET, which essentially represented the revealed interests of Brazil during the negotiation process. Thus, January 1, 1995, the CET approved by the four countries came into force and began to be applied to imports of goods not originated from member countries of MERCOSUR.

However, the implementation of the CET did not include the total universe of products of the nomenclature, because the countries decided to establish exceptions to the CET as a solution to the differences arising in the negotiation process. For imports of productive inputs, capital goods, informatics and telecommunications, the countries set National Tariffs (NT), whose levels should converge towards the CET, within a time period agreed by the countries.

Peculiar reasons of the regional crisis made that the convergence commitments from the NT towards the CET were sidelined, and the simultaneous and universal implementation of the CET has been postponed several times. At present, about three

quarters parts of the imports entered the MERCOSUR do not pay the tariff trade policy of the bloc. This result is synonymous that the current structure of the CET shows structural weaknesses in its application in the four MERCOSUR members.

For these reasons, this study aims to assess the differences and interests not reflected in the current structure of the AEC, to simulate alternative scenarios in a computable general equilibrium model with the aim of generating discussion and policy recommendations for a realistic review of the incentive structure of the CET that will help getting common positions to full adoption of the same.

Productive asymmetry in the MERCOSUR and its influence on the design of the common commercial policy.

Regional integration is sometimes presented as a unidirectional process that progress in stages from the creation of a free trade area into a broader and deeper integration.

However, if we look at the experience of NAFTA (North American Free Trade in North America) we realize that it includes very important aspects of a common market beyond trade in goods (services, investment) and in any case much more significant and extensive than those included in MERCOSUR bloc, even without have been raised the "step" with the preceding stage of Customs Union (AU). On the other hand, MERCOSUR, has touched many themes of political union (from the clause to educational cooperation, judicial and police) without having advanced almost nothing in terms of common market.

MERCOSUR has sought strengthen the customs union without much success, whose most important characteristic feature is the adoption of the Common External Tariff (CET). While in the year 1994 was put into a force the Common External Tariff, until now the member countries have been unable to comply it fully because of the exception lists for all member, that's remain to care for the interests of their productive sectors.

In fact, Julio Berlinski (2005)² demonstrates the importance of the CET exceptions schemes and special regimes for the members of MERCOSUR. In this regard, 78% of imports in Paraguay, 69% of imports from Brazil, 72% of imports from Uruguay and

² The deep integration in MERCOSUR. (Perspectives from Argentina, Brasil, Paraguay and Uruguay). Julio Berlinki, Coordinator.

81% of total imports from Argentina are admitted for one of these lists, which give member countries an almost autonomous management of its commercial policy. This scenario creates serious difficulties in setting the common commercial policy where "political" has been shown to go the MERCOSUR. In that sense, Gaya (2008)³ found that asymmetries increased since the creation of MERCOSUR.

Following this reasoning and noting that since its foundation the MERCOSUR do not included explicit treatment of asymmetries between its members, there is a widespread feeling of disenchantment with the results of the integration process and after 18 years of the Treaty of Asuncion (TA), especially the smaller partners. Currently the regional bloc is at a turning point that has only two possible outcomes: i) review the original objectives aimed at building a common market, leading to the existence of one free trade zone or ii) generate a reengineering "policy" to maintain the heritage commercial won until now, besides all the progress in elements of political union.

³Gayá, Romina E.. "Asymmetric distribution of costs and benefits in MERCOSUR. The role of the diversion of trade imperfect integration. FLACSO/Argentina. San Andrés University in cooperation with the University of Barcelona.

Theoretical review about delegation of trade policy in a context of regional integration

The theory of endogenous tariff formation describes how a combination of agents' preferences on trade policy and the weighting given to the preferences of different groups on the determination of policy can stimulate the diversion of the first best trade policy, which should regulate the efficiency of trade flows.

So Olarreaga and Soloaga (1998)⁴ analyzed seven conditions of sectors variations in tariff protection, which may justify the tariff structure of MERCOSUR. These variables are listed below:

- 1) The level of industrial concentration is high. This condition captures the kind of *free-riding* incentives. In general, the literature assumes that industry concentration requires a high level of protection
- 2) The ratio of imports penetrating is low. Therefore, the objective function of government to influence the ability of consumers is low with respect to the producers.
- 3) The *proxi* of the sales inputs is low. This condition captures the rivalry of the *lobby*. If sector "j" purchase goods to sector "i" then the sector "j" will not support any request for increased protection in the sector "i".

⁴ Endogenous Tariff Formation: The case of MERCOSUR. The World Bank Economic Review, vol. 12, N° 2: 297-320.

4) The ratio of labor/capital is high. Cadot, de Melo, and Oarreaga (1997) show that tariffs are high in sectors where the share of capital remuneration in value added is large.

5) The share of intra-industry trade is small. If the elasticity of intra-industry trade is large, the tariff is low because the cost efficiency of the tariff is relatively large compared the earnings of producers.

6) The equilibrium wage in the sector is low. The optimal tariff for each sector is positively related to participation of specific capital in total sales.

7) The share of work is large in total employment in the economy. Alternatively, it can happen here that it could have great importance the amount of voters in the sector.

Given these parameters and an empirical model to test it, they go to the following conclusions:

- In the first 5 years MERCOSUR achieved not only a significant degree of integration among the members but also with the rest of the world.
- The MERCOSUR has a high protection to the rest of the world; the CET is two times larger than the tariff level of OECD countries.
- Brazil's interests have the largest weight in the tariff structure.
- Internal barriers to free trade tend to be higher in sectors with potential for trade creation.

- The convergence to the CET signed in Ouro Preto will establish a platform for trade creation.
- This happened to pose significant challenges facing the lobbies of the different member countries.
- The MERCOSUR countries need to make serious arrangements for achieving the policy objective of Ouro Preto.
- If the tariff structure of MERCOSUR reflects the interests of its members would facilitate the convergence to it.

On the other side Olarreaga and others (1999)⁵ wonder what generates the formation of customs unions, finding that in the case of MERCOSUR are important the terms-of-trade effects, as well as the effects related to economic policy in exchange markets with consequent protection of the market expanded.

The terms-of-trade effects is not a general consensus, as according to Krugman (1991) tariffs could be increased after the formation of the Customs Union (CU), which is related to the internalization of the terms-of-trade effects in the CET, then if the potential members of the CU tend to import similar goods, then the formation of a large block, of course, will establish a high level of tariffs and increased market power in international trade.

However, other authors such as Richardson (1994) using arguments of economic policy, finds that tariffs for the rest of the world decline after the formation of the CU, due to the problem of *free-riding* in large groups, as lobbyists increase pressure will be more difficult to organize and the effectiveness of their orders would decline.

⁵ Olarreaga, M, Soloaga I., y Winters, L. A. "What's behind MERCOSUR's Common External Tariff?. November 1999.

On the other hand, Laens and Terra (2008)⁶ analyzed different options of CET for MERCOSUR, and they conclude that there are no theoretical arguments in favor of a high tariff level for capital goods or goods such as computers and telecommunications as planned in the CET negotiated in MERCOSUR, therefore the simulation performed on a different tariff structure with low levels yielded results that increase the flow of trade along a couple of productive efficiency. They also show Uruguay to be in a better position if they avoid the convergence to the tariff levels agreed in the block.

Following the analysis, the authors recognize that the effects of alternative structures of the tariff level impacts unevenly on smaller countries as in bigger countries, and a strengthening in the form of customs union deal will require more aggressive programs to offset the transfer of trade policy instruments, which in the case of Paraguay is important since according to Gomez (2008)⁷ full adoption of the CET would impact negatively on the majority of the country's productive structure.

However, the search for an alternative tariff structure should be aimed toward production efficiency in the globalized world beyond the formation of endogenous tariff that is naturally biased toward the interests of the countries referred to as "major" of the MERCOSUR (Soloaga and Larreaga - 1998) having a level 3 times higher than OECD countries, which leads to inefficiency and a distance from world markets.

In this regard, a point of departure in the quest for this alternative may be fixed on the concept of simulating the optimum tariff for small and open country, of which Paraguay and Uruguay are representative or introduce the hypothesis of a large and open country,

⁶ Laens, S y Terra M.I. "MERCOSUR: Asymmetries and Strengthening the Customs Union – Options for the Common External Tariff".

⁷ Gómez Leiva, Edgar. "Elimination of multiple charge of CET in MERCOSUR". A General Equilibrium Analysis. Ministry of Finance. Asunción, Paraguay.

which in this case would lead to Brazil and Argentina, which is logical given that MERCOSUR represents 3% of the world economy and 4% of world population⁸.

Negotiation process of the MERCOSUR Common External Tariff

The MERCOSUR countries have experienced significant liberalization effort if we consider that in 1986 the average tariff in Brazil was about 80% to 41% in Argentina, Paraguay in the 20% and 36%⁹ of Uruguay. Paraguay is the country that historically has the largest opening in the block.

According to Bouzas, da Motta and Torrent (2002-2003) the original objectives of MERCOSUR and the process evolution is based on two facts:

- 1) The existence of an initial *trade-off* between access to the Brazilian market and on the positions of alignment of Brazil in international relations matters.
- 2) The breakdown of this *trade-off* as the 1990s progressed and the inability (unwillingness) to find a new one since then.

Therefore from the reading of this postulate, the *trade - off* was the compensation that the "minor" countries (Paraguay and Uruguay) considered sufficient to support the tariff structure signed in 1994. This is logical and reasonable, taking into account that the fundamental attractiveness from the making of the block was justly the expansion of the market, with the Brazilian great appeal to the productive development of any country.

⁸ Paraguay, Ministry of Finance (2009). Seminar "Paraguay and the MERCOSUR: the challenge of the commercials and industrials asymmetries."

⁹ Mendoza, Mario. 1996. "Which MERCOSUR Anyway". Latin America Integration Bulletin, special edition, December. Pag 32-36.

However, the breaking of this agreement throughout the life of the integration process finally leads to the need for revision of the tariff protection structure that holds the block or at least would hold if perforations to the CET were eliminated and by which countries currently are not compensated.

Alternative structures of common external tariffs simulation and their macroeconomic and sectors impacts

The simulations cover the regions and sectors included in Gómez (2008)¹⁰. The present study aims to show both ends of the situation in the MERCOSUR.

The first group of simulation is based on member countries of the bloc to adopt common external tariffs fully agreed in 1994 with no perforations to the list, that means, the formation of a single territory based on the protection of the productive sector from large countries.

To reach this, the base 2001 is fixed with the tool *altertax* of GTAP, and then applies CET agreed in 1994 to this result, but corrected to 2007. In this regard, Table N° 1 shows the level of tariffs of MERCOSUR members in three moments of time weighted by trade in the four countries of MERCOSUR, which includes perforations that each country maintains to the CET.

¹⁰ Op Cit.

Table N° 1

Weighted average tariff of MERCOSUR

GTAPAgr	Descripción GTAP	Argentina			Brasil			Paraguay			Uruguay		
		2001	2006	2007	2001	2006	2007	2001	2006	2007	2001	2006	2007
1	CEREA	3	3	3	10	7	3	6	12	0	2.3	0.0	0
2	VEGFRU	16	8	8	14	13	6	11	13	3	8.5	7.1	5
3	OLEAG	6	3	0	9	5	0	3	12	0	3.9	5.2	2
4	OPAGRI	5	4	5	5	3	7	7	15	12	1.9	1.2	6
5	GANAD	4	2	3	6	5	6	7	3	6	2.5	0.1	2
6	ENERG	0	0	0	0	0	0	0	20	3	0.0	0.0	0
7	MINER	5	2	3	2	1	2	5	0	12	2.2	1.7	3
8	CARNE	9	4	11	11	6	8	15	7	10	8.9	4.9	7
9	ACEITE	12	9	11	12	9	10	10	17	16	9.2	8.4	10
10	LACT	19	13	16	16	17	15	18	7	15	8.4	8.3	11
11	ALIMEN	19	10	13	12	9	10	17	3	8	14.6	7.6	13
12	AZUCAR	22	3	16	15	16	16	16	11	17	0.6	8.8	8
13	TEXTI	23	16	16	17	13	14	17	3	19	15.2	9.6	17
14	CUERO	22	11	17	19	9	14	16	6	15	19.9	14.3	17
15	MANLIV	16	10	14	11	7	13	11	3	1	14.2	9.6	15
16	PETRO	2	0	0	1	0	0	4	3	12	4.3	1.8	1
17	QUIMI	10	6	9	7	5	8	9	12	11	6.0	3.5	9
18	METAL	8	5	9	8	5	8	11	6	17	7.6	4.4	9
19	PMETAL	15	10	16	14	10	16	14	7	19	15.4	10.8	17
20	VEHIC	11	8	13	14	9	12	14	12	9	8.4	6.2	12
21	MAQYEQUI	8	6	10	8	5	9	10	13	0	9.4	5.0	12
22	SVCES	0	0	0	0	0	0	0	0	0	0.0	0.0	0

Source: Author's calculations with National Tariff (NT) y BADAM data base.

Tariff levels agreed in 1994 in the Brazilian city of Ouro Preto weighted by trade with the regions are shown in table N° 2 for Argentina, table N° 3 for Brazil, Table N° 4 for Paraguay and Table N° 5 for Uruguay .

Table N° 2
Argentina – CET Weighted average (%)

GTAP	Descripción	UE	ASIA	RA	RM
1	CEREA	0,1	10,0	0,0	0,2
2	VEGFRU	9,3	9,6	5,3	8,7
3	OLEAG	0,0	0,0	0,0	0,0
4	OPAGRI	5,0	7,8	1,2	6,9
5	GANAD	2,4	8,2	0,9	1,2
6	ENERG	0,0	0,0	0,0	0,0
7	MINER	2,4	2,9	3,7	1,2
8	CARNE	10,0	16,0	6,4	12,0
9	ACEITE	10,4	10,5	10,8	11,1
10	LACT	16,4	16,0	14,9	15,2
11	ALIMEN	12,9	12,3	13,2	14,3
12	AZUCAR	16,0	16,0	16,0	16,0
13	TEXTI	14,5	16,9	14,9	17,5
14	CUERO	16,0	19,7	13,8	17,3
15	MANLIV	11,5	17,7	12,9	13,9
16	PETRO	0,0	0,5	0,0	0,0
17	QUIMI	8,6	9,5	9,1	7,1
18	METAL	8,5	9,5	10,5	8,4
19	PMETAL	15,9	16,7	16,3	16,1
20	VEHIC	14,0	10,6	16,6	11,0
21	MAQYEQUI	10,6	11,7	7,0	11,1
22	Svces	0,0	0,0	0,0	0,0

Source: Author's calculations with CET y BADAM trade data.

Table N° 3
Brasil - CET Weighted average (%)

GTAP	Descripción	Ue	Asia	Ra	Rm
1	CEREA	10,0	0,0	0,1	1,1
2	VEGFRU	9,8	1,2	5,4	7,0
3	OLEAG	0,0	0,0	0,0	0,0
4	OPAGRI	6,2	9,2	5,4	8,2
5	GANAD	6,8	8,1	2,3	4,8
6	ENERG	0,0	0,0	0,0	0,0
7	MINER	2,5	2,9	1,1	1,0
8	CARNE	10,2	7,9	8,2	6,3
9	ACEITE	10,1	10,0	10,4	9,3
10	LACT	15,3	14,7	15,3	14,7
11	ALIMEN	13,3	10,1	12,6	5,6
12	AZUCAR	16,0	16,0	16,0	16,0
13	TEXTI	14,6	15,6	13,3	14,5
14	CUERO	11,8	19,5	12,3	11,3
15	MANLIV	13,2	17,4	9,7	10,5
16	PETRO	0,0	0,0	0,4	0,0
17	QUIMI	7,9	9,3	8,0	5,2
18	METAL	7,5	9,9	8,4	7,8
19	PMETAL	15,7	16,0	16,2	16,3
20	VEHIC	12,7	11,6	14,6	10,2
21	MAQYEQUI	10,2	8,9	7,7	8,3
22	Svces	0,0	0,0	0,0	0,0

Source: Author's calculations with CET y BADAM trade data.

Table N° 4
Paraguay - CET Weighted average (%)

GTAP	Descripción	Ue	Asia	Ra	Rm
1	CEREA	0,0	0,0	0,0	0,0
2	VEGFRU	0,0	1,8	0,1	10,0
3	OLEAG	0,0	0,0	0,0	0,0
4	OPAGRI	13,2	13,5	7,3	13,3
5	GANAD	6,2	16,0	0,7	2,0
6	ENERGÍA	0,0	0,0	0,0	0,0
7	MINER	4,3	4,0	0,4	1,4
8	CARNE	16,0	8,2	16,0	8,0
9	ACEITE	10,0	10,1	10,1	10,1
10	LACT	16,0	16,7	14,2	16,0
11	ALIMEN	13,2	16,4	14,6	16,7
12	AZUCAR	0,0	16,0	16,0	0,0
13	TEXTI	18,3	18,1	13,8	17,8
14	CUERO	17,9	20,0	19,2	18,7
15	MANLIV	11,7	19,5	14,5	14,5
16	PETRO	1,1	1,8	0,0	0,0
17	QUIMI	10,5	13,4	12,4	13,1
18	METAL	6,9	12,5	11,4	12,4
19	PMETAL	16,6	16,8	16,6	16,8
20	VEHIC	18,6	18,4	19,3	19,6
21	MAQYEQUI	12,4	9,4	6,5	8,7
22	Svces	0,0	0,0	0,0	0,0

Source: Author's calculations with CET y BADAM trade data.

Table N° 5
Uruguay - CET Weighted average (%)

GTAP	Descripción	UE	Asia	Ra	Rm
1	CEREA	0,0	0,0	0,0	0,0
2	VEGFRU	6,8	8,9	0,0	5,6
3	OLEAG	0,0	8,0	0,0	0,0
4	OPAGRI	11,1	6,3	1,4	4,5
5	GANAD	2,3	3,7	0,6	1,8
6	ENERG	0,0	0,0	0,0	0,0
7	MINER	4,1	3,5	4,0	0,0
8	CARNE	9,3	8,0	10,0	0,0
9	ACEITE	10,0	10,0	10,0	10,0
10	LACT	16,0	0,0	15,0	14,7
11	ALIMEN	12,9	10,8	13,6	13,4
12	AZUCAR	16,0	0,0	16,0	0,0
13	TEXTI	16,2	18,1	15,1	17,7
14	CUERO	15,0	19,9	19,1	14,8
15	MANLIV	14,4	18,1	13,8	15,4
16	PETRO	0,1	3,8	0,0	1,3
17	QUIMI	8,9	11,5	10,2	7,4
18	METAL	8,3	11,3	5,7	11,6
19	PMETAL	16,1	16,8	17,0	16,8
20	VEHIC	6,6	17,2	12,9	13,0
21	MAQYEQUI	12,1	13,8	11,5	10,0
22	Svces	0,0	0,0	0,0	0,0

Source: Author's calculations with CET y BADAM trade data.

The second group of simulation, making the small and open country assumption, which takes the country's more open approach of the block, ie., Paraguay, whose tariff structure "autonomous" was established in 1992, which is shown in table N° 6. Therefore, it is simulated the scenario in which the bloc adopts this structure.

Table N° 7
Paraguay Tariff - 1992

GTAP	Dsc. GTAP	Arancel prom
1	Arroz con cáscara	10,00
2	Trigo	10,00
3	Otros cereales	3,17
4	Vegetales, frutas, frutos secos	16,40
5	Semillas oleaginosas	3,14
6	Caña de azúcar, remolacha	-
7	Plantas de fibra	3,00
8	Otros cultivos	4,08
9	Ganado vacuno, ovino y caprino, caballos	9,40
10	Otros productos animales	9,41
11	Leche	-
12	Lana	-
13	Silvicultura	4,86
14	Pesca	10,00
15	Carbón	10,00
16	Producción petrolera	3,00
17	Producción de gas natural	3,00
18	Otros minerales	4,99
19	Productos de la carne bovina	10,00
20	Otros productos cárnicos	10,00
21	Grasa y aceites vegetales	10,00
22	Productos lácteos	9,86
23	Arroz procesado	10,00
24	Azúcar	9,53
25	Otros productos alimenticios	9,66
26	Bebidas y tabacos	9,64
27	Textiles	9,70
28	Ropa-Indumentarias de uso	10,00
29	Productos del cuero	13,48
30	Productos de la madera	16,64
31	Productos de papel, publicaciones	6,10
32	Productos del petróleo y del carbón	3,00
33	Productos químicos, caucho, plásticos	5,87
34	Otros productos obtenidos de los minerales	8,97
35	Metales ferrosos	4,25
36	Otros metales	3,15
37	Productos metálicos	9,58
38	Vehículos motorizados y partes	11,10
39	Otros equipos de transporte	10,25
40	Equipos electrónicos	9,80
41	Otras maquinarias y equipos	7,41
42	Otras manufacturas	11,01

Source: Author's calculations with BCP data base.

Community policy to reduce impacts on vulnerable sectors (not yet completed)

Conclusions (not yet completed).