



# Canning House



## Canning Paper What future for Mercosur?

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## Today's Topics

What future for Mercosur?

Page 3

What has Mercosur achieved so far?

Page 4

Argentina: Protecting national industry remains a priority

Page 6

Brazil: Change of approach on the horizon with return of Lula

Page 7

Paraguay: Keen for trade liberalisation but remaining pragmatic

Page 8

Uruguay: Longstanding frustrations boiling over

Page 8

Summarising the Mercosur agenda

Page 9

What next for Mercosur?

Page 11

Conclusion

Page 12

## Executive summary

- Mercosur was created in 1991 to “provide a space that can generate commercial opportunities”. So far it has fallen well short of its potential although it has deepened regional integration for 300m people and increased trade to some degree. The bloc’s ‘golden age’ was in the 1990s, but it failed to reach its target of creating a customs union by 2000, with the process of integration slowed by Brazil’s 1999 devaluation and then hit again by Argentina’s economic crisis in 2001.
- Now Mercosur member states face new headwinds, which might limit the appetite for the compromises that are necessary for further progress on integration, with the continuing effects of the Covid-19 pandemic and the fallout from Russia’s invasion of Ukraine. Mercosur has also been slow to open to international markets. There is no FTA with the United States, and the agreement with the European Union, reached in 2019 after 20 years of negotiation, is yet to be ratified.
- The strongly divergent approaches of various members have not helped. On the one hand there is Argentina under President Alberto Fernández determined to defend national industry from competition, including from within Mercosur. Argentina, under the current administration, has no intention of ratifying the EU trade deal.
- Meanwhile, Uruguay has become so frustrated with the lack of progress that it has sought to reach unilateral trade deals with external partners, including with China. President Luis Lacalle Pou has described Mercosur as a “corset in which our country cannot move”.
- For Mercosur to progress there are many issues that need to be resolved, including reducing the level of Mercosur’s common external tariff (CET) and the high number of exceptions to the CET; the potential readmittance of Venezuela to the bloc and the accession of Bolivia; and negotiating new trade deals with external partners at a time when protectionist instincts are running strongly.
- However, the coming to power of President Lula da Silva in Brazil could have a positive effect, not least because Lula’s more environmentally friendly policies are likely to find favour with the EU and could help improve the dynamics between the two blocs. President da Silva may also help to find a compromise position with Uruguay over flexibility for members in bilateral relations, and he may edge the bloc towards negotiations with China.
- It is hard to deny that the bloc has failed to fulfil its potential, and that it faces many entrenched internal and external challenges. However, there is at least a possibility that 2023 could provide evidence of a desire to progress. Much will depend on the ambitions and influence of the new administration in Brasilia.

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## What future for Mercosur?

The Southern Common Market, or Mercosur, is a South American trade bloc and customs union comprising Argentina, Brazil, Paraguay, and Uruguay whose “primary objective is to provide a space that can generate commercial opportunities and investments through competitive integration of national economies in international markets”.

Conceived in 1991, the bloc has implemented freedom of movement for all citizens, as well as a common design for vehicle number plates and passports, but its customs union remains flawed and attempts to further deepen integration have been stymied by internal divisions.

Detractors have accused the bloc of being

a cumbersome juggernaut, unable to reach consensus on a plethora of issues, owing to the diverging interests of political leaders from member states over the past three decades. Proponents say that Mercosur has deepened regional integration and increased trade, and they argue that the bloc still has plenty more to offer. What is clear is that the bloc has fallen short of its potential, and tensions have increased in recent years as member states have failed to reach a consensus on how they should deal with a rapidly changing world.

Here we assess Mercosur’s progress to date; policies towards the bloc in individual member states; recent diplomatic developments; and what may come next.

## What has Mercosur achieved so far?

Mercosur brings together around 300m people across a territory of almost 15m square kilometres, boasting incredible biodiversity, fertile farmlands, and extensive energy resources. The bloc was conceived in 1991, a time of increasing multilateralism, and was made possible by rapprochement between long-time rivals Brazil and Argentina. Its founding document, the Treaty of Asunción, calls for the “free movement of goods, services, and factors of production between countries,” and in 1994 the Mercosur nations agreed to a customs union with a common external tariff (CET).

The early years of Mercosur were a great success,

**Figure 1: Mercosur members (dark orange) and associate members (light orange)**



and the 1990s are known as the bloc’s “golden age” as both international trade and trade between member states grew rapidly. Tariff protection plummeted and non-tariff barriers were also reduced, and at the same time cooperation increased and border tensions and arms competition decreased.

However Mercosur then missed its deadline to fully implement a customs union in the year 2000, and it remains incomplete to this day due to the persistence of “Lists of Exceptions,” which allow member states to apply different import tax rates. In addition, Brazil’s currency devaluation in 1999 and Argentina’s massive 2001 economic crisis shook the bloc’s foundations and slowed the process of integration.

Despite these difficulties, efforts to expand the bloc followed. For example, Venezuela became a full member of Mercosur in 2012, but political tensions made for rocky relations and the country was suspended from the bloc in 2017. Bolivia started the accession process in 2012, but it remains an associate member pending approval of its full membership application by Brazilian lawmakers. Other associate states, which enjoy some trade benefits but are not members of the customs union, include Chile, Colombia, Ecuador, Guyana, Peru, and Suriname.

As for trade deals, Mercosur has been slow to open to international markets. There is no agreement with the US, after Mercosur rejected the idea of a 34-nation Free-Trade Area of the Americas (FTAA) proposed by Washington in 1998. And Mercosur took 20 years to negotiate a trade deal with the EU, which was finally reached in 2019 but is yet to be ratified. That same year a deal with the European Free Trade Association (EFTA), which comprises Iceland, Liechtenstein, Norway, and Switzerland, was agreed, but it too remains unratified. And in July 2022 Uruguay’s announcement that it would pursue a separate free trade deal with China sparked yet more tensions within Mercosur.

Member states are continually negotiating the CET, which averages 10%–12%, as well as changes to rules governing exceptions and other trade barriers, and supranational institutions have been developed to facilitate this. However these institutions remain weak compared to their counterparts in the EU, for example, lacking the autonomy to uphold the rules of the bloc. Presidential power predominates in Mercosur negotiations, leaving the interests of the bloc vulnerable to being overpowered by domestic

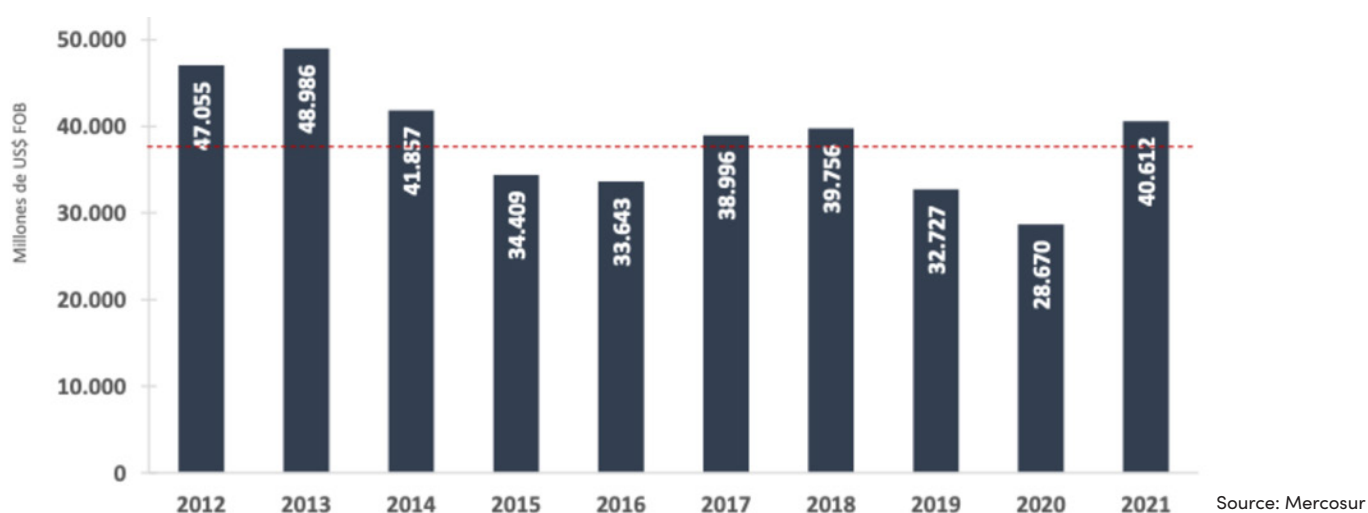
priorities. This has become increasingly important as member states have had to deal with political and economic turmoil in recent years, linked to falling commodity prices, corruption scandals, the Covid-19 pandemic, and the fallout from Russia's invasion of Ukraine.

At the same time, Mercosur has failed to maintain its early record of increasing trade between member states, which peaked in 2013 at US\$48.9bn. As shown in Figure 2, in recent years intra-bloc trade has decreased from US\$39.8bn in 2018 to US\$32.7bn in 2019 and US\$28.7bn in 2020, before rebounding to US\$40.6bn in 2021, the latest figures available. Economic interdependence between member states has been weakening as external economies

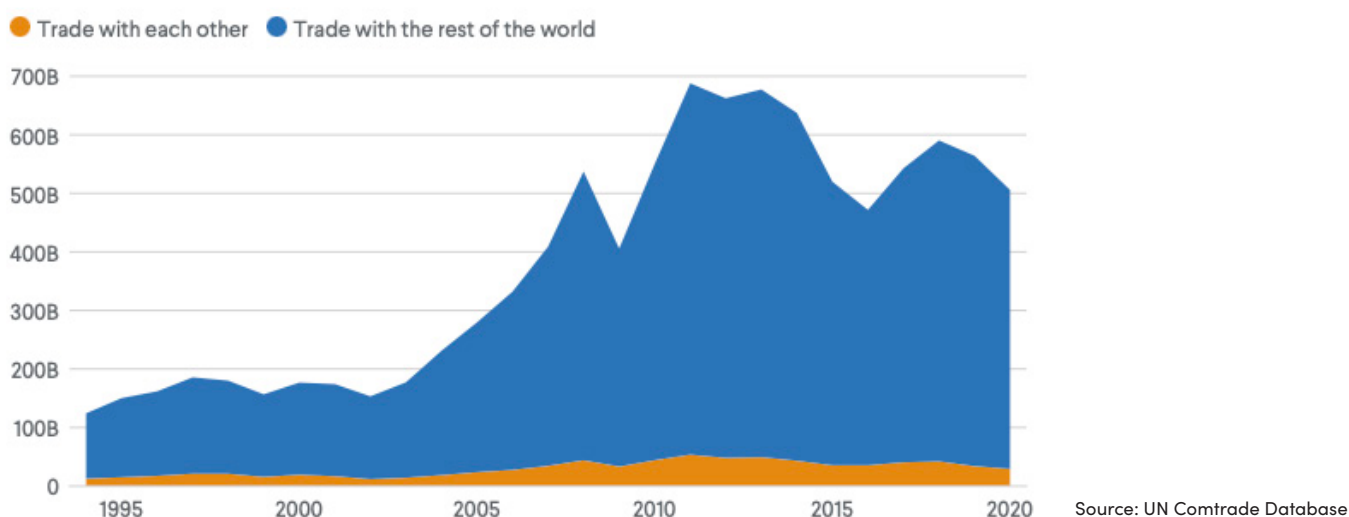
such as China have increased their share of trade compared to intrazonal trade (as shown in Figure 3), which has made raw materials more important in Mercosur's trade balance and exposed the bloc's low involvement in global value chains.

Mercosur is still one of the largest economic blocs in the world, but it remains a flawed customs union rather than a common market. Macroeconomic developments have encouraged member states to return to protectionist measures and thrown down further obstacles to integration. The question is whether Mercosur can overcome these longstanding difficulties to fulfil its potential, or if fundamental differences between member states mean the bloc is doomed.

**Figure 2: Mercosur intrazonal trade 2012-2021**



**Figure 3: Mercosur trade in goods in current US\$**





## Argentina: Protecting national industry remains a priority

After a push towards greater trade liberalisation under former President Mauricio Macri (2015–2019), Argentina has pushed back against attempts to open Mercosur to international trade during the government of President Alberto Fernández (2019–present). Fernández has rejected proposals to lower the CET, instead prioritising the defence of national industry from competition in the face of a global economic crisis.

In fact, the Fernández government has erected additional non-tariff barriers such as the new import system, according to Marcelo Elizondo, president of the International Business Chamber. “You want to import from a Mercosur country and it gets more difficult each time because Argentina imposes restrictions on doing it from any country, without giving any preferential treatment to this market,” he said. And as Figure 4 shows, Mercosur’s share of Argentina’s exports has fallen in the last decade.

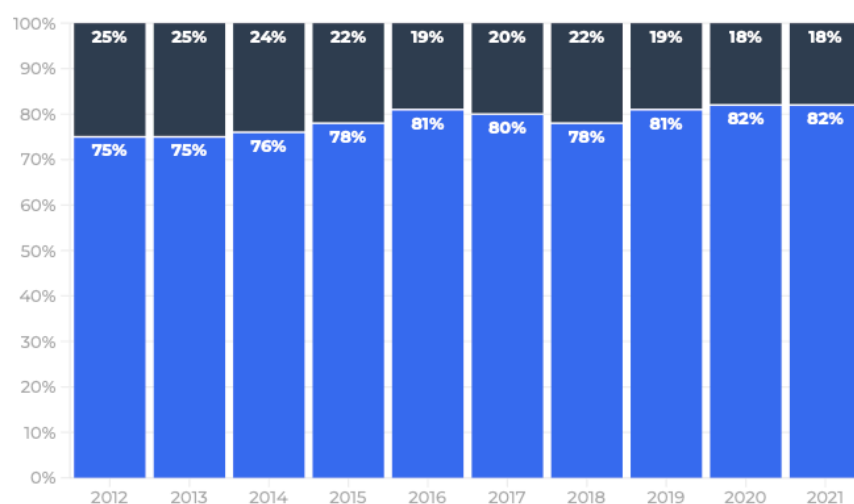
As for the EU trade deal, the Fernández government has no intention of ratifying it, according to economist Romina Gayá, as while the agreement would benefit Argentina’s agricultural sector, it would have negative effects on industry by making manufactured goods from the EU less expensive.

Argentina has consistently spoken out against attempts to make bilateral deals more flexible. In December 2022 Foreign Minister Santiago Cafiero warned that a “unilateral path being taken could result in a rupture” in the bloc following discussions

around Uruguay’s desire to chart its own course. However Fernández has recognised that Mercosur needs to work on its “asymmetries” and expressed an interest in pursuing a Mercosur-China FTA. That said, the prospects of such a deal seem slim given Argentina’s longstanding protectionist policies and fears that a deal could allow cheap Chinese imports to flood the market. Fernández has also said that “globalisation isn’t working like it did before,” and posited that the world is moving away from free trade. In addition, political will to work on a deal is likely to remain low in the short term as Argentina prepares for a general election in October 2023, and the country continues to face a rolling economic crisis.

In the diplomatic area, relations have been strained with Uruguay and Brazil, which were both ruled by ideological opponents of the centre-left Fernández government until the inauguration of leftist President Lula da Silva in Brazil at the beginning of the year. This should see better alignment with Brazil, but, while Fernández could run for reelection, this may only last until a change in the Argentinian government at the end of 2023.

**Figure 4: Mercosur share of Argentina’s exports 2012–2021**



**Note:** Dark blue donates Mercosur’s share of exports

Source: Mercosur

## Brazil: Change of approach on the horizon with return of Lula

As shown in Figure 5, Brazil-Mercosur trade increased steadily for a decade and a half but then started to fall, kickstarting a desire to reform and modernise the bloc. Under former President Jair Bolsonaro (2019-2023), Brazil demonstrated an appetite to shake up Mercosur. It proposed a 20% reduction in the CET, which was rejected, but then imposed a temporary unilateral reduction in most-favoured nation tariffs, going against the rules of the bloc. Bolsonaro also floated the idea of a monetary union with Argentina, although the country's central bank denied there was any plan to implement one, and his government announced that it was open to a "flexibilisation" of rules limiting the negotiation of FTAs by member states. Plus in April 2022, then foreign minister Carlos França said that Brazil was open to restarting discussions on a Mercosur-Turkey FTA.

However, under President da Silva things look slightly different. His government programme calls for a rejuvenation of 'South-South' cooperation and mentions strengthening regional institutions like Mercosur, the Brazil-founded Union of South American Nations (Unasul), and the Community of Latin American and Caribbean States (Celac).

In December, da Silva said that he would try to advance FTAs such as the deal with the EU, but he has also said that he would "adjust" its terms to benefit Brazilian industry. "What we want in our discussion with Europe is to not give up on our desire to reindustrialise," said da Silva in August 2022. Some in Europe have opposed the existing



deal due to concerns that products from Brazil may contribute to environmental degradation, but da Silva's pledge to implement more environmentally friendly policies than his predecessor could help reach an agreement. And on 2 January, Marina Silva, the newly appointed environment minister, said that her most pressing task is to resolve outstanding issues so that the EU approves the deal.

In terms of diplomatic relations, da Silva's presidency means that Uruguay's centre-right President Lacalle Pou has lost an ally in Bolsonaro, and Argentinian President Fernández gains a more natural bedfellow. In January, Daniel Scioli, Argentina's ambassador to Brazil, said that da Silva's election means that the two countries will be able to boost trade and integrate faster, as well as refloating the idea of a common currency for bilateral trade. However the situation could change again depending on the results of October's elections in Argentina.

**Figure 5: Brazil-Mercosur trade 1997-2021**



Source: SECEX/Ministry of Economy of Brazil

## Paraguay: Keen for trade liberalisation but remaining pragmatic

Paraguay was temporarily suspended from Mercosur in 2012 after being accused of breaking a protocol designed to protect democracy when then-President Fernando Lugo was impeached by the senate. The country was reinstated in 2013, and its economy is highly dependent on trade with Mercosur countries to this day.

Lugo's presidency was a brief interlude in decades of rule by the right-wing ANR-Colorado party, which has maintained a positive disposition towards greater openness to international markets. This has continued under President Mario Abdo Benítez (2018-present), and in December 2022, Foreign Minister Julio César Arriola said that the country's position would not change. "The Mercosur integration process is the most important one in the region, and we will continue to back this belief in the bloc," he said.

Abdo has criticised Uruguay's campaign to allow more flexible bilateral negotiations with third countries such as China, saying that such a move "denatures the essence" of the bloc. Minister Arriola has also underlined Paraguay's commitment to the idea that decisions should be taken by consensus. Abdo has proven clear eyed in assessing the potential impact of an FTA with China, positing that Beijing's "very competitive costs could pose a threat to industries not just in Paraguay but also Argentina and Brazil". At the same time, it is difficult to see Paraguay supporting an FTA with China as it is the only Mercosur country to maintain relations with Taiwan.

Paraguay is preparing for general elections at the end of April, but it appears unlikely that its policies will change a great deal. The frontrunner, economist Santiago Peña, is also part of the Colorado party, and has spoken of his desire to strengthen Mercosur. Paraguay has benefited hugely from Mercosur as the country was isolated from the rest of the world until 1989, according to Peña, who wants to see more integration. However he is also realistic about the potential speed of reform, recognising that changes will not happen overnight and that the future of the bloc depends largely on the political leadership of Argentina and Brazil. Peña has also said that he doesn't think that Paraguay's relations with Taiwan

have affected its ability to do business with China.

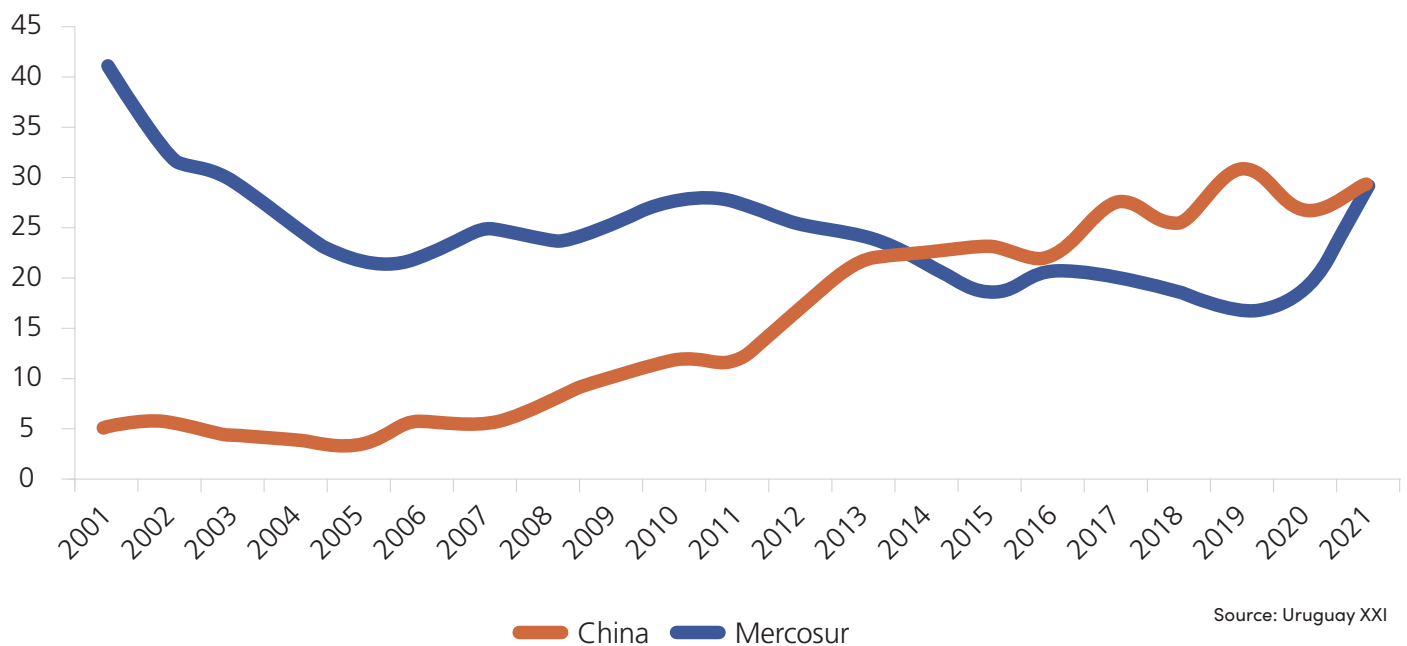
## Uruguay: Longstanding frustrations boiling over

Uruguay has been the main proponent of opening to international markets in recent years, and there is a wide-ranging consensus across the country's political parties that it should be able to conduct more flexible bilateral relations. The government of President Luis Lacalle Pou (2020-present), known as the Coalición Multicolor, includes anti-globalist elements that want to move away from regionalism and have encouraged "Mercoscepticism". Foreign Minister Francisco Bustillo has even said that Mercosur is "doomed to failure" due to "deficiencies" in the integration process.

Lacalle Pou has been vocal in his criticism of the bloc, likening it in March 2021 to a "corset in which our country cannot move". He has since doubled down, calling the bloc a "liability". According to Elizondo, the problem is that Mercosur is restricting Uruguay's development plan. "Uruguay, with a strong agroindustrial sector, is looking for markets where its products can enter with no tariffs and be competitive," he said. "Mercosur makes this impossible."



**Figure 6: Uruguay exports to China and Mercosur (2001-2021) in US\$m**



Lacalle Pou has criticised the bloc’s sluggishness in securing trade deals such as the EU FTA, declaring that it was neither serious nor credible to wait such a long time to sign an agreement, which is why Uruguay was moving to seek other possibilities. In November, Lacalle Pou visited Japan and secured an agreement to resume exports of beef tongue. He is also seeking membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) trade deal, and, most importantly, an FTA with China.

On 14 July, Lacalle Pou announced that a feasibility study on a Uruguay-China FTA had been successfully completed and that formal negotiations were poised to begin. Officials are uncertain about the time frame for negotiations but suggest a deal will be completed during Lacalle Pou’s term as president, which runs to March 2025. Some say it could happen earlier.

The president is ineligible for reelection, and the latest polls show his coalition neck and neck with the leftist Frente Amplio. However it seems unlikely that the next government will retreat from a policy of trade liberalisation, as presidents from different parties have floated the idea of bilateral agreements since the turn of the century.

## Summarising the Mercosur agenda

The issue of opening to new markets appears to be the most important for Mercosur to address. Uruguay’s exploration of bilateral deals violates the rules of the bloc, and threatens its future viability. Each of the other members have spoken out against Uruguay’s unilateral approach, but Lacalle Pou’s insistence on forging ahead means the bloc is having to grasp the nettle.

Indeed, Beijing has stepped up efforts on its side, releasing an official document in January stating its readiness to negotiate an FTA with Mercosur as a whole or any single member of the bloc. At the end of November, Chinese Ambassador to the World Trade Organisation Li Chenggang encouraged Brazil to step up to the plate. “China believes it is essential to improve Brazil’s regional integration and export diversification,” said Li. “In this regard, China encourages Brazil to play an active role in expanding Mercosur’s network of regional trade agreements with key trading partners.”

Another massive issue is the trade deal with the EU, which has proven to be a major source of frustration for Uruguay, although there has been some progress in addressing some sticking points. The deal required Mercosur to work on a set of rules of origin that can determine in which country a product was sourced or made, and that text is now



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complete. And interestingly Mercosur demonstrated a change in approach in 2019 with the decision to allow the EU deal to come into force in individual member states, rather than the bloc as a whole. While the bloc's FTA with Israel set a precedent in this regard, that deal pales into insignificance compared to the size of the EU agreement.

At the same time it is worth pointing out that there is some opposition to the deal in Europe, particularly among environmental NGOs, who are concerned about poor environmental standards, and agricultural lobbies worried about an influx of cheap foodstuffs from Mercosur. That said, EU officials have signalled that they want the deal to be ratified as soon as possible.

Elsewhere, Mercosur has reached an agreement with Singapore on an FTA. Discussions have also been held with Korea and Lebanon; exploratory dialogues have taken place with Indonesia and Vietnam; and contact has been made with the Eurasian Economic Union, Tunisia, Morocco, Nigeria, and the African Union. Closer to home, Mercosur has also implemented a new ecommerce agreement to strengthen and facilitate trade in goods and services.

Other discussions include the perennially fraught issue of the CET. In 2021 a proposal was made to implement a 10% reduction in the CET on all non-sensitive goods, but Uruguay blocked the move after insisting that any reduction could only be implemented on the condition of increased flexibility in bilateral negotiations with external countries. Instead Brazil implemented a unilateral temporary

reduction, demonstrating once again the weakness of Mercosur integration. In addition, the bloc moved to extend exceptions to the CET which were due to expire between December 2021 and December 2023, putting off any progress towards a more complete customs union. On a more positive note, discussions were held about the possible inclusion of the sensitive automotive and sugar industries in the customs union, with the Mercosur sugar group meeting for the first time in almost 20 years.

The question of Bolivian accession has also surfaced. In July 2019, Paraguay's President Abdo Benítez made a renewed call for its neighbour to become a full member of the bloc, but its application remains blocked by Brazilian lawmakers. And in July 2022, Bolivia's Foreign Minister Rogelio Mayta underlined his view that "the best tool to deal with global problems is the integration of our region". It appears that Brazil's President da Silva agrees, promising Bolivia's President Luis Arce in September 2022 that he would help to expedite full membership for the country were he to be elected.

There has also been some movement towards readmitting Venezuela to the bloc after it was suspended in 2016. A Venezuelan delegation travelled to Asunción in July 2022 to discuss rejoining Parlasur, the Mercosur parliament, and in that same month Argentina appointed Oscar Laborde as the country's ambassador to Venezuela, the first ambassador to the country since 2015. In addition, President da Silva has said that he will push to readmit Venezuela, and appoint an ambassador to Caracas.



## What next for Mercosur?

As outlined above the Mercosur countries have plenty of issues to resolve moving forward. While Uruguay will likely keep pushing to liberalise Mercosur, and Argentina is predicted to keep pulling in the opposite direction, da Silva's taking over as president of Brazil, Mercosur's largest economy and most influential member, could have a huge influence on the direction of the bloc.

First of all, da Silva is scheduled to travel to China early this year, and Beijing may ramp up pressure to agree to an FTA, either as a bloc or individually. As things stand a joint FTA with China appears unlikely given the internal divisions of the bloc, but pressure from both Beijing and Brasilia could be brought to bear on other members. A potential deal could exclude some vulnerable sectors of industry, and include a phasing-in process that provides for the gradual reduction of bilateral tariffs, as the EU deal does. This would allow Mercosur time to adapt and become more competitive. According to Uruguay's former president José Mujica (2010-2015), da Silva is likely to try and find a compromise position with Montevideo over more flexibility in bilateral negotiations.

As for the EU deal, it appears that there will be a renewed push to finalise the deal in Brussels as well as Brasilia. European officials don't want to lose influence in South America, particularly as China continues to grow in prominence in the region, but while da Silva has said that his government will promote the deal, he has also said that it should be renegotiated to the benefit of Brazilian industry. This will not be an easy process, and da Silva himself has said there is "no need to rush" to implement the agreement.

Debates around the CET will also continue. While member states agree that the CET is high compared to tariffs in most countries or trade blocs, there is as yet no agreement on the speed, coverage, and percentage of any reduction.

Da Silva has also promised to expedite Bolivia's accession to the bloc as a full member, but opposition lawmakers control both upper and lower houses of congress, which will make it harder for the president to enact his agenda. As for Venezuela, it appears that relations will continue to normalise throughout the year, with da Silva driving South-South cooperation as promised in his government programme.



## Conclusion

Mercosur is at a crossroads. In the last couple of decades, following a strong start to life, it appears to have lost its way. While the bloc has played a role in maintaining peace and democracy in the region, it has failed to become a true common market in the mould of the EU. There are too many exceptions to the CET, which also remains too high, and major policy differences at a national level mean that the bloc appears weaker now than at the turn of the century. Mercosur also lacks strong supranational institutions, which have proven ineffective in enforcing the rules of the bloc. This means that governments can prioritise domestic concerns over the health of the bloc.

Opening to new markets has proven difficult and Uruguay has become increasingly frustrated with a lack of dynamism, with Lacalle Pou proving more insistent than his predecessors in forcing the issue. At the heart of the problem is a tension between competing development models, and an increasingly complicated geopolitical situation means that certain decisions are becoming more pressing. Mercosur economies have been battered in recent years by rolling crises, so the temptation to try something new is understandable to a certain extent, but the accession of President da Silva in Brazil could breathe new life into Mercosur.

The bloc can demonstrate its commitment to opening up to trade by improving environmental standards to encourage further progress with the EU, and then overhaul production processes in order to become more competitive compared to European and Chinese firms. Or it can continue on its current protectionist path, which risks pushing Uruguay to go it alone and throwing Mercosur into crisis. Turning a juggernaut takes time, but 2023 should provide some indication of the direction of travel.

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