

*The Development of Mercosur and Potentialities
of the Energy Sector*

INTRODUCTION

The 1980s were the beginning of several changes in many Latin American countries. At the beginning of that decade, almost all Southern Cone countries – except for Chile – faced a process of re-democratization that put to an end a period of *coups d'état* and military governments with different consequences in each case.

Economically speaking, this period is known as *the lost decade*, due to the effects of the debt crisis in the economy of these countries. Most Latin American economies suffered for important processes of hyperinflation, unemployment, low levels of growth, etc., which were confronted more or less successfully in each country.

The 1990s were the era of *dense* globalization. Generally speaking, and mostly in economic terms, globalization has been identified as the process in which countries become more interdependent and a tendency to convergence among industrialized and developing countries is generated. It is also generally associated with the reinforcement of the multilateral trading system and the emergence of the World Trade Organization.

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All these factors, among others, had certain impacts on South American countries. The global environment of the 1990s also arrived in the region. In this decade – although in different degrees – South American countries faced a process of structural reform in their economies, under the umbrella of the well-known *Washington Consensus*. Mercosur's creation should be located in a context where market openness, free trade and free capital flow movements were seen as the most precious objectives to follow. As discussed later on, this process has been part of the set of policies and initiatives that Southern Cone countries have carried out during this period in order to reintegrate their economies in the world market.

After fifteen years from its institution, the process is a long way far from its final objective: Mercosur is an incomplete free trade zone and an imperfect custom union, with an institutional structure governed by the intergovernmental principle. Moreover, since the end of the 1990s, given a series of events occurred inside and outside the block, it seems that the process would have entered into some sort of marsh, which hinders its path.

At the same time, many voices in the sub-region have been claiming that the energy sector is one of the issues where Mercosur member states may find the impetus needed to give the regional integration new momentum. The legacy of cooperation in this field and its economic and developmental relevance make of energy an ideal issue-area from where some kind of *spillover* could start that may lead to further integration.

The aim of this paper is not certainly to give solutions for the topics mentioned, but trying to start giving some answers to certain matters, such as:

which were the reasons for Mercosur's emergence? What the impact on the national economies? Which is the role that has been played - or that may it play in the future - by its institutional structure? Which are Mercosur's realistic potentialities? Finally, given the particular relevance presented by the energy sector in the world economy - as well as in the sub-region - how may the energetic issue affect Mercosur's development?

The first section of the paper will show the economic performance of Mercosur member states during its come to existence, highlighting the Argentinean and Brazilian cases, and the peculiarities of Mercosur as a process of open regionalism. As a following step, the focus will be oriented particularly in one of the most debated topics of this study case, that meaning of the institutional architecture of Mercosur - taking into consideration, as well, some theoretical contributions that may be of help in order to comprehend the peculiarities of the process.

In a third step, given its global relevance - and mainly for the countries under study - the energy sector will be analyzed in terms of its importance for Mercosur member states and the potentialities that may have emerged from a serious - although now it seems rather hypothetical - deepening in energetic cooperation among Mercosur countries. To conclude, some clarifications will be given about the analysis exposed all along the paper.

**MERCOSUR: CAUSE OR EFFECT OF THE ECONOMIC PERFORMANCE
IN THE SOUTHERN CONE?**

There is nothing new in saying that the 1980s were a tough decade for Latin

American countries – also known as the *lost decade*. The end of that decade saw Argentina immersed in a hyper-inflationary crisis of serious economic consequences, while for the Brazilian economy it meant low growth rates, macroeconomic difficulties – mainly, inflation – and per capita GDP stagnation.

The era of the import substitution model – where not only national governments played a decisive role in the political realm, but also they were strategic actors in the economic decisions and the development of their national economies – came to an end. The 1990s brought about an environment of market openness, which reinforced the role played by private actors – meaning generally the nation-state weakness.

In this fashion, under Menem’s administration, Argentine readdressed its economic direction implementing a deep market-oriented structural reform program that would change drastically its domestic economy. This was accompanied by the implementation of a fixed exchange rate under the name of Convertibility Plan, which established a fixed parity between the Argentinean peso and the United States dollar¹. These reforms have received a decisive influence from what was generally known as the *Washington Consensus*, being free trade, liberal policies and free movements of capital – which made a proper environment to facilitate capital inflows and outflows – some of its main pillars.

In Brazil, the beginning of that decade was less benign: its economic

¹ With the implementation of this plan, 10.000 Australes –the previous Argentinean currency – accounted for 1 peso, which was equivalent to US\$ 1.

situation continued to show problems of high inflation and low internal investment rates. However, “the Brazilian economy in the '90s went through a period of structural and regulatory transformations, associated to the revision of the development strategy and the gradual implementation – although not always in a harmonious and non conflictive way – of new public policies paradigm in the trade and investment areas” (Da Motta Veiga, 2002).

In this environment, and considering the previous experiences and attempts of economic cooperation both in Latin America in general and among Argentina and Brazil in particular, Argentina, Brazil, Paraguay and Uruguay signed the Asunción Treaty, which established Mercosur in 1991. The objective of enlarging national markets dimensions through integration would be reached through the establishment of: free movement of goods, services and productive factors; a Common External Tariff (CET); a common trade policy; the coordination of macroeconomic and sectoral policies; and the harmonization of legislation in pertinent areas.

Mercosur emerges in what is called the *open* or *new regionalism* wave (Ethier, 1998). This topic of open regionalism has attracted the attention of many scholars in the economic as well as the political fields. Among its political features, this new kind of regionalism is characterized by a minimal, flexible and intergovernmental institutionalization. Open regionalism strengthen regional cooperation, is seen as a geopolitical tool and has also facilitated North-South integration.

In its economic dimension, open regionalism can be identified both as a strategy to secure what has been done in the structural reforms’ process and as

a strategy to deepen trade liberalization and trade creation². Contrary to what was a central characteristic of old regionalism, FDI is conceived as a vital objective for development and economic growth in open regional processes.

The broader trade policy environment that prevailed in the sub-region along with the integration mechanism adopted by member states and some exogenous factors – like international economic trend – let us understand how a “sharp increase in economic interdependence, rapid elimination of tariffs and fixing of a CET during the transition period took place against a background of macroeconomic instability and divergent macroeconomic performances” (Bouzas, 1999).

There is a large consensus highlighting the impressive economic performance of the Mercosur member states in the period between the beginning of the process and the end of the 1990s, coinciding with the Brazilian crisis and the Argentinean recession – which would then turn in a sharp crisis. The economic development dynamics of the economies that take part of the regional integration process have suffered some adjustments since then.

We can take into consideration two indicators, such as trade development – particularly intra-regional trade and the Argentinean/Brazilian trade partnership – and FDI flows to Mercosur, in order to demonstrate what has been sustained.

² To better understand the relation between regional integration process and multilateralism see Bhagwati 1993.

Trade Development

Trade is often taken as one of the main indicators of regional economic integration success. Although it is difficult to differentiate Mercosur's direct impact on trade from unilateral policies to liberalize trade, what is certain is that Southern Cone countries are more integrated into the international market. As we can see in the Table 1, total trade has grown impressively since the beginning of the 1990s, even though it decreased in the periods of recession or crisis. Total trade as a share of GDP proved especially important, particularly for the smaller economies of the Southern Cone.

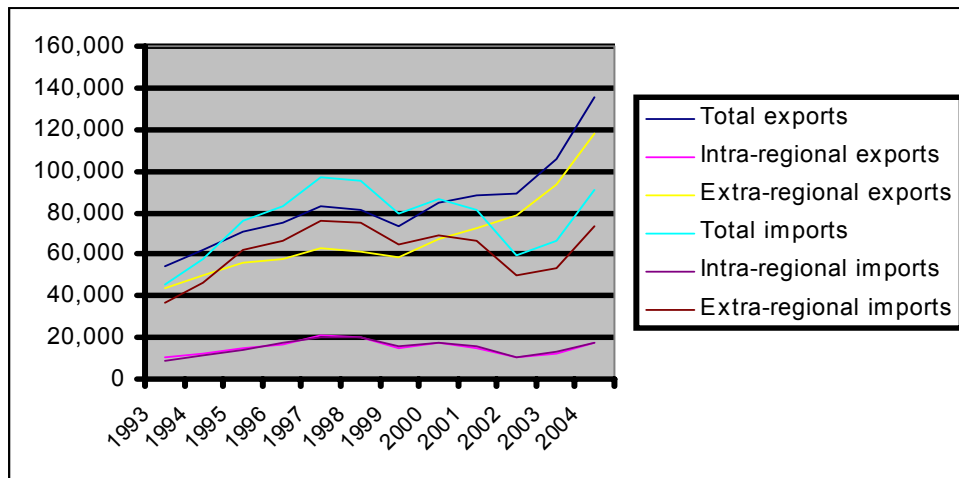
Intra-regional trade - conventionally taken as a key indicator to measure the level of interdependence among two or more economies - continuously grew from the beginning of the 1990s until 1997 (see Figure 1). In the first five years of existence, Mercosur's intra-regional exports grew at an annual rate of 29.6%, while total exports grew by 11.3%. In this way, intra-regional exports doubled their share in total exports: from 11.1% to a

	1990	1995	1999	2004
Exports of goods (fob) - Millions of US\$				
Argentina	12,353	20,963	22,626	34,550
Brazil	31,414	46,506	48,011	96,474
Paraguay	959	919	741	1,626
Uruguay	1,693	2,106	2,237	2,918
Imports of goods (cif) - Millions of US\$				
Argentina	4,077	20,122	25,535	22,447
Brazil	20,661	49,972	49,282	62,766
Paraguay	1,193	2,782	1,711	2,652
Uruguay	1,343	2,875	3,357	3,114
Trade Balance - Millions of US\$				
Argentina	8,276	841	-2,909	12,103
Brazil	10,753	-3,466	-1,271	33,708
Paraguay	-235	-1,863	-971	-1,026
Uruguay	350	-769	-1,120	-195
Exports as a percentage of GDP				
Argentina	8.7	8.1	8.0	22.8
Brazil	6.8	4.5	8.9	9.1
Paraguay	18.1	10.2	8.6	23.2
Uruguay	18.2	10.9	10.7	24.6
Imports as a percentage of GDP				
Argentina	2.9	7.8	9.0	14.8
Brazil	4.4	7.1	9.4	10.4
Paraguay	22.6	31.0	19.9	37.9
Uruguay	14.4	14.9	16.1	26.3

Source: Author's elaboration based on CEI data

Table 1. Mercosur's Trade, 1990-2004

20.4%. The biggest growth rates were those of Argentina (36%) and Brazil (27.8%).



Source: Author's elaboration based on CEI data

Figure 1. Intra and extra regional trade, 1993-2004 (millions of US\$)

An increased interdependence makes of integration an important objective, in order to maximize benefits from intra-regional liberalization while distributing its costs in a balanced way among member states. Even though Mercosur consolidation is sustained by the growing interdependence of its economies as years passed by, such interdependence is still asymmetrical: Argentina and Brazil count for the major bulk of intra-regional trade.

Brazil became the main destination for Argentinean exports, and Argentina turned into the second market of importance for Brazilian exports.

Bilateral trade between them acquired great dynamism: in six years it increased by 34%. As far as trade structure is concerned, it: “continued subject to specialization patterns already in effect at the beginning of the '90s originated by natural competitive advantages endowment or constituted in the period of import substitution” (INTAL, 1997).

From the very beginning of the process until 1997, regional GDP have had positive signs. The group of states that takes part of Mercosur experienced a synchrony in their economic cycles, meaning a reduction of divergences in their economic performance. Mercosur economies witnessed the end of a period in 1997: although intra-regional trade continued to increase, there was a convergence in the grow path of intra an extra-regional trade flows. Moreover, the next year Mercosur's foreign trade experienced a sudden stop that affected both intra and extra-regional trade, and by the first time in its history extra-regional exports grew slightly faster than intra-regional ones. Mercosur countries experienced negative growth rates in their exports, while the trade balance remained in deficit. In fashion with this picture, Argentinean growth rates – which had been rising since the Mexican crisis – suffered a slow down. The Asian crisis was responsible for the decrease of extra-regional trade, as well as the halt of the Brazilian economy³ – that, together with the decrease in commodities’ prices, affected intra-regional trade. This first setback was also affected by the 30% loss of the Brazilian currency that affected decisively intra

³ In January 1999 Brazil decided to devaluate its currency, putting to an end the Plan Real. By the first months of 1999 Brazil accumulated a nominal devaluation of 50% – related to the US\$. From the import side, this devaluation was significant for Brazil and rather negative for its commercial partners of the region – relative price changes affected imports trade.

regional trade flows.

While recession was aggravated in Argentina and Uruguay and the Brazilian economic situation developed in a positive path after its crisis, intra and extra regional trade suffered a drop for the first time since 1991 – a trend that would have continued for some years. Total exports in Argentina and Brazil were contracted, and the importance of Mercosur as a regional market decreased. Regional interdependences *functioned* just in a negative way: the Brazilian economic recovery brought in few benefits to its regional partners, while its currency crisis as well as the Argentinean one spread their negative effects.

As we can see in Table 2, the year following the Brazilian crisis showed negative GDP growth rates for all Mercosur economies, except from Brazil. One of the main concerns in those years was the vulnerability of these countries due to the necessity of foreign financing. The US interest rate had

	1991	1995	1998	1999	2000	2001	2002	2003	2004
Argentina	12.67	-2.58	3.85	-3.39	-0.79	-4.41	-10.89	8.84	8.98
Brazil	1.30	4.20	0.10	0.80	4.40	1.30	1.90	0.54	5.18
Paraguay	2.47	4.71	-0.42	0.49	-0.3	2.66	-2.32	2.55	2.90
Uruguay	3.54	-1.45	4.54	-2.85	-1.44	-3.39	-11.03	2.17	12.27

Source: Author's elaboration, CEPAL data

* based on figures taking 1990 as the reference year.

** percentages' variations are considering the previous year.

Table 2. GDP Growth at constant 2000 US\$* (%)**

been rising, which worried investors because it involved emerging markets capacity to repay their debts. In fact, except from Uruguay, the other economies displayed a current account deficit superior to 4% of their GDP.

Mercosur started facing a severe recession, so its member states looked for new markets to sell their production – helping further the decline of intra-regional exports compared to total ones. The gap between intra-regional trade and extra-regional trade was extended (-10% and -36% respectively), and that is why some called it the *de-Mercosurization* period.

Mercosur's two main economies found a common source for their problematic situation: increasing difficulties to have access to foreign financing of their public sector, mainly as far as stock debt was concerned. This was particularly evident when Argentina defaulted in 2002⁴. Not surprisingly, that same year was Mercosur's worst year since its establishment, with a 2% drop of its regional GDP. Brazil was the only one to experience output growth, although it suffered from international capital markets pressure.

Argentina experienced an abrupt fall in imports, which produced a US\$ 16.5 billion trade balance in 2002. The mentioned fall in imports was mainly explained by the contraction of its internal demand and some kind of import substitution due to the increased exchange rate. The 15% decrease on imports was due to the change in relative prices and the change in the aggregate

⁴ The Argentinean crisis was a combination of: default, end of its monetary regime, restriction on the availability of deposits in the financial system, deep and disordered change in the contract's scheme and serious political crisis. It was the consequence of a number of serious and long processes that included a negative development of interchange terms, the strengthening of the US' dollar, the Brazilian devaluation, and the increase of risk perception for emerging markets financing –both sovereign risk and US interest rate increased.

demand composition – more exports and less investment. Most of Argentinean and Brazilian trade was directed to extra-regional exports – US\$ 70.5 billion between both countries.

Argentina and Brazil experienced positive trade balances in 2002, in part thanks to real depreciation of their currencies. Both countries showed positive, but moderate, evolutions: competitive improvement and recovery of foreign demand. In an environment signed by world economic recovery, Mercosur economies returned to the economic growth path after four difficult years, improvement largely led by the recovery of the Argentinean economy.

FDI performance

Mercosur's success in the first half of the 1990s widened the amount of topics covered by its agenda, especially as far as corporate strategies and capital flows into and within the region. As time went by, the integration scheme started to be part of corporate strategies.

In the first half of the decade, Southern Cone countries –mainly Argentina, Uruguay and Paraguay – received 30.3% of the FDI destined to Latin America and the Caribbean (see Table 3). Market oriented reforms, which included privatization programs, and economic stabilization – that affected positively domestic demand – were the main determinants attracting FDI. A favorable legal FDI framework is a necessary condition to attract it, although it may not decisively determine an investment. By the mid-1990s, while Argentina and Paraguay had removed all restrictions to FDI, Brazil and Uruguay still had some limitations to it.

FDI inflows	1980	1985	1990	1995	1999	2003
Argentina	678.00	919.00	1836.00	5609.42	23987.70	478.00
Brazil	1910.20	1418.40	988.80	4405.10	28578.40	10143.52
Paraguay	29.79	7.87	71.06	103.20	94.50	81.87
Uruguay	289.50	-7.90	41.54	156.60	235.26	263.07
Total	2907.49	2337.37	2937.40	10274.32	52895.86	10966.46
FDI outflows						
Argentina	-110.00	42.00	62.87	1497.15	2325.48	774.00
Brazil	366.50	81.10	624.60	1095.60	2854.00	249.30
Paraguay	1.90	2.33	-0.90	5.10	5.60	5.47
Uruguay	..	7.90	-0.66	0.42	9.30	3.20
Total	258.40	133.33	685.91	2598.26	5194.38	1031.97
FDI instock						
Argentina	5343.64	6562.86	8778.25	27991.00	61926.00	35100.00
Brazil	17480.03	25664.48	37143.41	41695.62	86472.10	128425.00
Paraguay	212.14	301.23	399.39	705.20	1215.70	886.17
Uruguay	727.06	763.06	976.20	1432.44	1215.70	1554.07
Total	23762.87	33291.64	47297.25	71824.26	150829.50	165965.24
FDI outstock						
Argentina	5997.06	5944.30	6105.53	10695.60	20117.70	21302.60
Brazil	38544.80	39439.10	41044.20	44473.70	49664.60	54646.00
Paraguay	112.71	127.74	136.90	178.60	208.20	150.17
Uruguay	168.63	181.23	183.11	185.53	208.20	270.71
Total	44823.20	45692.38	47469.73	55533.43	70198.70	76369.48

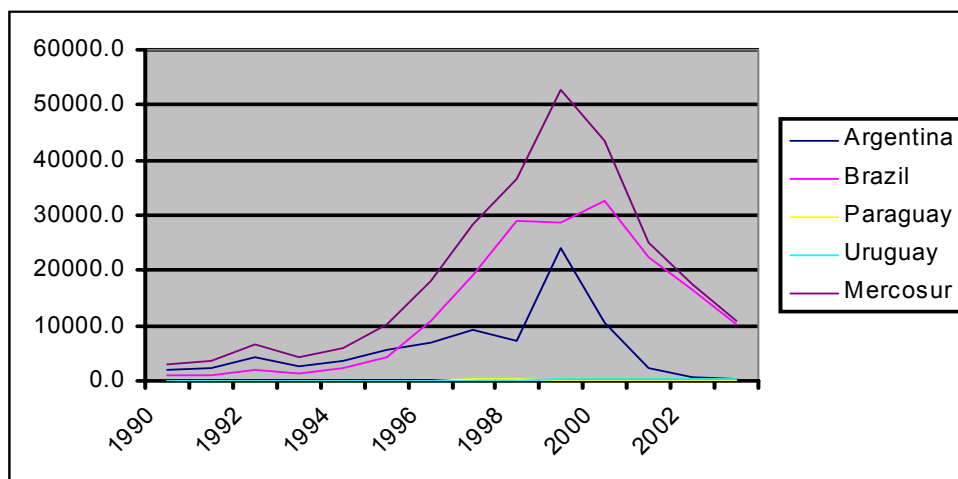
Source: Author's elaboration based on UNCTAD data.

* Current prices

Table 3. FDI flows and stocks, 1980-2003 (millions of US\$)*

The elimination of restrictions to FDI flows into the region was accompanied by measures aimed to liberalize TNCs affiliates operations, assuring an equal treatment of the given national firm. While in this period more than 60% of FDI flows to Argentina were due to privatizations, from 1994 to 1996 its contribution in that country was not superior to 15%.

By the second half of the 1990s Brazil started its privatization program, so FDI started to increasingly flow to its economy (see Figure 2). At the same time, Argentina had almost finished its privatization process, so its financing was mainly through debt. Argentina and Brazil counted for the 16% of FDI to developing countries from 1994 to 1999. FDI entering in the region was a key factor to help the maintenance of structural reform programs in its member



Source: Author's elaboration based on INTAL data

Figure 2. FDI inflows from 1990 to 2003 (US\$ millions)

states.

More than 90% of the US\$ 156 billion that entered to Mercosur in the 1990s did it in the last five years of that decade. According to Chudnovsky and López, the TNCs presence in the region went hand in hand with FDI's boom. Joint ventures constitution has been less frequent, being investments where foreign stockholders totally control the firm or at least they have a major control of the firm the predominant form (Chudnovsky and López, 2001).

In that period Mercosur *per se* seemed to have a minor influence in these trends. Nevertheless, it had certain effects in some sectors, mostly in those where there is a strong presence of transnational firms and in sectors where a process of rationalization and productive complementation was undergone (INTAL, 1996). The industry sector was less important *vis-à-vis* the service sector, which is characterized by pure market-seeking strategies and stand alone modalities. Reorganization investments⁵ were significant in some sectors such as: automobiles, food and beverages, petrochemicals and textiles.

FDI went mainly to the natural resource sector, as well as the manufacture and the service sector. FDI's boom was also favored by the increased importance of M&A, aiming at purchasing local firms with strategic assets to exploit the internal market. From 1991 to 1996, Brazilian M&A grew by 100%.

As it happened with trade and GDP developments, the Asian crisis meant also changes in the investments flows both worldwide and in the sub-

⁵ Reorganization investments result from the effects of trade creation produced by economic integration.

region. Brazil, that became the second main recipient country among developing countries, adopted a series of monetary restriction policies and a fiscal package in order to face the aforementioned crisis. However, the Asian crisis seemed not to have affected adversely FDI flows intensity to the region.

From 2000 to 2001, FDI flows to Mercosur continuously decreased, putting more pressure on the balance of payments of these economies. At the same time, their currencies depreciated both in nominal and real terms. Clearly, the Argentinean case was the more relevant, whose nominal exchange rate increased by 300% in 2002. The Brazilian currency did it by 54%, Uruguay - after abandoning its currency system - increased its exchange rate by 95%, while Paraguay did so by 43%.

Capital outflows from Mercosur worsened this situation, inducing a current account surplus in the balance of payments and a reduction of international reserves of these countries. For the first time since the 1980s, Mercosur aggregate current account had a positive sign: US\$ 7000 millions. But it did not cover the amount of capital outflows, producing a US\$ 6.7 billions decrease of international reserves assets in 2002.

Despite of the Paraguayan and Uruguayan cases, FDI continued decreasing in 2003, following the Latin American trend. However, Brazil maintains its dominance as the main FDI destination in the Southern Cone. In the last two years Latin America registered growth in its FDI inflows. Argentina, led by an important increase in its exports and an impressive economic growth, became the fourth FDI recipient in Latin America, behind Mexico, Brazil -which registered an important drop in terms of FDI flows

compared to the previous year - and Chile.

THE LEGAL AND INSTITUTIONAL ARCHITECTURE OF MERCOSUR

It is important to highlight that previous regional integration experiences in Latin America -namely LAFTA and LAIA - had left a legacy of being highly inefficient, costly and with a rigid and enormous institutional structure. Those in charge of Mercosur's institutional architecture had in mind these previous experiences of regional institutions in the region. In part because of it, Mercosur architects opted out of an intergovernmental structure. Their aim was to try to avoid defects such as disrespect to institutions that had an important impact on credibility.

The Asunción Treaty established a four-year transition period as far as tariffs were concerned, and its Annex I included a trade liberalization program in order to complement the efforts to carry out the free trade zone. The sector-by-sector approach that characterized the ABEIP⁶ period was abandoned. The Common Market Council (CMC) established a negotiation mechanism - the so-called "*Cronograma de Las Leñas*" - in order to harmonize national policies so that the process would be enhanced. Unfortunately commitments in non-tariff barriers were looser.

It was also established that member states should accord a Common External Tariff by the end of 1994. The need for a dispute settlement mechanism became visible in the Brasilia Protocol, in which an *ad hoc* tribunal

⁶ It refers to the Argentine-Brazilian Economic Cooperation and Integration Program, implemented in 1986, aimed to stimulate, in a balanced way, bilateral trade growth, establishing mechanism to foster intra-sectoral complementation (Bouzas and Fanelli, 2001).

composed by three judges would decide through arbitration. In the normative field, Mercosur's organs faced some difficulties derived from resistance by its member states to implement CMC and Common Market Group (CMG) decisions.

Most of intra-regional trade reached zero tariff rates; just a few products were subject to positive tariffs, which are known as "Adequate Final Regime" (*Régimen de Adecuación Final*). These regimes transitorily exempt from the free tariff treatment to intra-regional trade to a series of products included in national lists. The more paradigmatic examples of exceptions are given by two sectors: automobiles and sugar –both were subject to special accords.

Although during its first years Mercosur showed an impressive development, the lack of coordination between Argentinean and Brazilian initiatives led to some macroeconomic disparities that hindered the integration process. As a consequence, Mercosur saw its first conflicts emerge, with its two main partners negotiating to overcome the imbalances produced by their asymmetries.

All disagreements among Mercosur member states were handled by political means, thanks to the inexistence of an accurate dispute settlement mechanism. As pointed out by Cason, Brazil's role in the process' dynamics is fundamental. Having the largest and most profitable internal market of the sub-region, the country is *allowed* to have a behavior defined as "shooting first and asking questions later" (Cason, 2002).

By the end of the transitional period, Mercosur's member states realized that aims agreed on had not been completely reached. An additional protocol

was approved by the end of 1994: the Ouro Preto Protocol, which defined the institutional structure and gave Mercosur international legal status. It improved the dispute settlement mechanism and it also created the Mercosur Trade Commission, which considers national sections claims, originated by member states or by individual's complaints.

The Ouro Preto Protocol consolidated the institutional structure as follows: the Common Market Council (the top political and decision making body), the Common Market Group (executive body), the Mercosur Trade Commission (with a supervisory role), the Joint Parliamentary Commission and the Economic and Social Consultative Forum (both with a consultative role), the Administrative Secretariat, twelve working groups and ten technical committees.

A very important indicator of Mercosur's consolidation in this second period was the reduction of protectionism toward the rest of the world. The CET accord in 1995 included 11 tariff levels between 0 and 20% with an average tariff of 11.3%. Almost 88% of the tariff world had its CET in force since the beginning of that year. The remaining 12% belonged to: temporarily excluded sectors (sugar and automobiles), capital goods sectors, computing and telecommunications, and products included in national lists of exceptions (INTAL, 1996).

The normative development in this second period involved the adoption of some instruments which were very complex: non-tariff barriers and policy asymmetries. These difficulties made member states adopt some temporal trade regimes.

By the end of the 1990s it was clear that policy coordination was an imminent requisite. In the Argentinean-Brazilian relation, up till that moment, there has been more convergence than coordination. Informal mechanism of coordination had been preferred due to the low interdependence at the beginning of the process. The institutionalization emerging in the first years of Mercosur “can be partly explained by the lack of strong functional demand pressures to reduce market fragmentation and stimulate policy harmonization” (Bouzas and Soltz, 2001).

Interdependence had been actually low by the time Mercosur emerged; it was integration that produced an increase of interdependence. The process took impulse from political decisions, concentrated in the presidential institutions of each country. That is why Malamud concludes that Mercosur is an extreme case of intergovernmentalism, called interpresidentialism (Malamud, 2000). Presidential institutions may make possible the progress in the integration process as well as its paralysis or its setbacks. From Malamud’s point of view, presidentialism acts as a functional equivalent of supranational institutions. Interpresidentialism implies that decisions will be concentrated in one institution. Hence, Mercosur institutions can be more or less important in the direction of the process, but they are not supranational, and it is highly improbable that they will become so.

Economic development in the integration process overcame the interest of creating strong institutions, situation that decisively influenced the way in which Mercosur’s member states have perceived the way to settle disputes. The harmony in the macroeconomic cycles of Argentina and Brazil from 1995

to 1998 explains the increased interdependence between them, as well as the way it contributed to Mercosur's lack of institutionalization and depth. Tulchin and Espach argue that relative gains problems, non-tariff barriers and exceptions on some industries were solved with *ad hoc* actions at the ministerial level and at presidential meetings (Tulchin and Espach, 2002).

Although some of the obstacles that Mercosur experienced in the late 1990s were not new ones, the magnitude of the problems faced by the two major partners and the change in the economic conditions that each one was undergoing, made them particularly delicate to deal with. Some issues that had been offset by the good results obtained in the previous periods re-emerged more vigorously, such as completing the CET. Considering the difficulties the process was undergoing, national governments - through the CMC - agreed in 2000 on an agenda known as "Relanzamiento del Mercosur", but this *re-launch* seemed to have different meanings to each government.

Macroeconomic difficulties, as well as the lack of compliance with the rules agreed on and the weak efforts to dismantle the last barriers in order to reach the ultimate objective -the single market-, may explain Mercosur's stagnation.

Mercosur member states considered that the institutional structure weakness was to be modified in order to avoid the difficulties that it was imposing to the process. The first step was to turn the Administrative Secretariat into a technical structure. That same year a new Protocol was signed on settlement dispute that would substitute the Brasilia one. This Protocol, aimed at adjusting and deepening the regional process, is known as

“Protocolo de Olivos”, which entered into force in 2004. It stipulated the creation of a Permanent Review Tribunal, strengthening the dispute settlement mechanism of Mercosur. Still, the mechanisms fixed in this protocol do not constitute a permanent system for the dispute settlement body.

The Mercosur Permanent Representatives Commission, whose president is elected by the Council, was created in 2003 in order to complement the CMC work and the Pro-tempore presidency. These initiatives took place in an environment characterized by convergence in the exchange rate policies of Mercosur member states, economic growth in the sub-region, and the presence of presidents that share the common interest of giving the process a stronger relevance.

Initial, although relevant, steps are being taken in the sense of macroeconomic coordination and in trade liberalization on the service sector – in accordance with GATS rules. However, issues such as the incompleteness of the CET and the lack of intra-regional trade defense instruments as well as unilateral protectionist measures – not precisely minor items – have not yet succeeded in overcoming the current obstacles. As a matter of fact, the commercial conflict between Argentina and Brazil in 2004, or the current dispute between Argentina and Uruguay shows not only how the sub-region lacks the presence of a strong dispute settlement body, but also the lack of coordination in their respective initiatives.

In a regional economic integration process trade conflicts arise more frequently as countries involved in the process get more interdependent and integrated. In the Mercosur case the key problem is not just the emergence of

trade conflicts but “the inexistence of sub-regional institutions able to contribute to solve disputes that emerge from the enlarged market and to foster a political cooperation that may secure Mercosur’s construction” (Cimadamore, 2001).

BRINGING TOGETHER MERCOSUR MEMBER STATES VIA ENERGY COOPERATION

In the previous sections Mercosur’s dynamics, achievements, obstacles and challenges since its very beginning until our days have been showed. There are many voices claiming the necessity of a change in the direction of the process. It seems evident that the current situation of stagnation is not destined to prevail much longer. However it has not been yet elucidated whether this change implies a step forward in the process in the direction of a higher deepening of the regional common objectives or if it means the softening of Mercosur, leaving it into a mere free trade zone. Although this work is not aimed at taking part in the aforementioned debate, it is highly probable that the first alternative will be the most suitable solution for Southern Cone countries.

In fashion with this line, nowadays there is a key sector for Mercosur countries – but not just for them – that may develop into an *issue-area* that can help them to acquire greater dynamism: the energy sector. As pointed out by Malamud and Schmitter, “regional integration has to begin somewhere and the best place to do so under contemporary conditions is with a functional area that is of relatively low political visibility, that can apparently be dealt with separately and that can generate significant benefits for all

participants” (Schmitter and Malamud, 2005). Consequently, the following part of this work will concentrate on the energy sector and its potentialities – and probabilities – of integration.

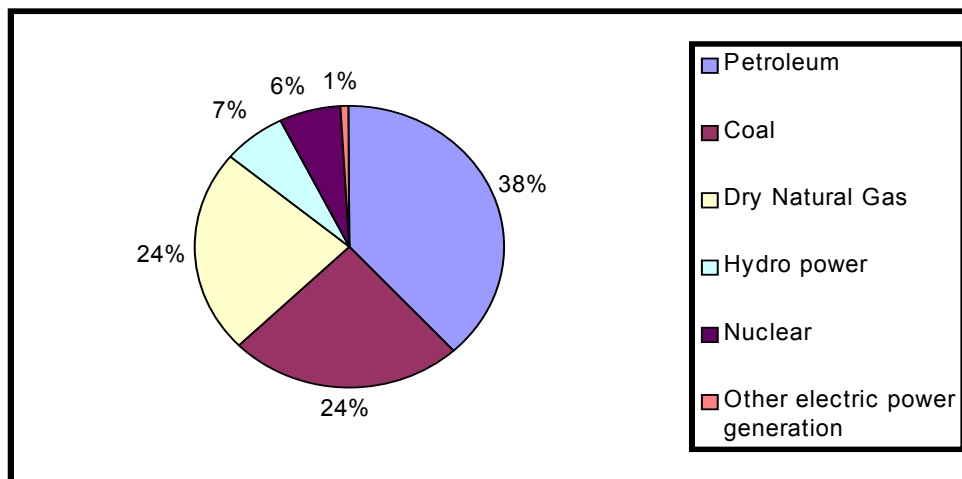
Global and Regional Context

There is nothing new in saying that energy is an extremely controversial issue, mainly considering that regions such as the Middle East and North Africa play a crucial role as oil and natural gas suppliers. Moreover, the sharp increase in oil prices in the last years has introduced considerable signs of uncertainty in the energy markets. According to the *Oil & Gas Journal* data of mid-April, and mainly due to political tensions-, the average price for OPEC’s basket –that includes eleven benchmark crudes – was up to US\$ 65.80/bbl, while oil futures prices rocketed to US\$ 71/bbl in the Us and US\$72 in British markets.

Considering the current picture of the world’s energy resources (see Figure 3), the International Energy Agency (IEA, 2005) sustains that fossil fuels will continue dominating the energy world supply. Petroleum persists as the most important primary energy source, followed by coal –whose supply is mainly concentrated in India and China. Natural gas, which is expected to overtake coal’s position in the primary energy ranking by less than ten years, is experiencing an important upsurge, mainly thanks to power generation. Finally, hydro, nuclear and other electric power generation (geothermal, solar, wind, and wood and waste) are placed in fourth, fifth and sixth position respectively.

In a regional analysis, the IEA states that most of the projected growth in

energy demand -until 2030 - will take place in non OECD-countries. Energy demand in developing countries will be boosted by factors such as: economic growth, industrialization, population growth and urbanization. In this way, non-commercial biomass will leave place to commercial fuels. The Agency also shows us that there will be some kind of regional mismatch between demand and production that “will result in a major expansion of international trade in oil and gas, both in absolute terms and as a share of supply” (IEA, 2005).

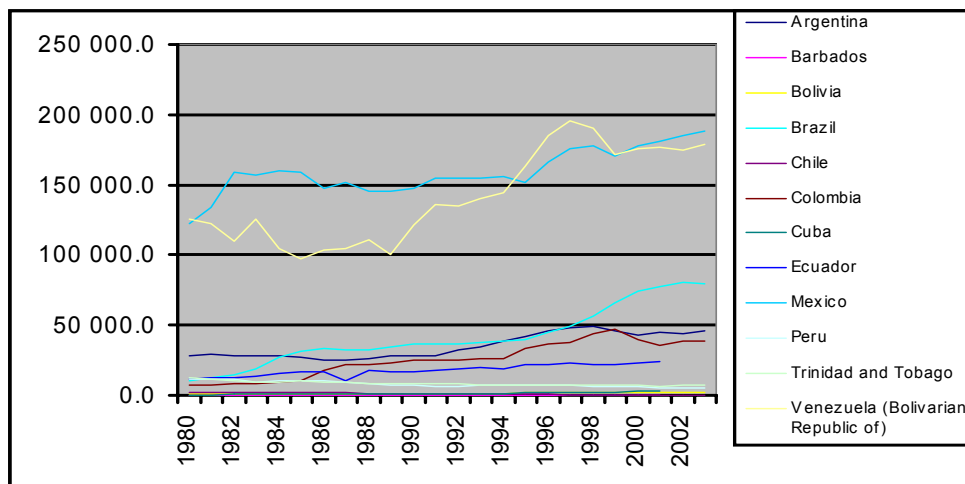


Source: Author's elaboration based on EIA data

Figure 3. World Primary Energy Source, 2003 (%)

According to ECLAC data, petroleum production in Latin America and the Caribbean (see Figure 4) have witnessed an important increase in the last 25

years, but mainly since the beginning of the 1990's, reaching a production of 557,115 thousands of m³ by 2000. Mexico, with a petroleum production of 188,350 thousand of m³ (2003), is the main producer in the region, followed nearly by Venezuela (179,300 thousand of m³).

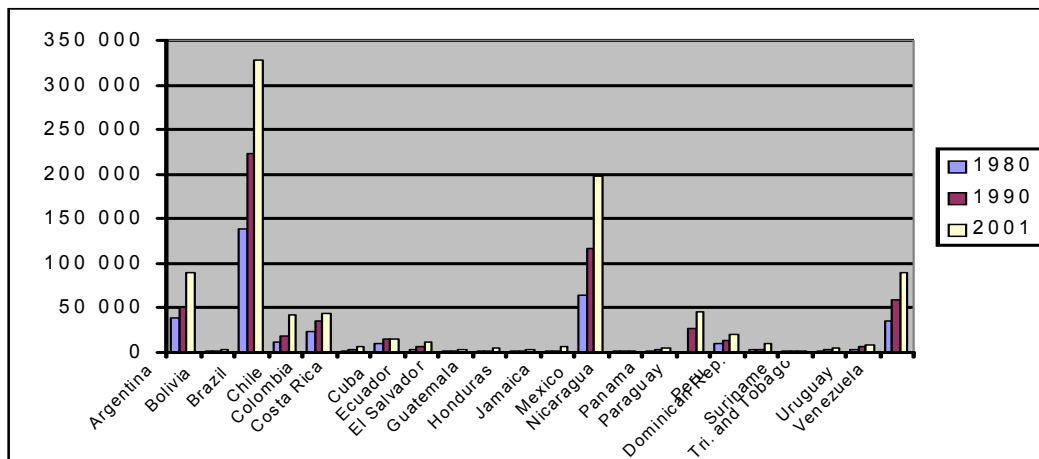


Source: Author's elaboration based on ECLAC data

Figure 4. Petroleum production, 1980-2003 (thousands of m³)

Electric energy production in the region (see figure 5), which constantly increased for twenty-one years, arrived at 958,368 millions of Kilowatt-hours as for 2001. Brazil rank first in the electricity production, counting for the 34.1% of the regional production. This country is followed by Mexico (20.6%), Argentina and Venezuela (both with 9.4%).

Hydrocarbons total consumption in Latin America and the Caribbean increased by 3.1% from 1980 to 1990. Petroleum consumption also grew in the 1990s, except from its last two years. As far as electric energy is concerned, total consumption has showed positive growth rates all along the 1980s and the 1990s.



Source: Author's elaboration based on ECLAC data

Figure 5. Electricity Production 1980-2001 (millions of kilowatt hours)

In per capita terms (see Table 4), hydrocarbons consumption in Latin America and the Caribbean continuously grew from 1980 until 1997. According to the last data available for the whole region, as for 1998 hydrocarbons consumption per capita was of 735 kilograms of petroleum equivalent. Per capita electric energy consumption also has showed a considerable and gradual increase all

along the last two decades, starting from 1049 kWh in 1980 to 1951 kWh in 2000.

		1980	1985	1990	1995	2000	
Argentina	hydrocarbons	1 065	987	1 108	1 294	...	
	electricity	1 406	1 492	1 591	1 991	2 437	
Bolivia	hydrocarbons	235	188	232	383	...	
	electricity	281	237	326	402	470	
Brazil	hydrocarbons	378	290	328	378	427	
	electricity	1 148	1 442	1 673	1 948	2 304	
Chile	hydrocarbons	495	416	582	722	675	
	electricity	1 058	1 158	1 402	2 105	2 713	
Colombia	hydrocarbons	351	350	547	385	...	
	electricity	890	1 054	1 020	1 184	1 039	
Ecuador	hydrocarbons	447	389	451	479	453	
	electricity	420	512	616	729	839	
Mexico	hydrocarbons	1 029	1 048	1 116	1 123	897	
	electricity	972	1 176	1 455	1 665	2 323	
Paraguay	hydrocarbons	102	129	155	233	...	
	electricity	213	328	575	913	1 116	
Peru	hydrocarbons	376	294	278	266	297	
	electricity	567	615	641	732	768	
Uruguay	hydrocarbons	560	298	346	415	492	
	electricity	1 182	1 302	1 580	1 946	2 390	
Venezuela	hydrocarbons	1 965	2 010	2 005	2 722	...	
	electricity	2 298	2 771	3 051	3 422	3 525	

Source: Author's elaboration based on ECLAC data

* Kilograms of petroleum equivalent

** Kilowatt hours

Table 4. Per capita consumption of hydrocarbons* and electricity, 1980-2000**

There are some tendencies that characterize the current picture of the energy sector development in the region that are important to be considered, like the fuel basket change and the emergence of natural gas as the main fuel in the region. Energy markets are fragmented and they are starting to be more competitive because energy is strongly becoming a tradable good in the international market. This situation implies that there are important incentives for private actors to take advantage of, which turns into an increased number of actors in the energy market.

There are many voices rising in favor of strategic coordination in the energetic sector in Latin America, highlighting the benefits of taking advantage of economies of scale, improving reliance, integral use of abundant renewable resources in the region, diminishing costs and prices of energy, etc (Muñoz Ramos, 2004).

Maybe one of the most *promising* projects in the energy sector in Latin America is the Initiative for the Integration of South American Regional Infrastructure (IIRSA), which emerged in 2000 at the South American Presidents Summit in Brasilia, Brazil. The initiative is aimed at developing transport, energy and telecommunications infrastructure in South America and is based in principles such as open regionalism, integration and development, etc, working through a mechanism of coordination and information among different actors: national governments, regional financial institutions, the private sector and the civil society.

IIRSA is primarily focused on supporting a strategic vision for the South American physic integration, defining the so-called Integration and

Development Axis and identifying some Sectoral Integration processes in order to promote harmonization in the legal, institutional and political realms

Despite the important differences in size, industrial structure, development and natural resources endowment among Latin American countries, when talking about the necessity to strengthen energy sector in the region one might identify some issues related to it that bring these countries together:

- consolidation of structural reforms underwent during the 1990s;
- extension of the modern options of energy;
- development of productions patterns and efficient and environmental-friendly use of energy;
- foreign and national capital attraction in order to finance the sector;
- energy markets integration in the region as a key element in their economic integration process (Vives Llabrés and Millá, 1999).

Is the construction of an internal energy market possible in Mercosur?

As it has been already mentioned, the 1990s meant sharp and deep economic reforms in Latin American countries. Due to its importance, the energy sector was a very controversial area. The process of privatization in the oil, electricity and natural gas industries did not proceeded at the same speed in these countries nor it was homogenous.

Argentina underwent a deep restructuring that involved the separation of the national state from the “electricity and natural gas companies, electricity generation competition and – to a lesser extent – in oil and natural gas

production, as well as competition in the electricity and natural gas wholesale markets (including contracts market and spot market)" (Lutz, 2001). These measures were accompanied by some ownership restrictions in order to prevent discrimination and dominant market power.

On the other side, countries such as Brazil are still opening their energy markets, implementing gradually policy reforms and redefining the role played by the national government. Related to this last issue, it is interesting to notice that, while some countries have privatized oil state-owned companies (like Argentina), others still show a state-control over this industry (such as Brazil or Venezuela).

Brazil, responsible for the 65% of the sub-regional energy production, dominates by far Mercosur energy production, showing the decisive role that this country plays when talking about this topic. Given the fact that Chile is not a big energy producer, and Bolivia is a big natural gas producer but it has no relevant oil reserves in its field - both Associate Members of Mercosur - the sub-regional energetic scheme would only decisively change in case Venezuela would be taken into consideration. This country produced 179.62 Mtoe (millions tones of oil equivalent) in 2003, which means 8.48 Mtoe more than the Brazilian performance that same year (See table 5).

Not surprisingly, Brazil ranks also first as far as Total Primary Energy Supply is concerned (TPES), amounting 193.24 Mtoe by 2003, and it is also the country that consumes more electricity (341.55 TWh). Crude oil counts for the 44% of TPES in Mercosur countries, followed by combustibles renewables and waste (21%) and gas (16%). As it is widely known, environmental concerns are

inherently intertwined with energy matters and that is why renewable resources of energy became so relevant in our analysis. Due to environmental, socio-economic and strategic reasons, biofuels are of vital importance.

	Production	Imports	Exports	TPES	TFC
Argentina	84,318.00	1,916.00	-25,874.00	59,851.00	44,499.00
Brazil	171,139.00	74,105.00	-21,471.00	193,245.00	167,907.00
Paraguay	6,623.00	1,185.00	-3,885.00	3,989.00	3,717.00
Uruguay	1,161.00	2,092.00	-251.00	2,519.00	2,222.00
Mercosur	263,241.00	79,298.00	-51,481.00	259,604.00	218,345.00
Bolivia	7,728.00	281.00	-3,723.00	4,451.00	3,118.00
Chile	8,336.00	20,437.00	1,686.00	26,268.00	20,606.00
Venezuela	179,622.00	0.00	-124,728.00	54,227.00	35,576.00

Source: Author's elaboration based on IEA data

Table 5. Energy indicators I, 2003(thousand tones of oil equivalent, ktoe)

In this field Mercosur countries show an interesting feature: biodiesel production. Biodiesel is a fuel made from natural and renewable sources, such as vegetable oils and animal fat. It can be used in diesel-cycle engines, in its pure form or with some sort of blending with petroleum-diesel, without any kind of modification of the engine. Given its environmental qualities –it is free of pollutants such as sulphur dioxide and it is also biodegradable – the importance of increasingly use this kind of fuels relates to the fact that “bio-diesel can be considered as and additive to standard diesel which can help oil companies, refineries and automotive plants to achieve fuel qualities and emission levels compatible with national regulations” (Sala and Gaioli, 2002).

Brazil shows a leading position as far as biofuels production is concerned. It has six plants to process biodiesel with a capacity of 57.4 million liters per year. Although is one of the top world producer of oil seeds together with Brazil – and consequently it can play an important role in this field – Argentina has not started yet biodiesel production on a commercial scale. Both countries show considerable natural vantages to the production and commercialization of this biofuel, and, in the Brazilian case, many hold that it can potentially become one of the most important biodiesel producers of the world.

Something similar happens with ethanol, a biofuel made from sugar-cane. Brazil is the top world sugar-cane producer as well as the top world ethanol producer – 15.1 billions of liters in 2003-2004-, and it has also developed a car with a combustion engine that can burn ethanol and gasoline. In Argentina, despite its natural resource advantages in exploiting it, ethanol is only destined to few industries, such as food and pharmaceutical, but it is not used as a fuel (SAGPyA, 2005).

Other than the environmental impact of these biofuels, it is highly important the economic incentive of developing such fuels: en periods of high oil prices, they became a valuable alternative. They are also crucial sources to diminish imports dependence of hydrocarbons – mainly diesel imports.

Coming back to the TPES analyses, when doing a country-by-country analysis, we find out that crude oil is an important component of the TPES in Argentina, Brazil and Uruguay, but it is not so in Paraguay. On the other hand, while hydro power and renewable combustible and waste are significant

elements in Brazil, Paraguay and Uruguay, gas does its part in Argentinean TPES share – the case of biofuels production and use is illustrative of this situation. This means that Mercosur member states have a differentiated and complementary supply of primary energy, which is an important asset when speculating about *constructing* a regional energy market.

The industry sector counts for almost 42% of the Total Final Consumption (TFC) of energy in Mercosur countries (See table 5), followed by the transportation sector (30%) and the residential sector (15%). Both in Argentina and Brazil the industry sector stands for the most important portion of the total energy consumption within each country (35% and 44% respectively), while in Paraguay and Uruguay it is the residential sector to be the major consumer of energy (30% and 37% respectively).

Taking into consideration Table 6, we can appreciate the relation among variables like population size of Mercosur countries related to their energy supply and their electricity consumption. Energy production and consumption play vital roles in the economic development of a country. Mercosur member states have been experiencing economic growth rates of their GDP, and their populations are estimated to increase. This indicates that electricity consumption will increase and that the supply of energy should increase in order to improve or at least maintain the current figures.

As it has been declared by the IEA, in order to meet projected world energy demand growth “cumulative energy-sector investment needs are estimated at about \$17 trillion (in year-2004 dollars) over 2004-2030, about half in developing countries” (IEA, 2005). In this way, the agency recognizes the

great challenge posed to these economies –including, of course, Mercosur countries – as far as the financial needs are concerned.

	TPES/Population (toe/capita)	TPES/GDP (PPP) (toe/ thousand - 2000 US\$ PPP)	Electricity Consump- tion/Population (kWh/ capita)
Argentina	1.63	0.14	2,259.00
Brazil	1.09	0.15	1,934.00
Paraguay	0.71	0.16	834.00
Uruguay	0.75	0.10	1,800.00
Bolivia	0.51	0.21	423.00
Chile	1.67	0.17	2,912.00
Venezuela	2.11	0.45	2,664.00

Source: Author's elaboration based on IEA data

Table 6. Energy indicators II, 2003

This very last point about future investments in the energy sector is to be considered of vital importance. Just to name two cases – but there are more – countries such as Brazil (in 2001) and Argentina (in 2004) underwent serious energetic crisis –in the second case, affecting energy trade of the country with its neighbors. In 2001, Brazil suffered from an electric shortage caused by insufficient rainfall, which highlighted Brazilian deep reliance on hydro power. This crises also demonstrated that this country have not met the needed investments in the sector. As a consequence, the national government had to “force” Brazilian consumers to rationate their electricity consumption for almost nine months and implemented a new energy program.

The Argentinean energy crisis of 2004 had an important impact not only on that country, but also on Chile and Uruguay, with which Argentina trades natural gas and electricity. Due to low energy prices – produced by caps

imposed by the Argentinean government – there was a considerable increase in energy demand that by far exceeded supply. Therefore, the Argentinean government had to stop gas exports to Chile – breaking the accords with this country in this field – and it started to import natural gas from Bolivia.

These two examples indicate two important issues: first of all, they stressed the importance of planning when talking about energy, which includes new projects – and so new investments in the sector. The second relevant topic has to be with the interconnectedness of energy in the Southern Cone. As it has been showed, the Argentinean crisis had its consequences at least in three of its neighbor countries. This point leads the analysis to the implications of cooperation or regionalization in the energy sector.

POTENTIALITIES AND REALITY FOR ENERGY INTEGRATION

When Hugo Chavez, president of the Bolivareanan Republic of Venezuela, announced by the end of 2005 that his country intended to be part of Mercosur as a permanent member state, it was clear that one of the most salient topics would be that of energy and the possibility of managing it jointly with the other Latin American countries. Venezuela has one of the most important oil and natural gas reserves in the world, it is an OPEC member state and it is one of the main oil suppliers of the United States.

The Venezuelan president have been entering into negotiations in order to establish a mechanism of energetic macro-coordination, PetroSur, that would include Venezuela, Brazil, Argentina and Uruguay –whose head of state share an ideological affinity. In the oil sector, other than the already

mentioned project of PetroSur, we find that national-oil companies of Venezuela (PdVSA) and Brazil (Petrobras) have in mind a series of projects with important effects for the region and that there are various projects to undertake joint investments, mainly in the upstream sub-sector.

In the natural gas sector there have been also important projects that are being undertaken or at least planned. In this way, one of the most renowned projects is the "South American energetic ring", a titanic gas pipeline project that would start from the Peruvian Amazonia (Camisea), carrying natural gas to the north of Chile, Argentina, Uruguay and the South of Brazil.

Another important project is building up an enormous gas pipeline of more than 9 thousand kilometers that would carry 85 millions of m³ a day of natural gas from Venezuela, crossing all the Brazilian territory, arriving to Buenos Aires and Montevideo. The mega-initiative has been planned in the framework of IIRSA.

However, as it could be imagined, this project is rising a growing number of concerns. To name just a few, its cost - estimated around US\$25 billions - and the availability to finance it emerged as the most obvious ones. Moreover, there are feasibility studies that put some doubts on the convenience of building up such a long pipeline, because of the transportation losses. Then, although Venezuela has 1,048.9 billions of cubic feet of natural gas reserves, there is no certainty that this country is able to meet the regional needs of natural gas. Other than the environmentalist concerns -that are not minor, considering that the pipeline should cross all the Amazonian field - political and regulatory fears stem from the highly regulated natural gas market in the

Southern Cone.

This initiative produced enthusiasm in countries such as Brazil, because it is said that it would be able to save around US\$11 annually in natural gas imports. But at the same time, it generates great tension with Bolivia, which depends heavily on the natural gas exports destined to Brazil.

It would be erroneous to affirm that cooperation within the energy sector is a novelty in the region, neither the effect of just ideological affinity among some presidents nor an initiative that emerged as a consequence of the Venezuelan's initiative to be admitted in Mercosur – whose member states possess important oil and natural gas reserves and a vast potentiality for hydroelectric power generation.

The electricity sector shows an important precedent of cooperation and sector integration among Latin American countries. In 1976 emerged the first electric interconnection of Central America – between Honduras and Nicaragua. As time passed by, Central American countries agreed on signing the Framework Treaty to Create the Central America Electric Market. In the case of the countries belonging to the Community of Andean Nations, the first electric interconnection took place in 1969 between Colombia and Venezuela – the Zulia-La Fría line.

It was also in the 1960s that some negotiations started in the Southern Cone in order to undertake joint initiatives in the electric sector. One of the most paradigmatic cases is the *Itaipú* dam, owned by the Brazilian and the Paraguayan governments. In the sub-region there are other important electric interconnections, such as: the *Salto Grande* power station (Argentina and

Uruguay), the *Yaciretá* power station (Argentina and Paraguay), and the *Salta* power station (Argentina and Northern Chile) (Muñoz Ramos, 2004). Mercosur shows the more concrete steps taken towards the creation of energy market integrations, mainly through hydroelectric bi-national projects and the electric interconnections.

The electric sector has been subject to many studies and researches about the potentialities that it presents as a sector in which Mercosur member states may deepen their cooperation. According to some scholars, and as it has been already mentioned, South American countries have an important asset due to their complementarities in their energy resources, which can allow them to interchange electricity among countries with surplus and deficits of electricity (Muñoz Ramos, 2004).

At the Mercosur level, an increasing number of international interconnections would be turned in important economic benefits, due to the decrease in energy prices as a result of the increased in both the availability of options in the generation and the transmission fields and in the number of participants that would deliver the regional market (Lutz, 2001).

Taking into consideration other cases as the NAFTA and the EU energy market –highly influenced by Nordic and the United Kingdom cases–, there are key potentialities for building up an electricity common market in the Southern Cone. The UE has adopted directives in order to implement an internal market for gas and an internal market for electricity. Although the EU has still much to improve in this field, this legacy is of great importance for Mercosur countries in order to have a case to take as a reference of what can be

achieved and what cannot, and the difficulties of accomplishing such an ambitious objective.

The case of the Nordic Power Exchange (Nordpol) -formed by Norway, Sweden, Finland and Denmark - is one of the most successful in the energy cooperation. It is said to be the most flourishing energy integrated market, achieving good results in both the spot and the futures market. Supporting this idea that Nordpol is a good model of an integrated market, Hira and Amaya concludes that exist some prerequisites for the existing of such a market: "physical and administrative infrastructure to run the market, common regulatory principles and a regional regulatory authority to create rules, set up a pricing mechanisms, manage transmission and contracts; and clear up disputes, and customization of regulations towards the peculiarities of a region's energy resources and the actors that dominate the national electricity markets" (Hira and Amaya, 2003).

Although it is clear that Southern Cone countries do not present all these prerequisites, the current interconnectedness in the electricity sector and the increasing trade flows in the natural gas sector may induce policy makers of the region to start thinking seriously on the idea of integrating these markets under the Mercosur project.

CONCLUSION

Mercosur is the world's fourth largest regional integrated market and it played a key role in the structural reforms programs carried out by Southern Cone governments. Open regionalism was a central part of their market oriented

policies, giving to the process new characteristics compared to previous regional attempts.

Its member states became more interdependent, but it did not bring about the necessity to deepen the institutional and legal framework of the process. Mercosur's path, still marked by its asymmetries, has been largely induced by its major economy's necessities and strategies, so "size differences that characterize Mercosur economies provide structural limitations to the development of interdependence linkages with a relatively symmetric intensity" (INTAL, 1998). The Argentinean-Brazilian relations are also signed by asymmetry: Brazilian internal market is twice and a half times that of the Argentinean one. Both countries followed diverse economic strategies: while the former continued its specialization in the agricultural sector, the latter did so in the industrial goods sector.

This situation has conferred the process with certain characteristics. As pointed out by Reid, quoting a famous Brazilian analyst (da Motta Veiga), "Brazil's negotiation position is certainly one of the main explanations for Mercosur's current profile, halfway between a free-trade area and a customs union with few mechanisms for institutionalization and limited positive discrimination for the benefit of the smaller economies of the bloc" (Reid, 2002).

From a strictly economic point of view, Mercosur has not given Brazil the gains that it is giving to the other member states. It seems that Brazil has been seeing it more like a political-strategic process than an economic one. That is why it is so reluctant to put part of its sovereignty into risk under common

regional institutions.

For the other member states, Mercosur is a valuable instrument although with diverse importance. For Argentina is a very important commercial project, and in the last years it has developed some weight as far as foreign policy is concerned – mostly since Kirchner administration arrival. On the other hand, Paraguay and Uruguay show a decisive dependence on the two Mercosur major partners in terms of trade and investment flows.

Without serious political compromises from member states governments it is highly improbable the aim to improve the current Free Trade Zone and the incomplete Custom Union. Otherwise, any attempt will have the same future as the Mercosur *re-launch 2000*: obsolescence.

The current institutional architecture is not accurate to face the problems that Mercosur member states are undergoing. The normative and institutional Mercosur deficit are mainly due to: the diverse ways in which member states incorporate rules sanctioned by Mercosur's organs; deficiencies in the dispute settlement mechanism, and the lack of a judiciary body in charge to interpret and enforce agreements; and, the intergovernmental character of Mercosur bodies, of political nature.

At this stage of the integration process, and with the tensions created among Mercosur Member and associates states as far as the energy sector is concerned, it would be important to follow Hira and Amaya when they sustain that “the real question for energy integration is not if it will happen –it will, but what shape the regional and national regulatory frameworks will take and how they will work together in practice” (Hira and Amaya, 2003).

Structural reforms in the energy sector of the countries analyzed should have delivered market competitiveness, increased efficiency, etc. However, due to incomplete liberalization of the sector or to important mistakes in the energy policy planning in each country, these results did not fully come into reality.

Not only should Mercosur countries think about energy integration and projects in this field considering just non-renewable resources, but also renewable ones. The hydro-power capacity in the sub-region has been greatly developed, especially in Brazil and Paraguay. Moreover, Mercosur countries, especially Argentina and Brazil, can take advantage of their natural endowment in order to exploit the potentialities that biofuels put in front of the current world energy challenges.

As it has been highlighted, there are great potentialities for the integration in the gas and electricity markets. The considerable hydro-power shared resources and the impressive amount of gas reserves in the sub-region make of it an ideal opportunity to build up a regional market that may accompany the current economic growth, making it also sustainable. It is highly probable that the electricity sector becomes the first sector in which energy markets may cooperate more and even integrate their markets, considering both bi-national hydroelectricity projects and cross-border interconnections.

However, there are important challenges to overcome in order to reach such an ambitious aim, like geographical peculiarities, regulatory differences, technological differences, etc. Along with it, the investments needed require

very complex and long term agreements among neighbouring countries. For all this, it is important to carry on *serious and feasible* joint projects both in the electricity and natural gas markets, in order to continue integrating Southern Cone markets. These two words, *serious* and *feasible*, become particularly important when considering Venezuelan announcements about both its admission to Mercosur and joint energy projects such as the 9,000 kilometres-long gas pipe line.

Energy cooperation among Mercosur member states may potentially involve with it agreements in so many topics that it is highly probable that it will result in a serious and real deepening of the integration process. And, following Robert Baldwin reasoning, it is plausible that deeper integration may bring the expansion of the integration process (Baldwin, 1995). In this way, the *spillover* effect may take off, giving Mercosur and its neighbouring countries a new momentum.

Mercosur's future is not something that can be willfully changed. Behind this process there are political objectives and economic interests that cannot be put aside. Hence, the question is: can a group of countries, different in their economic size and capabilities - with the political conditions that current member states show - reach the goal of the Common Market? Supposing the answer is yes: can they do it with the current institutional dynamics and solving any dispute as they have been doing up till now? And finally, will the energy sector be the tip of the iceberg, unleashing further cooperation in energy adjacent areas -and by consequence *producing* more integration?

A basic first step is to recognize differences in capabilities, both in the

economic as well as the political realm, in order to reach for a credible and acceptable accord to all parties.

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Latin American Integration Association (LAIA) <http://www.aladi.org>

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