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An Inquiry on General Equilibrium Effects of MERCOSUR—An Intertemporal World Model

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A multiregion dynamic computable general equilibrium model is constructed to analyze effects of the Southern Common Market (MERCOSUR) on the member countries as well as third-party nonmember countries. The model is based on intertemporal optimization behaviors of consumers and firms with eight endogenously specified regions. By taking into account dynamic general equilibrium adjustments, we observe significant shifts of trade diversion away from the nonmember trading partners to the member countries. We also find that, following the MERCOSUR's common external tariffication, growth of intraregional trade would likely be accompanied by increases in trade between MERCOSUR and other countries. In this case, not only MERCOSUR member countries gain more, but also the nonmember countries are better off in terms of their production, consumption, and consumer welfare. © 2000 Society for Policy Modeling. Published by Elsevier Science Inc.

[1] AFTA, ASEAN Free Trade Agreement, came into effect in January 1993 to cover 330 million people, with an aggregate GNP of over US$ 300 billion. The ASEAN consists of Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand (Bowles and MacLean, 1996).

[2] European Union-Extended Free Trade Agreement includes, in addition to the regular 12 members, Finland, Austria, and Sweden.

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1. INTRODUCTION

There is a growing interest on the economics of formation of customs unions and trade blocs, given the second wave of regional integrations with the emergence of NAFTA, AFTA,[1] EU-EFTA,[2] MERCOSUR (Southern Common Market including four South American countries), and negotiation on APEC (Asian Pacific Economic Association) in the recent years. Most studies to assess the effects of these regional integration agreement (RIAs) on trade and welfare have generally focused on the participated member countries. Examples are Francois and Shiells (1994) on NAFTA, Mercenier (1995) on EU, Adams and Park (1995) on ASEAN, and Behar (1995) on MERCOSUR. The formation of regional trading blocs, however, will not solely affect trade flows and welfare of the member countries, it will likely substantiate significant trade diversion from the nonmember trading partners and affect nonmember countries' welfare. In this paper, we study such third party spillover effects in the context of a newly created commodity trade bloc, the Southern Common Market, and its previous major trading partners.

MERCOSUR was launched by the Treaty of Asuncion signed in March 1991, with the purpose of creating a free trade area and a custom union among Brazil, Argentina, Uruguay, and Paraguay. Before that in 1960, countries in South America established the Latin American Free Trade Association (LAFTA), the largest and most ambitious integration scheme. The failure of LAFTA to attain its main objective, namely, the complete elimination of trade barriers among the member countries, led to its reorganization into a more flexible scheme, the Latin American Integration Association (LAIA) in 1980. The LAIA agreements included provisions for negotiating reductions in tariffs on intraregional trade on a global basis, the regional preferential tariff, but at the same time, they allowed the liberalization of tariff barriers among members on a bilateral basis. An example of the bilateral basis of trade liberalization is provided by the 1988 economic cooperation agreement between the two largest South American countries, Argentina and Brazil, which stipulated the elimination of all barriers to reciprocal trade over a 10-year period. The advancements in economic integration made by these two countries, as well as the importance they have for the entire region compelled Uruguay and Paraguay to join the Argentine–Brazilian trade agreement in March 1991. The new cooperation treaty, the Treaty of Asuncion,

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