

***EVALUATION OF THE EC SUPPORT TO THE
MERCADO COMÚN DEL SUR
(MERCOSUR)***

Synthesis report

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TABLE OF CONTENTS

0	EXECUTIVE SUMMARY	1
0.1	PURPOSE, SCOPE AND METHODOLOGY	1
0.1.1	<i>The purpose of the evaluation and its scope.....</i>	<i>1</i>
0.1.2	<i>The evaluation process and its phases.....</i>	<i>1</i>
0.1.3	<i>Methods of data analysis</i>	<i>2</i>
0.2	SYNTHESIS OF THE EC STRATEGY AND PROGRAMMES IN MERCOSUR	2
0.2.1	<i>A dynamic view of EC-MERCOSUR relations from 1991 to present.....</i>	<i>2</i>
0.2.2	<i>The implemented strategy: areas of intervention and programmes.</i>	<i>3</i>
0.2.3	<i>Bilateral co-operation and EC commitments to MERCOSUR and its Member States for the integration process.....</i>	<i>4</i>
0.2.4	<i>MERCOSUR integration process evolution</i>	<i>4</i>
0.3	MAIN FINDINGS AND CONCLUSIONS	4
0.3.1	<i>Relevance.....</i>	<i>4</i>
0.3.2	<i>Impact</i>	<i>5</i>
0.3.3	<i>Effectiveness</i>	<i>5</i>
0.3.4	<i>Efficiency</i>	<i>6</i>
0.3.5	<i>Sustainability</i>	<i>6</i>
0.3.6	<i>Policy co-ordination and internal coherence</i>	<i>6</i>
0.4	RECOMMENDATIONS	7
0.4.1	<i>Recommendations at strategy level</i>	<i>7</i>
0.4.2	<i>Recommendations at co-ordination and policy coherence level</i>	<i>8</i>
0.4.3	<i>Recommendations at project and management level.....</i>	<i>9</i>
1	THE PURPOSE OF THE EVALUATION AND ITS SCOPE	11
1.1	THE METHODOLOGY	11
1.1.1	<i>The evaluation process and its phases.....</i>	<i>11</i>
1.1.2	<i>The evaluation questions</i>	<i>13</i>
1.1.3	<i>Methods of data analysis</i>	<i>14</i>
1.1.4	<i>Difficulties encountered.....</i>	<i>15</i>
2	THE CONTEXT.....	16
2.1	SYNTHESIS OF THE EC STRATEGY AND PROGRAMMES IN MERCOSUR	16
2.1.1	<i>Shaping the strategy: a dynamic view of EC-MERCOSUR relations from 1991 to present</i>	<i>16</i>
2.1.2	<i>The implemented strategy: areas of intervention and programmes.</i>	<i>19</i>
2.1.3	<i>EC commitments to the MERCOSUR sub-region.....</i>	<i>21</i>
2.1.4	<i>EC commitments to MERCOSUR and its Member States for the integration process.....</i>	<i>27</i>
2.1.5	<i>Concluding remarks</i>	<i>29</i>
2.2	MERCOSUR INTEGRATION PROCESS EVOLUTION	30
2.2.1	<i>The early 1990s: MERCOSUR opens up to the rest of the world.....</i>	<i>30</i>
2.2.2	<i>The late 1990s: the negative effects of the regional and world crises on the MERCOSUR integration process.....</i>	<i>30</i>
2.2.3	<i>Future MERCOSUR perspectives.....</i>	<i>32</i>
2.3	MERCOSUR TRADE FLOWS	33
2.3.1	<i>Intra-regional trade.....</i>	<i>33</i>
2.3.2	<i>Extra-MERCOSUR trade</i>	<i>35</i>
2.4	MERCOSUR ASYMMETRIES IN THE INTEGRATION PROCESS	36
3	ANSWERS TO THE EVALUATION QUESTIONS.....	38

3.1	EQ 1: ON THE COHERENCE OF THE EC STRATEGY WITH THE MERCOSUR INTEGRATION	
	MODEL AND PRIORITIES	38
3.1.1	<i>Rationale</i>	38
3.1.2	<i>Observed developments</i>	38
3.2	EQ 2: ON THE RELEVANCE OF THE EC IMPLEMENTED STRATEGY TO THE CHANGING NEEDS	40
3.2.1	<i>Rationale</i>	40
3.2.2	<i>Observed developments</i>	40
3.3	EQ 3: ON THE EC CONTRIBUTION TO BUILDING UP AND STRENGTHENING MERCOSUR	
	INSTITUTIONS	44
3.3.1	<i>Rationale</i>	44
3.3.2	<i>Observed developments</i>	45
3.4	EQ 4: ON EC CONTRIBUTION TO THE OBJECTIVE OF ECONOMIC AND TRADE INTEGRATION	
	PROCESS.....	48
3.4.1	<i>Rationale</i>	48
3.4.2	<i>Observed developments</i>	48
3.5	EQ 5: ON THE EC AID MANAGEMENT PROCEDURES, IMPLEMENTATION MECHANISMS AND	
	DISBURSEMENT OF FUNDS	51
3.5.1	<i>Rationale</i>	51
3.5.2	<i>Observed developments</i>	52
3.6	EQ 6: ON POLICY CO-ORDINATION AND INTERNAL COHERENCE.....	56
3.6.1	<i>Rationale</i>	56
3.6.2	<i>Observed developments</i>	56
3.7	EQ 7: EC CONTRIBUTION TO THE SUSTAINABILITY OF THE MERCOSUR INTEGRATION	
	PROCESS.....	58
3.7.1	<i>Rationale</i>	58
3.7.2	<i>Observed developments</i>	58
4	CONCLUSIONS	60
4.1	RELEVANCE	60
4.2	IMPACT.....	62
4.3	EFFECTIVENESS.....	63
4.4	EFFICIENCY	64
4.5	SUSTAINABILITY	65
4.6	POLICY CO-ORDINATION AND INTERNAL COHERENCE	66
5	RECOMMENDATIONS	66
5.1	RECOMMENDATIONS AT THE STRATEGY LEVEL	67
5.2	RECOMMENDATIONS AT THE CO-ORDINATION AND POLICY COHERENCE LEVEL	70
5.3	RECOMMENDATIONS AT PROJECT AND MANAGEMENT LEVEL	71

LIST OF TABLES:

TABLE 1: MERCOSUR SUB-REGION - COMMITMENTS BY MACRO-SECTOR AND BY YEAR.....	22
TABLE 2: MERCOSUR SUB-REGION AND COUNTRIES - COMMITMENTS AND PAYMENTS, 1992-2002	27
TABLE 3: MERCOSUR SUB-REGION AND COUNTRIES - COMMITMENTS BY MACRO-SECTOR, 1992-2002.....	28
TABLE 4: MERCOSUR COUNTRIES – SUPPORT TO OTHER ACTIONS FOR DEVELOPMENT BY SECTOR, 1992-2002.....	29

LIST OF FIGURES

FIGURE 1: MERCOSUR SUB-REGION: COMMITMENTS VARIATION BY PERIODS AND MACRO SECTOR 1992-2002.....	22
FIGURE 2: SUPPORT TO TRADE IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002.....	24
FIGURE 3 : SUPPORT TO ECONOMIC INTEGRATION AND INTRA-REGIONAL COOPERATION IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002.....	25
FIGURE 4 SUPPORT TO OTHER INSTITUTIONAL ISSUES IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002.....	26
FIGURE 5 SUPPORT FOR OTHER ACTIONS FOR DEVELOPMENT IN MERCOSUR COUNTRIES. DISTRIBUTION OF COMMITMENTS BY COUNTRY, 1992-2002.....	28
FIGURE 6: INTRA- MERCOSUR TRADEFLOW - USD MIL. - CURRENT PRICES.....	34
FIGURE 7: MERCOSUR – EU TRADE FLOWS- USD MIL. CURRENT PRICES	35

LIST OF DIAGRAMS

DIAGRAM 1: EC INTERVENTION LOGIC MODEL FOR THE SUPPORT TO MERCOSUR- SUB-REGIONAL FUNDS	20
DIAGRAM 2: THE GLOBAL LOGIC OF THE EC INTERVENTION MODEL TO MERCOSUR	21

TABLE OF CONTENTS OF VOLUME 2 **SYNTHESIS OF THE CASES STUDIES**

STATISTICAL CO-OPERATION WITH MERCOSUR MEMBER COUNTRIES – ASR/B7-311/IB/96/0165	1
CO-OPERATION AND TECHNICAL ASSISTANCE PROJECT ON TECHNICAL STANDARDS - ALA 93/15	8
EC-MERCOSUR CO-OPERATION PROJECT AND TECHNICAL ASSISTANCE ON AGRICULTURAL MATTERS - ALA 93/16.....	16
SUPPORT TO THE ADMINISTRATIVE SECRETARIAT OF MERCOSUR (SAM) – ASR/B7-3110/IB/98/0426	24

TABLE OF CONTENT OF VOLUME 3 **ANNEXES**

ANNEX I – TERMS OF REFERENCE	2
ANNEX II – LIST OF PERSONS MET	18
ANNEX III – BIBLIOGRAPHY	23
ANNEX IV – TRENDS OF TRADE	30
ANNEX V - MERCOSUR ASYMMETRIES: COUNTRY PROFILE	35
ANNEX VI –INVENTORY	44
ANNEX VII - SYNOPTIC TABLE OF EU & MERCOSUR STRATEGIES.....	64
ANNEX VIII – OTHER DONORS	66
ANNEX IX – INTERVIEWS STATISTICAL ASSESSMENT.....	86
ANNEX X - THE EVALUATION MATRIX.....	90

ACRONYMS

ALADI	<i>Asociación Latinoamericana de Integración</i>
ALBAN	Scholarship programme for Latin Americans in the European Union
ALFA	EU-Latin America Higher Education Programme
AL-Invest	EU-Latin America Programme for Investment promotion
ALIS	Alliance for the Information Society programme
AMN	<i>Asociación MERCOSUR de Normalización</i>
CET	Common external tariff
CSP	Country strategy paper
EC	European Commission
ECIP	European Community Investment Partner
ECLAC	Economic Commission for Latin America – UN
EQ	Evaluation question
EU	European Union
EuropeAid	European Commission Co-operation Office
EUROSTAT	Statistical Office of the European Communities
FFAA	Financial Agreement
FTAA	Free Trade Area of the Americas
IFCA	Interregional framework co-operation agreement
GSP	Generalized System of Preferences
IMF	International Monetary Fund
INMETRO	<i>Instituto Nacional de Metrologia, Normalização e Qualidade Industrial, Brasil</i>
OAS	Organisation of American States
MERCOSUR	Mercado Común del Sur
MoU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
NGO	Non governmental organization
NSIs	National Statistics Institutes
RSP	Regional strategy paper
SAM	Administrative Secretariat of MERCOSUR
SME	Small and Medium Enterprise
SPS	Sanitary and Phytosanitary Measures
TA	Technical Assistance
TBT	Technical Barrier to Trade
ToR	Terms of Reference
USA	United States of America
WTO	World Trade Organisation

0 EXECUTIVE SUMMARY

0.1 Purpose, scope and methodology

0.1.1 *The purpose of the evaluation and its scope*

The objective of the study is an assessment of the strategy of the European Community (EC) in support of MERCOSUR, in advance of the completion of negotiations for the signature of an interregional association agreement. The evaluation has mainly a formative objective: *to extract lessons learnt from past co-operation experience in order better to fine-tune future co-operation once the Agreement negotiations are completed, and with the additional aim of supporting the process of creating a MERCOSUR common market.* The study covers the 1992-2002 period, and embraces an analysis of EC co-operation policy and projects implemented with MERCOSUR and its Member States in the areas supporting sub-regional integration.

0.1.2 *The evaluation process and its phases*

Responding to the terms of reference the evaluation was carried out in three phases with the following aims:

(i) The structuring phase aims were to define the evaluation issues and the overall framework of the analysis; to reach agreement on the work plan, budget and evaluation team; and to reconstruct the EC's intervention logic through a complete analysis of the policy and strategy documents and of data on projects funded in the region¹.

(ii) The field visit phase aims were to complete the data collected in the structuring phase and to gather new information in support of the conclusions and recommendations of the study².

(iii) The synthesis report phase entailed analysis of all data collected previously to complete the answers to the evaluation questions and prepare the synthesis report that includes the final conclusions and recommendations. The conclusions and recommendations take into account the results of the seminar held in Montevideo on the 16 March, with representatives of the MERCOSUR institutions, implemented project counterparts, non state actors, MERCOSUR and Chile Unit from DG RELEX Evaluation Unit of EuropeAid and EC Delegation of Uruguay and Paraguay, to present and agree on the findings conclusions and recommendations of the study.

¹ See Annex II for the full list of the people meet and Annex III for the biography consulted.

² Secondary data were also assembled related to MERCOSUR trade flows and to its Member States' socio-economic indicators to identify country asymmetries (See Annex IV and V)

0.1.3 *Methods of data analysis*

The evaluation has been supported by a methodology based on three main components.

- Qualitative analysis of documents and data from interviews. All the information compiled has been analysed in qualitative and quantitative terms to identify the historical evolution of the relations between the two blocs as well as to define their implications for the strategies and actions funded by the EC. The interviews and meetings with stakeholders and informants in Brussels and in the field were used to complete the document analysis.
- Cluster analysis of the actions funded. A data base (inventory) was prepared and classified by sectors and then clustered according to the main areas of intervention of the EC projects funded between 1992 and 2002. The inventory and the qualitative data were used to build up the EC strategy model and to formulate the evaluation questions.
- Project case studies. Four projects were selected (“case studies”) as a tool to verify the coherence and linkages between the three analytical levels addressed by the evaluation: policy, strategy and actions. It also allowed a review of the functioning of all EC and MERCOSUR structures, coordinating mechanisms, implementation modalities, strategies, and instruments used.

0.2 Synthesis of the EC Strategy and Programmes in MERCOSUR

Two objectives summarise EC policy towards MERCOSUR: (i) promotion of development; and (ii) promotion of integration into the world economy. Promotion of development has been pursued primarily through bilateral co-operation agreements with MERCOSUR countries, using a variety of typical development instruments. The second objective is supported by the EC's unique expertise in the EU integration process and the conviction that regional integration is a catalyst for development and integration into the world economy³.

0.2.1 *A dynamic view of EC-MERCOSUR relations from 1991 to present*

The dynamics of the EC-MERCOSUR relationship and the application of the EC strategy have been defined and characterized in three periods, and the identification of the EC projects and priorities is linked to the strategic approach applied in each period.

The first period (1991-1995) is dominated by the initiation of the relationship between the two blocs. Trade and the formation and consolidation of a common market in MERCOSUR were the focus of European interest.

The second period (1996-1999) is considered a transitional period for MERCOSUR, and was characterized by an EC focus on the development of MERCOSUR's internal economic integration process, and the building of its institutions.

³ See also the COM (95)212: EC support to regional integration initiatives in developing countries

During *the third period, from 2000 onwards*, the process of strategic and structural adjustment in both entities was reflected in and characterised by the renewal of EC support for economic integration issues, and by a re-focusing of its support for trade.

0.2.2 *The implemented strategy: areas of intervention and programmes.*

During the dynamic analysis of the history of the EC and MERCOSUR, the review of documents and of interviews provided the basis for constructing a model of the EC strategy of support to MERCOSUR, where four related areas of intervention (or macro-sectors) are identified: (i) trade; (ii) economic integration and intra-regional co-operation; (iii) institutional issues; and (iv) other actions for development. Within the 1992-2002 period the EC has allocated Euro 49,316 millions to the four selected sectors.

i) Trade. The EC's trade strategy has pursued two objectives: (i) increasing the weight of MERCOSUR in international trade, and in particular to boost trade with the EU; and (ii) supporting the trade integration process within MERCOSUR countries. The supporting actions have taken place in two main sectors: *Customs harmonization, and Technical standards* (including *Sanitary and Phytosanitary*). In terms of funds allocated this is the most important macro-sector, representing 43% of total allocation (almost €21 million over the whole period). Despite the importance accorded to these actions over the period and the results already achieved, the objective of improving and diversifying trade relations between the two parties remains a priority. The MERCOSUR-EU trade dimension is subject to creation of a single market within MERCOSUR, which so far has not taken place and it is also an important pre-condition for the conclusion and implementation of an Inter-regional Agreement. MERCOSUR has yet to develop a harmonized trade and commercial policy for negotiations with the EC. On the EC side, additional consideration to intra-MERCOSUR trade policy was not explicitly given until 2000, when the trade strategy regained momentum and is now more in line with MERCOSUR's needs and priorities as identified in the RSP.

ii) Economic Integration and intra-regional co-operation. In this sector the focus has been on two objectives: (i) supporting and increasing the economic integration process among MERCOSUR members; and (ii) obtaining greater interaction and integration between the sub-region and the EU. The initiatives funded relate to *Policy Harmonization* (macroeconomic and industrial harmonization); *Statistics*; and *MERCOSUR intra-regional development* (consolidation of the internal market). After Trade, this is the second most important sector according to funds allocated: around €19 million was committed during the period (representing 39% of the total). Initially EC interest in promoting MERCOSUR economic integration process was limited, while the objective of promoting closer co-operation between the EC and MERCOSUR economies remained outside the focus of the strategy. The obstacles encountered in seeking consensus between the four countries explain in part why the EC's support was limited at regional level. However, since the end of the second period the EC has become more active and has pursued closer economic integration between both parties, but it has also introduced an element of conditionality, under which MERCOSUR is obliged to improve harmonisation of its internal policies to facilitate action as a common bloc.

iii) Institutional issues. In this area two main objectives are specified: (i) strengthening *MERCOSUR's institutions*; and (ii) strengthening *Civil Society*. The accumulated actions of the EC through the implementation of projects have supported construction of an intra-regional

co-operation system specific to MERCOSUR. The transfer of EU experience on regional co-operation and institutional building has been instrumental in providing MERCOSUR with the basis of an administrative, technical and legal infrastructure. The strategy was however less active in practice in supporting civil society. The accumulated amount of funds in this macro-sector is around €8 million, equivalent to 17% of the allocated funds.

iv) Other Actions for Development. Under this area the objective is to enhance national capabilities and reduce asymmetries between its members through the execution of *horizontal programmes* (i.e. @LIS, ALBAN, AL-INVEST, UR-BAL ALURE, and ALFA); and *bilateral co-operation*. The connection of *horizontal* initiatives with the integration process is not clear.

0.2.3 Bilateral co-operation and EC commitments to MERCOSUR and its Member States for the integration process.

The accumulated support to MERCOSUR Member States during the period 1992-2002 represents 82% (€225 million) of the total funds committed to the sub-region (only 18% or €49 million was for direct allocation to MERCOSUR itself). Consequently the EC support strategy for MERCOSUR integration has relied primarily on bilateral co-operation rather than support for regional action. But in spite of this there is not enough evidence to determine the direct contribution of these programs to the integration process and to building MERCOSUR as a viable regional alternative.

0.2.4 MERCOSUR integration process evolution

MERCOSUR has evolved as a regional organization in a context where internal and external factors have influenced its development and achievements; and its integration process has passed through three different periods: the early 1990s when MERCOSUR countries started implementing policies that opened up their economies and sought greater participation in international trade; the late 1990s when the negative effects of the regional and world crises affected MERCOSUR's integration; and the period since 2000 when the integration process has been at its strongest, enjoying a favourable political resurgence.

0.3 Main findings and conclusions

0.3.1 Relevance

1. The strategy was not very **supportive of the model of integration** that the MERCOSUR Member States agreed upon, and has not addressed either the uncertainties intrinsic in the “learning by doing” system or MERCOSUR's desire to execute its activities through interstate or working group structures.
2. The strategy has fallen short of increasing and promoting stronger **integration with the EU**. The existence of protectionist EU policies has limited the export capacity and performance of MERCOSUR, thus partially offsetting the benefits realised through the assistance programmes.

3. The EC bilateral projects in MERCOSUR Member States aimed at **enhancing national capabilities, and improving the social and economic environment, and reducing the existing asymmetries**, have all been relevant to the strategy. However many of these initiatives have, for the most part, been actions in response to each country's short-term problems, and have not been directly correlated with the long-term goals of the integration process.

0.3.2 Impact

4. As a result of the EC co-operation MERCOSUR stakeholders' **negotiating skills**, and **technical knowledge** of regional institutions, have increased during the negotiation process. The projects have had a positive impact on progress in the negotiations and in the effective preparation of a timetable and agenda for MERCOSUR.
5. With reference to the **consultation process**, the observed impact on **participation of Civil Society**, as an active actor capable of influencing negotiation of agreements or MERCOSUR's strategy of achieving integration, has been inadequate at multinational level.
6. With respect to **trade**, and despite the small size of the financial contribution in relation to the size of the MERCOSUR economy, EC assistance has invigorated and facilitated trade within Member States although not sufficiently to tighten commercial links between both blocs.
7. EC projects in **economic integration** have had a positive impact on intra-MERCOSUR commerce, improving market access. At the same time the technical capabilities of enterprises have indirectly benefited from EC initiatives on market expansion, establishment of networks, and creation of new business opportunities.

0.3.3 Effectiveness

8. The extent of **achievement of the planned objectives of the different projects has been limited**. Ambitious objectives, restricted resources, and excessive rigidity in the administrative and managerial structures and procedures of both MERCOSUR and the EC, have adversely affected the effectiveness of the strategy. But despite these shortcomings at project level, the EC strategy has been **very effective in facilitating commercial flows and market expansion for MERCOSUR**.
9. The projects in which the **asymmetries between the MERCOSUR countries were taken into consideration achieved the best results**. However, initiatives and projects that were divided into equal parts for each member country regardless of size, generated problems and implementation delays, and did not result in a reduction in intra-MERCOSUR disparities.

0.3.4 *Efficiency*

10. Administrative delays in Brussels and disagreements within MERCOSUR's Member States over management and project components seem to have constrained the efficiency of the strategy. In addition, **significant delays** have occurred between **the identification phase** and the preparation and submission of the Terms of Reference; consequently many project components were obsolete by the time of execution. MERCOSUR initially could not offer appropriate experience or suitable counterparts to handle the project components or the implementation modalities.
11. Limited participation of MERCOSUR and its Member States in the EC **programming and implementation cycles** was noted. As a result, identification of needs, priorities, activities and implementation modalities was not properly reflected in the projects.
12. The low rate of disbursement demonstrates poor **implementation performance**. Both organisations had to undergo a learning curve in the initial years which affected the disbursement rate. While the rate of expenditure varied from project to project the programme has also suffered from the absence of **adequate regional management** in both blocs. Moreover, the absence of a proper **co-ordinating mechanism** within the EC structures for developing a coherent and integrated regional strategy diminished the potential impact that the actions taken could have had on the integration process.

0.3.5 *Sustainability*

13. MERCOSUR has survived political, organisational and technical disagreements within its members and also resisted a severe economic crisis; despite these factors, there have been sustainable achievements generating important political, technical and economic assets.
14. MERCOSUR's sustainability depends on its internal capacity to overcome the disagreements and conflicts evident in the negotiations and in the sub-regional market in recent years, and on deepening the policy co-ordination process. At project level, many of the good results achieved in terms of institutional strengthening and capacity-building need further consolidation to be sustainable.

0.3.6 *Policy co-ordination and internal coherence*

15. The EC's strategic environmental priorities have not been applied in a systematic or structural way to address the MERCOSUR Member States' needs and priorities. Although most Country Programmes identify the environment as an area for attention, their scope and implementation have been limited to individual national problems, and no mechanisms are in place at regional level to support co-ordination and coherence between the different initiatives.
16. The thrust of the EC strategy in support of MERCOSUR's regional integration and of eliminating country asymmetries is counterbalanced by the negative effect of certain of the EC's external relations policies applied in Latin America in favour of neighbouring

countries. There is no regional co-ordinating structure or mechanism to monitor the impact of external relations policies.

0.4 Recommendations

0.4.1 *Recommendations at strategy level*

1. **Develop a medium-to-long term strategic plan.** A medium and long term strategic plan to achieve integration should be prepared by the relevant EC Services, detailing each sector's objectives and goals. This plan should be supported by output, outcome, and impact indicators so the actions are measurable and capable of evaluation. Preparing an action plan based on an analytical assessment, sector by sector, will facilitate both the required consistency and coherence between policy, strategy and actions, and also reduced reactivity to short term needs. (Conclusions.4, 5, 8,11)
2. **Pursue integration from multiple angles.** The EC should attempt to match its strategic interventions to the real institutional framework within which MERCOSUR is developing. The following initiatives could contribute to strengthening of MERCOSUR institutional structures:
 - (i) **Integration from within MERCOSUR structures.** This will require the design of a special facility, targeting each specific group involved in the construction of MERCOSUR. Transferring know-how to the different subcommittees and working groups, or providing TA to institutions working in the integration process, would be effective means for achieving integration. [Conclusion n. 3,9,23,24]
 - ii) **Integration from within government institutions.** Integration should also be sought from each Member State's government institutions, ministries, or special government agencies (Chancellery), transferring EC experience and know-how in design and management of the integration process within the context of national government perspectives. (Conclusions 2, 22)
 - iii) **Sector –Horizontal- Integration.** The construction of a “regional identity” from a sectoral perspective should be supported from within each Member State's sectors and institutions engaged in the integration process.. The strategy should support construction of sector level networks that can contribute to integration. Examples of sectors that could contribute to the integration process include SMEs, environment, transport and telecommunications and energy, among others. [Conclusions 12, 13,15,26].
 - iv) **Greater country-sensitivity.** The EC support strategy for MERCOSUR should be more country-sensitive and consider each country's specific characteristics and needs. The regional programmes should systematically identify and address sectors and sub-sectors in each country where projects contribute not only to reducing existing asymmetries and increasing the economic development of the less advanced countries, but also to furtherance of the integration process. (Conclusions 6, 16, 18).

3. **Support the creation and dissemination of a MERCOSUR Culture.** The EC strategy should support activities aimed at reducing the existing gap between the political authorities of MERCOSUR and civil society, emphasising the concept of integration as a “tool for development”. For example, the “Economic and Social Consultative Forum” should be stimulated as a way of stimulating and disseminating a more comprehensive MERCOSUR Culture. This strategy should also consider the increase participation of private sector organizations, educational centres, NGOs, labour unions and similar bodies. [Conclusions 9, 10, 15, 24, 26]
4. **Integrate into the strategy a coherent environmental and external policy framework.** To enhance the potential benefits of the integration process, especially on the environment, the Commission needs to integrate a coherent external and environmental policy framework into its global strategy for the sub-region and increase co-ordination and coherence with bilateral interventions. The following steps are recommended to this end: (i) environmental and other external policies should be incorporated and linked to the overall EU principles of achieving sustainable economic and social development; (ii) identification and selection of co-operation projects for funding should be the joint responsibility of the MERCOSUR institutions and the competent Commission Services; and (iii) a structure for monitoring and supervising the environmental dimension of the regional programme should be designed and developed. Increasing co-ordination and dialogue with MERCOSUR environmental groups, other donors and ministries in the design of regional projects with potential environmental effects, would also ensure coherence at national and regional levels. [Conclusions 27].

0.4.2 Recommendations at co-ordination and policy coherence level

5. **Establish a formal co-ordination mechanism within the EC.** It is recommended that co-ordination between the various Commission Services in Brussels (AIDCO, DGs RELEX, Trade, Agriculture, etc.) on policy issues and technical co-operation be enhanced. To this end, the construction of a formal system, namely an EC-MERCOSUR FORUM, is recommended whereby co-ordination of policy aspects and technical co-operation can take place within both HQ and the EC Delegations of the sub-region. The objective of this Forum should be to assess the policy and strategy underlying the regional programme, review achievements and lessons learnt, and provide policy guidelines for continuation of the integration process between MERCOSUR and the EU (Conclusion 14, 18, 22, 23, 27).
6. **Set up a formal consultation process through a Regional Steering Committee to improve co-ordination between the EC Delegations.** Under the auspices of the Delegation in Uruguay and Paraguay a formal ex-ante and ex-post consultation and co-ordination process, in the form of a Regional Steering Committee, should be established with the other Delegations (Argentina and Brazil,) to define responsibilities over the execution of the regional program. The EC Delegations need to take a pro-active approach towards the regional programme, participating in programming, ensuring that there are synergies and complementarity between country, regional and other external EC policy initiatives, and increasing their role in project management and monitoring. It is recommended that EC officials from the Delegations meet on a regular basis to discuss, follow up and to assess the impact and the effectiveness of regional projects over the

integration process and also their contribution to their respective Member States. Issues relating to implementation modalities, project execution, monitoring and evaluation should all be addressed at these meetings. Relevant documents (Identification Form, Financing Proposal, Evaluations...) should be circulated in a draft format, either from Head Quarters or from Montevideo, to Asunción, Brasilia and Buenos Aires, allowing the other delegations to make comments. Ultimately this consultation process should form part of the proposed EC-MERCOSUR Forum. [Conclusions 7, 17, 18, 19, 20, 22, 27]

7. **Include a Regional dimension in Country Strategy Papers.** Regional and bilateral co-operation needs to be increased. Country Programmes should include the development of MERCOSUR and achievement of integration as goals for the medium and long term. At the same time, each bilaterally-financed project should include outcomes linked to the regional integration process, whether in terms of coordination (i.e. creation of MERCOSUR networks) or of specific activities. [Conclusions 16, 20, 23, 26, 27]
8. **Increase policy co-ordination, harmonization and competitiveness within MERCOSUR.** Promoting and supporting a “Regional Policy Dialogue” as a forum for senior policy-makers to share ideas and to discuss co-operation and policy harmonization between Member States would be one way of contributing to this objective. The outcome of these meetings or seminars should be disseminated widely among universities or think-tank institutions in the private and public sectors, with a view to giving information on the sustainability of the integration process. [Conclusions 10, 24, 25, 26]

0.4.3 Recommendations at project and management level

9. **Encourage increased MERCOSUR responsibilities in project identification and design.** Increasing MERCOSUR responsibilities in the definition and design of the projects should be encouraged by the EC. The Commission should provide TA to the MERCOSUR structures (i.e. to the GMC and to the technical committees and sub-committees including the Secretariat) to improve programming and project identification and design. The outcome of this initiative should be the preparation and presentation of a MERCOSUR Project Portfolio in which all administrative, legal and technical requirements, as well as EC and MERCOSUR strategic priorities, are reflected. [Conclusions 7, 14, 17, 18, 19, 20]
10. **Promote the creation of a MERCOSUR Technical Co-operation Centralized structure.** The EC should press for a centralized structure (a specialised agency or a cooperation desk) in which all technical co-operation issues can be dealt with efficiently. The creation of a single entity capable of negotiating and assuming legal responsibility for all MERCOSUR projects financed by international organizations would be an efficient mechanism for improving co-operation between MERCOSUR and the international donor community. It is therefore recommended that under EC sponsorship a feasibility study be undertaken on creating such a joint MERCOSUR structure/body taking account of the current structures for programming and implementing sub-regional cooperation. The roles, responsibilities, and legal status of this structure should be clearly defined. [Conclusions 14, 17, 18, 19]

11. Adapt the EC Financial Regulation to the real regional context of MERCOSUR.

The application of EC Financial Regulations to regional programmes like MERCOSUR needs to be adapted to the actual regional co-operation context and made more flexible so as to improve efficiency and contribute to full achievement of project objectives and thus the EC's strategic objectives. The EC should consider introducing more flexible mechanisms within its current Financial Regulations, particularly Article 164 on the legal, institutional and financial requirements for project selection and implementation. [Conclusions 3, 14, 17, 21]

12. Improve the EC project preparation cycle. The time taken from project conception to actual implementation needs to be shortened (in particular, identification and preparation of ToRs is too lengthy) and more flexibility should be introduced into ToRs so that changes that occur in the project environment can be reflected in adaptation of project activities. The Delegation in Uruguay should have the authority to approve such amendments. [Conclusions 14, 17, 18]

PART 1: THE EVALUATION FRAMEWORK

1 THE PURPOSE OF THE EVALUATION AND ITS SCOPE

The objective of the overall study is an assessment of the EC strategy in support of MERCOSUR, in advance of the completion of negotiations for the signature of an interregional association agreement.

The evaluation, which does not respond to any legal obligation, has mainly a formative objective: *to extract lessons learnt from past co-operation experience in order better to fine-tune future co-operation once the Agreement negotiations are completed, and with the additional aim of supporting the process of creating a MERCOSUR common market.*

To fulfil the above global objective, the evaluation team has considered important extension of the analysis to the first years of support to MERCOSUR. Therefore the historical period considered by the study is 1992-2002, although the Terms of Reference (ToR) stipulated an analysis over the period 1995-2002 (Annex I contains the full set of the study ToRs).

The study embraces an analysis of EC co-operation policy and projects implemented with MERCOSUR and its Member States in the areas supporting sub-regional integration. It also examines the liaison with the other EC policies that have an external relation dimension and that are relevant for the analysis of the EC-MERCOSUR relations, in particular the Trade policy.

1.1 The methodology

1.1.1 The evaluation process and its phases

A team of 7 experts, including an Evaluation Contract Manager responsible for quality control and for fluidity and clarity in communications with the Commission, carried out the evaluation. Two members of the team (one senior and one junior expert) were based in MERCOSUR. As a result of the on going devolution process, working from the field since an earlier phase of the evaluation was considered indispensable. From the Commission's side, a Steering Group - chaired by EuropeAid's Evaluation Unit and composed by EC officials from different services of the Commission including from the EC delegations involved with MERCOSUR, with an

interest in the subject of the evaluation - followed the study with the objective of discussing and approving the methodology and outputs⁴ produced in the course of the study.

The evaluation was carried out in three phases: a structuring phase; a field visit phase; and an analysis and synthesis phase.

The structuring phase

The aims of the first part of this phase were clarification of the evaluation issues and the overall framework of the analysis and agreement on the work plan, budget and evaluation team. During this period interviews with the main stakeholders based in Brussels and an analysis of policy and strategy documents were carried out⁵. During the second part, the team reconstructed the EC's intervention logic through a complete analysis of the policy and strategy documents and of data on projects funded in the region, completing the interview round with EC officials and other key institutional stakeholders located in the MERCOSUR region. The team provided also an historical overview of the context of the EU and MERCOSUR relationship from the side both of the EC and of the MERCOSUR. This work was used to elaborate the evaluation questions - which were not provided in the study ToRs - the judgment criteria and development of the methodology for the field visits. The evaluation questions and the methodology for the field visit were validated by the Evaluation Steering Group. The structuring phase lasted from May to September 2003.

The field visit phase

This phase aimed at completing the data collection from the field on three levels. Data concerning overall strategy and policy in the framework of EC-MERCOSUR relations and MERCOSUR's internal agenda were gathered through interviews with relevant stakeholders and key informants such as the national and regional institutions, civil society, other donors, project counterparts, think tanks and researchers. In parallel, data related to four projects funded under the MERCOSUR sub-region allocation were also collected. These projects were selected to represent the main areas of support of the EC strategy towards MERCOSUR in the period covered, and to analyse the coherence and complementarity between sub-regional bilateral co-operation. The projects are: (a) *support to the MERCOSUR Administrative Secretariat*; (b) *Statistical co-operation with MERCOSUR countries* (1997); (c) *Technical Assistance in the field of Technical Standards* (1993); and (d) *Co-operation and technical assistance for MERCOSUR in the field of Agriculture (sanitary and phytosanitary)* (1993)⁶. Finally, during the field visits, secondary data were collected related to MERCOSUR trade flows (intra and external) and to its Member States' characteristics so to identify country asymmetries⁷.

⁴ The outputs of the evaluation are: an Inception Note, (end of June 2003) a Desk report, (September 2003) a field visit de-briefing presentation (mid November 2003), a Synthesis draft report, (January 2004) and a final Synthesis report (April 2004).

⁵ See Annexes II for the full list of people met and III for the bibliography consulted

⁶ See Volume 2 for the detailed synthesis of the case studies

⁷ See Annex IV for the MERCOSUR trade flows and Annex V for the country profile and asymmetries

During the field phase the expert team visited all four MERCOSUR countries, each expert spending between one and two days per country within an average overall period in the field of 8-9 days⁸.

The synthesis report phase

This concluding phase entails the analysis of the data collected during the field visits to complete the answers to the evaluation questions, and the preparation of the synthesis report that includes the final conclusions and recommendations of the study. To conclude the synthesis phase a seminar was organised in Uruguay to present and discuss the draft synthesis report before its finalisation.

The synthesis report is organised in three volumes. The first volume is a summary of the findings and includes the conclusions and recommendations. The second volume includes the synthesis of the case studies of the four projects analysed during the field phase. The third volume includes the Terms of Reference of the study (Annex I), the list of people met during the study (Annex II), and the supporting documents used for answering the evaluation questions: the consulted documentation (Annex III), the MERCOSUR terms of trade (Annex IV) and country profiles (Annex V); the Inventory of the projects funded in the region both through the regional and bilateral co-operation (Annex VI); the synopsis of the EC intervention strategy in MERCOSUR and of the MERCOSUR agenda, both sub-divided according to the three periods identified in chapter 2 (Annex VII); a review of other donors' actions in MERCOSUR in relation to the regional integration process (Annex VIII); and the statistical analysis of the data collected through interviews in the field phase (Annex IX). Finally the Evaluation Matrix, which synthesizes the evaluation questions, judgment criteria, means of verification and analysis, is included in Annex X.

1.1.2 The evaluation questions

The questions have been formulated according to the global and specific objectives of the evaluation, moving from the “macro” perspectives of integration and co-operation strategy to the actual results obtained from the application of the strategy in its projects. In total seven Evaluation Questions (EQs) have been formulated covering four main areas:

- The relevance of the EU strategy and its coherence with the priorities and needs of MERCOSUR in the period from 1992 to 2002
- Achievements and their sustainability in relation to the proposed objectives (i.e. trade, regional integration, institutional issues and EU-MERCOSUR co-operation)
- The efficiency and effectiveness of the strategy implementation process

⁸ Therefore meetings with the relevant stakeholders could take place only in the capitals. In Brazil also Sao Paulo and Rio de Janeiro were visited. In total the field visits were carried out over a period of 40 days, from October to mid November 2003

- Policy co-ordination and coherence.

1.1.3 *Methods of data analysis*

Qualitative analysis of documents and data from interviews

The analysis of documents concentrated mostly on reviewing EC policy and strategy documents such as Regional Agreements, Communications, Country Strategy Paper (CSPs), the Regional Strategy paper (RSP), and Indicative Programmes. Information from other donors and from MERCOSUR's institutional documents were also reviewed and analysed. This analysis was used to define the historical evolution of the relations between the two blocs as well as their implications for the strategies and actions funded under EC support to MERCOSUR. It also allowed an *ex post* analysis of MERCOSUR's needs in the different periods and a review of the risks and assumptions that the EC took into consideration while developing its intervention strategy.

At the project level, data collected related to financing proposals, monitoring and evaluation reports and project files. Their analysis allowed determination of the following aspects: (i) project relevance (to the national/regional strategy, to EU policy and strategy, to beneficiaries, etc); (ii) project structure (sector, activities, instruments, beneficiaries, objectives, etc); (iii) project implementation (quality and quantity of output delivered); and (iv) the project impact and sustainability.

The interviews and meetings with stakeholders and informants in Brussels and in the field were used to complete the document analysis and furthermore were used for the following objectives: (i) to ascertain their perceptions of the results and relevance of the EC's co-operation strategy in supporting MERCOSUR, and the efficiency of the implementation mechanisms; (ii) to understand the internal and external mechanisms of co-ordination and communication; and (iii) to collect data relevant for the case studies and for the preparation of the field visits.

Cluster analysis of the actions funded

Using data provided by the EC on projects funded in the area between 1992 and 2002, an inventory has been compiled including information such as project title and committed, contracted and paid amounts⁹. Projects were classified by sectors and then clustered according to the main areas of intervention as identified through the document analysis. This method has been used to build up the EC strategy model, which is presented in Chapter 2 of this report, and to analyse how the strategy has been translated into specific projects and whether and why there were differences between the intended strategy as set out in the policy and strategy documents and the achieved strategy as represented by the financed projects. This

⁹ Annex VI includes also the description of the methodology used to collect and classify the data as well as their statistical exploitation

analysis was used for the formulation of the evaluation questions and as a guide for subsequent data collection and analysis.

Project case studies

Since the policy and strategy materialized in specific and concrete actions and projects, the evaluation has used four “case studies” as a tool to verify the coherence and linkages between the three analytical levels of the evaluation: policy, strategy and actions. The selected “case studies” allowed a review, from conception to implementation, of the functioning of all EC and MERCOSUR structures, coordinating mechanisms, implementation modalities, strategies, and instruments used. Similarly, the study of specific cases has allowed assessment of the technical and administrative procedures of both EC and MERCOSUR, and of the internal efficiency and effectiveness of the structures and modalities set up within the Commission.

This “bottom-up” approach has enabled the evaluators to determine, from the specific actions, the logic, coherence, relevance, impact and efficiency of the EC support to MERCOSUR. By analysis of the selected project case studies in each of the MERCOSUR countries, it was also possible to highlight differences at country level and possible lessons learnt.

1.1.4 Difficulties encountered

The team was confronted with two main difficulties:

- o The high turnover of Commission staff has made it difficult to identify and meet the people that were instrumental to the definition and design of the strategies and projects over the period considered. This aspect was further exacerbated by the de-concentration process going on in EuropeAid as project documents were difficult to locate and consult. The same difficulty was encountered in the MERCOSUR Member States where people who were instrumental to the integration process in specific historical periods, no longer cover those positions. Lack of institutional memory has therefore made particularly challenging not only the historical reconstruction of the relations between the two blocs, but also the reconstruction of the type of assistance provided in the early periods¹⁰.
- o The resources that could be allocated to the field visits were quite limited, which resulted in very short visits. The logistics difficulties also meant that the interviews carried out were mostly individual. Therefore the representativeness of the data collected has been reduced, although more than 100 people were met, covering key positions.

¹⁰ This was particularly the case of the support to the MERCOSUR Administrative Secretariat as for the first 2 projects, the expert did not succeed in obtaining the financing proposals and/or other project documentation.

2 THE CONTEXT

2.1 Synthesis of the EC strategy and programmes in MERCOSUR

The EC's strategy towards MERCOSUR has to be viewed within the context of the global principles and objectives of EC development policy and also within the specific experience, history and know-how of the European Union in the area of regional integration.

Two objectives summarise explicit EC policy towards MERCOSUR: (i) promoting development; and (ii) promoting integration into the world economy. Within this policy frame the European Commission has been structuring its strategy and actions since 1992 to support MERCOSUR. Promotion of development has been pursued primarily through bilateral co-operation agreements with MERCOSUR Member States using a variety of typical development instruments. The second objective is supported by the EC's unique expertise in the EU integration process and the conviction that regional integration is a catalyst for development and integration into the world economy¹¹.

The EC strategy towards MERCOSUR is a reflection of the evolution of the historical relationship between the EC and MERCOSUR. It is a relationship in which both sides have demonstrated varying degrees of commitment according to the specific moment in time. Therefore a review of EC strategy in support of MERCOSUR has to be seen within a dynamic perspective, taking into account the evolution and changes that occurred both worldwide and in particular in each region over the last 15 years.

2.1.1 Shaping the strategy: a dynamic view of EC-MERCOSUR relations from 1991 to present

Three periods characterize and define the dynamics of the EC-MERCOSUR relationship, and consequently the application of the EC strategy:

- **1991-95:** this period is dominated by the initiation of the relationship between the two blocs;
- **1996 to 1999:** this is considered a transitional period for MERCOSUR and one in which the consolidation of EC support to the regional integration process occurred;
- **From 2000 onwards:** this period reflects a process of strategic and structural adjustment in both entities.

In each period the strategy has been implemented through an array of modalities, and project execution was always in the context of one or more components of this strategy. As a result,

¹¹ See also the COM (95)212: EC support to regional integration initiatives in developing countries

the identification of the EC projects and priorities is linked to the strategic approach applied in each period.

1991-1995: a progressive support to the integration process.

In 1991, the European Union and MERCOSUR initiated political discussions on their mutual interest in potential co-operation between the two blocs. Although it was not clear for MERCOSUR Member States the kind of integration model they wanted to develop,¹² their immediate aim was to create a common market in goods, services and capital. In 1992, after an initial negotiation process, the EC and MERCOSUR signed the first Inter-institutional Agreement and the EC provided, for the first time, technical assistance to MERCOSUR's Administrative Secretariat.

The signature of the Ouro Preto Protocol in 1994, which established a legal framework for the MERCOSUR organization and allowed action as a single entity, facilitated the strengthening of ties with the European Union. That same year, at the Corfu European Council (June 1994), the EU reiterated its willingness to strengthen its relations with MERCOSUR, and proposed a twofold strategy towards that objective. The first component of the strategy was the conclusion of an Interregional Framework Agreement on trade and economic co-operation, which was signed in 1995; the second was the creation of an Interregional Association Agreement. The aim of the inter-regional framework Co-operation Agreement was a strengthening of the relationship between the parties and preparation of the ground for the creation of an interregional association.

The consolidation of EU-MERCOSUR political ties by the 1995 framework agreement contributed towards growing trade and investment relations between the two blocs (see Annex IV on MERCOSUR trends of trade). For MERCOSUR it was the first agreement signed as a legal entity; for the EC, it provided a treaty basis for development co-operation and technical assistance, and created building blocs for further economic activities in support of the integration process. In this first period, trade and the formation and consolidation of a common market in MERCOSUR was the focus of European interest.

1996-1999: the transition period

After 1995, MERCOSUR experienced a boom in its economies and further economic and trade integration were sought with the EU. However, at this time, EU and MERCOSUR negotiators experienced uneasiness, particularly on the terms of their trade agreements. Several issues associated with agricultural products, non-tariff matters, and fulfilment of international regulations (i.e. WTO), were foci of concern and of four years of political discussions. Finally, in 1999 the EU-Latin America summit in Rio provided the framework for the resolution of these differences. Both sides agreed that ***“the expansion of trade, through the development of free trade between MERCOSUR and Chile and the European Union, would constitute a central element in the construction of a more dynamic relationship”*** and ***“with this purpose, they agreed to***

¹² Uruguay and Paraguay were inclined towards a stronger degree of supranational governance, whereas Brazil and Argentina did not accept this model

launch negotiations between MERCOSUR, the EU and Chile, aiming at bilateral, gradual and reciprocal trade liberalization, without excluding any sector and in accordance with WTO rules”¹³.

However, despite this declaration, the EU reacted to MERCOSUR's ambivalence over progress in the integration process - and its institutional development - by diminishing its direct interventions in MERCOSUR on issues related mainly to interregional trade, and refocused its attention on supporting individual Member States. The EC strategy's objective became the strengthening of the internal economies in areas and activities related to the promotion of economic integration within the internal economies. Economic co-operation at sub-regional level as well as development of institutional building mechanisms gained momentum at the expense of trade and commercial aspects. Thus, the second period is characterized by a renewed focus on development of activities related to the internal economic integration process, and to the building of institutions, leaving aside considerations of trade and the integration sought between MERCOSUR and the EU.

At the political level, however, trade was still a priority for the EU strategy which aimed to safeguard MERCOSUR's commercial territory from the competition, particularly from the Free Trade America Area (FTAA) promoted by the United States. Although this period is marked by confusion and contradictions, the EU did actively prepare the negotiation's agenda and content. Five years after the signing of the framework agreement in Madrid in 1995, the EU presented a historic negotiating offer to MERCOSUR in Montevideo in 1999, covering 90% of agricultural trade and 100% of industrial trade, in line with WTO rules as regards free trade areas.

2000 to present: the restructuring period

Two important events occurred in this period in the area of EC- MERCOSUR co-operation: i) the signature in 2000 of the Memorandum of Understanding (MoU) which provides the framework for the use of the financial resources available for co-operation with the region¹⁴, establishing both the overall indicative global amount for the period 2000-2006 and the sectors of intervention; and (ii) the approval in September 2002 of the MERCOSUR RSP. The RSP provides the overall strategic framework for EC relations with MERCOSUR and for the first time it links co-operation to support for the negotiation process.

The RSP indicates as its overall objective support for the creation of the MERCOSUR common market as a pre-condition for finalisation of the negotiations and for the sustainability of the inter-regional association. It also confirms the areas of intervention already identified in the MoU, but alters the order of priorities¹⁵, which for the period 2002-2006 are now: a) completion of MERCOSUR's internal market; b), enhancement of the institutionalisation of MERCOSUR, and c) the regional and international openness of MERCOSUR. Although the current EC strategy is pending full implementation, it can be noted that the framework and the instruments for implementation designed in the RSP reflect a more solid understanding of each other's needs and priorities, and provides more specific

¹³ Extracts from the: “The EU and Latin America summit in Rio de Janeiro”. Dec. 1999

¹⁴ Only the co-operation foreseen by the ALA Regulation and covered by the budgetary lines B7-310 and B7-311

¹⁵ In the MoU the priorities were defined as follows: 1) stronger institutions for MERCOSUR; 2) Making MERCOSUR's economic and trade structures more dynamic; 3) support for the civil society.

methods for consolidating the upcoming inter-regional association. The third period is characterized by the renewal of EC support for economic integration issues, so as to consolidate further internal economic development, and a re-focussing of its support for trade.

2.1.2 *The implemented strategy: areas of intervention and programmes.*

The documentation review of interviews provided the basis for constructing a model of the EC strategy of support to MERCOSUR, where four related areas of intervention (or macro-sectors) are identified: (i) trade; (ii) economic integration and intra-regional co-operation; (iii) institutional issues; and (iv) other actions for development.

i) Trade

Within this area the EC strategy has two primary objectives: (i) to increase the weight of MERCOSUR in international trade, and in particular to boost trade between MERCOSUR and the EU; and (ii) to support the trade integration process within MERCOSUR countries with the objective of integrating and strengthening the economic capacity of each member state, especially as regards the trading of goods and services, so as to achieve gradual and reciprocal trade liberalization between both parties¹⁶. Within this area of support, the actions have been funded in two main sectors, representing the most relevant issues of the trade policy:

- **Customs harmonization, and**
- **Technical standards (including SPS)**

ii) Economic Integration and intra-regional co-operation

In terms of economic integration and intra-regional co-operation, the EC strategy with MERCOSUR has two specific objectives: (i) to support and increase the economic integration process among MERCOSUR members; and (ii) to obtain greater interaction and integration between the sub-region and the EU. The intention is to promote and support the co-ordination of internal policies, internal market completion and the improvement of the sub-region's common information systems. Therefore, initiatives funded in this area can be classified according to the following sub-areas (or sector) and types:

- o **Policy Harmonization**
 - *Macroeconomic harmonization*
 - *Industrial harmonization*
- o **Statistics**
 - *TA to generate national and regional statistics*
- o **MERCOSUR Intra-regional development**
 - *Initiatives oriented towards the consolidation of the internal market*

¹⁶ This postulate is also present in MERCOSUR's agenda, and it is a critical issue in the discussions leading towards the Interregional Association Agreement.

iii) Institutional issues

The *Institutional Issues* component of the strategy has as its central objective the goal of **strengthening MERCOSUR's institutions** so as to improve MERCOSUR's capacity to negotiate and achieve a sustainable and effective interregional political and economic association. This conceptual approach rests on two assumptions¹⁷: 1) that there is a direct relationship between strong inter-regional integration and strong agreement; and 2) that regional integration drives sub-regional development. The other sub-component of this macro-sector aims at strengthening **civil society** as a vehicle for enhancing national capabilities and organizations supporting the integration process. Initiatives that are oriented towards local government, academic institutions, and non-governmental organizations are designed to enhance the integration process within the population of MERCOSUR Member States. The components of each sub-sector are presented below:

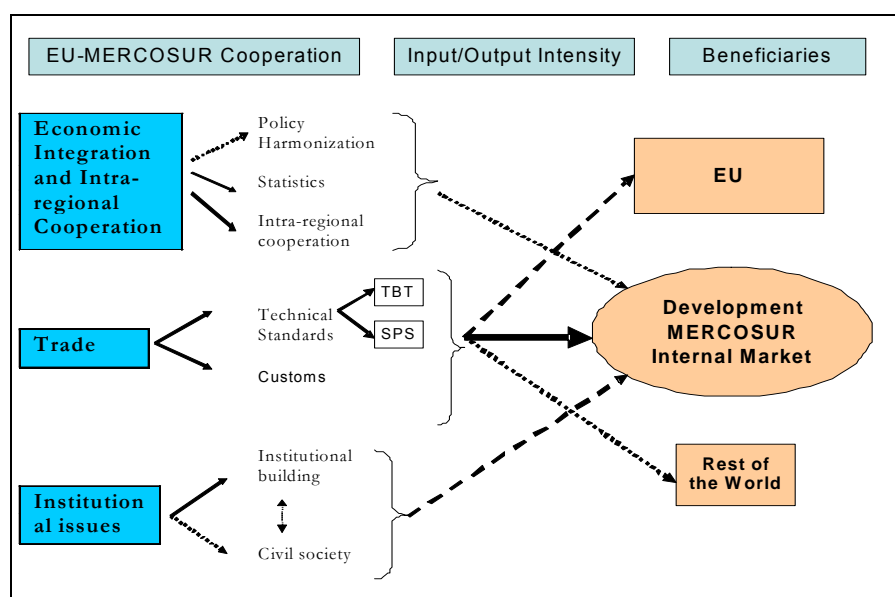
o Institution Building

- Support to MERCOSUR technical and organizational institutions (i.e. SAM)
- Support to MERCOSUR institutional structure (i.e. legal structure)

o Civil Society

- Education and culture
- Social dimension of MERCOSUR

DIAGRAM 1: EC INTERVENTION LOGIC MODEL FOR THE SUPPORT TO MERCOSUR- SUB-REGIONAL FUNDS



iv) Other Actions for Development

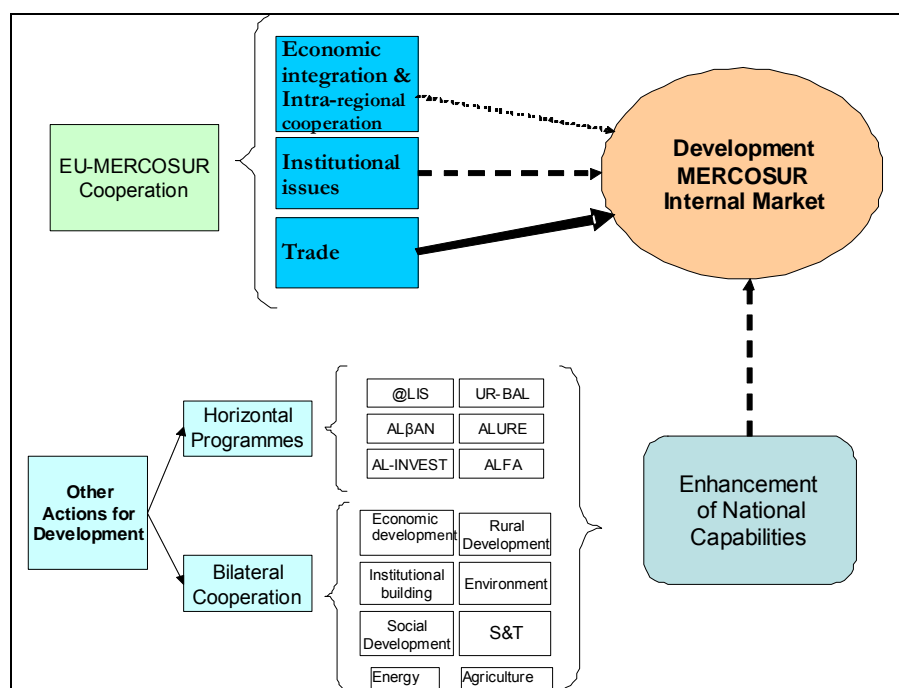
Under *Other Actions for Development* support has been divided into two main categories: (i) horizontal programmes (i.e. @LIS, ALBAN, AL-INVEST, UR-BAL ALURE, and ALFA);

¹⁷ Letter from Lamy and Patten to MERCOSUR Ministers regarding Ministerial Meeting, 07/2002

and (ii) Bilateral Co-operation. The *horizontal programmes*, launched around 1995 for all Latin America (with the exception of @LIS that started in December 2001), have made a significant contribution in creating and strengthening networks for organising common events and exchange of information and practices. This has resulted in a closer relationship between the two regions. Besides the effect on the business environment, which is directly affected only in the case of AL-Invest, these programmes have also contributed to creating liaisons between institutions representing civil society within the MERCOSUR sub-region. *Bilateral co-operation* has also been recognized as an indirect contributor to the integration process, although its initiatives are primarily oriented towards improving the national capabilities of the Member States. Such actions have been focused on such areas as environment, agricultural research, science and technology, rural development, social development, institutional support and economic development.

While the first three macro-sectors act directly on the objective of developing MERCOSUR's internal markets, the supporting macro-sector acts to enhance the national capabilities of MERCOSUR's Member States, and to reduce asymmetries between its members. This structure, in turn, aims at promoting development and integration into the world economy. Diagram2 shows the global logic of the EC intervention model for MERCOSUR.

DIAGRAM 2: THE GLOBAL LOGIC OF THE EC INTERVENTION MODEL TO MERCOSUR



2.1.3 *EC commitments to the MERCOSUR sub-region*

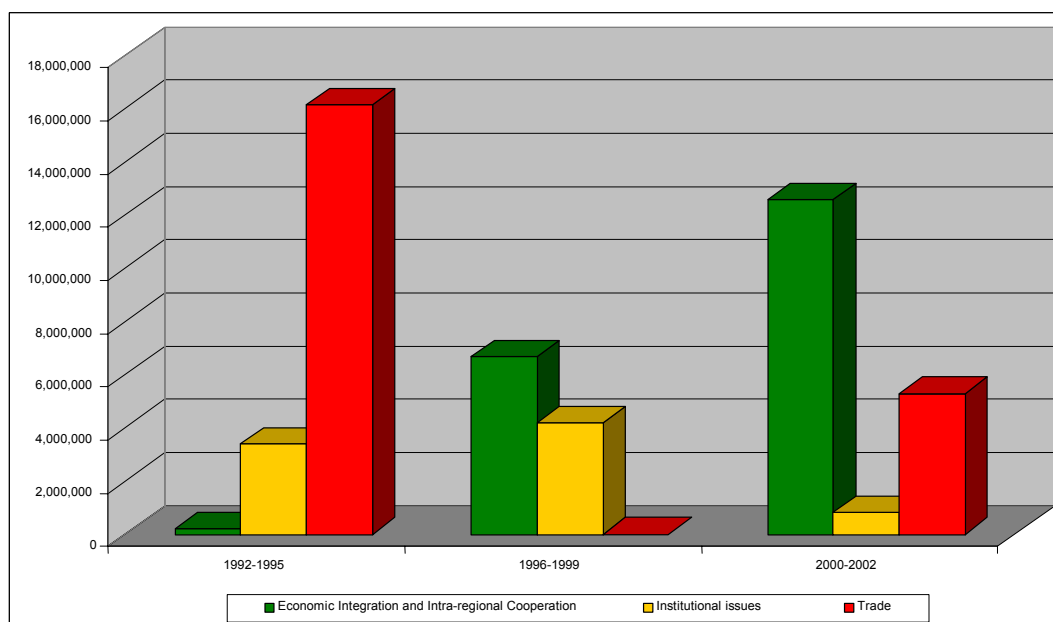
Total commitments for the period 92-2002 for the MERCOSUR sub-region were € 49,3 million. The funds were allocated primarily in support of activities related to trade (43%) and economic integration and intra-regional co-operation (39%), and to a lesser extent to institutional issues (17%) [Table 1]

TABLE 1: MERCOSUR SUB-REGION - COMMITMENTS BY MACRO-SECTOR AND BY YEAR

	Economic integration and Intra-regional Co-operation	Institutional issues	Trade	Total amounts	Total (%)
1992	0	433,000	0	433,000	0.88
1993	0	250,000	16,165,000	16,415,000	33.29
1994	0	1,215,350	0	1,215,350	2.46
1995	194,150	1,494,215	0	1,688,365	3.42
1996	893,112	991,296	0	1,884,408	3.82
1997	4,135,000	1,136,197	0	5,271,197	10.69
1998	785,000	1,020,000	0	1,805,000	3.66
1999	855,000	1,037,175	0	1,892,175	3.84
2000	12,600,000	812,000	0	13,412,000	27.20
2001	0	0	5,300,000	5,300,000	10.75
2002	0	0	0	0	0.00
TOTAL	19,462,262	8,389,233	21,465,000	49,316,495	100.00
(%)	39.46	17.01	43.52	100.00	

Source: Evaluation Inventory, November 2003

Support for each of the above macro-sectors follows the dynamic of the EC strategy where important changes can be observed in the aims and objectives for each of the identified periods [Figure 1]

FIGURE 1: MERCOSUR SUB-REGION: COMMITMENTS VARIATION BY PERIODS AND MACRO SECTOR 1992-2002

Source: Evaluation Inventory, November 2003

A brief analytical description of the four macro-sectors of the global strategy is presented below.

Trade

Within this area, the EC has supported the following sub-sectors: (i) **Technical Standards** (TS) and (ii) **Customs**. In relation to TS, two main projects have been funded both in the first period: a trade project (Technical Barriers to Trade – TBT, € 3,9 million) and an agricultural project (*Sanitary and Phytosanitary – SPS*, € 11,2 million), both completed. In **Customs** two projects have been financed with great relevance to MERCOSUR objectives, though only the first, approved in 1993, has been implemented, the second and financially most important one (€ 5.3 million) having still to be contracted (see Inventory)

All these projects contributed effectively to the removal of technical barriers to trade within the MERCOSUR bloc through the harmonization of standards, requirements and procedures, and to improving the quality of infrastructure. The SPS project was also highly relevant in improving trade conditions between the EU and MERCOSUR. The existence of serious veterinary diseases in MERCOSUR countries had seriously inhibited trade and in the past there was virtually no standardization of procedures or harmonization of policies amongst the four countries. There was also considerable asymmetry between the Member States. Argentina and Brazil benefited from stronger economies and a more sophisticated sanitary infrastructure as compared to Paraguay and Uruguay. The projects helped in addressing those asymmetries successfully, resulting in improvement in trading conditions within each country and also improvement integration of the different institutions through uniform standards and harmonized policies.

Despite the importance of and the results achieved by the above projects, the EC strategy on trade exhibited a certain ambivalence. The initial Co-operation Agreement signed in 1995 stimulated political dialogue and favoured closer trade relations with the aim of “*encouraging the increase and diversification of trade, preparing for gradual and reciprocal liberalization of trade which are conducive to the establishment of the interregional Association*”. But EC interest in intra-MERCOSUR integration did not develop beyond a formal expression of the EC’s willingness to support the process.

The EC, despite recognizing the importance of the issues related to integration, remained an external partner and was therefore not fully involved in this process¹⁸. Also it must be noted that the MERCOSUR-EU trade dimension was subject to the creation of a Single market within MERCOSUR. Such a creation is an extremely important pre-condition for the conclusion and implementation of an Inter-regional Agreement, given that each party must have a common trade policy. MERCOSUR has yet to develop a harmonized trade and commercial policy for negotiations with the EC. As for the EC, additional consideration to intra-MERCOSUR trade policy was not explicitly developed. However, since 2000 the trade strategy has regained momentum, is more in line with MERCOSUR’s needs and priorities as identified in the RSP, and addresses the EC’s response strategy to MERCOSUR’s challenges during the 2002-2006 period.

¹⁸ The co-operation projects implemented, at bilateral and sub-regional level give support to that approach [See Inventory, Annex VI].

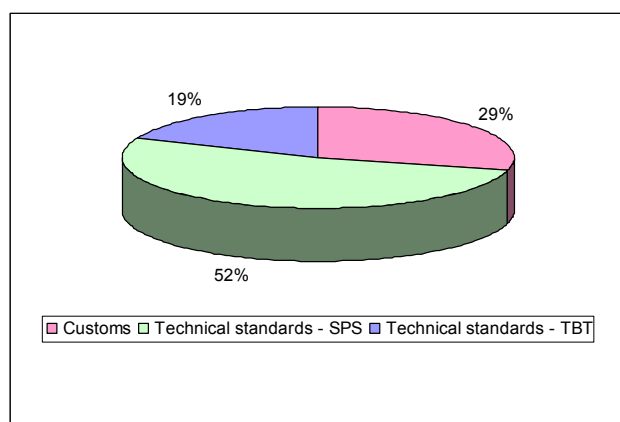
The objective of improving and diversifying trade relations between the two parties remains a priority. Improving commercial relations is one of the objectives of the implementation of the free trade zone, as included in the future Inter-regional Association Agreement under negotiation since November 1999. An essential condition for supporting the Association Agreement is development and improvement of the MERCOSUR integration process. The more the rules are harmonized, the procedures are uniform, access to market conditions is homogeneous, the norms and technical regulations (etc.) are compatible, the more MERCOSUR can develop and the easier it will be to improve trade between the parties. Implementation of the free trade zone and the success of the inter-regional Association Agreement will at least partly depend on this being achieved.

Economic Integration and intra-regional Co-operation

Within this area, the main action funded in terms of budget is in the sector of *Intra-regional Co-operation*, which includes initiatives primarily related to the navigability of the Pilcomayo river in Paraguay and the Uruguay river. Other minor initiatives such as feasibility studies and promotion of investments have also been executed.

The *Statistical Co-operation* has been very successful. The objectives, enhancement of statistical

FIGURE 2 FIGURE 2: SUPPORT TO TRADE IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002



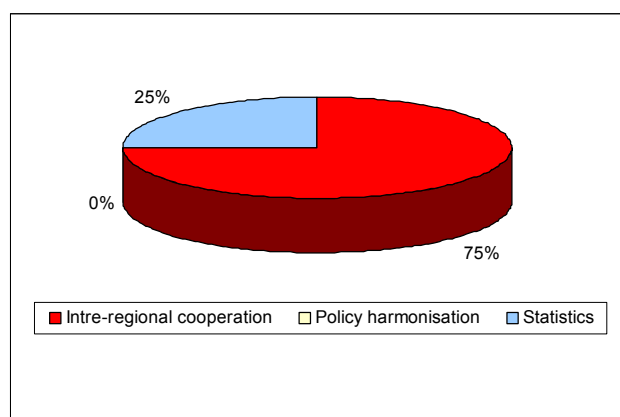
integration between Chile and the MERCOSUR countries and to development of harmonized statistical indicators between the European Community (EC), Chile (has participated as a full member since 1999) and MERCOSUR were successfully achieved (see also the case study in Volume 2). This has prepared the ground for further harmonization.

In the *Policy Harmonization* sector concrete actions have yet to be executed. Nevertheless, its implementation is expected to improve the macroeconomic co-ordination of the Member States¹⁹.

¹⁹ Projects in this area are planned in the RSP 2002-2006. Some identification missions took place in the second half of 2003.

During the first period of EC support to MERCOSUR, interest in promoting the MERCOSUR economic integration process was limited, while the objective of promoting closer co-operation between the EC and MERCOSUR economies remained outside the focus of the strategy. The obstacles encountered in seeking consensus between the four countries could explain in part why the EC's support was limited at regional level. The "Interregional Framework Co-operation Agreement" (IFCA), signed in 1995 (Period 2) reiterated the desire for strengthening the existing relations between the two Parties and recognized the need for

FIGURE 3 : SUPPORT TO ECONOMIC INTEGRATION AND INTRA-REGIONAL COOPERATION IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002



preparing the conditions for the creation of an Interregional Association (IA). As compared to the initial period, the signature of the 1995 Agreement shows a clear evolution and commitment from the EC to be more active and to pursue closer economic integration between both parties. The main Statistics project was funded in this new context.

The RSP provides an important contribution in defining the strategy for economic integration. It emphasizes the need for MERCOSUR countries to co-ordinate evolution of some

macroeconomic variables so as to strengthen MERCOSUR institutions. The EC currently plans to provide technical assistance to help MERCOSUR countries improve their macroeconomic policy co-ordination, which includes harmonisation of key macro-economic statistics and establishment of effective mechanisms to ensure a higher degree of compliance with the macroeconomic targets²⁰. Furthermore, the RSP adds a new perspective to EC support for the economic integration process. It indicates that the EC will act and will implement its *actions based on the future political and economic association between both parties*. Here the EC introduces an issue of conditionality, particularly on policy harmonization, and establishes a stronger link between internal integration and economic integration with the EU. The condition set by the EC is that MERCOSUR has to improve harmonisation of its internal policies to facilitate action as a common bloc. The lack of harmonization in the past has hampered the negotiation process and has also affected the internal integration process.

²⁰ The above is extracted from the pre-identification mission on MERCOSUR's macroeconomics harmonisation project that took place in July 2003. The RSP reference to macro-economics is within support to institutionalisation: *...The European Union should encompass the MERCOSUR initiatives of further integration of MERCOSUR, particularly field of sectoral policies on trade, agriculture, industry, culture and audio-visual, fiscal, monetary, exchange rate, transport and communication issues, environment, as well as in other fields to be agreed in the future.* Within this context, the expected results at macro-economic level are indicated as: *Improvement of a MERCOSUR macro-economic policy; - Implementation of a regular macro-economic dialogue EU-MERCOSUR and better macro-economic co-ordination of MERCOSUR including the field of statistics.* (RSP, pages 29-30).

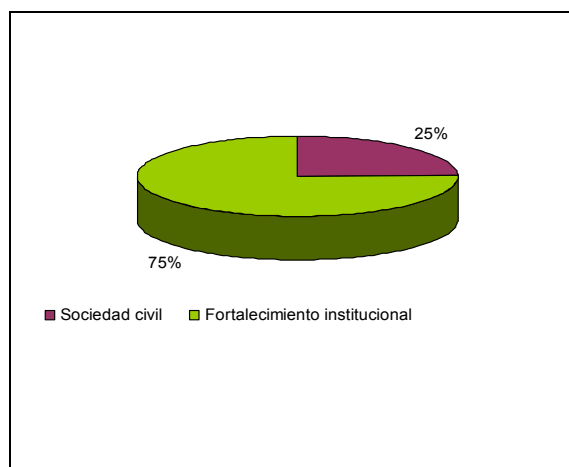
Institutional Issues

Within this area the EC has financed mainly support to the MERCOSUR institutions, starting with the Administrative Secretariat (SAM), which has been receiving fund since 1992 to a total of €2.5 million, representing about the 40% of the funds allocated to institutional strengthening²¹.

Support for civil society has not been so far fully developed and the majority of the funds have been absorbed by central governments or related technical institutions. Actions funded were mostly seminars and conferences on issues related to the integration process, and mostly its trade and economic aspects.

As regards the intervention logic in this area, during the initial phase there was an absence of a proper model with clear objectives and priorities designed specifically to support the

FIGURE 4 SUPPORT TO OTHER INSTITUTIONAL ISSUES IN MERCOSUR SUB-REGION. COMMITMENTS BY SECTOR, 1992-2002



integration process within MERCOSUR. However a political decision was made to support the MERCOSUR process with actions that provided for the transfer of EU experience on regional co-operation. Within this framework, the EC provided institutional support to the SAM and to the Pro-Tempore Presidency of MERCOSUR, the project providing support to this Presidency being channeled through a mechanism called “agility funds”. This mechanism allowed for a rapid response to MERCOSUR demands for seminars and training sessions and contributed to the preparation of issues for the regional integration agenda. The support for SAM was also critical, since it provided MERCOSUR with the basis of an administrative and legal infrastructure.

Between 1995 and 1999 the EC intervention strategy in this sector remained focused on providing information and training to establish and further deepen the dialogue between the two blocs at both governmental and technical level. In 1999, support for the MERCOSUR institutions was also confirmed by further financing to the SAM and the inclusion for the first time of support to the MERCOSUR Parliamentary Commission.

Although initially there was no systematic strategy in place to undertake the internal development of MERCOSUR, the accumulated actions of the EC through the implementation of projects have served to construct an intra-regional co-operation system specific to MERCOSUR. In the case of SAM, the Secretariat has evolved as a technical support organization, and most recently has also gained status as the legal counterpart for the

²¹ For details on the support to the SAM, See the Volume 2 on the Case studies.

implementation of projects financed by Member States, the EC and other donors. Similarly, the technical assistance, equipment and training provided to the Parliament and to the Pro-Tempore Presidency, have yielded satisfactory results in terms of designing and supporting the institutional apparatus of MERCOSUR.

2.1.4 EC commitments to MERCOSUR and its Member States for the integration process

The EC strategy for support to the MERCOSUR integration process is also to an important extent represented by the funds allocated to each MERCOSUR member state for the specific purpose of consolidating their capacities for improving trade, supporting the economic integration process, and to co-operating in intra-MERCOSUR strengthening.²²

Table 2 shows that the accumulated support provided directly to MERCOSUR since 1992 to 2002 represents only 18% of the total funds committed to the sub-region. During the 1990s the EC support strategy for MERCOSUR integration has therefore relied primarily on the implementation of bilateral co-operation rather than on support for regional actions.

TABLE 2: MERCOSUR SUB-REGION AND COUNTRIES - COMMITMENTS AND PAYMENTS, 1992-2002

	Total Committed	Total paid	Total Committed (%)	Expenditure rate
MERCOSUR	49,316,495	24,024,848	17.92	48.72
Argentina	49,639,234	30,405,022	18.04	61.25
Brazil	46,515,313	24,123,113	16.90	51.86
Paraguay	92,944,162	33,906,101	33.78	36.48
Uruguay	36,749,450	14,092,717	13.36	38.35
TOTAL	275,164,654	126,551,801	100	47.33

Source: Evaluation Inventory, November 2003

Globally MERCOSUR region has received support mostly through its Member States with initiatives allocated under *Other Development Actions*. This sector represents almost 78% of the accumulated amount in support of MERCOSUR and its Member States [Table 3].

²² The bilateral projects taken into account are those relevant to the EC strategic objective of support for the MERCOSUR integration process as stated in the different periods. A full list of these projects is included in the Inventory, Annex VI

TABLE 3: MERCOSUR SUB-REGION AND COUNTRIES - COMMITMENTS BY MACRO-SECTOR, 1992-2002

	Economic integration and Intra-regional Co-operation	Institutional issues	Trade	Other actions for development	Unallocable	Total amounts	Total (%)
Mercosur	19,462,262	8,389,233	21,465,000	0	0	49,316,495	17.92
Argentina	2,035,678	85,000	820,000	46,698,556		49,639,234	18.04
Brasil	170,000	1,734,650	0	44,106,473	504,190	46,515,313	16.90
Paraguay	1,749,400	250,000	950,000	89,994,762		92,944,162	33.78
Uruguay	806,500	950,000	0	34,961,400	31,550	36,749,450	13.36
TOTAL	24,223,840	11,408,883	23,235,000	215,761,191	535,740	275,164,654	100.00
(%)	8.80	4.15	8.44	78.41	0.19	100.00	

Source: Evaluation inventory, November 2003

The distribution of funds between countries (see Figure 5) shows that the commitments under Other Development Actions have varied and were mostly concentrated on Paraguay (42%); Argentina and Brazil received 22% and 20% respectively (half Paraguay's), and Uruguay's allocations were the least (16%).

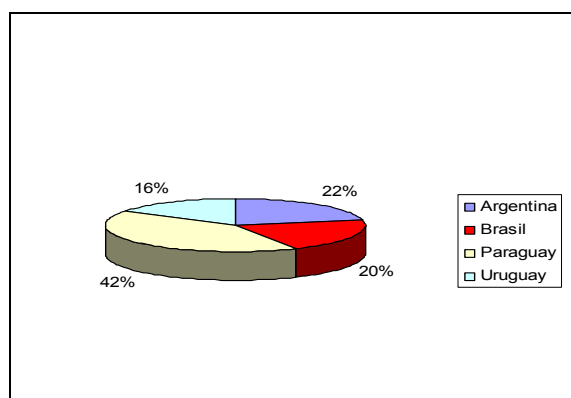
FIGURE 5 SUPPORT FOR OTHER ACTIONS FOR DEVELOPMENT IN MERCOSUR COUNTRIES. DISTRIBUTION OF COMMITMENTS BY COUNTRY, 1992-2002

Table 4 summarises the distribution of funds by sectors and member state. EC commitments have largely concentrated on issues related to Social Development (38%), to help mitigate the severe crisis experienced by the population in the region since 1999. Substantial support has also been allocated to Rural and Economic Development (around 21% for both sectors), followed by Institutional Building (15%). Other sectors, i.e. Agriculture, Energy, Environment and Science & Technology, have been modestly supported²³. The international economic instability of the 1990s and the socio-economic conditions of each country, as well as the recent economic events affecting the region since 1999, have influenced this distribution.

²³ This distribution reflects only projects that have some kind of relation or impact in the MERCOSUR integration process.

TABLE 4: MERCOSUR COUNTRIES – SUPPORT TO OTHER ACTIONS FOR DEVELOPMENT BY SECTOR, 1992-2002

	Agricultur e	Economic developmen t	Energy	Environment	Institutional building	Rural developmen t	Science & technology	Social developm ent	Total amounts	Total (%)
Argentina	475,500	15,458,143	2,310,000	277,000	3,789,400	0	1,427,511	22,961,002	46,698,556	21.64
Brasil	0	2,706,342	2,666,876	0	13,354,050	0	1,992,163	23,387,042	44,106,473	20.44
Paraguay	0	22,200,600	0	852,000	7,991,262	39,665,000	100,900	19,185,000	89,994,762	41.71
Uruguay	0	3,457,540	0	1,191,250	7,899,610	5,150,000	0	17,263,000	34,961,400	16.20
TOTAL	475,500	43,822,625	4,976,876	2,320,250	33,034,322	44,815,000	3,520,574	82,796,044	215,761,191	100.00
(%)	0.22	20.31	2.31	1.08	15.31	20.77	1.63	38.37	100.00	

Source: Evaluation inventory, November 2003

Although the objectives of these activities and the amounts allocated to them are very relevant for achievement of the social and economic development goals, there are questions about the direct contribution of these programs to the integration process and to building MERCOSUR as a viable regional alternative. There is not enough consistency in the allocation of funds at a sector level to allow establishment of a clear link with the overall integration process. In most cases, the CSP defines the lines of action and the priorities for each country, without identifying synergies and complementarities with the regional programme.

If it was the aim of the country programmes to eliminate asymmetries between countries and provide support during the crisis period, overall coherence with these principles is not always evident. For example, despite the limitations of the Paraguayan economy as compared to those of Argentina and Brazil, it is difficult to explain why Paraguay's allocation is worth almost three times more than Uruguay's, which is also going through severe economic and social crises.

2.1.5 Concluding remarks

The strategy towards MERCOSUR as implemented was characterised prior to 2002 by a lack of proper strategic documentation at both regional and bilateral levels, and was dominated by an approach based on annual negotiation of projects according to a "demand-offer approach" with little attention to ensuring coherence and complementarity between national programmes and regional programmes, as well as being strongly influenced by the annual financial allocations to the sub-region and its Member States. Two factors may help explain this: a) the difficulty of dialogue at the MERCOSUR level for achieving specific projects given that the decision-making process was based on inter-governmental agreements; and/or b) the internal difficulties that MERCOSUR had in the second half of the 1990s, which placed the integration process on stand-by and therefore left the bilateral channel as the only viable option for supporting integration.

2.2 MERCOSUR integration process evolution

In the 1980s a number of international²⁴ and regional events heralded a significant period of change and transformation in Latin America. The democratisation process in Latin American countries and the end of the Cold War are clear examples. Within this context, new economic phenomena inspired by free market and liberalization policies were sweeping Latin America, as well as elsewhere, through the globalisation of the world economy.

2.2.1 The early 1990s: MERCOSUR opens up to the rest of the world

At the beginning of the 1990s the MERCOSUR countries started implementing policies that opened their economies to investors through trade liberalization, macroeconomic restructuring including the introduction of privatisation policies, and a call for greater participation in international trade discussions. The adoption of many of these policies linked to the so-called “Washington Consensus” was seen as an opportunity for MERCOSUR countries to become an attractive destination for trade and investment. At this same time, concepts such as “open regionalism” were discussed, as well as the notion that trade, investment and regional integration could be mutually beneficial. As these ideas gained momentum in the region, MERCOSUR’s aim was to position itself as a principal actor on the international stage. It was also a response to the ongoing changes in US policy towards Latin America. This new approach focused on the strengthening of political relationships and the adoption of a three-component strategy: global, national and sub-regional. The sub-regional component changed the perception of the region as an economic and geopolitical unit.

2.2.2 The late 1990s: the negative effects of the regional and world crises on the MERCOSUR integration process

The economic boom of the early and mid-1990s came to an abrupt halt in the late 1990s. The international crisis initiated in Mexico (“Tequila crisis”), the recession in the US economy and the financial crisis in Asian countries and in Russia, cumulatively affected Latin America, and as a consequence its economic stability was threatened. Brazil in 1999 and Argentina in 2001 experienced severe crises, and growing economic and commercial tensions were manifested in these two countries²⁵. In this period the integration process of MERCOSUR also suffered delays and ambivalence in trade and tariff issues. In addition, slow progress in key areas such as institutional development, policy harmonization, quality control and intra-MERCOSUR integration were also sources of concern.

EU imports from Latin America virtually ceased to grow (the annual average was just over 1% between 1998 and 2002), and EU exports to the region slumped by almost 5% per year in the

²⁴ The break up of the former Soviet Union and the communist block, the launching of the hemispheric free trade initiative by the United States, the consolidation of the European Union as a powerful world economic player, and the revival of liberalization and privatisation, as an alternative to growth and development.

²⁵ First Brazil’s devaluation and then Argentina’s economic and political crises in 2001-02 put a halt in the progress of the implementation of a common external tariff (CET) which is the basis of the Custom Union, while Member States started re-introducing national safeguard measures.

same period. EU Member States now account for just 12% of Latin America's total exports. Additionally, since the mid-1990s Europe has experienced a gradual decline in its share of the Latin American import market, from over 18% in 1994 to an estimated 14% in 2002. Other countries, especially in the Western Hemisphere, expanded their presence in the region at the expenses of the EU (see Annex IV on trade trends).

When the economic crisis hit Argentina in 2002, it reverberated across MERCOSUR, affecting the integration process to such an extent that MERCOSUR had to scale back some of its short-term objectives, and investments in the region became increasingly scarce. European investment in Argentina - the backbone of growing EU-MERCOSUR relations in the first half of the 1990s²⁶ - suffered severely, while the Brazilian economy tried to isolate itself from the effects of declining intra-MERCOSUR trade. In 2002, at the peak of the economic crisis, social unrest and a resultant cost in human suffering affected Argentina, a country previously considered relatively prosperous and unaccustomed to such a decline in social welfare. The shock effect of the crisis also reached Uruguay and Paraguay. During this period MERCOSUR as an institution became idle with no progress on either political or economic levels. On the contrary, the fragility of its structure and the ambivalence over the MERCOSUR model was threatening the progress made over the previous eleven years.

For MERCOSUR the focus on trade as well as various other forms of economic co-operation was the ideal mechanism for achieving its main political objectives and for promoting economic integration and development through the flow of investment from the EU Member States and elsewhere. Investors were encouraged by the reputation of the MERCOSUR countries as having adopted the right macroeconomic and trade liberalization policies²⁷. This new economic atmosphere was combined with a stabilizing domestic political environment and attracting foreign investors, not only to MERCOSUR but also throughout Latin America. The economic boom of the early 1990s between the EU and Latin America was largely propelled by rapidly growing European exports and investments. Between 1990 and 1998 the value of exports to the region grew by an average of 14% a year. European FDI flows to Latin America, which had averaged USD 1,2 billion a year in the 1980s, surged in the following decade and reached USD 30 billion in 1998, far surpassing investment from the United States. EU imports from Latin America were much less dynamic, expanding by only 3% a year between 1990 and 1998. Latin America's export performance in the European market was striking in light of the region's much stronger overall export growth of around 9% in the same period²⁸.

²⁶ FDI in Argentina amounted to USD 14.76 billions between 1990 and 1994 whereas in Brazil they were only USD 8.5 billions in the same period (Source: IMF International Financial Statistics). This was however reversed at the end of the decade: in 1998 FDI in Argentina decreased to USD 7.3 billions whereas in Brazil it went up to USD 31.9 billions in 1998. Afterwards it decreased substantially in both countries and in 2001 was USD 3.2 billions in Argentina and USD 22.6 billions in Brazil (source World Bank country statistics, 2003)

²⁷ A study by Paolo Giodano and Javier Santiso: "Las estrategias de inversión europea en MERCOSUR". Dec. 2000. A Review of Latin America Problems; concludes that the creation of MERCOSUR was the main reason for investing, along with the adoption of appropriate macroeconomic policies and the potential growth of domestic markets.

²⁸ Inter-America Development Bank, Integration and trade in the Americas, May 2002, Washington DC. See also Annex IV on MERCOSUR trade trends

2.2.3 *Future MERCOSUR perspectives*

By the end of 2002, political changes in Brazil and Argentina²⁹, combined with greater stability in the world economy brought back renewed hopes for the integration process. The recent changes of government and other political events within each MERCOSUR country are also favourably affecting MERCOSUR's position as well as helping to consolidate and re-establish constructive negotiations. The governments of Brazil, Argentina and Paraguay restored their ability to act as a bloc, and in the recent round of negotiation at the WTO in Cancun, under the leadership of Brazil, a display of unity were shown in the negotiations with the EU and USA³⁰. Most recently, the same unifying position was exhibited in Miami at the forum held in December 2003 to formalize the NAFTA initiative put forward by the USA.

After 13 years of association, the integration process in MERCOSUR is enjoying a favourable political resurgence. The political commitments of the governments to act in unity - especially in its negotiation agenda with the EU and with USA - are at their strongest and, despite the irregularities in the internal process of integration, MERCOSUR has not only survived, but has also acquired experience and a respectable reputation as a regional organization. This recognition was expressed recently by the desire of other countries to be associated with MERCOSUR³¹.

Prevailing trends in the global economy - freer trade, greater internationalisation of production and closer integration of markets worldwide - will provide a strong basis for strengthening bi-regional economic relations in the long term. Escalating competition for markets, however, poses a challenge. In Latin America, Europe will increasingly face competition not only from local and North American businesses but also from Asian firms. As Latin American countries seek to diversify their exports away from basic commodities, the result will be more direct competition from both local and foreign suppliers of these goods in the EU market. As traditional trade and investment patterns are modified, Europe's and Latin America's capacity to strengthen bi-regional relations will depend on their economic potential relative to that of other countries. Multilateral trade liberalization, if it continues at its current pace, will eventually erode existing bilateral or regional preferences and provide a window of opportunity for exporters and investors to establish a stronger position in "preferential" markets and to prepare for higher levels of competition as those markets expand. These circumstances further underscore the importance of timely advances on bi-regional trade initiatives, an area in which progress is both possible and, unlike global economic trends, more directly in the hands of regional policy makers.

²⁹ Brazil's presidential elections (October 2002) and Argentina's presidential elections (April 2003) brought into power respectively Mr da Silva and Mr Kirchner. In a recent meeting, they agreed to strength the commitments and actions of both countries to deepening of the integration process (June 2003, joint press release, Brasilia)

³⁰ With the exception of Uruguay the three other countries were members of an emerging group called G21, an association of countries opposing the EU and USA postulates primarily over trade and agriculture,.

³¹ MERCOSUR has just accepted Peru as an associate member, like Chile and Bolivia in 1996, and other countries like Venezuela, Ecuador and Cuba have expressed their desire to be associates as well.

2.3 MERCOSUR trade flows

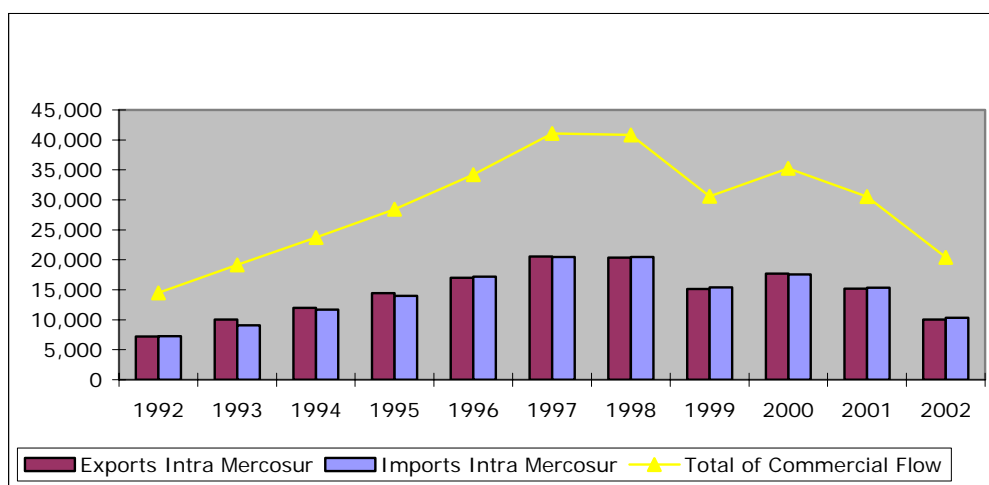
Since the very beginning of the integration process, one of the main axes to develop MERCOSUR has been to increase commercial relation among its Member States and with the rest of the world, and particularly with the European Union. The performance of trade both, at the intra-regional level, as well as at the extra-regional level has been, in turn, influenced by the economic and geopolitical national and international contexts.

2.3.1 *Intra-regional trade*

By the end of 2002 MERCOSUR intra-regional trade (in current USD) was only 12% higher than in 1993 [Table 1, Annex IV]. However, since 1991 two very different and successive trade evolution paths have taken place. During the period 1992-1994 total intra-MERCOSUR exports were very dynamic and grew almost 70%, while imports into MERCOSUR grew 60%. This performance was maintained in the next period (1995-1998) and by the end of 1998 intra-regional trade figures reached four times those corresponding to the first year of the integration process. This dynamism, at least until 1998, was an illustration of a very successful case of “open regionalism”, where the policy mix of re-structural macroeconomic adjustment and privatisation played a key role. A favourable international economic environment that encouraged Foreign Direct Investment (FDI) to the region, particularly into Brazil and Argentina, also boosted this increase in trade³². The economic recovery and growth in Brazil and Argentina and the integration framework put in place to facilitate trade conditions within MERCOSUR were also among the main drivers of this impressive evolution of intra-regional trade during that period³³.

³² In fact, Brazil, for example, at the end of 1998, was the second largest receiver of FDI in the developing world, after China

³³ The EU regional co-operation has also contributed to this performance, providing support for the improvement of customs procedures and harmonization of technical standards.

FIGURE 6: INTRA- MERCOSUR TRADEFLOW - USD MIL. - CURRENT PRICES

Source: CEI (Centro de Economía Internacional), Ministry of Foreign Affairs of Argentina.

In the second period 1999-2002, commercial flows decreased significantly almost to the same level displayed in 1993. Intra-MERCOSUR trade went down by 50% compared to the previous period. Several reasons account to explain this set back. Since the middle of 1998 and well into 1999 the internal demand in MERCOSUR countries was severely affected. The world recession, but particularly the international crisis that shook Asia and Russia impacted negatively in the region. The financial turbulences and price reductions in commodities affected immediately the internal demand of MERCOSUR, and the confidence in FDI was damaged. At the same time, Brazil's vast devaluation reduced its capability to absorb regional production. The downfall of intra-regional trade came from declining imports of the biggest MERCOSUR partners but also from Paraguay and Uruguay.

This negative trend was temporarily reversed in 2000 and intra-regional flows went up again by 15% mainly as a consequence of the economic recovery of bilateral trade between Argentina and Brazil. However, in 2001 the Argentinean crises strongly affected its level of production activity and, as a result, the demand for goods, services and equipment, as well as the commercial dynamism fell. In 2002 the severe recession and price instability following the Argentinean devaluation and debt default at the beginning of the year deepened the regional crisis contributing to a significant reduction of intra-regional trade.

This general performance was accompanied by some changes in the relative countries' shares in the regional market. Argentinean imports felt more than those of the other Member States, while this latter experienced a reduction in their exports. In overall, the relative importance of the intra-regional trade has been higher for the smaller members, whereas the biggest impact has been registered in Argentina and Brazil [Table1, Annex IV].

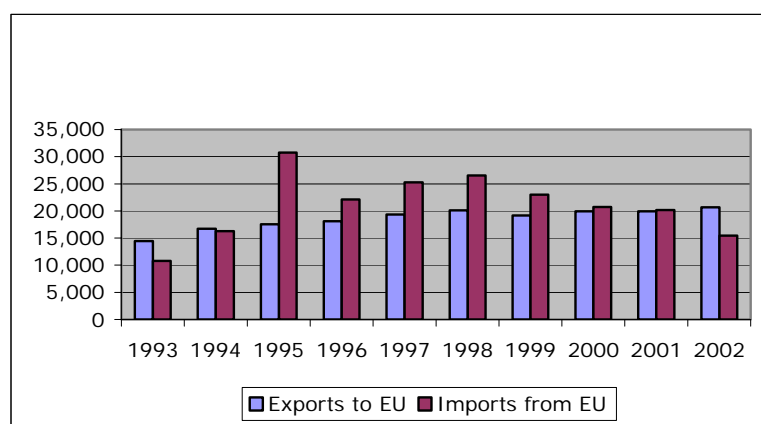
2.3.2 *Extra-MERCOSUR trade*

Trade flows with the rest of the world followed a similar pattern to the one displayed by the intra-regional trade³⁴. Trade was very dynamic with third countries until the end of the nineties and diminished considerably during the last years. Imports to MERCOSUR grew faster than exports from MERCOSUR until 1998. This trend changed in 1999 and with stagnant or declining imports the extra-MERCOSUR balance became positive since 2001. Despite the fact that total trade flows have stagnated, exports to third markets have increased at a significant rate in the last years. The combined recession in the four MERCOSUR Member States shifted the export dynamics from the intra-regional markets to the extra-regional markets.

In reference to the trade flows between the European Union and MERCOSUR, exports to the EU after increasing in the first years, have stabilised on the level of 1995 with a small fall in 1999. Imports from the EU, on the other hand have had a different path. Imports from the EU increased steadily until 1998, reaching their peak in 1995, and then diminishing noticeably up to 2002.

The trends of MERCOSUR imports from the EU are more cyclical than those corresponding

**FIGURE 7: MERCOSUR – EU TRADE FLOWS- USD MIL.
CURRENT PRICES**



Source: CEI (Centro de Economía Internacional), Ministry of Foreign Affairs of Argentina

internal cycle accordingly with their higher income-elasticity ratio.

The trade flows between MERCOSUR and the rest of the world (excluded the EU) repeat the same pattern along the analysed period. The trade balance analysis shows that MERCOSUR

to exports. The economic cycle affecting the production activity level and the internal demand in the MERCOSUR countries is again the main factor behind this tendency. On the other side, MERCOSUR exports continued to be concentrated within a scope of products affected by low income-elasticity, market access restrictions and price fluctuations. In this context, MERCOSUR exports tend to stagnate or grow rather poorly while its imports overshoot the

³⁴ The reasons behind the fluctuations of the external trade are also the same as the ones affecting the performance of intra-regional trade (i.e. international economic crisis, economic recessions, devaluations, etc)

performs better in terms of trade flows with the rest of the world than with the EU [Figure 5, Annex IV].

2.4 MERCOSUR asymmetries in the integration process

The context in which MERCOSUR integration process is evolving is also influenced by the marked structural asymmetries among its Member States. For example, if the size of the economy and the population are observed, the two largest countries (Brazil and Argentina) concentrate almost 97% of regional Gross Domestic Product (GDP) and 96% of the population [Figures 1 and 2, Annex V]. Brazil's GDP is more than twice that of Argentina and its population is almost five times larger, while the two smaller members (Uruguay and Paraguay) represent only 3% of regional GDP and have 4% of MERCOSUR population.

Asymmetries between Member States are even deeper in terms of some economic development indicators. If the comparative size of the manufacturing sectors is considered, the differences among them are quite impressive: Brazil represents 75% of MERCOSUR total Manufacturing GDP, Argentina 22%, Uruguay less than 2% and Paraguay 1% [Figure 3, Annex V]. Both Uruguay and Paraguay economies are mainly agricultural based and have a marginal industrial sector: in Uruguay agriculture accounts for 8.5% of Gross National Product (GNP), and in Paraguay, agriculture accounts for as much as 28% of its GNP. This is in marked contrast with Brazil and Argentina, which, besides their impressive agricultural sectors, also enjoy well-developed industries, especially in the automobile, telecommunications, pharmaceuticals and petrochemical sectors.

The position of the countries in the asymmetry map changes when the GDP per capita is considered. Argentina has the highest GDP per capita (41%), followed by Uruguay (32%), while Brazil is positioned in the third place (18.7%). Paraguay remains in the last position with 7.5% GDP per capita [Figure 4 of Annex V]³⁵. The same placement of the Member States is observed in terms of the Human Development Index³⁶ (HDI) [Table 1, Annex V]. Argentina and Uruguay display better indicators than Brazil and Paraguay, in terms of HDI, Adult Illiteracy and Human Poverty Indicator (HPI).

The above indicators in a way determine the existence of two sub-blocs within MERCOSUR. On the one hand, there is a bloc composed by Brazil and Argentina as the bigger, more developed and more populated countries, and on the other hand, there are Uruguay and Paraguay as the smaller, less developed and less populated bloc. When the differences are looked at through social development indicators there are also two very distinctive blocs. The

³⁵ Estimations are distorted by the alignments of currency parities predominating until 2001. The huge devaluations in Argentina and Uruguay during 2002 and 2003 would have change this scenario narrowing the observed differences with the Brazilian standard. The corresponding data are not still available in harmonized international data bases.

³⁶ The HDI, prepared by the United Nations Development Programme (UNDP) includes: a) Life expectancy at birth, years 2000-2005 (Data refer to estimates for the period specified); b) Adult literacy rate (% age 15 and above) 2001; c) Combined primary, secondary and tertiary gross enrolment ratio (%) 2000-2001 (Data refer to the 2000-01 school year); d) GDP per capita (PPP USD) – 2001.

first and more developed one is composed by Argentina and Uruguay, and the other one, which is less developed, is composed by Brazil and Paraguay.

The different sizes of the countries and their disparities also amplify the risks of transferring no desirable effects to the smaller members. In a more equitable circumstances among partners building a regional market, the size of a country or of a market like Brazil and Argentina should be a very strong incentive for the relative small members like Paraguay and Uruguay to participate in the bigger markets; nevertheless, the supply capacity of the largest Member States is threatening the competitive position of the smallest ones. Similarly, while intra-regional trade and investments grew since the settlement of MERCOSUR so did the economic interdependence and the smaller economies become more dependent on Brazil and Argentina. Since the crisis of 1999, for example, the weak economic performance of Brazil and later of Argentina, impacted seriously the economic and social structures (i.e. production, exports, imports, services, employment, etc) of Paraguay and Uruguay. The increased intra-MERCOSUR trade and the intensifying flow of FDI into the region have provided the strongest dynamic for the significant rise of interdependence between the four Member States, but has also been more favourable for the biggest countries, than for the smallest. Illustrative of this is the increasing levels of investment by Brazil in Argentina: according to the Brazilian Association of SMES, more than 500 companies have settled in Argentina since 1991. In the same period new companies settle in the smaller countries do not reach three digits.

These asymmetries have also a profound impact in the decision making process of MERCOSUR, since the needs and requirements of each Member State for its development are, to some extent, very different. The weight and capacity to influence the integration process also vary from country to country. While Brazil and Argentina, for example, strongly advocate the implementation of programs that can sustain further their economic expansion in the global economy, Uruguay and Paraguay are struggling to maintain their competitive capacity within their own country and within the region.

The critical internal problems derived from the existing asymmetries between Member States are not likely to be resolved in the short and medium term. Thus, and in response to this problem, the smaller countries are calling for the adoption of “compensatory measures” to minimize the impact of these structural problems but also to minimize the impact of the free-market policies on the less competitive sectors of the economy. In this context, in February 2003, Paraguay submitted a proposal called “MERCOSUR’s Treatment of Asymmetries” (Tratamiento de las Asimetrías en MERCOSUR), where arguments are presented to reduce the structural differences between Member States.

PART 2: MAIN FINDINGS AND ANALYSIS

3 ANSWERS TO THE EVALUATION QUESTIONS

3.1 EQ 1: on the coherence of the EC strategy with the MERCOSUR integration model and priorities

To what extent is the EC strategy coherent with the model and the priorities of the MERCOSUR integration process, and has it contributed to improving MERCOSUR's willingness to strength its co-operation with the EU?

3.1.1 Rationale

The EC has been supporting the MERCOSUR integration process for the last 13 years. Within this period almost € 50 million has been committed directly to MERCOSUR institutions for the implementation of initiatives aimed at developing MERCOSUR and its co-operation with the EU. In addition, another € 225 million has been committed at bilateral level to its Member States to strengthen their internal market and institutions, which can further contribute to reducing the asymmetries and promoting integration and development among MERCOSUR's Member States. The EC strategy to MERCOSUR has been based on the establishment of a political dialogue combined with direct interventions designed to support the MERCOSUR integration process and to increase co-operation with the EU. The use of the EU integration model and know-how were the main components of the EC strategy to build on and consolidate the MERCOSUR common market and to strength its co-operation with the EU.

3.1.2 Observed developments

Although the EC overall strategy has been relevant in addressing key needs of MERCOSUR, in certain cases its priorities were not fully reflected and the EU model of integration was presented as the only alternative

Despite the economic, institutional and political drawbacks displayed throughout the history of EU-MERCOSUR co-operation, MERCOSUR has made significant progress towards establishing a common market, and the support provided by the EC has been very valuable. Although the degree of impact of the EC strategy on MERCOSUR objectives and priorities varies from area to area, the EC strategy has addressed key areas for the achievement of the integration process. Contributions from the EC to MERCOSUR have been relevant to improving, for example, the process of policy harmonization; facilitating and increasing trade

and investment among its Member States and with the EU; and supporting the strengthening of the institutions governing and managing MERCOSUR.

Despite those results, the strategy was not totally developed around what MERCOSUR felt to be its priorities, in particular support for the selected MERCOSUR model of integration and strengthening of its integration with the EU. Perhaps, based on the historical development of the EU, the strategy has promoted its model, where integration is achieved mostly through the development of “supranational” institutions. However, the model currently applied by MERCOSUR - to work at inter-governmental level, with sub-groups - appears adequate, as far as MERCOSUR is concerned. In this area, the EC has been, at times, disinclined in its strategy to recognize the intergovernmental and operational structures chosen by MERCOSUR and explicit emphasis was placed on creating and building “supranational” institutions as the only vehicle suitable for the integration process and for the conduct of political agreements, particularly with the EU. The emphasis placed, for example, on institution-building and the creation of a “single” entity capable of controlling the integration and negotiation process led the EC to believe that the Secretariat could assume those functions. MERCOSUR for its part wanted the Secretariat to be only a supporting and administrative organization. MERCOSUR recognizes that the EU experience in building a common market has been very successful, but the structure and organization that MERCOSUR is currently working on to consolidate its integration is based on inter-state agreements and its execution is based on special working groups, and not on centralised systems as proposed by the EU.

Similarly, the strategy has fallen short of increasing and promoting stronger co-operation with the EU. The EC initiatives, despite the emphasis placed on trade and on economic integration as tools for improving co-operation, for example, have not been able to yield significant benefits. The existence of policies protecting the EU and MERCOSUR markets has limited the export capacity and performance of both blocs. Food items, for example, account for more than half of MERCOSUR’s exports to Europe but agricultural protection in Europe impedes its capacity to penetrate further into EU markets. Similarly, MERCOSUR protectionist policies to industrial and financial products from the EU have hampered further cooperation with the EU. Other minor initiatives such as AI Invest, Urb-AI, Alice, etc have probably contributed to improving general co-operation between the EU and MERCOSUR, but its link with the overall integration process remains to be assessed

- The EC approach: political dialogue, combined with the support strategy, requires revision to better support the integration process and to increase co-operation with the EU.

While political dialogue between the two blocs on the integration process was fluid during the last 13 years of partnership, the support strategy was mostly reactive to the different circumstances and short-term needs of both the EC and MERCOSUR. This is reflected particularly in the two initial periods where strategic concepts for addressing either co-operation component were not fully developed. The lack of reasoned argument or insufficient guidance for defining the needs and priorities of the EC strategy in these periods has probably reduced the potential impact of the strategy in its support for the integration process. Similarly, the planning process needed to achieve mid- and long-term objectives was mentioned in the political dialogue but was absent in the strategy. The budgetary constraints imposed by the EC

financial regulations, administrative procedures, and MERCOSUR's fragile institutions were stated by both EC and MERCOSUR officials as the main reasons for this deficiency.

In addition, a question arises as to whether the political dialogue and the support strategy have mutually cohered to meet the overall objectives and to address MERCOSUR's needs and priorities. After reviewing the case studies considered in this evaluation, it was possible to conclude that the institutions and representatives receiving and using the support are often quite separate in terms of roles, experience, background, specializations, etc. from the officials undertaking the dialogue, with the result that the necessary interaction may not take place and that the desired feedback in both directions does not occur, or not to the extent that it might. The interaction between policy level and actions in the ground needs strengthening. This observation is valid for the EC as well as for MERCOSUR. With the preparation of the RSP in the third period there is a new focus on improving the definition of priorities and actions and linking the political dialogue to the support strategy more effectively.

3.2 EQ 2: on the relevance of the EC implemented strategy to the changing needs

To what extent was the EC implemented strategy taking into account the specific needs of MERCOSUR and its Member States and their changes over the period evaluated?

3.2.1 Rationale

The EU co-operation strategy should be in line with the general objectives of the MERCOSUR. The EC's wide range of abilities and experience in designing and managing integration processes should be reflected in the implementation of its strategy, and its actions should be relevant for building MERCOSUR. In turn, it is expected that MERCOSUR's demand for co-operation is more consistent with the definition and development of its institutional and normative objectives. Thus, the successful implementation of the co-operation strategy and the quality of its results depends on the realization of an adequate correspondence between the needs and requirements of both the EU and MERCOSUR. From the EU perspective, there is a growing desire for its support strategy to stay in line with the needs and priorities stated by MERCOSUR and its Member States. As the process deepens, on the other hand, MERCOSUR finds more common recognition among its Member States of the long-term potential benefits that integration offers, and it is endeavouring to consolidate the sustainability of this sub-regional bloc. EC support for the fulfilment of this objective has been fundamental and widely appreciated by the recipients.

3.2.2 Observed developments

- The macro-sectors and EC projects defined by the strategy are coherent and have addressed for the most part MERCOSUR's most important needs and priorities.

Although the strategy has changed during the three periods of co-operation to accommodate the needs of both parties, the identified macro-sectors and the main components were, for the most part, in tune with the priorities explicitly set up by MERCOSUR countries, as reflected in official documents. In fact, during the initial period, the strategy gave more attention to trade issues than macroeconomic co-ordination, for example, and the implementation of projects related to trade facilitation and sub-regional market integration adhered very closely to MERCOSUR's effective priorities. The review of projects like TBT and SPS reveals that they were relevant and that they have contributed to making the free circulation of goods more effective and have facilitated the development of the common market. These actions were fully in tune with MERCOSUR needs and priorities. Moreover, they were also in direct relation to MERCOSUR's main objectives and were necessary to eliminate trade barriers, to normalize the differences in technical standards that each country was implementing, to solve common disease problems, to achieve better integration in the animal and plant health areas, and to open new markets and expand existing ones.

Although at the beginning of the co-operation programme MERCOSUR's initial priorities were mostly concerned with developing trade in the expanded market (customs, TBT, SPS), other projects suggested by the EC have contributed to the integration process. This is the case, for example, with projects focused on the construction of common MERCOSUR institutions. The support to the Secretariat, or to the Parliamentary Committee, has provided MERCOSUR with some foundations for strengthening its institutional base. Other initiatives, such as the support provided for statistics, have also directly assisted MERCOSUR in its objective of facilitating the existence of standardized common regional information.

In the case of the Statistics project, despite the fact that there were previous statistical harmonization efforts to build on, particularly with the ECLAC and ALADI initiatives, MERCOSUR countries have obtained with the EC project additional resources and know-how for their NSIs, and statistical harmonization was introduced as a necessary tool for achieving economic integration in general and for policy co-ordination in particular. In the case of the SAM projects, while recognising the need to build up a common structure in charge of administrative processes, insufficient importance was granted by MERCOSUR officials to this structure. The best example of this is the small budget allocated to SAM and to the debts and deferred disbursements that MERCOSUR Member States (except Brazil) have experienced since SAM's birth. Owing to the EC project, some institutional and organizational modifications have been recently adopted by the Secretariat. Technical advisory functions have been incorporated and staff have been increased to complement the thematic Working Groups. At the same time, a new agreement has been reached between the Joint Parliamentary Commission and the Common Market Group aiming at improving the process of monitoring and the internalisation of norms.

When these projects were launched, MERCOSUR priorities were focused more on facilitating trade in the expanded market than on activities related to economic integration and policy co-ordination. The suggestions made by the EC and the actions implemented in areas that complement MERCOSUR's needs and priorities were coherent, reflecting the EC's know how and experience to achieve the integration process, and have produced satisfactory results.

- Throughout the co-operation history the EC strategy's, global financial allocation and programming were in relative conformity with MERCOSUR needs and priorities.

In the period 1991-1995 the needs of MERCOSUR were primarily concerned with building up the common market. Activities towards dismantling tariffs for intra-MERCOSUR trade and on setting the CET were the priorities. In this period less importance was given to institutional issues. In fact, the Treaty of Asuncion established a low-institutionalisation model defined by the inter-governmental nature of its bodies, and put priority on finding mechanisms for achieving consensus in the decision-making process and supporting initiatives to minimize the absence of a supranational autonomous operational and legal order within its Member States. The EU co-operation strategy was relatively consistent with these needs, and most of the committed funds were directed towards the trade macro-sector, where 81.8% of the total funds were allocated to SPS, TBT and customs projects. The rest of the funds committed were allocated to issues that were not directly related to the MERCOSUR integration strategy, but rather to the strengthening of MERCOSUR's institutional structures (support to the SAM and to the Parliament).

In the mid-1990s, despite increasing intra-regional trade, MERCOSUR was confronted with serious macroeconomic and structural problems, and the institutional model planned for the transition period did not correspond to the priority issues at that time. The construction of MERCOSUR then faced two alternatives: strengthening common mechanisms for planning and administration on a regional scale, or promoting ongoing unilateral changes to the conditions for access to the market. The "MERCOSUR 2000" program, signed by the end of 1995, was a positive response to the above dilemma. The program synthesized the priorities of MERCOSUR's internal agenda: i) harmonization of border procedures and customs regulations; ii) harmonization of technical and sanitary rules; iii) definition of common procedures for regulating the automobile and sugar sectors; iv) liberalization of services' related to intra-regional commerce; v) assumption of codes or regulations for the defence of competition; and vi) establishment of a procedure for public procurement.

In the second period (1996-1999) the difficulties encountered in the negotiation process, specially over trade, led the EC to stop its trade support initiatives and shift its actions towards supporting economic integration and regional co-operation (61.4% of the total funds committed, mainly focused on the Statistics sector) and to a lesser extent on institutional issues (38.6%, allocated on institution building and the strengthening of civil society). This allocation was not in conformity with MERCOSUR's stated needs for the period, since the MERCOSUR countries' priorities were mostly related to the facilitation of trade and dismantling of non-tariff barriers. Nevertheless, the implementation of the projects in the previous period (related to trade) had anticipated future needs for the MERCOSUR integration process, and the fact that its execution was delayed allowed temporary coincidence with MERCOSUR's new needs. Both institutional issues and the harmonization of statistics were topics of less interest for MERCOSUR, but were accepted in order that additional resources and know-how could be incorporated into the integration process.

The year 2000 brought a new scenario characterized by the Brazilian devaluation, the general recession in the partner countries, and the hardening of international financial conditions, which forced a change of priorities in the MERCOSUR negotiation process. Efforts were

made to search for settlement mechanisms with a view to managing the effects of changing disputes on commercial fluxes and the price-competitiveness of the economies. This was the scenario for the “MERCOSUR re-launch” commitment in 2000, where macroeconomic co-ordination and the addressing of market related issues were set as priorities. Other areas also taken into consideration for their importance to the integration process were the following: i) acceleration of border responsibilities; ii) harmonisation of investment incentives; iii) full enforcement of the CET; iv) adoption of permanent mechanisms of controversial solutions; v) insurance of commercial defence and competition; vi) regular institutionalisation of MERCOSUR standards and internalisation of adopted MERCOSUR regulations; vii) institution strengthening, in particular of SAM; viii) co-ordination of foreign relationships; and ix) the financing of economic development.

EU co-operation from 2000 to 2002 was largely concentrated on supporting economic integration and regional co-operation (67.3% was allocated for this macro-sector). The rest of the committed funds were allocated to renewed activities in trade (28.3%, for the execution of a second phase of the Customs project) and to a lesser extent to the institution-building sector (4.3%). From the point of view of the allocation of funds, macroeconomic co-ordination and common-market-related priorities in the EC strategy were still different from MERCOSUR's. Nonetheless, these priorities have been well assessed in the framework of the RSP and the respective projects are in the identification phase (second phase of TBT, and MERCOSUR Macroeconomic harmonisation project).

- The EC strategy has allocated significant resources to its Member States as a way of reducing the existing asymmetries between them and to improve their economic development, but better co-ordination and coherence would have increased the efficiency and effectiveness of its actions.

There is full agreement in MERCOSUR countries that existing differences in economic size between MERCOSUR partners is one of the main reasons negatively affecting the integration process³⁷. The two larger countries, Brazil and Argentina, concentrate almost 97% of regional gross domestic product (GDP) and 96% of the population. Brazil's GDP is more than twice of Argentina and its population is almost five times as large, while the two smaller members have only 3% of regional GDP and 4% of MERCOSUR population. Normally regional market size should be a very strong incentive for the relative small members, but the supply capacity of the larger countries threatens their competitive position, for the most part in the recessive phase of the economic cycle. Asymmetries seem to be even more serious in terms of some economic development indicators. For example, if the comparative size of the manufacturing sector is considered, Brazil represents 75% of MERCOSUR's total manufacturing GDP, Argentina 22%, Uruguay 2% and Paraguay 1%. The problem with this disparity is that the integration pattern within MERCOSUR tends to be of an inter-sectoral nature, affecting the process of real convergence.

In addition Brazil and Argentina, as the largest economies (in terms of both market size and productive capacity) within MERCOSUR, strongly determine MERCOSUR's evolution. The size disparities also amplify the risks of transferring undesirable effects to the smaller members.

³⁷ See Annex V for the country profiles and their main asymmetries

Intra-regional trade and investment, for example, has grown since the establishment of the MERCOSUR programme, as has economic interdependence, strengthening the integration process and generating different benefits for each member. However, the smaller economies became more dependent on Brazil and Argentina and, in the last few years, the weak economic performance of these two larger members has had a strong effect on the structure of production, exports and macroeconomic policies of Uruguay and Paraguay, exacerbating even more the social and economic disparities.

The EC strategy has allocated almost € 215 million under what in Chapter 1 has been called *Other Development Actions* to enhance the national capabilities of MERCOSUR's Member States and to help reduce the existing asymmetries. The amounts allocated and the objectives of these activities are very significant for achieving social and economic development in these countries. However there are questions about the direct contribution of this component of the strategy to the integration process and to building MERCOSUR as a viable regional alternative. The strategy shows insufficient consistency and coherence in the allocation of funds at a sector level, and it is difficult to find a link with the overall integration process. These initiatives, like rural development, social development or science and technology have contributed to the development of the Member States individually, but their contribution to the integration process or to the reduction of the disparities remains to be assessed. Additionally, from the strategic point of view, there are very few references in each Country Strategy Paper where functional and structural links with the regional program are established. It appears, from the allocation point of view, that many of these initiatives are, for the most part, reactive measures to alleviate each country's short-term problems, and they are not directly correlated with the long-term goals of the integration process. These observations also raise the question of coherence between policy, strategy and implementation, and of co-ordination between bilateral and regional support for the construction of MERCOSUR.

3.3 EQ 3: on the EC contribution to building up and strengthening MERCOSUR institutions

To what extent has the EC support contributed in building up and strengthening MERCOSUR institutions and its capacities to negotiate an effective Interregional Association Agreement?

3.3.1 Rationale

The EC regards the building of MERCOSUR institutions, and the participation of civil society, as critical to improving the political dialogue and creating successful conditions for an effective Inter-regional Association Agreement. The role and participation of regional institutions and the quality of their contribution to the negotiation process is supposed to have increased the dialogue between the two blocs. The aim of EC support (technical and political) to MERCOSUR organizational and institutional structures, to regional institutions, civil society networks and regional technical working groups, was to strengthen these organizations so that their contributions and participation would improve the negotiation process between both parties. The EC actions in this area are not intended to create a replica of the EU institutions

at a MERCOSUR level but rather to improve the effectiveness of institution-building in the member countries

3.3.2 Observed developments

- Technical and political support provided by the EC has had a positive impact on MERCOSUR negotiating skills, and the role and participation of the civil society and regional institutions in the negotiation process has increased, but the EC support strategy to the civil society needs to be reinforced.

The most significant contributions of the EC strategy to MERCOSUR has been the strengthening of sub-regional and national technical groups by improving their influence and contribution as compared to a few years ago. The EC strategy has emphasized mostly the strengthening of MERCOSUR structures and organization. Significant support has been allocated to consolidation of the Secretariat and the Parliamentary Committee, both of which have increased their roles and become more organized entities. Throughout the co-operation period, a number of MERCOSUR officials received training and education in their countries and in Europe on technical and policy issues that were later reflected in the dialogue both among themselves and with the EU.

Although not much impact has been observed as regards new modalities of government consultation with civil society representatives, the dialogue with business or labour sector organizations for channelling their expectations or the defence of their interests with their respective governments has modestly increased, particularly in sectors concerned with international trade. Civil society organisations, namely from the business and labour sectors, were involved mainly at project level as part of the consultation process necessary to implement the project components³⁸. Recently the Civil society organizations have become more active, for example as a result of disagreements over trade policies or tariffs. Differences of opinion, asymmetries and conflicts, particularly between Brazil and Argentina and especially over trade issues, have induced more active participation by the private sector. Direct action was taken by businesses and sometimes labour unions to defend their interest. The national press also acted as an echo of social and sectional interest in the automobile, textile, footwear, poultry, and sugar and paper sectors. Other non-government institutions, like academics and business organizations, were equally very active in the political debate about MERCOSUR, but with little or no influence over the negotiation process, and with insufficient support from the EC or from other donors.

- The EC has contributed in improving the quality of the dialogue between the two blocs.

The quality of the consultation process especially at national level has improved in the areas where the EC has supported them. The learning curve for the EC and for MERCOSUR shows more understanding of the limitations and possibilities of each. The dialogue has been

³⁸ An example of this is the project *Cooperation and technical assistance in Agriculture matters* (ALA 93/143), which in its institutional building component provided a large number of training courses also for small and medium producers (See also Volume 2 - Synthesis of the case studies).

enhanced in terms of both quantity and quality; the number of proposal and agreements produced over the last four years is significantly better than during the initial co-operation period. The communication process between the two blocs, through either regional or national institutions dealing with delicate issues of harmonization, asymmetries, quality of products, norms and standards, technical barriers to trade etc., has also become more fluid and both the conceptual arguments and the technical aspects reflect greater maturity than was displayed in the first period. Similarly, EC support has allowed MERCOSUR to develop the capability to request co-operation from the EC and from other donors more in tune to its specific needs and resources, financially and human, while the EC has been able to adapt and to restructure its co-operation strategy to include a consultation process with recipient countries in the preparation and definition of its support program. These factors have proved critical in improving the dialogue between the two blocs.

Additionally, even though the dialogue between policy makers and technical experts needs to be improved, most EC projects - which are of a technical nature - have contributed in increasing the dialogue and communication process. Clearly, better-prepared technical personnel are capable of better quality dialogue and can advise policy makers more competently and comprehensively. All informants from plant and animal health working groups stressed, for example, the great benefits they gained from personal interactions through travelling in turn to each others' countries for meetings. The training provided to the National Institutes of Statistics has increased the quality and the flow of information among Member States; the training provided to parliamentarians in MERCOSUR countries and in EU countries, for example, has been highly beneficial for understanding the mechanisms used by the EC and the functions performed by the EU institutions; the support provided to technical groups in areas of trade, normalization and standards and to the Secretariat in Montevideo has influenced the quantity and the quality of the dialogue between the two blocs. All these initiatives are evidence of the validity of the EC contribution to the integration process in general and to strengthening MERCOSUR's institutions and capacities to negotiate an effective Inter-regional Association Agreement.

- There have been improvements in the MERCOSUR organizational and institutional structures, a significant strengthening of technical working groups and a relative strengthening of networks in areas where the EC has funded projects.

EC co-operation has resulted in the strengthening of MERCOSUR's organizational and institutional structures. The EC, for example, has contributed significantly in building up and reinforcing the structures of the SAM. The impact of this support has been translated into making the Secretariat more dynamic, introducing new technical skills in management, database analysis, and communication and diffusion of information among MERCOSUR, its Member States and external agents. The importance of the Secretariat has grown over time largely due to EC co-operation, from a purely administrative institution to being additionally a source of technical advice. Similarly, the regional integration process has moved forward appreciably in the agriculture and livestock sector since the SPS project started. The extent to which this progress is a direct result of the project varies from aspect to aspect, but there are many achievements in integration in this area directly attributable to this initiative supported by the EC. Another achievement of the SPS project has been the creation of a network of laboratories for Regional Reference. The goal of unified internalised diagnostic methods has

not been reached yet, but there has been much progress and greater interaction than before in pursuit of that goal in the four countries.

Similarly, as a result of the Harmonization of Statistics project for the NISs of the MERCOSUR countries, new skills and methodologies as well as equipment have been acquired, and valuable awareness has been introduced on the need for standardized information at the regional level in MERCOSUR and for a regional institution in charge of co-ordinating, gathering, processing and broadcasting statistical information about MERCOSUR, similar to that of EUROSTAT in the EU. The TBT project has also made significant contributions to the regional integration process through the creation of a network of institutions involved in normalization, certification, accreditation and quality related activities. The existence of this network, in which information and knowledge can be exchanged and mutual help offered based on the technical knowledge of the personnel involved, did not exist before the project started.

Moreover, EC co-operation has promoted and facilitated creation of some sub-regional institutions and structures. MERCOSUR's institutional development has been enhanced by the creation of the General Statistics Commission under its Technical Sub-Group 14. The contacts and relationships created throughout the statistics harmonisation project have also enabled the creation – within the institutional infrastructure in MERCOSUR – of a Statistics Specialized Forum. In addition, the directors of the MERCOSUR NIS have signed an agreement to promote statistical harmonization beyond the scope of the project. Within this agreement, two annual meetings are held for exchange of opinions and discussion of regional needs for statistical harmonization.

Under the TBT project, the “*Asociación MERCOSUR de Normalización*” (AMN) has been created and co-ordinating mechanisms at national and horizontal levels have been strengthened. The horizontal co-operation activities between MERCOSUR countries and INMETRO from Brazil, for example, were harnessed to provide technical assistance to Paraguay. The creation of a strategic alliance between the metrology institutes of the MERCOSUR countries is also an accomplishment stimulated by the project. Likewise, the MERCOSUR business sector is now aware of the importance of normalization and quality management procedures as a requirement for entering foreign markets.

Regarding organizational structures, the co-operation seems to have strengthened the interaction between the national institutions of the Member States, whose teams and members had not previously met. EC support has also allowed increased co-operation between organizations that were able to participate in the projects and the creation of synergies among technicians from these institutions in most cases.

As a result of EC intervention, the capacities of national institutions to participate, negotiate and achieve an effective Inter-regional Association agreement were increased. The financial and TA support provided to consolidate MERCOSUR negotiating structures and strengthening of regional technical working groups has impacted positively on progress in the negotiations in terms of quantity and quality, and on the effective preparation of a timetable and agenda for MERCOSUR. For example, Brazil and Paraguay recently have elaborated a proposal denominated “Objective 2006” where a programme is presented for the consolidation of the customs union and for the initiation of the common market. This

initiative, along with the joint declaration made by the MERCOSUR presidents in Paraguay on June 18, 2003, re-assuring their commitment to the integration process, illustrates the political will and the actual desire to keep on working jointly in the consolidation of this sub-regional bloc.

3.4 EQ 4: on EC contribution to the objective of economic and trade integration process

How have the projects funded in economic and trade integration contributed to the enforcement of the MERCOSUR integration process, to foster closer co-operation with the EU and to create a better environment for the improvement of competitiveness?

3.4.1 *Rationale*

The EC has been supporting actions for economic and trade integration and for the creation and consolidation of a common market. A successful and sustainable design of more harmonized policies should have fostered an increased volume of intra-regional trade between the two blocs. EC actions and investments in areas such as standards and enterprise development should have improved market access and enterprise's capabilities and competitiveness. Acquired capacities of relevant national bodies in realizing controls and in establishing common practices in the areas of customs, technical standards, animal and plant health and statistics should be reflected in closer economic integration and in increasing trade within and outside MERCOSUR. In a common market scenario the free movement of services, labour and goods between Member States should be taking place.

3.4.2 *Observed developments*

- There is not enough evidence to show how the EC strategy has impacted in the commercial relations between the two blocs.

Given the vast sizes of the MERCOSUR region's commercial flows, it has been difficult to determine in quantitative terms the effects of EC co-operation in terms of increasing both trade and economic integration. While trade and the free movement of goods among MERCOSUR Member States have in fact increased during the three periods, the extent to which this was due to the support strategy of the EC is unclear. EC co-operation measured by the value of its contribution to trade (less than € 25 million) represents less than 1% of the commercial flows of MERCOSUR in any of the years between 1992 and 2003. This marginal contribution, as compared to the size of the MERCOSUR economy, has probably invigorated and facilitated trade within Member States and with the EU. Although not accountable in quantitative terms, by making freer the movements of goods and services, and by introducing quality controls to products, for example, more access to international markets was obtained. By the end of 2002 MERCOSUR intra-regional trade (in current USD) was only 12% higher than in 1993. This does not seem a good performance considering the length of the period. Nevertheless, since 1991 two very different and successive trade evolution paths have taken

place. In the period 1992-1994 important growth was achieved. Total intra-MERCOSUR exports grew almost by 70% while imports grew by 60%. This steady performance was maintained in the next period (1995-1998) and by the end of 1998 intra-regional trade figures reached four times those corresponding to the first year of the integration process. At least until 1998, MERCOSUR was a very successful case of “open regionalism”. This was possible due to the favourable international environment that encouraged Foreign Direct Investment (FDI) in all countries, especially in Argentina and Brazil. The economic recovery and growth in both countries and the integration framework easing trade conditions were the main drivers of the impressive evolution of intra-regional trade before the 1999 crisis.

Similarly, the flows of trade with third countries were also very dynamic until the end of the 1990s. The extra-MERCOSUR trade performance followed the same pattern as that of intra-MERCOSUR trade, with the corresponding fluctuations. Imports to MERCOSUR grew faster than exports until 1998. This trend changed in 1999, and with stagnant or declining imports the extra-MERCOSUR balance has been positive since 2001. Despite the fact that total trade flows have stagnated, exports to third markets have kept increasing at a significant rate in the last years. The combined recession in the four MERCOSUR Member States shifted the export dynamics from the intra-regional to the extra-regional markets. Trade flows between the European Union and the MERCOSUR reveals that exports to the EU have been permanently increasing since 1993, with a small fall in 1999. On the other hand, imports from the EU have followed a different path; they were growing until 1998 (with a significant peak in 1995) and then diminished dramatically up to 2003. The trends of MERCOSUR imports from the EU are more sensitive than those corresponding to exports in either positive or negative stages of the cycle. The cycle of the level of activity and internal demand in the MERCOSUR countries is the main factor behind this tendency in those instances where the economies completed their trade reforms at the beginning of the 1990s. On the other side, MERCOSUR exports continued to be concentrated within a range of products affected by low income-elasticity, market access restrictions and price fluctuations. In this context, MERCOSUR exports tend to stagnate or grow rather weakly as compared to its imports. Through the 1990s MERCOSUR has had a negative trade balance with the EU. This deficit was almost zero in 1991 but turned into a surplus in 2002, mainly as a result of the dramatic fall in Argentinean imports and the weak growth of exports. Moreover, the trade flows between MERCOSUR and the rest of the world (excluding the EU) shows the same pattern described in all periods, but in terms of trade balance the MERCOSUR economies perform better outside the EU.

– However, improvement has been found in the facilitation of intra-MERCOSUR and EU trade as a result of EC support

There is strong evidence that EC co-operation has facilitated commercial flows through its support strategy. For example, actions such as harmonization of technical standards and sanitary and phyto-sanitary requirements, and the reduction of technical barriers to trade, have contributed to effective access of products to the extended market. The introduction of improved quality control systems in the footwear, furniture and agri-products industries, for example, combined with an effective reduction of technical barriers, have allowed the participating industries to increase and expand their markets, not only in MERCOSUR but also in the southern cone. EC support has also contributed to advances in such areas as strengthening relationships and links between the participating MERCOSUR national organizations, improving technology, obtaining international certification for some

laboratories, and generating common regulations, among others. Many of these advances have effectively improved intra-MERCOSUR trade and have allowed more access to European markets.

However the high expectations from some projects were not always realised, in some cases because administrative and technical issues interfered with implementation or because project designed was not properly structured within execution. In the case of the SPS project, for example, the relatively short span considered for implementation (i.e. project design) was exacerbated by delays in execution (i.e. project implementation, administrative and technical issues) and many of the activities were just beginning to work when the project was entering its final phase. As a result, the objectives of obtaining the expected mid-to long-term effects such as improved access to markets and increases in trade did not have enough time to be developed. Likewise, EU support for the harmonization of technical standards and elimination of technical barriers to trade has not been directly significant in improving commercial relationships between MERCOSUR and the EU. The existence of effective trade barriers has prevented access to the EU market, thus offsetting potential contributions from the co-operation strategy projects. Moreover, access to the European market is hindered, in many cases, by EU countries' national regulations, which go further than EC guidelines. Co-operation projects have done very little to remove such barriers (i.e EU Member States trade regulations, and barriers, have affected negatively increasing commercial cooperation between the two blocs, as a result some projects objectives were not realised)

- EC projects in the area of economic integration have improved market access to some degree and the technical capabilities of the enterprises were indirectly benefited.

EC co-operation has had a positive impact on intra-MERCOSUR competitiveness. Not only have the activities on standardization promotion, certification, accreditation and quality improved access to the markets but it has also encouraged efficiency gains within the Southern bloc.

The project's influence on the improvement of MERCOSUR firms' competitiveness has been indirect, but covered several areas: a) improving business services; b) increasing information about business opportunities and other countries' regulations, and supporting Merco-Info Centres and focal points; c) enhancing capacity to certify products locally in national technological organizations and laboratories; d) increasing quality through the application of ISO 9000 consultancy and certification; e) generating reliable and standardized information at national and regional levels; f) facilitating the involvement of producers across the region in campaigns aimed at improving production and controlling and preventing diseases (fruit fly control in citrus, and improved disease control in livestock), resulting in a sustainable change in national and sometimes regional attitudes; g) facilitating the creation of networks and developing contacts between cooperatives, groups of producers, women's organizations and trade unions through seminars and workshops across the region; and h) supporting the integration of many small and medium-size producers into the information forum related to the Common Agricultural Policy and EU requirements for the import of agricultural products.

- Relevant national bodies have acquired important capacities in realizing controls and in establishing common practices in the areas of technical standards, sanitation and phyto-sanitation, and statistics as a result of European co-operation.

As a result of EC co-operation relevant national organizations have benefited. For example, the SPS project has permitted a) the preparation of sanitary standards for the transportation of animals and plants, for products, for materials and for spare parts; b) the identification and improvement of important frontier quarantine posts which have received the most advanced equipments and communication technologies; c) protected areas to be defined; and d) the design and preparation of a regional strategy for action by the sanitary services. These results are sustainable because they have improved the technical know-how of the participants, and they can now contribute effectively to the regional sanitary forum.

With regard to Statistics, the capabilities of the local NIS and their staff have been favoured through training modules, and know-how transferred by European experts, and knowledge shared between the participants. The experience obtained through co-ordination, joint work and mutual understanding, was also enhanced. Moreover, horizontal co-operation activities have been carried out among the beneficiary countries, organizing a “statistics working group” were more regional awareness of harmonise statistics, as a tool for integration is being promoted. Likewise, as a result of the European co-operation there is an improvement in the compilation of data in MERCOSUR countries.

In the frame of the TBT project, improvement in structures related to normalization, certification, accreditation and quality has been registered, especially in those countries with a lower level of development and with insufficient infrastructure for metrology activities. The main results in this area have been: a) upgrading of the technological level of the equipment, both computer and metrological; b) better knowledge of the state of the art in terms of TBT; c) the possibility of creating horizontal co-operation activities among MERCOSUR countries; d) improvement in the relationship and co-ordination of joint activities among the different national normalization institutes; and e) accreditation of some laboratories within the national institutes of technology which have been internationally recognized so that they can perform product certification for export.

3.5 EQ 5: on the EC aid management procedures, implementation mechanisms and disbursement of funds

To what extent have the EC co-operation management procedures, its implementation mechanisms and disbursements of funds affected the capacity of the strategy to achieve results?

3.5.1 Rationale

The application of EC management procedures, implementation mechanisms and the disbursement of funds is supposed to be efficient and to contribute to the realization of the projects and thus of the EC strategic objectives. The correspondence between the financial commitments and financial allocations, as well as the analysis of the pace of project implementation and disbursements, should be reflected in the optimum realization of the projects and thereby in the achievement of expected results. Co-ordination and dialogue between the EC and MERCOSUR on project implementation and management should have

influenced the quality of the technical and political dialogue and the identification and design of the projects. The internal mechanisms for management structure such as co-direction for the realization of regional projects and the different implementation mechanisms should have enhanced the efficiency of the EC procedures and project implementation mechanisms.

3.5.2 Observed developments

- *The EC rate of expenditure was affected by administrative procedures, by inadequate identification of project components and by MERCOSUR's capacity to absorb the funds*

EC commitments in support of MERCOSUR regional programs, development of its Member States, and initiatives towards the integration process are very significant in budgetary terms. In fact, the EC is the biggest and is the most important contributor to the integration process: its committed funds represented more than 95% of the total in the four macro-sectors selected, over the 15 years of co-operation.

However, not all funds committed were allocated or actually spent on their respective programs or projects. On average, for the four macro-sectors, almost half (47%) of the funds committed were spent. This rate of expenditure is similar in each macro-sector. The slow pace of implementation also mirrored areas of particular difficulty within the MERCOSUR integration process itself. Although it would have been desirable for all committed funds to be allocated, the actual expenditure rate does not seem to have influenced or slowed down the integration process. MERCOSUR being a new regional organization lacked the experience and administrative structure to absorb more funds than those actually absorbed. The EC, on the other hand, did not have a regional management system in place either to speed up the process or to supervise properly the actual implementation and disbursement of funds. Both organizations have undergone a learning curve in the initial years which affected the disbursement rate. MERCOSUR has now learned more about EC procedures and the EC has learned more about its own and MERCOSUR limitations on the execution of projects, and it is expected that in the 2002-2006 period the disbursement rate will be increased, and that the programming of activities will reflect more the actual absorption capacity of MERCOSUR and related institutions in charge of project implementation.

- *The long EC project cycle: from identification to disbursement and the pace of each phase have affected efficiency, effectiveness and the expected results*

Assuming that the expenditure rate is a reflection of the actual capacity of both MERCOSUR and the EC to allocate and disburse funds, what seems to have affected the efficiency of the programmes more is the long project cycle. On average, it takes more than two years to start executing activities after project identification is concluded (i.e. approval of the financing agreement, which *per se* already takes one year) The long period taken to deliver the assistance made some of the project components obsolete, and the rigidity of the Financial Agreements (FFAA) and the Terms of Reference do not allow introduction of changes or modifications to the project to reflect new realities and circumstances. As a result some objectives originally conceived in the project were not achieved (see SPS case) or certain components became irrelevant (see TBT case). Administrative delays in Brussels and disagreements within MERCOSUR's Member States over management and project components seem to have been

the main reason for these delays (for example, in the case of the macroeconomic co-ordination project the negotiation process for the preparation of the ToR is taking over two years). Significant delays have also been found in the approval of the Annual and Global Operation Programmes and in the subsequent disbursement of funds. The heavy administrative procedures in Brussels were again presented as the main reason hindering the implementation of projects and negatively affecting the execution of the overall strategy. Moreover, once a project is already running the transfer of funds from Brussels to the project bank account is, in the majority of cases, very slow. This has seriously affected the timing, programming and efficiency of the projects and put the achievement of the objectives in danger.

Similarly, the project duration has been often badly calculated given the programme objectives. During the SPS project, for example, considerable difficulties and delays were experienced. Originally the project was supposed to be carried out over three years. Overly ambitious objectives were considered given the implementation period and budget, and the unstable situation in the region in 1994 did not allow the project deadline to be met. It took more than six years to be completed (from 1995 to August 2001). In the case of the TBT project, the design was completed in 1993 and implementation began in 1994. It was scheduled to be completed in 1997, but the Project ended in 2003 after two extensions, with many components in the ToR obsolete. In fact, the tasks and actions originally included in the project became irrelevant, and new ToRs had to be prepared.. The SAM project is still in its implementation phase. The implementation of the projects improved as they were adapted to specific requirements, but a better and more “custom made” design would have prevented many delays and disappointments.

- Limited participation of MERCOSUR and its Member States has been detected in the EC programming and implementation cycles.

The realization of the strategy has also suffered from very limited participation of MERCOSUR's institutions and from their respective government officials in the identification and design process³⁹. This was more evident in the initial stages of the co-operation than in the late 1990s. The programming activity was undertaken fully by Brussels with partial participation of the institutions or recipients involved. Despite the fact that some consultations were made with the local organizations, government and MERCOSUR authorities, the final version of the projects usually did not incorporate their suggestions or requirements. As a result the identification of needs and priorities was not properly reflected in the projects' activities and implementation modalities. The EC attributes its procedure to the fact that initially it did not have a proper counterpart to deal with the project components or with the modalities to be implemented. On the other hand, MERCOSUR considers that the EC has imposed some projects and project components insisting that its experience and know-how in the integration process required those initiatives. While both arguments are considered valid, the degree of involvement of the local institutions and the EC decision-taking process were not the most efficient and to certain degree this has affected the effectiveness of the strategy. In the SPS project, for example, the logical framework was prepared after the initiation of the

³⁹ This aspect was also mentioned during the seminar held in Montevideo on 16 March, particularly the fact that identified projects were not approved by MERCOSUR institutions before being submitted to the ALA Committee in Brussels.

project, as a result the changes introduced in implementation originated delays in the execution of activities. This could have been avoided if a proper consultation with the recipients had been made. In the case of the Statistics project, the proposed objectives were very ambitious; as a result many of them were not achieved.

Under the MoU and in the RSP there are more opportunities for MERCOSUR to express its needs and participate more actively in the preparation of Terms of Reference than in the previous identification and programming cycles. It is also expected that as a result of deconcentration project identification and definition of the ToR will be improved and more involvement will be sought from MERCOSUR organizations and direct project recipients. Nevertheless, after 12 years of co-operation, skills have been acquired and improvements made in both organizations to help in defining the priorities and actions to be executed by the projects.

- The mechanisms and EC procedures set up for the implementation and management of regional projects is not effective.

The management and implementation of regional projects seems to have influenced the efficiency and effectiveness of the overall strategy. Unlike the mechanisms set up for managing country programs, there are no *ad hoc* mechanisms for managing and supervising regional projects and programs. The lack of a proper structure and co-ordinating mechanism within the EC to undertake regional project implementation has created uncertainty between the EC delegations over the managerial responsibilities and follow-up of the activities. As a result, many projects have suffered from insufficient advice over procedures or implementation, reflected in the end in non-achievement of the expected results or in delays. Even now, and after 13 years of implementing regional programs in MERCOSUR, the EC Delegation in Montevideo has insufficient mechanisms for supervising not only project management but the whole project cycle: from identification to implementation. This is specially the case of regional projects that have activities executed in more than one country, and there are no clear co-ordinating mechanisms or clear definition of responsibilities between the delegations over managerial and supervisory procedures.

With regards to project management, until 2000 EC implementation procedure was based on the co-direction mechanism requiring national and EC co-directors. Both assumed equally the implementation and managerial responsibilities for the project. While this administrative structure has not influenced the strategy as such, it seems that it has affected the implementation of some projects. Two of the main reasons given were: (i) conflicting personalities between the co-directors; and (ii) unclear guidelines over tasks and responsibilities. The supporting argument for the first reason is rather objective; cultural, technical and procedural differences between the co-directors were mentioned. The second reason reflects insufficient clarity in the ToRs and guidelines over the mandates that each co-director should have had. Whether one reason is more important than the other is difficult to determine, but the combination of both reasons affected the effectiveness and efficiency of the projects whenever this problem was present. The 2002 Financial Regulation⁴⁰ introduced the

⁴⁰ Council Regulation 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities

possibility of decentralised implementation by the beneficiary third country and stipulates the authorities which can be entrusted with the management of certain actions if they meet the given criteria⁴¹. This provision allows a move to a management structure based on a single project director. The change has been welcomed by all participants and is expected to bring more benefits to the programme and to the projects. However, in its current formulation the Financial Regulation does not take into account the possibility of cooperation with regional organisations such as MERCOSUR, which creates new complications in finding appropriate counterparts for the future projects planned under the Regional Indicative Programme. This factor is currently the main obstacle to the starting of new projects under the sub-regional cooperation framework.

At the same time, application of the requirements of the Financial Regulation have created problems of coherence with national legislation. A typical case is the auditing of the state organisations often identified as project counterparts.

- The projects in which the asymmetries among the MERCOSUR countries (in the elaboration and design of regional projects) were taken into consideration achieved the best results.

The EC strategy's adaptation to MERCOSUR's needs also depends on the capacity of its initiatives to contribute to reducing the internal asymmetries of the Member States and to coordinating actions between national and regional programmes. Projects where implementation was divided into national modules, as for Statistics, and projects such as SPS that addressed sub-regional and national objectives, have achieved successful results and were able to adapt better in fulfilling the objectives. For instance, the regional statistical project was complemented by national projects reflecting the different needs and priorities of each NIS. Similarly, both sub-regional and national objectives were addressed by the SPS project where sanitary conditions were improved within each country and integration of various institutions through the objective of uniform standards and harmonized policies was achieved at regional level. This practice of complementarity and co-ordination between national and regional initiatives thus reflected not only regional concern but national needs and priorities as well.

However, initiatives and projects that were divided into equal parts for each member country generated problems and were subject to implementation delays. Division of projects into equal parts for each member country not only ignores their asymmetries but it also adversely affects regional spirit. In this context, sub-regional co-operation projects did not result in a reduction of intra-MERCOSUR disparities. This is the case with the TBT project, where the implementation of its activities was divided equally between the four Member States countries. However, some activities, while very relevant for some countries, were irrelevant, redundant or useless for others. Similarly, the implementation of some activities required advance technical know-how that some countries did not have or in which the technical aid was difficult to absorb due to the lack of skills or human resources. As a result, in some countries some

⁴¹ Such criteria are: a) segregation of the duties of authorising officer and accounting officer; b) existence of effective systems for internal control of management operations; and in the case of project support, existence of procedures for presentation of separate accounts showing the use made of Community funds; c) existence of a national institution for independent external auditing; e) transparent and non-discriminatory procurement procedures; f) a commitment by the country to undertake regular checks to prevent fraud and ensure correct use of Community funds. (Art.164, EC Regulation 1605/2002)

objectives were not achieved or were only partially accomplished, and asymmetries were not reduced.

3.6 EQ 6: on policy co-ordination and internal coherence

To what extent have co-ordination and coherence with other EC policies having an external relation dimension, particularly environment been insured within the realized strategy?

3.6.1 *Rationale*

The integration process requires co-ordination and coherence in project design and implementation within the EC, with MERCOSUR and with other donors operating in environmental issues. It is also expected that EC projects implemented in Latin America are coherent with other EC policies with international dimensions, as for example with EC projects with environmental policy objectives. Co-ordination and dialogue with MERCOSUR environmental groups and ministries for the identification and design of regional projects with potential environmental effects is one way to assure coherence and complementarity.

3.6.2 *Observed developments*

- The EC lacks an adequate strategy for addressing environmental concerns at a regional level

The EC strategy's environmental concerns have not been applied in a systematic or structural way to the MERCOSUR Member States' needs and priorities. In fact, the review of the projects and programs at regional level showed the absence of specific initiatives dealing with the environment. Although most Member States' country programs consider the environment as an area to be developed, the scope and implementation are limited to their national problems, and there are no mechanisms in place to support co-ordination and coherence between the different initiatives. The funding limitations and absence of proper co-ordinating structures within MERCOSUR to execute projects at regional level, are two reasons hampering the integration process with respect to the environment. Similarly, the absence of a proper co-ordinating mechanism within the EC structures to develop a coherent and integrated environmental policy has diminished the potential impact that this sector could have had on the environment in MERCOSUR.

The lack of co-ordination between projects and between policies does not mean that the EC projects are not coherent with the overall EC policy environment. The environment is, in the majority of cases, an important component of each project, regardless of the nature of the activity. Whether the project deals with SMEs, or with industrial, agricultural or other productive activities, there is a clause where it is indicated that the project has to meet environmental norms (EC standards), avoid any kind of environmental contamination, and refrain from using any kind of toxic materials. It is assumed that each government, beneficiary, implementing agency and the EC delegations supervise and monitor compliance with this requirement.

- The EC should consider integrating more its environmental policy with the strategy and actions at regional level.

Although the environmental aspects of the EC policy are integrated at project level, the link between project, policy and strategy at regional level is missing. The absence of a coherent and co-ordinated environmental policy in MERCOSUR is reflected in the overall EC strategy, where there is little evidence of its presence in either allocation of resources or in technical assistance, at both political and institutional levels.

- The EC should seek increasing co-ordination and dialogue with MERCOSUR environmental groups, other donors and ministries to design regional projects with potential environmental effects that are coherent at national and regional levels.

So far co-ordination and dialogue has been limited and restricted to the implementation of national programs and there is no evidence of the existence of systems or structures for co-ordinating the design and implementation of environment-related projects. The importance of the EC commitment to environment and its relationship with the overall objective of regional integration is not reflected in the EC interventions. As a result, consideration for the environmental specificities and concerns of the MERCOSUR Member States, and of the EC's internal knowledge and stance on environmental issues, is missing. Integrating a coherent environmental policy into the overall EC regional strategy, increasing co-ordination with bilateral interventions and supervising coherence between project results, will enhance the potential benefits of the EC environment strategy.

- The EC also needs to improve co-ordination and coherence in the implementation of policies with international dimension.

There is also a need to pursue better coherence and co-ordination between the EC policies with an international dimension. Some EC policies with international dimensions favour some Latin American countries but also generate negative effects on others. This is the case for example with the "Generalized System of Preferences" (GSP) policies that grant a general preference for some products to countries seeking to eradicate the production of drugs and are trying to diversify their agricultural production. Under this program the production of soja in Bolivia has a preferential price in EU markets. But this program has also negatively affected Paraguay which is not part of the GSP program but is also a soja producer and exporter to the EU. In this case, the same policy has created a perverse effect in Paraguay affecting its international competitiveness.

Similarly there are EC policies with international dimensions which support the preservation of the Amazonian ecology, for example, but there are no policies in support of countries without access to the ocean like Paraguay and Bolivia. The environmental policy in the Amazon, regardless of its good intentions and immediate benefits, also accentuates the asymmetries between countries and disturb the competitive conditions for their products, as compared to countries that do not have or are not part of the so called "preferential policies".

3.7 EQ 7: EC contribution to the sustainability of the MERCOSUR integration process

To what extent has the EC strategy contributed to MERCOSUR's sustainability, and how is this sustainability addressed in the context of the RSP?

3.7.1 *Rationale*

The consolidation of the integration process depends upon the existence of solid and well-established organizational and institutional structures. The EC has actively participated in the political, economic, and technical organization of MERCOSUR institutionalisation; its contribution to its consolidation should be reflected in greater sustainability. Nevertheless, the effective political commitment of MERCOSUR Member States is the first and main factor behind the achievement of such goal.

3.7.2 *Observed developments*

- MERCOSUR is a political project on its way to being consolidated. The EC co-operation has contributed to the enhancement of its institutional framework and to improving its negotiating capabilities.

The development of the MERCOSUR integration process generated two kind of important assets from the beginning: on the one hand there is an institutional network with growing experience in managing and negotiating the integration programme, and with a growing level of technical and political exchange; on the other hand there is a business community with a growing structural network of commercial and, to a lesser extent, patrimonial relationships. The importance of these two assets invites the conclusion that MERCOSUR “*is here to stay and that any hypothesis of a possible extinction or abandonment of the process is not feasible*”. This statement was stressed by both the business community and by government officials interviewed in each Member State. In addition, the political changes that have occurred recently in the region have being translated into improvements in relations between Member States’ governments. The recent changes of government and political events in each MERCOSUR country are also enhancing MERCOSUR’s position as well as helping to consolidate and re-establish constructive negotiations. The governments of Brazil, Argentina and Paraguay restored their ability to act as a bloc, and in the recent round of negotiation at the WTO in Cancun under the leadership of Brazil, a display of unity was shown in the negotiations with the EU and USA. Most recently, the same unified position was exhibited in Miami at the forum held in December 2003 to formalize the NAFTA initiative put forward by the USA. These events also invite the hypothesis that the evolution of the process of integration will take place in a climate of less conflict and that greater co-operation between Member States will be sought.

- MERCOSUR governments believe that EC know-how and experience and its co-operation strategy have been useful and appropriate for the strengthening of integration. However sustainability does not depend on these contributions.

For the MERCOSUR national authorities the European co-operation is seen as extremely positive, and there is full recognition of the benefits generated by the projects. Many activities would have not been possible for MERCOSUR without EC assistance. However, MERCOSUR's sustainability depends on its own capacity to overcome disagreements and conflicts that were evident in the negotiations and in the sub-regional market in the last few years, and on the deepening of the policy co-ordination process, mainly in the macroeconomic and microeconomic spheres.

Independently of the original consensus about the "open regionalism" style and the positive effect that creation of the regional market had on the export performance of all Member States, their political divergence indeed damaged the evolution of the integration process. During much of the nineties MERCOSUR disagreements were reflected in the members' different perceptions of the domestic economic model, their divergent assessment of asymmetries, and their disagreements on the strategy to be followed to achieve international integration. Clear conceptual leadership was missing to overcome these divergences and when the regional macroeconomic environment deteriorated, MERCOSUR went through a very dangerous institutional impasse.

- The enforcement of the MERCOSUR integration process is dependent on urgent political decisions on the regional and international scenarios.

The enforcement of the integration process rests upon the political decisions taken by the MERCOSUR Member States, particularly on decisions proposed or made by Argentina or Brazil. Political decisions seem to be the key to advancing the integration process towards a more ambitious scheme in which harmonization of macroeconomic policies is the next step. Currently, there are no obstacles to progress in this area, since appears that the four countries have reached a consensus to move forward. This consensus has been facilitated by the political affinity of Brazil, Argentina and Paraguay, and it is expected that Uruguay may well join next year given the approaching elections for a new president and the Frente Amplio perspectives.

The evident indifference over the strengthening of common institutions or the weakness displayed in negotiations, particularly at the technical level, were not the main constraints on MERCOSUR's sustainability; rather the main problem was the lack of an effective commitment to internalise agreed norms and rules and to guarantee adherence to them. At the level of the private and social sectors, inappropriate negotiating stances strongly contributed to the adoption of defensive actions protecting specific and particular interests, causing even greater deterioration in institutional support and in the quality of the process. Given the new, more favourable regional political context, the main contribution of the EU to MERCOSUR sustainability would be centred on the development of a systematic and well-balanced scheme of competitive policies aiming at disseminating the potential benefits of economic integration among all the partners.

4 CONCLUSIONS

4.1 Relevance

1. **The EC's interventions have enhanced stakeholder perceptions of MERCOSUR's objectives and priorities, and the continuing local demand for further EC support for regional integration based on European experience, together with the perceived importance of EU-MERCOSUR relations during the creation of a MERCOSUR common market, are positive indicators of the programme's relevance to date.** The EC strategy towards MERCOSUR is based on the EU's integration experience and technical knowledge; as such, the intervention strategy for MERCOSUR targeted the relevant areas in support of integration: trade, economic integration and institutional issues. The specific actions in trade, institution building, policy harmonization, technical standards and statistics are among the most relevant initiatives supporting the integration process.
2. **In certain cases EC assistance was relevant even though it did not correspond to a specific request by MERCOSUR member countries.** A case in point is the statistics project, originally considered an imposition from Brussels and accepted only because it represented additional free resources. In addressing standardisation, co-ordination and harmonisation of national statistical services, it paved the way to a policy harmonization process that is now central for the creation of the MERCOSUR common market, even though MERCOSUR's priority at the time was mainly trade development in the expanded market. Similarly, support for the SAM based on the EC's know-how and experience, originally not considered important within the local institutional setting, led to some institutional and organizational modifications have by MERCOSUR, with results now accepted locally as important for the integration process.
3. **The fact remains, however, that the results of the EC strategy as implemented were not supportive of the integration model agreed by the MERCOSUR Member States.** Its instruments and application have been too rigid, taking no account of either the uncertainties intrinsic in the MERCOSUR "learning by doing" system or MERCOSUR's desire to work through interstate and working group structures. This frustrated the EC's aim of encouraging early development of centralised institutions to implement its co-operation agreements. MERCOSUR, on the other hand did not consider a priority the creation of supranational organizations. Since 2002 the prospects for fruitful cooperation have been also affected by the application of the New Financial Regulations, particularly Article 164's financial and legal requirements for project implementation which have mostly been found inadaptable to the real circumstances in which MERCOSUR is evolving, notably in respect of finding suitable counterparts.
4. **Similarly, the strategy has partly failed to increase and promote stronger integration with the EU because of inadequacies in the planning process set up to address the mid- and long-term objectives of the integration process between the two blocs.** The strategy's relevance would have been enhanced had details of each sector's objectives and goals, supported by indicators of priorities and needs, been provided. Despite their

emphasis on trade and integration as tools for improving co-operation, the EC initiatives have not delivered significant benefits. Some EU and MERCOSUR policies protecting each other markets have impeded the programme's potential benefits to increase MERCOSUR's and EU export/import capacity and performance⁴².

5. **Despite the fluidity of the high-level political dialogue between the two blocs during the last 13 years of partnership, the support strategy was mostly reactive to the different circumstances and short-term needs of both sides.** While EC support for MERCOSUR was a combination of political dialogue at the highest level and financial assistance in key areas, for neither co-operation component were the strategic concepts fully developed during the early stages; also the planning process to achieve mid- and long-term objectives was mentioned in the political dialogue but not in the strategy. The recently-prepared RSP has improved definition of priorities and actions and the linkages between the political dialogue and the support strategy, including financial means and intervention sectors, all vital for ensuring the overall coherence of the EC strategy.
6. **Similarly the main EC projects and certain minor activities - seminars, training, and publications - have also addressed the lack of dialogue (in both quality and quantity) on integration issues,** both within MERCOSUR and with the EU, and among the different MERCOSUR stakeholders by providing for exchanges of views and experience. Projects relating to civil society networks, regional technical groups, regional and national institutions were successfully oriented to increasing these bodies' participation in the process and in the dialogue between the two blocs.
7. **The funds allocated to the sub-regional strategy over the period were adequate, even though limited (about €50 million) when compared to bilateral allocations (about €250 million) and the size of the MERCOSUR economies.** As a new regional organization MERCOSUR lacked the experience and administrative structure to absorb more funds than those provided. The actual disbursement rate of 47% seems neither to have slowed down the integration process, nor to have impacted negatively on the EC capacity to contribute to it.
8. **Despite significant support to MERCOSUR Member States for projects in various sectors, many initiatives were in response to short term problems, and were not directly correlated with the long-term integration goal,** despite their additional aim of reducing existing asymmetries. The sectors included: rural development, social development, energy, science and technology, enterprise development and institutional building to enhance national capability and improve the social and economic environment. Even the latest CSPs, with their mid-term perspective, mention neither the regional integration process nor the need to link country development to it.

⁴² In the case of Trade, one of the main components of the strategy, there were not documents supporting a planning process, even if this could have contributed to focus the strategy in areas where the impact could have been higher. The selection of the components or sub components were analysed between MERCOSUR and the EC indicating how those components were going to increase trade between the two blocs, or what kind of products were not subject of negotiations i.e. "agriculture".

4.2 Impact

9. **MERCOSUR stakeholders' negotiating skills, and the role and participation of civil society and regional institutions in the negotiation process, have increased, although a clear MERCOSUR culture still has to emerge.** This reflects the EC co-operation programme's steady emphasis on strengthening MERCOSUR structures and organization. Key officials and technicians from MERCOSUR institutions and its Member States have received training and education in their countries and in Europe on technical and policy issues. This has been reflected in the dialogue process both between them and with the EU, with positive impact on the negotiations, on preparation of a timetable and agenda for MERCOSUR, on a wider recognition among its Member States of the long-term potential benefits of integration, and on the sustainability of the sub-regional bloc. But the accumulated know-how and experience has not yet created a true MERCOSUR culture, and supporting activities are needed to reduce the gap between political authorities and Civil Society and promote the concept of integration as a tool for development.
10. **On the other hand, with reference to the *consultation process*, little impact was observed in relation either to new modalities of government consultation with civil society representatives, or to the ability of business or labour sector organizations to convey expectations or defend their interests vis-à-vis their respective governments⁴³.** Nor was it possible at multinational level to detect civil society influence on either government strategies or on influencing negotiations on agreements.
11. **With respect to *trade*, there is not clear evidence to show how the EC strategy has impacted on commercial relations between the two blocs.** There has been little difference between trends in EU-MERCOSUR trade and that of MERCOSUR with other regions [Annex IV, MERCOSUR trade flows]. While trade and the free movement of goods among MERCOSUR Member States increased during the three periods, the extent to which this was due to the EC support strategy is unclear given the limited financial assistance in relation to the size of the MERCOSUR economies. On the other hand, it invigorated and facilitated trade among Member States in particular as it addressed issues that represented real limitations to further trade integration during the 1990s, such as diseases in animals and citrus products, two of the main export items. Therefore, EC support has been a good mechanism for creating a better environment for improving MERCOSUR's internal relationships, but it has not been sufficient to tighten commercial links between both blocs.
12. **EC projects in *economic integration* have improved market access to some degree and the technical capabilities of enterprises indirectly benefited.** European co-operation has had a positive impact on intra-MERCOSUR commerce; not only have activities relating to standardization promotion, certification, accreditation and quality improved access to markets but they have also fostered efficiency gains within the

⁴³ However, during the seminar the case of Argentina was mentioned as a very positive instance of involvement of different civil society actors, an experience which could be transferred also to other MERCOSUR countries

Southern bloc. The business sector has also benefited indirectly from EC initiatives on market expansion, establishment of networks, and creation of new business opportunities.

13. **Finally, in areas of EC project funding there have been improvements in MERCOSUR organizational and institutional structures, significant strengthening of technical working groups and a relative strengthening of networks.** The impact of the EC's support, however, would have been increased if the strengthening of the institutional frame would have been pursuing also from multiple angles. For example, reinforcing integration from within government structures and from sector to sector – horizontal - integration would have added more benefits in building a solid institutional base in which MERCOSUR is supported. Activities that reinforce integration within each Member States government structures (Chancelleries, ministries of economics and planning, etc.) transferring know how about achieving regional integration were missing in the strategy. Similarly, the integration at sector level i.e. SME, transport and telecommunication, energy, etc. would have enhanced the regional integration process developing networks and establishing productive, technological and commercial chains⁴⁴

4.3 Effectiveness

14. **Despite the strategy's relevance, the capacity for achieving the planned objectives for the different projects has been limited.** The case studies⁴⁵ indicated that the objectives were often too ambitious given the originally planned duration of the project and resources allocated. At the same time, the limited time allocated to project identification and design and needs analysis, along with the rigidity of terms of reference, resulted in irrelevant or outdated objectives, and lengthy reformulation or launch procedures meant that, even with several extensions, it was impossible for the projects to achieve all the expected results. On the other hand, where it was possible to apply the direct experience of the European Union in a given area, certain steps were achieved more rapidly and to a point beyond that originally planned.⁴⁶
15. **Despite the above shortcomings at project level, the EC strategy has been very effective in facilitating commercial flows and market expansion for MERCOSUR. Both intra-MERCOSUR trade and product access to wider markets including Europe have been enhanced by such actions as harmonization of technical standards and sanitary and phyto-sanitary requirements; reduction of trade barriers; and improved relationships between participating national organizations in improving technology, obtaining international certification for laboratories, and generating common regulations, among others.** On the other hand the strategy was insufficient to promote a networking policy capable of bringing about longer-term co-ordination, harmonization and competitiveness.

⁴⁴ There are positive examples showing that the creation of a network at sector level (i.e. Agriculture, Norms and Standards) is possible and it is significant for the integration process.

⁴⁵ The case study of TBT, SPS and statistics

⁴⁶ This was for instance the case with the TBT project (AL 93/15) see Volume 2 - Synthesis of the case studies

16. Projects which took into consideration asymmetries between MERCOSUR countries (in elaborating and designing regional projects) achieved the best results.

Projects divided into national modules or which simultaneously addressed sub-regional and national objectives were also successful were better able to adapt to fulfil their objectives. In contrast, initiatives and projects divided financially into equal parts for each member country caused problems and implementation delays, as this approach not only ignores the asymmetries but also affects regional spirit adversely. In this context, sub-regional co-operation projects were found not to result in reduced intra-MERCOSUR disparities.

4.4 Efficiency

17. Three of the four main EC-funded sub-regional projects experienced major problems relating to the project cycle. No project was completed within the planned period, project duration on average being more than double that originally scheduled, resulting in failure to achieve the expected results and associated objectives as planned ⁴⁷

18. Significant delays occurred between the identification phases and the preparation and submission of the Terms of Reference. On average this period was more than two years. The main apparent causes were administrative delays in Brussels and disagreements within MERCOSUR's Member States over project content and management, while poor design gave rise to lack of proper consideration either of risk factors or of the budget structure in relation to the objectives and to the real capacity of each country to take part in the projects. Part of the problem also arose from the MERCOSUR institutions' long consultation and decision-making processes, but the difficulty of finding appropriate beneficiaries was also significant. The risks usually present in these phases might well have been reduced had the EC Delegations participated more.

19. Participation by MERCOSUR and its Member States in the EC programming and implementation cycles was limited. Consequently the projects did not properly reflect local needs, priorities and implementation modalities. This was more evident in the earlier stages of co-operation than more recently. The EC argued that this was because MERCOSUR lacked counterparts capable of handling project components or implementation modalities, while MERCOSUR argues that the EC imposed some projects or components on the grounds that its integration experience required them.

20. Implementation performance was poor, illustrated by a low rate of disbursement, on average 47%. This was due to (i) EC programming and identification being based on overestimates of the speed and progress of integration; (ii) unrealistic allocation of funds; (iii) lack of local organizational and institutional capacity to absorb all allocated funds; and (iv) implementation phase problems. The EC, moreover, had no regional management system in place either to speed up the process or to supervise properly disbursement and implementation. Both organizations had to undergo a learning curve in the initial years.

⁴⁷ This conclusion derives not only from the interviews related to the four case studies but in general from the interviews with the EC and MERCOSUR governments officials.

21. **In contrast the implementation mechanism used in project management, that is , the co-direction modality (an European co-director with a counterpart in the country where the Co-direction Unit was based, plus a local coordinator in each of the other countries) worked well and ensured good implementation in some cases.** Capacity building was attained regionally as the MERCOSUR Co-director and local co-ordinators were very much part of the management system. Appropriate Annual and Global Programmes were produced, and the few difficulties that resulted stemmed from inadequate internal arrangements in certain countries. In contrast, management communication and division of responsibility between local co-ordinators sometimes resulted in confusion, adversely affecting the pace of implementation. The current changes in implementation mechanisms and procedures (deconcentration, and the identification of a single MERCOSUR coordinator) are viewed by the different interviewees as positive factors which should improve both procedures and project implementation.
22. **In terms of co-ordination and dialogue with national and regional counterparts and other donors, there is an apparent lack of systems or structures designed to co-ordinate regional project design and implementation.** The absence of a proper co-ordinating mechanism within the EC structures to develop a coherent and integrated regional strategy diminished the potential impact of interventions on the integration process. But co-ordination and dialogue between the EC and MERCOSUR on project implementation and management have recently improved and have favourably influenced both the quality of technical and political dialogue and project identification and design.

4.5 Sustainability

23. **MERCOSUR's sustainability depends on (i) its capacity to overcome conflicts and disagreements recently evident in negotiations and in the sub-regional market, (ii) deepening of policy co-ordination, mainly in the macroeconomic and microeconomic spheres, and (iii) achieving effective commitment to internalise agreed norms and rules and guarantee adherence to them,** all this notwithstanding that the MERCOSUR national authorities view the EC co-operation programmes and its benefits as very positive, many activities having been impracticable without EC assistance.
24. **The fact that the MERCOSUR integration process has generated (i) creation of an institutional network with growing experience in managing and negotiating the integration programme, and with a growing level of technical and political exchanges, and ii) a business community with a growing structural network of commercial relationships, suggests that MERCOSUR is sustainable.** It has demonstrated potential for increasing its integration efforts and a capacity for promoting economic development within its member countries, *despite* periodic internal political, organizational and technical disagreements and also a severe economic crisis.
25. **Recent political changes in the member countries have shown strong commitment towards strengthening MERCOSUR.** Recent changes of government and political events in each MERCOSUR country are enhancing MERCOSUR's position as well as

helping consolidate and re-establish constructive negotiations. Recently unity was displayed in negotiations with the EU and USA, and also at the forum in Miami in December 2003 to formalize the USA's NAFTA initiative, inviting expectations that the integration process will advance in a climate of greater co-operation between Member States.

26. **At project level, many of the good results achieved in institutional strengthening and capacity-building need consolidation.** Some project components were completed hurriedly just before the termination deadlines or were not finalised at all, risking limited life in the absence of follow-up or a second phase⁴⁸. In addition, certain institutional and organisational arrangements produced by the projects, such as technical working groups or harmonised standards, are at risk if other EU-MERCOSUR trade barriers are not removed, as their relevance would steadily decrease and the consequent frustration would outweigh any positive effects generated by their results. In the case of SPS, if support to the national institutions is not extended to introduce control standards for other animal diseases, the potential negative effect on trade would offset the previous achievements.

4.6 Policy co-ordination and internal coherence

27. **Co-ordination in project design and implementation within the EC, with MERCOSUR and with other donors operating in the area of environment, needs to be improved.** EC strategic environmental priorities have not been applied in a systematic or structured way to MERCOSUR Member States' needs and priorities. A review of regional projects and programmes showed an absence of specific environmental initiatives. While most Member States' country programmes identify environment as an area for attention, scope and implementation are limited to their individual problems, and no mechanisms exist to support co-ordination and coherence between different initiatives. Funding limitations also hamper the integration process in relation to the environment.
28. **The thrust of the EC strategy in support of MERCOSUR's regional integration and elimination of country asymmetries is counterbalanced by the perverse effect of certain external relation policies applied in Latin America in favour of neighbouring countries.** An example is the "Drug System of Generalised Preferences" aimed at reducing coca leaf production in countries such as Bolivia, an associate of MERCOSUR, and which directly affect the export competitiveness of a MERCOSUR member state, Paraguay.

5 RECOMMENDATIONS

The following recommendations stem from the analysis carried out in the course of the study and the conclusions presented in the previous chapter. They have been developed also taking into account the results of the seminar held in Montevideo on the 16 March with representatives of the MERCOSUR institutions, implemented project counterparts,

⁴⁸ At the moment only for the TBT a second phase is under discussion.

MERCOSUR and Chile Unit from DG Relex, Evaluation Unit of EuropeAid and EC Delegation in Uruguay and Paraguay to present and agree on the findings and the conclusions of the study. They relate to three different levels: (i) the strategy level; (ii) the co-ordination and policy coherence level; and (iii) the implementation and management level.

5.1 Recommendations at the strategy level

1. **Develop a medium-to-long term strategic plan.** The EC strategy to promote integration and development in MERCOSUR and its Member States should be less reactive to short-term needs. Although the macro-sectors components of the strategy have been relevant, a medium and long term strategic plan to achieve integration should be prepared by the respective Commission Services, detailing each sector's objectives and goals. This plan should be supported by output, outcome, and impact indicators so the actions are measurable and capable of evaluation. More analytical and detailed information should be provided for each sector of the Commission strategy, viz. (i) how the institutional strengthening will be achieved, (ii) which institutions are considered critical for the integration process, (iii) what are the priorities for policy and harmonization and why, (iv) the extent of the risks and limitations, (v) how the actions will contribute to achieving the desired integration of the two blocks, (vi) how these achievements will be measured. These are the type of question the strategy should address to assess its effectiveness and impact during the integration process. The strategic plan should contribute to defining the medium and long-term goals of the co-operation agreement and, therefore, allocation of funds. Preparing an action plan based on an analytical assessment, sector by sector, will facilitate both the required consistency and coherence between policy, strategy and actions, and also reduced reactivity to short term needs. At the same time, this plan should ensure continuity in the support provided, taking into account that supporting the integration process is a long-term exercise and that more than one project may be needed to achieve and consolidate all planned results. [Conclusions n. 4,5,8,11].
2. **Pursue integration from multiple angles.** While the EC can transfer, from its own model of regional development, its experience and know-how for achieving regional integration based on an increased role for supranational institutions, it should also attempt to match its strategic interventions to the real institutional framework in which MERCOSUR is developing. The following initiatives could contribute to strengthening MERCOSUR's institutional structures:
 - (i) **Integration from within MERCOSUR structures**, that is (i) support for MERCOSUR's decision-making body and its political and technical structures, thereby making it more efficient and flexible in reaching consensus on policy and actions; and (ii) transferring know-how to the different subcommittees, working groups, participating in the integration process would be an effective tool for achieving integration rather than concentrating EC assistance towards building supranational institutions that, so far, Member States are not prepared for or have yet to consider necessary. This will require the design of a special facility, targeting each specific group involved in the construction of MERCOSUR. It should (i) support the policy-making body (i.e. COREPER, GMC); (ii) assist the technical and programming unit (CCT, and sub-committees); and (iii) reinforce the executive and supervisory entity (Secretariat). A

- well-organised and efficient institutional structure would also facilitate the negotiation process with the EC and the donor community over issues of technical co-operation [Conclusions 3,9,23, 24].
- (ii) **Integration from within government institutions.** Integration should also be sought in each Member State's government institutions, ministries, or special government agencies (Chancellery), transferring EC experience and know-how in design and management of the integration process within the context of national government perspectives. The Commission should assist in the strengthening and rationalization of sub-regional or regional institutional frameworks to help advance both the integration process and the transition towards a common market. It should continue to collaborate with those national institutions which are the counterparts for the integration process, and develop the corresponding civil service areas. The EC strategy should also continue to support human resources training in individual countries to help develop the requisite pool of experts to manage regional and multilateral negotiations and the implementation and monitoring of agreements. Such training should encourage deeper understanding of the costs and benefits associated with trade negotiations, and also to manage such undertakings in a socially efficient manner. Training in development of inter-ministerial co-ordination mechanisms and civil society consultation procedures should also be addressed. [Conclusions 2, 22]
- (iii) **Sector –Horizontal- Integration.** The construction of a “regional identity” from a sectoral perspective should be supported from within each member state's sectors and institutions engaged in the integration process. To achieve this objective, the strategy should support construction of sector level networks that can contribute to integration. Sectors such as SMEs, energy, environment, transport and telecommunications, central and regional government, and civil society, which are strong at country level, would be enhanced by networking and consolidating them and consolidating into a regional dimension. By building up a MERCOSUR “regional identity” it would reinforce participation of the private sector. Government institutions would also be enhanced. [Conclusions 12, 13,15,26]
- (iv) **Greater country-sensitivity.** The EC support strategy for MERCOSUR should be more country-sensitive and consider each country's specific characteristics and needs. The regional programmes should systematically identify and address sectors and sub-sectors in each country where projects contribute not only to reducing existing asymmetries and increasing the economic development of the less advanced countries, but also to furtherance of the integration process. The strategy needs to recognise each country's characteristics in terms of institutional and human development, infrastructures and government policies, and its effective absorption capacity. Its actions should address country needs in areas such as agriculture, technical standards, macroeconomic policy and co-ordination, investment, physical integration, SME development, social and labour issues and environment, which are all potential areas of integration achievable from the starting-point of the country context. Reflected in the strategy, this approach would ensure that both the sector composition of the co-operation programme and its individual actions would result in a greater degree of achievement of the defined objectives. Proper identification of and consultation with the stakeholders would assist in defining needs and priorities. [Conclusions 6, 16,18].

3. **Support the creation and dissemination of a MERCOSUR Culture.** The EC strategy should support activities aimed at reducing the existing gap between the political authorities of MERCOSUR and civil society, emphasising the concept of integration as a “tool for development”. For example, the “Economic and Social Consultative Forum” should be stimulated as a way of stimulating and disseminating a more comprehensive MERCOSUR Culture. The EC horizontal programmes should also take full account of existing regional initiatives in Latin America (i.e. the Andean Market, and MERCOSUR). The strategy should also envisage increased participation by private sector organizations, educational centres, NGOs, labour unions and similar bodies. Together these initiatives would contribute towards increased participation by civil society in building up a more sustainable MERCOSUR Culture. [Conclusions 9, 10, 15, 24, 26].
4. **Integrate into the strategy a coherent environmental and external policy framework.** To enhance the potential benefits of the integration process, especially on the environment, the Commission needs to integrate a coherent external and environmental policy framework into its global strategy for the sub-region and increase co-ordination and coherence with bilateral interventions [Conclusion 27]. The following steps are recommended to this end:
 - (i) **Environmental and other external policies should be incorporated and linked to the overall EU principles** of achieving sustainable economic and social development. In the future Inter-Regional Association Agreement, the environment should be treated as an intrinsic component of the integration process and not, as presently conceived, as an “external policy factor”. At the same time the design of a regional environmental program for MERCOSUR should be based on the definition of specific accountable objectives to be achieved in the short, medium, and long term. It should indicate clearly the responsibilities at regional and country levels, and also define the instruments through which the policy and strategy will be supported.
 - (ii) **Identification and selection of co-operation projects for funding should be the joint responsibility of the MERCOSUR institutions and the competent Commission Services.** The relevant DGs, mainly DG Environment, in consultation with the respective environmental working groups of MERCOSUR and with the participation of all stakeholders, should be directly involved in defining country priorities and programme content, in the light of available resources. To achieve maximum benefits, the environmental program should work very closely with the ongoing initiatives developed by other organizations both in each country and at MERCOSUR level. Currently, GTZ is implementing an environmental initiative for “clean production” with the four Member States. Similar or complementary initiatives should be sought under the EC programme.
 - (iii) **The EC should also consider reinforcing existing national institutions working in environment at regional level** with TA and material resources, designing and developing a structure for monitoring and supervising the environmental dimension of the regional programme. This structure should ensure agreement on, and monitoring and enforcement of, social and environmental commitments within the programme. Increasing co-ordination and dialogue with MERCOSUR environmental groups, other donors and ministries in the design of regional projects with potential environmental effects, would also ensure coherence at both national and regional levels.

5.2 Recommendations at the co-ordination and policy coherence level

5. **Establish a formal co-ordination mechanism within the EC.** The co-ordinating mechanism within the EC for the dialogue process with MERCOSUR needs to be strengthened. It is recommended that closer co-ordination between the various Commission Services in Brussels (AIDCO, DGs RELEX, Trade, Agriculture, etc.) on policy issues and technical co-operation be enhanced. Previous lessons learnt from the technical co-operation process should be reflected in the negotiations on the Inter-Regional Association Agreement. Similarly, the design and definition of the strategy and of the component projects should reflect the dialogue and consultation process between the two blocks. Thus a formal system, in the form of a **EC-MERCOSUR FORUM**, is recommended whereby co-ordination of policy aspects and technical co-operation can take place within the Commission; discussion of external policies between the DGs mentioned above, and the EC sub-regional Delegations should then take place on a regular basis. The objective of this Forum should be to assess the policy and strategy underlying the regional programme, review achievements and lessons learnt, and provide policy guidelines for continuation of the integration process between MERCOSUR and the EU. Formal meetings should be convened regularly every year or every two years). This co-ordination would also help bridge the existing gaps in the dialogue process between the levels of policy, strategy and technical aspects in the field. [Conclusions 14, 18, 22, 23, 27]
6. **Set up a formal consultation process through a Regional Steering Committee to improve co-ordination between the EC Delegations.** The co-ordination mechanism between the EC Delegations of the sub-region needs to be improved so that the regional programme reflects each country's needs, and also so that country components are linked to and articulated with regional initiatives and vice versa. To this aim, it is recommended that, under the auspices of the Delegation in Uruguay and Paraguay, which takes the lead on sub-regional cooperation, a formal consultation process be established with the other Delegations (Argentina and Brazil) through a Regional Steering Committee with two main coordinating functions: programming and monitoring. [Conclusions 7, 17, 18, 19, 20, 22, 27].
 - (i) ***Programming:*** the EC Delegations should take a pro-active approach towards the regional programme, participating in programming and ensuring that there are synergies and complementarity between country, regional and other external EC policy initiatives, through an ex-ante and ex-post consultation and co-ordination process. The joint meetings should also provide inputs for the definition of policy, strategy, practical priorities and needs and contribute to budget preparation and allocation of funds. Ultimately this consultation process should form part of the proposed EC-MERCOSUR Forum. By improving co-ordination between the EC Delegations, Brussels HQ and within MERCOSUR, the Inter-Regional Association Agreement should reflect the progress of the integration process and achievement of its long-term objectives. It is recommended that the Committee's programming meeting takes place at least once a year.
 - (ii) ***Monitoring:*** the EC Country Delegations should take on a more active role in supervising regional projects. The Committee should meet to discuss, follow up and

assess both the impact and effectiveness of regional projects during the integration process, and also their contribution to the respective Member States. Specific monitoring tools, including indicators on rate of implementation, rate of achievement, and problems encountered, could be developed on a project basis to assist the Regional Committee in its regional programme monitoring function.

7. **Include a Regional dimension in Country Strategy Papers.** As regional integration assumes greater primacy in national agendas there is growing demand for stronger links and better co-ordination between regional and national programmes. The Regional program will benefit from interchange of knowledge with those working on country issues, while those engaging in country programs will gain a regional perspective on the wider repercussions of their respective initiatives. Furthermore country asymmetries that affect the pace of regional integration and its impact need specific attention in country programmes. It is recommended that Country Programmes include development of MERCOSUR and achievement of integration as goals for the medium and long term. This would imply that part of the country programme and bilateral cooperation are clearly focused on reducing asymmetries hampering integration in the light of strategic analysis at regional level and the objectives established by MERCOSUR for the creation of the common internal market (see above recommendation 2.iv). At the same time, each bilaterally-financed project should include outcomes linked to the regional integration process, whether in terms of coordination or of specific activities. This could be done by stimulating the creation of MERCOSUR networks, facilitation of discussion forums or seminars, transferring know-how on managing and developing integration, fostering establishment of production and distribution chains, promoting legal and regulatory harmonization, etc. [Conclusions 16, 20, 23, 26, 27]
8. **Increase policy co-ordination, harmonization and competitiveness within MERCOSUR.** Assuming a more country-oriented approach in the regional programme and establishment of stronger mechanisms for co-ordination between regional and bilateral co-operation, the EC should focus its co-operation on developing a systematic and well balanced policy mix aimed at improved policy co-ordination, harmonization and competitiveness in the medium and long term. Promoting and supporting a “Regional Policy Dialogue” as a forum for senior policy-makers to share ideas and discuss co-operation and policy harmonization between Member States would be one way of contributing to this objective. This initiative of encouraging policy discussion should be aimed at professionals, researchers and acknowledged economic and policy authorities in the four countries. The outcome of these meetings or seminars should be disseminated widely among universities or think-tank institutions in the private and public sectors, with a view to giving information on the sustainability of the integration process. Providing such a dialogue would also contribute to legitimatising the MERCOSUR. The participation of the COREPER in this Dialogue should be encouraged. Similarly, research and policy oriented to fostering integration should be promoted. [Conclusions 10, 24, 25, 26].

5.3 Recommendations at project and management level

9. **Encourage increased MERCOSUR responsibilities in project identification and design,** to improve quality, management and execution. The Commission should provide

TA to the MERCOSUR structures (i.e. to the GMC and to the technical committees and sub-committees including the Secretariat) to improve programming and project identification and design. The outcome of this initiative should be the preparation and presentation of a MERCOSUR Project Portfolio in which all administrative, legal and technical requirements, as well as EC and MERCOSUR strategic priorities, are reflected. This document would have to be approved and endorsed by Member States. If conducted regularly - annually or every two years - this programming exercise would shorten the long cycles now needed for identification of projects and beneficiaries. It would also facilitate project selection by the EC as well as by other donors, shorten the time needed to identify project components, contribute to planning and final allocation of resources, and finally contribute to improving disbursement rates. Implementation of this project would generate additional benefits to the EC Delegation in Uruguay and Paraguay assisting in identifying projects and counterparts that meet the financial and legal requirements established by the Financial Regulation. [Conclusions 7, 14, 17, 18, 19, 20].

10. **Promote the creation of a MERCOSUR Technical Co-operation Structure.** Since MERCOSUR's current structures are still at an early stage of development, the project cycle and consultation process between Member States needed to reach consensus on external co-operation needs improvement. The creation of a single entity (such as a specific agency or desk) capable of negotiating and assuming legal responsibility for all MERCOSUR projects financed by international organizations would be an efficient mechanism for improving co-operation between MERCOSUR and the international donor community. The EC, as the main donor to MERCOSUR, should propose the creation of a centralized structure in which all technical co-operation issues can be dealt with efficiently. It is therefore recommended that under EC sponsorship a feasibility study be undertaken on creating a joint MERCOSUR structure taking account of the current arrangements for programming and implementing sub-regional cooperation. The roles, responsibilities and legal status of the agency should be clearly defined. In addition the agency should be part of the EC program of institutional strengthening and be dovetailed into the existing structure of other bodies concerned with MERCOSUR (COREPER, the Secretariat, GMC, CCT, technical sub-committees, etc.). As other sub-regions (Caribbean and Asia where technical agencies are in charge of negotiating and supervising all foreign technical programs) have demonstrated, having a single, centralised unit focusing on technical co-operation generates additional benefits in shortening and approving legal procedures, and implementation of projects would be more in tune with the corresponding programming cycles. Furthermore, the creation of such an Agency would also facilitate the implementation Recommendation 9 as preparation of the MERCOSUR project portfolio could be coordinated by the Agency. This new structure will also contribute towards deepening the integration process between the Member States and communication with the international donor community would become more efficient. At the same time, interaction between policy makers and technical experts could be strengthened through this more intensive consultation process. (Conclusion n. 14, 17, 18, 19)
11. **Adapt the EC Financial Regulation to the real regional context of MERCOSUR.** The application of EC Financial Regulations to regional programs like MERCOSUR needs to be adapted to the actual regional co-operation context and made more flexible so as to improve efficiency and contribute to full achievement of project objectives and thus the EC's strategic objectives. The EC should consider introducing more flexible mechanisms

within its current Financial Regulations, particularly Art. 164 on the legal, institutional and financial requirements for project selection and implementation. The EC's HQ should give power and authority to the Delegation in Uruguay to adapt the Financial Regulation to the existing institutional, legal, financial and technical structures and capacities of local and regional counterparts at all levels, while ensuring the existence of transparent implementation mechanisms subject to accountability, monitoring, evaluation and auditing. To speed up implementation and avoid long consultation processes with Brussels on project implementation, the EC Delegation in Uruguay and Paraguay should also be allowed to review and approve contract amendments, modify project components and adjust the technical aspects of initiatives to the real context in which projects are executed. This should result in optimal realisation of project objectives, improvements in disbursement rates and thereby in achievement of the expected results. [Conclusions 3, 14, 17, 21].

12. **Improve the EC project preparation cycle.** The time taken from project conception to actual implementation needs to be shortened (in particular, identification and preparation of ToRs is too lengthy) and more flexibility should be introduced into ToRs so that changes that occur in the project environment can be reflected in adaptation of project activities. The Delegation of Uruguay and Paraguay should have the authority to approve such amendments. To achieve these aims it is important to improve the project identification and design phase through more extended and qualified dialogue with MERCOSUR institutions and its Member States over the objectives, results and risk factors. Furthermore, more co-operation with implementing institutions on defining management and co-ordination mechanisms should be sought. [Conclusions 14,17, 18].