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A Giant Awakens

The Promises and Challenges of MERCOSUR

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Inside:

Professional Employer Organizations 4

In the last years of the twentieth century, the political and economic landscape of Latin America underwent a fundamental transformation. During the "lost decade" of the 1980s, Latin America withered under hyperinflation, instability, crushing debt, and unabashed protectionism.

How things have changed. Today, every nation in the Western Hemisphere, aside from Cuba, boasts a democratically elected government and, to some degree, openly embraces the tenets of economic liberalism: privatization of state enterprises and promotion of both competitive, deregulated markets at home and free trade abroad. Mercosur (Mercado Comun del Sur, or the Common Market of the South) is the most striking signal of this transformation, one that promises to make a single market of a large swath of Latin America. At the core of Mercosur are Brazil and Argentina, the two largest economies in South America. Paraguay and Uruguay are also members; Bolivia and Chile, associates. A combined GDP of more than $1 trillion and a population of 220 million makes Mercosur the largest trade and investment bloc in the world after the European Union (EU) and the North American Free Trade Agreement (NAFTA).

Open Regionalism

Mercosur symbolizes the shift in Latin American public policy away from inward-looking protectionist development strategies toward outward-oriented global strategies, explicitly predicated on neoliberal principles of "open regionalism." The signatories' goal is to create a regional trading bloc that will reduce, and eventually eliminate, all barriers to trade and investment among its members and, by 2006, offer a common and liberal external tariff structure—i.e., a customs union—to the rest of the world.

At $113 billion in 1999 ($55 billion in exports, $57 billion in imports), U.S. trade with all of South and Central America remains small in comparison to U.S. trade with Mexico ($197 billion) and has grown more slowly than trade with Mexico, doubling in real dollar terms since 1990 compared to a quadrupling of trade with our NAFTA partner. At the same time, the United States has long enjoyed a positive trade balance with Mercosur ($6 to $10 billion annually since 1996), in striking contrast to its trade with Mexico, which netted out at –$23 billion in 1999.

Indeed, the Mercosur nations represent one of the few significant regions of the world in which the United States has consistently maintained a positive trade balance in recent years. Total trade between Mercosur and the United States (115 percent between 1990 and 1998) grew almost as fast as that between Mercosur and the European Union (129 percent). European exports to Mercosur, however, outstrip U.S. exports, both in terms of level and growth. At $26 billion in 1998, EU exports to Mercosur were more than 3.5 times the level they were in 1990.

Mercosur highlights:

• Annual growth in GDP (except for 1998–99) averages 4 percent
• Trade with the rest of the world has more than doubled since 1990, reaching $136 billion in 1998
• Current common external tariff covers 85 percent of all traded goods. Full implementation of the common external tariff is expected in 2006
• The stock of foreign direct investment (FDI) reached $205.7 billion in 1998
• Leading targets of FDI include automobiles and parts (36 percent); chemicals and pharmaceuticals (11 percent); food, beverages, and tobacco (9 percent); steel (9 percent); and electronics (6 percent)

The United States clearly faces stiffer competition from the European Union in Mercosur than it does in Mexico, where around 80 percent of all exports and imports are linked to the United States.

In addition, U.S.-Mercosur economic linkages remain significantly shallower than U.S.-Mexico linkages, not only in terms of the total volume of trade and investment, but also in the sense that the intraindustrial ties—through joint ventures, subcontracting, other forms of outsourcing, or vertical integration along an international production chain—are weaker with Mercosur than with Mexico. More than 92 percent of the $19.2 billion of U.S. exports to Mercosur in 1999 were final consumer products (e.g., chemicals, pharmaceuticals, machinery, and transportation equipment and parts) rather than intermediate inputs that would bind U.S. and Mercosur producers more tightly via sustained contractual arrangements along a production chain. Of course, Mexico's geographical propinquity and the longstanding maquiladora program give that country a natural advantage in building deep economic linkages to the United States.

The Texas Connection

Texas dominates U.S.-Mexican trade, accounting for nearly 50 percent of the U.S. total. Although the state ranks second only to Florida as an origin of U.S. exports to Mercosur (around 12 percent for Texas; 18 percent for Florida), 1999 figures show that only $2.6 billion of Texas' $91 billion in exports to the world were directed to Mercosur. This is dwarfed by the $41 billion that Texas sent to Mexico and is a surprisingly tiny sum for the nation's second largest exporting state.

Leading Texas exports to Mercosur include products related to petroleum refining (41 percent of the U.S. total) and chemicals (33 percent). Food products, agricultural crops, and computers and related machinery follow closely with about 10 percent of the U.S. total each. A 1993 study points to several sectors of the Texas economy that have not penetrated the Mercosur market as fully as the United States as a whole.[1] These include communications equipment, aircraft and parts, and engines and turbines, all of which are economic activities in which Texas is a significant player. The potential for growth in these sectors is great, especially in light of the recent privatization of the Brazilian telecommunications monopoly and the global strength of the Brazilian aircraft industry.

Distance between Texas and the Southern Cone of Latin America represents a clear challenge to the state's ability to build sustainable economic linkages with Mercosur. There is no continuous surface transportation connection. Lying outside the primary global transportation corridors that link South America to the United States, Texas seaports suffer a different disadvantage. It is costly for ships traveling between North and South America to detour to the Gulf of Mexico, dodging Cuba along the way. Air freight is the most promising direct transportation connection from Texas to the Mercosur market. Approximately 30 percent of U.S. trade with Mercosur travels by air, much of it in the

Mercosur Trade, 1990 and 1998

Total trade	**1990** *($U.S. millions)*	**1998** *($U.S. millions)*	**Growth** *(percentage)*
Among Mercosur nations	8,230	41,396	403.0
With non-Mercosur nations	65,569	135,582	106.8
With U.S.	15,146	32,580	115.1
With EU	20,298	46,528	129.2

Source: BADECEL Database, UN Commission for Latin America and the Caribbean.

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bellies of passenger aircraft. Recently scheduled daily nonstop flights between Dallas-Fort Worth and São Paulo, Brazil, and Santiago, Chile, and direct flights to Buenos Aires, put Texas in a position to gain even greater access to South American markets in the future.

Bumps in the Road

Mercosur offers tremendous opportunities for the future. Nevertheless, uncertainty surrounds the timeframe for further liberalization. Prominent among the concerns fueling this uncertainty:

- The international politics of the agreement reached at the December 1994 Summit of the Americas in Miami to establish a Free Trade Area of the Americas (FTAA) by 2005 tends to pit Brazil against the United States in ways that reinforce the former's historical tendency to protect its own industries and to favor managed trade over liberal trade.
- Under Brazil's leadership, Mercosur has placed a higher priority on broadening the trade agreement to reach out to other countries in the hemisphere (and beyond) through negotiated entry or through bilateral trade arrangements than on deepening the integration among existing members. This tendency saps energy from more critical efforts to implement the liberal ideals of Mercosur fully.
- While Mercosur has contributed to trade among the signatories, some of that trade has come at the expense of trade with the rest of the world. Mercosur citizens, in other words, are paying more dearly for relatively protected Mercosur-manufactured goods than for close substitutes from abroad.
- Mercosur lacks a firm institutional framework. This minimalism has left the integration directly in the hands of the respective heads of government and a small group of diplomats and financial officers. This not only contributes to uncertainty over the continuity of political will, but also places a daunting burden on a small cadre of officials to navigate the complicated path to economic integration.
- Establishing and maintaining an effective and stable and efficient customs union or common market require a great deal of coordination of domestic macroeconomic policy. Mercosur's short history has not inspired much confidence in this regard. Brazil's unilateral decision to devalue its currency in 1998, for example, not only shook its Mercosur partners and hindered the process of integration, but also highlighted the fragility of the banking sector in all the member countries. Taking a long-term perspective by pegging its peso one-to-one to the dollar, Argentina has weathered the crisis rather well, but at the expense of high levels of unemployment reaching around 11 percent.
- All modes of Mercosur's transportation infrastructure, so critical to establishing an integrated regional market, are in a woeful state. While progress is being made, the full promise of Mercosur cannot be realized until fundamental improvements are achieved.
- Finally, and closer to home, the inability of the U.S. Congress to renew the executive branch's "fast-track" authority to negotiate trade agreements is one of the most important impediments to moving forward with the kind of serious multilateral trade negotiations needed to streamline the hemispheric and global trading systems.

Conclusions

Mercosur's potential is undeniable, but the road to that promising future is anything but smooth. The secret to its success in achieving an integrated internal market and, consequently, in stepping up to the world stage will lie in its ability to achieve regional economic stability and to meet the challenges of globalization openly and head-on. U.S. firms seeking to do business with this huge market stand to reap rich benefits from these developments, but the short run will be rocky. Those with patience and the willingness to commit themselves to the long run, and those who can establish working relationships with local partners who know the lay of the land will be in the best position to take advantage of Mercosur's distinct break with the past.

Professional Employer Organizations

A Growth Industry in Human Resource Management

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In a tight labor market, employers pay closer attention to any mechanism that may provide a competitive advantage in employee recruitment and retention. Small employers especially often lack not only the skills and expertise to compete effectively in recruitment and compensation activities, but also the size to obtain most fringe benefits at a cost equivalent to those paid by larger employers.

More and more, small businesses in Texas and around the country lease employees from professional employer organizations (PEOs, or, in legal parlance, license holders). A typical staff leasing arrangement involves three discrete entities: the PEO company, a client company, and employees. By definition, staff leasing is an "arrangement by which employees of a license holder are assigned to work at a client company and in which employment responsibilities are in fact shared by the license holder and the client company."[1]

Neither temporary help firms nor independent contractors, PEOs lease employees over the long term, and these employees comprise a majority of all employees at the client companies. The PEO and client company allocate some and share other employment responsibilities under the contractual arrangement, with the client company retaining essential management control over the end product of the work performed by the employees. Essentially, the client company provides day-to-day supervision and management of employees. The PEO assumes responsibility for a wide range of employer responsibilities and risks and is the legal employer of record for purposes of payroll tax, benefits, and administration.

The Evolution of the PEO Industry

The growth of the PEO industry gained momentum about 25 years ago when provisions in tax and pension laws made employee leasing very attractive to the owners of small businesses and professional practices.[2] Employers could offer tax-advantaged pension benefits to their owners, while segregating non-owning employees into a separate pool, which provided fewer benefits. Subsequent changes in federal legislation basically eliminated those loophole provisions.

A second growth spurt in the mid-1980s was based on economies of scale in buying health and workers' compensation insurance. Coverage was expanded to larger numbers of employees, and client companies reduced their costs through the bulk purchasing process. This phase eventually fell prey to imprudent self-insurance and risk management practices on the part of several large leasing companies, leading to the failure of several staff leasing companies and blemishing the entire industry.

The current growth surge began in the early 1990s. Characterized by increased professionalism and less risky business practices, the industry has also seen increased regulation by federal and state governments. PEOs now use economies of scale in human resource management and employee benefits. Several other advantages include improved fringe benefits, expertise in benefits administration, and assumption of an administrative function that has become increasingly complex because of employment regulation. PEOs offer a compelling option for the increasing number of small and medium-sized enterprises.

PEOs in Texas

Although still in its infancy, the PEO industry in Texas continues to grow at a healthy rate. Key findings from a recently completed baseline study of the industry within the state included:

- From 1994–1998, the number of client companies increased by an average of 21 percent annually. Although rather uneven, employee growth in that period averaged about 9 percent annually. (See fig. 1.) PEO employees represent approximately 1 percent of the total workforce in Texas.
- About 70 percent of all PEO employees work in the largest six counties in Texas, with Houston (Harris County) and Dallas claiming more than 40 percent. Growth by county from 1994–1998 has been the greatest in El Paso, followed by Dallas. (See fig. 2.)
- PEO employees cluster by industry: in 1998 the top three Standard Industrial Classification (SIC) categories—business services, construction trades, and health—composed nearly half (45 percent) of all employees. Recently, however, significant growth has occurred in wholesale trade, real

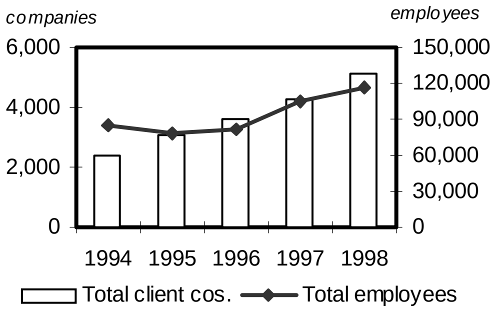

Figure 1
Number of PEO Client Companies and Client Company Employees, 1994-1998

estate, and, the most rapidly growing industry, eating and drinking establishments, indicating that the trend is veering away from concentration.

- According to a survey of Texas-based companies completed in late 1999, nearly all PEOs provide their client companies with assistance in the development of personnel policies and procedures. Also, nearly all PEOs provide coverage for workers' compensation, health insurance, and life insurance. A slightly smaller proportion, but still a large majority, provide vision insurance, disability insurance, and direct payroll deposit. About half of the PEOs offer employee assistance programs, access to a credit union, recruitment, and placement. Other services and activities, provided by some PEOs, include pre-employment testing and assessment, affirmative action plans, and training and staff development.

Current Outlook

While the number of covered employees and the range of services have increased over the past five years, the number of PEOs in Texas has decreased and will likely continue to decline as the relatively fragmented industry undergoes consolidation. Several of the larger organizations may purchase niche PEOs. Smaller PEOs will exit after determining they cannot achieve the requisite size to provide services in an industry that exists on thin margins. The remaining PEOs appear poised for at least continuing, if not accelerated, growth. Electronic transactions will enable the industry to become more dispersed geographically, and PEOs are penetrating further into new industries within the state, thereby opening up new opportunities.

Growth will be driven both by the productivity increases derived from economies of scale and by the expertise of PEOs in human resource administrative practices. Providing a tail wind for the industry will be continued outsourcing, a tight labor market, new fringe benefits, and a general trend toward more complex human relations statutes. With reasonable state regulatory policies and increased professionalism by the PEOs, this industry should continue to benefit employers and employees alike in coming years.

Notes

1. Robert C. Rice, *Texas PEO Handbook 1999 Edition*, Austin: Texas Chapter of National Association of Professional Employer Organizations, 1999.

2. Gore Flynn, *Professional Employer Organizations* (unpublished manuscript), Coastal Enterprises, Wiscasset, Maine, 1997.

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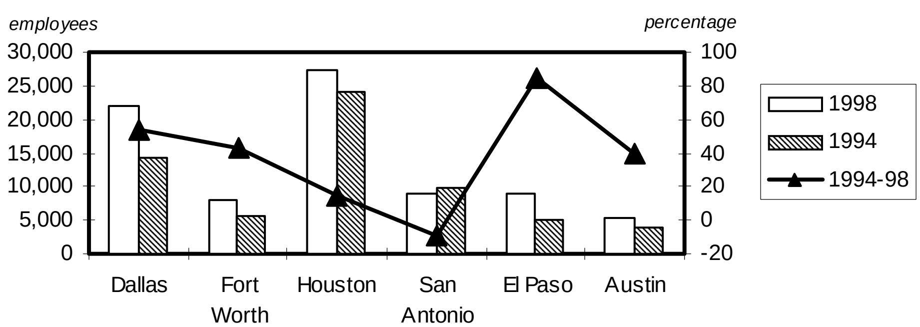
Figure 2
Growth in Number of PEO Employees by City, 1994–1998



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http://www.napeo.org/ (National Association of Professional Employer Organizations)

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Texas Exports to Mercosur, 1994 and 1999

By destination	**1994** (*millions $*)	**1999** (*millions $*)	**Percentage increase**
Argentina	587	776	32.2
Brazil	822	1,756	113.6
Uruguay/Paraguay	34	34	0
By sector	**1994** (*millions $*)	**1999** (*millions $*)	**Percentage increase**
Chemicals	605	835	38.2
Electronics	109	534	389.3
Industrial machinery & computers	440	758	72.3
Oil refining, etc.	65	85	29.3
Other	224	354	58.1

Source: Texas Department of Economic Development.

Announcement

After publishing **Texas Industrial Expansion** (**TIE**) for many years, the Bureau of Business Research will discontinue the monthly service after the August 2000 issue. However, the current **TIE** editor will continue the publication as a private concern. Check www.texasbusinessreport.com for subscription information. ◆