

TURNING INWARD

Ruling Coalitions and Mercosur's Retrenchment

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Mercosur (Mercado Común del Sur, "Common Market of the South") is the fourth-largest trading bloc (following the European Union [EU], North American Free Trade Agreement [NAFTA], and Association of Southeast Asian Nations [ASEAN]), and home to a BRIC (Brazil, Russia, India, and China) member. As it enters its twenty-second year, we consider what best explains Mercosur's trajectory thus far, from promising start to recent stagnation. The common market project requires Argentina, Brazil, Paraguay, Uruguay, and recent member Venezuela to integrate their markets and policies more deeply than would be required of a simple free trade area (FTA). Yet Mercosur lacks the binding supranational institutions an economic union would require. The four founding members sought regional integration that, according to the founding treaty, would yield greater economic development and competitiveness. Moreover, the newly democratized founding members also sought integration to consolidate their emerging open-economy democracies (Solingén 1998; Kaltenthaler and Mora 2002; Oelsner 2003).

Following the 1991 Treaty of Asunción, it appeared that integration would indeed yield the desired benefits: the flow of goods among members increased dramatically from 1991 to 1999, and Mercosur's organizational structure deepened and expanded, albeit in a limited way. Mercosur helped prevent a 1996 coup in Paraguay. A series of economic upheavals in its two prime engines, Brazil (1999) and Argentina (2000), revealed snakes in the integration garden and began stymieing the project. Intraregional trade (as a percentage of total trade) decreased and Mercosur's survival was in doubt (Carranza 2003). Some indicators, such as intraregional trade, improved somewhat since the doldrums of the early 2000s, but further progress toward a full common market stalled. Indeed, contention among members over multiplying exceptions and nontariff restrictions increased.

Why was Mercosur relatively successful initially only to lose steam at the dawn of the millennium? A robust theory must be able to explain rising, declining, and stagnant integration. We begin by reviewing theoretical explanations for this path and their shortcomings. Classical integration theories, particularly those deployed to analyze the European Union's expansion, are less useful for explaining Mercosur's trajectory. We argue, instead, that the character of members' ruling coalitions and the institutional framework of strong presidencies, particularly in Argentina and Brazil, were the main drivers of Mercosur's rise and decline. Current trends related to those drivers suggest that further integration of the kind envisaged by Mercosur's creators is unlikely.

Mercosur's Trajectory: Trade, Investments, and Institutions

Mercosur's founding had an explicit economic purpose that would also serve the strategy of political leaders advancing open-economy models of political survival. When member presidents signed the Treaty of Asunción, they assumed that it would expand domestic markets and "[secure] their countries a proper place in the international economy" (Alhadeff 1991, 1044). It was a stepping-stone to embed and enhance the integration of their economies into a global economy.

Because the Common Market's purpose was to facilitate freer trade flows, the best (and commonly used) indicator of Mercosur's integration performance is intraregional trade: imports plus exports as a percentage of Mercosur's total trade. In its first decade, Mercosur facilitated impressive increases in intraregional trade. While every founding member's total trade increased, intraregional trade doubled from 11 percent of total trade in 1990 to an all-time high of 23 percent in 1999. The average annual growth rate of intra-Mercosur trade between 1981 and 1990 was 5.3 percent, rising to an average 16.9 percent per year between 1991 and 2000. Figure 19.1 illustrates these trends. The solid black line represents all intra-Mercosur trade; the vertical line indicates Mercosur's founding. Importantly, Mercosur's creation preceded rising shares of intraregional trade.

Mercosur's "decline" began after Brazil's devaluation of the Real in 1999 and Argentina's 2000–2001 crisis and default (Baer, Cavalcanti, and Silva 2002; Bouzas 2003). Startlingly, intraregional trade nearly halved from about 23 percent of total trade in 1998 to 13.9 percent in 2002. All members saw their intraregional trade decrease, particularly Paraguay and Uruguay, for whom intraregional trade comprised a larger share of total trade. The decline reversed since 2003. Intraregional trade grew 13 percent annually on average from 2001 to 2010, 3.9 percent less than the previous decade. Intraregional trade as a percentage of total

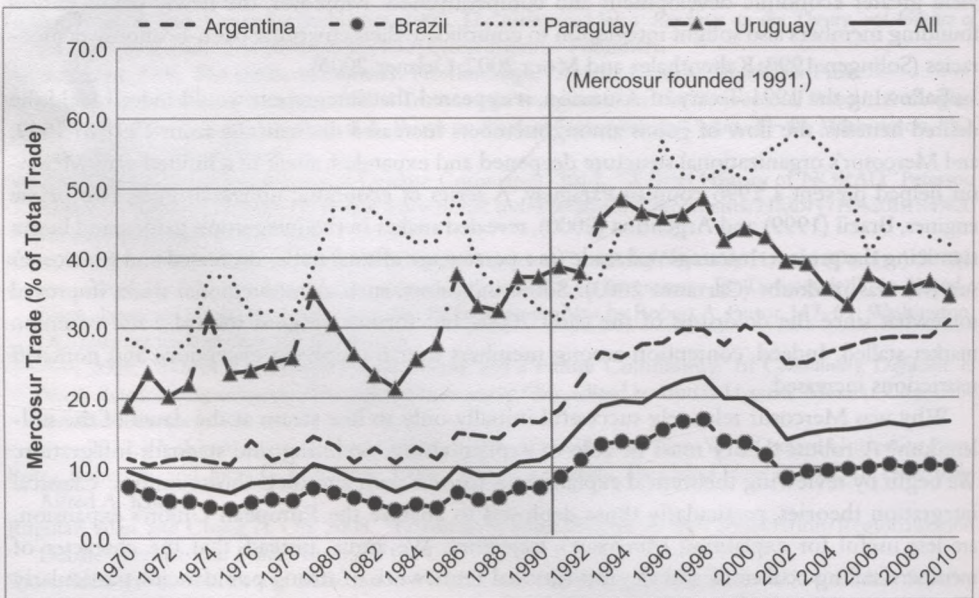


Figure 19.1 Intraregional Trade: Mercosur and Founding Members

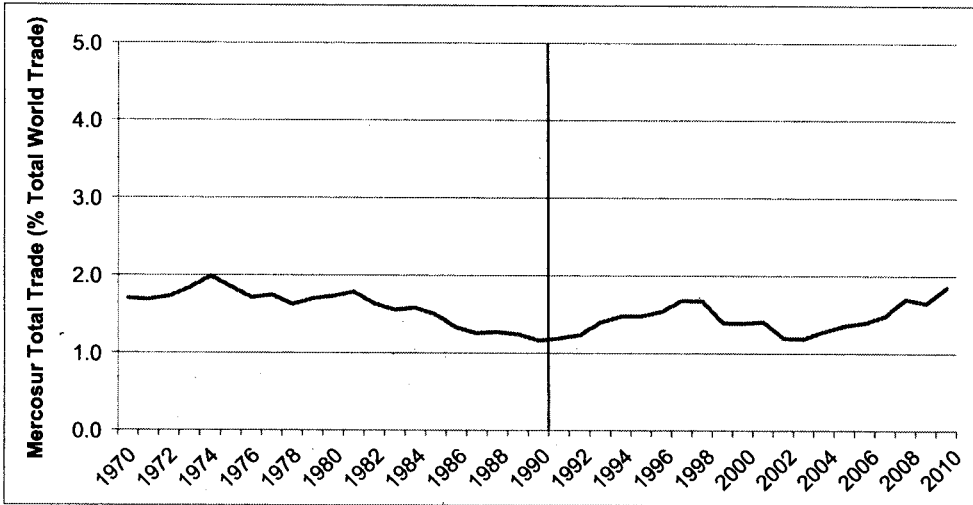


Figure 19.2 Founding Mercosur Member Total Trade

Source: IMF Direction of Trade Statistics (DOTS) and author's calculations.

Mercosur trade rose but remains lower than any year between 1992 and 2001. Member trade flows partially account for this trend. Brazil's interests—given its large economy—were beyond Mercosur; Brazil's trade accounted for 71 percent of Mercosur's total trade in 2010. Its intraregional trade as share of total trade remained relatively flat after 2001, the lowest of the four.

Mercosur's share of total world trade rose from 1.2 percent in 1991 to 1.7 in 1998, declined to 1.2 percent by 2002, and reached 1.8 percent in 2010. Figure 19.2 reveals that, considering the 1970s and 1980s, Mercosur's share of total trade merely kept pace with global trends. Indeed, total Mercosur trade as a share of total world trade reached just under 2 percent in 1974, declining until 1992. Mercosur did not seem to have enhanced the region's share of global trade.

Nor has Mercosur enhanced the Southern Cone's share of global foreign direct investment (FDI). From 1981 to 1990, between 2.2 and 3.2 percent of total world FDI stocks were invested in the founding Mercosur states. During Mercosur's first decade, total world FDI stocks invested in Mercosur ranged from 2.2 to 3 percent of total world FDI stock, and from 1.9 and 3.9 percent total stock in the second decade. Mercosur's outward FDI stock declined from more than 8 percent in 1980 to just more than 1 percent in 2010 (Figure 19.3). Brazil accounted for the bulk of FDI into/from Mercosur. Total inward and outward FDI stocks in Brazil as a percentage of total FDI stocks in Mercosur were, respectively, 85.3 and 86.4 percent in 2011.

Inward FDI stocks relative to gross domestic product (GDP), however, increased significantly (Figure 19.4). In 1980, inward FDI stock composed 7.2 percent of Mercosur's GDP but grew to 26.8 percent in 2011, primarily driven by Brazil. Inward FDI relative to GDP surged for all founding members but primarily for Argentina, where inward FDI stocks were more than 40 percent of GDP in 2002, declining dramatically in the aftermath of the default to 21 percent in 2011.

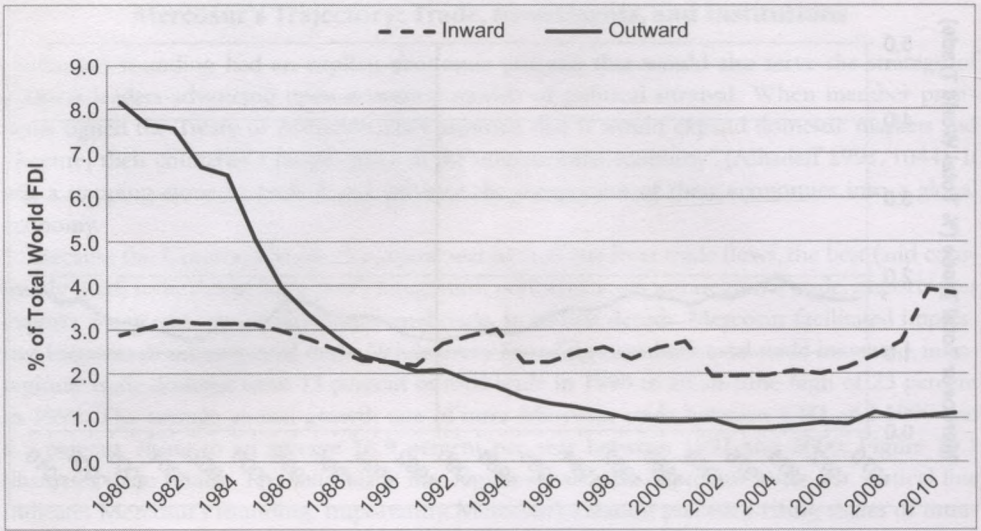


Figure 19.3 Mercosur Foreign Direct Investment (FDI) Stocks

Source: UNCTAD FDI data and author's calculations.

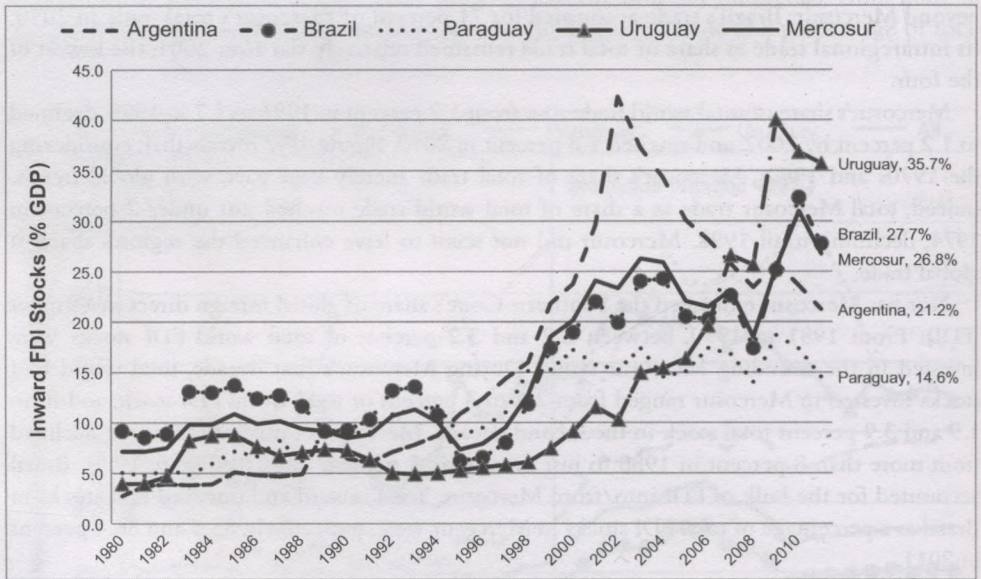


Figure 19.4 Inward Foreign Direct Investment (FDI) as a Percentage of Gross Domestic Product (GDP)

Source: UNCTADStat and author's calculations.

Mercosur's trajectory can also be examined through its institutional development. The treaty sought to create the necessary intergovernmental structure to manage market expansion, ensure macroeconomic "complementarity," and "gradually [bring] about Latin American integration" (Alhadeff 1991, 1044). Political efforts were directed at the creation of a common market featuring free flow of goods and services, a common external tariff, and coordination of macroeconomic and sectoral policies in several areas by December 31, 1994 (Paraguay and Uruguay were given an extra year). This deadline was never met, and a full customs union remains unrealized. The treaty specified two preliminary institutions to advance its goals: The Council of the Common Market (CCM), consisting of member states' ministers of foreign affairs and of economy, sets objectives and timelines for establishing a common market. The Common Market Group (CMG) executes CCM decisions, monitors compliance with treaty (and council decisions), and creates specific "measures" and "programs" to achieve a common market. Decisions were to be reached by consensus. The only schedule specified in the Treaty appears in its annex I and pertained to tariff reductions other directives were not specific (Pereira 1999).

Mercosur members stipulated dispute resolution procedures in the 1991 Protocol of Brasilia for the Solution of Controversies, later refined by the Protocol of Olivos in 2002. Briefly, states enter into direct negotiations; if unsuccessful, they may submit disputes first to the CMG; furthermore disputation takes place under a system of nationally designated arbiters (*ad hoc* Arbitration Court, with the possibility of review by the Permanent Review court). Failure to comply with decisions allows members to adopt temporary compensatory measures. Yet disputes have not necessarily been settled in this manner; in a five-year-long dispute regarding pulp mills on the Uruguay River, Argentina sought the International Court of Justice's (ICJ) review while Uruguay used Mercosur's mechanisms.

The scope of Mercosur's responsibilities widened initially. The 1994 Protocol of Ouro Preto established Mercosur as an internationally recognized entity capable of negotiating for all members. The council was to assume Mercosur's legal personality and to negotiate and sign agreements on its behalf. New organs within the CMG and CMC were created to deepen institutional arrangements, as were new bodies: Mercosur Trade Commission (MTC); Mercosur Parliament; Economic-Social Consultative Forum (ESCF); Mercosur Administrative Secretariat (MAS); and Mercosur Center for the Promotion of Democracy (CMPED). States were required to implement decisions as domestic legislation, with no specification of punishment mechanisms. Mercosur's Parliament neither creates nor passes legislation. Its directly elected members meet monthly to issue advisory rulings regarding legislative drafts. Mercosur's institutional structure remains intergovernmental rather than supranational (Phillips 2003).

Mercosur has five associate members: Bolivia, Chile, Colombia, Ecuador, and Peru. Guyana and Suriname signed protocols for associate membership in 2013. Mercosur signed a free trade agreement with Bolivia and an Economic Complementation Agreement with Chile in 1996, formally accepted Venezuela as full member in 2012, and signed a treaty of accession with Bolivia, yet it is unratified by national legislatures. Venezuelan membership was slowed by the Paraguayan and Brazilian legislatures since 2006. Brazilian ratification and Paraguay's temporary suspension allowed Venezuela's full accession. Chilean full membership negotiations ended after Chile signed a 2002 free trade deal with the US. Negotiations with the EU, begun in 1999, have stalled. The bloc-to-bloc negotiations mired over trade and investment issues, including the EU's farm import quotas and the sale of EU-manufactured cars to Mercosur. Table 19.1 shows major agreements and negotiations between Mercosur and other states and regional organizations since 1996.

Table 19.1 Mercosur Agreement Type by Date and Partner

Partner	Agreement type	Year of entry into force
Chile	Free Trade Agreement	1996
Bolivia	Free Trade Agreement	1997
Andean Community States	Tariff Preferences	2000
Mexico*	Auto Sector Framework Agreement	2002
Colombia, Ecuador, Venezuela*	Partial Preferential Agreements	2004
Peru*	Free Trade Agreement	2005
Andean Community States	Free Trade Agreement	2005
Dominican Republic	Exploratory Trade Talks	2005
Gulf Cooperation Council (GCC)	Exploratory Trade Talks	2005
Korea	Exploratory Trade Talks	2005
Panama	Exploratory Trade Talks	2005
Central American Integration System (SICA)	Exploratory Trade Talks	2005
Mexico	Framework Agreement	2006
South African Customs Union (SACU)*	Preferential Trade Agreement	2008
India	Framework Agreement	2009
Israel	Free Trade Agreement	2010
Egypt*	Free Trade Agreement	2010
Morocco	Framework Agreement	2010
Canada	Exploratory Trade Talks	2011

* Denotes the signing date and that the agreement was not yet in force, as of this writing.
 Source: OAS SICE (Foreign Trade Information System).

Theoretical Explanations for Mercosur's Rise, Decline, and Stagnation

We rely on the character of Mercosur members' ruling coalitions and their orientation toward the global political economy as a framework capable of explaining its creation, expansion, and subsequent stagnation. Before turning to that argument in greater detail, we review and critique a number of theoretical approaches. Classical economists accepted Ricardo's argument that free trade enhanced welfare: Viner (1950) adapted it to customs unions, arguing that trade could be created (thereby enhancing welfare) or diverted (reducing welfare), depending on partners' economic complementarity. Customs union theory soon developed greater theoretical breadth (Lipsey 1957; Cooper and Massell 1965). Venables (2003) argues that a state's comparative advantage vis-à-vis its regional partners and the *rest of the world* matters; regional integration works best when low-income states link with high-income states. States should thus seek to integrate when their economies are complementary rather than competitive. The strength of this approach lies in its ability to explain how variations in domestic economies produce variations in the effects of freer trade. These models, however, speak to the *effects* of customs unions; to the extent that they have any causal power, it is due to the beliefs of leaders, coalitions, or bureaucracies who would

negotiate the customs union's terms. They can observe existing trade benefits and speculate about potential costs and benefits of decreased trade barriers. The Treaty of Asunción reflected the view of presidents that, although integration would expand domestic markets, members would need to ensure complementarities across sectors. The protection of Argentina's automobile sector and Brazil's sugar sector even during the period of lowest intraregional tariffs reflects those compromises.

Economic theories do not elicit consistent hypotheses regarding how particular regional integration schemes behave. Argentina and Uruguay could be classified as middle-income countries and Paraguay as low-income. Examining member states' per capita GDP growth, however, suggests that Paraguay benefited less than did Argentina, Brazil, and Uruguay. Argentina's per capita growth rate between 1991 and 2000 was, on average, 3.4 percent, rising to 4 between 2001 and 2011; Brazil's average growth rate was 1 percent for the earlier period and 2.4 percent for the latter; Paraguay's was -0.5 percent for the first and 2.2 percent for the second. Importantly, as Venables admits, many models tend toward abstraction to examine how comparative advantage behaves under particular scenarios but do not identify *political* conditions that might push states to pursue a common market beyond a customs union. Nor do they address how regional integration schemes could regress. Why would decision makers pursue integration unless their economies were complementary in the first place? Given complementarity, why would states reassert national prerogatives? Within economic theoretical frameworks, the answers are unclear.

Integration theory developed primarily to explain the European Community. Haas's (1958) theory focused on political actors "[shifting] loyalties, expectations, and political activities to a new center" beyond preexisting national states. For Deutsch (1969), integration meant that a learned "sense of community" had become strong enough to make war unthinkable, creating "security communities." Oelsner (2003) classified Mercosur as a security community, yet war among Mercosur members was improbable long before Mercosur's existence despite sometimes tense relations between Argentina and Brazil in the 1970s. Nor did the absence of war produce genuine integration prior to Mercosur (or, some might say, after it came into being). Haas emphasized the role of spillovers from existing areas of cooperation into new ones but Mercosur does not appear to confirm such spillovers; indeed, higher nontariff barriers signal regression despite previous cooperation.

Other theories emphasize interdependence as fostering regional integration through multiple, repeated interactions that lead to the demand for institutions (Keohane 1984; Axelrod and Keohane 1985; Oye 1986). Neoliberal institutionalist approaches would explain Mercosur's emergence as an effort to escape from the pitfalls of international anarchy. However, their applicability to Mercosur seems doubtful: interdependence was arguably a (limited) product rather than a driver for Mercosur's emergence (Solingen 1998; Malamud 2005). Intraregional trade relative to total trade was lower in 1990 than in 1979. Furthermore, the region had a dense preexisting institutional infrastructure—for example, the Latin American Integration Association and the Latin American Free Trade Association before it—that never translated into genuine integrative frameworks.

Other structural theories emphasize the role of hegemons in organizing cooperation (Gilpin 1975; Krasner 1976; Webb and Krasner 1989). Hegemonic stability theory built on the example of US-led establishment of such public goods as international financial and security institutions. Yet Mercosur seems more the product of intraregional forces than US hegemonic pressure. Indeed, hegemonic preferences for freeing trade throughout the continent were often defeated. Although Brazil may have ascended to the role of regional hegemon in the last decade, the evolution of Mercosur can hardly be explained as a function of a uniquely Brazilian design. Brazil does play a major role, with its Mercosur partners, in stemming the diffusion of a market-friendly

“open regionalism” that nurtures tight connections with global partners. Preferential trade agreements such as the Pacific Alliance are the carriers of this open regionalism, as we discuss in the following (Quiliconi 2012). Another structural theory—World Systems Theory—gained particular refinement in Latin America in the form of Dependency Theory. In this view outcomes follow the logic of states’ positions within the global political economy (Wallerstein 2011; Caporaso 1978). The stipulated position of Latin American states at the periphery of the world’s capitalist system presumed their exploitation by core states. The key metric was relative improvement: the periphery may develop, in this view, but less quickly than core states. The last decade casts serious doubt about such claims. Prior to that, East Asia’s experience offered strong evidence to the contrary. Emerging markets became important drivers of the global economy in their own right.

Cason’s (2011) detailed analysis of Mercosur relies on structural and institutionalist factors to explain regional organizations’ degree of institutionalization. According to his Vulnerable Integration model, states with relatively undeveloped domestic political institutions that are more exposed to exogenous shocks from the global economy create weak regional organizations, primarily because of the need to manage their domestic economies, and decisions at inception will necessarily influence decisions regarding expansion or regression. The variance in the dependent variable, strength and institutionalization, is generally explained across rather than within regional organizations because important independent variables (e.g., exogenous economic shocks), do not vary significantly within cases. The theory thus addresses more effectively why Mercosur is “weaker” than the EU than why Mercosur may have been “stronger” in the 1990s than in the early 2000s; Mercosur’s position in the global political economy has not changed significantly, excepting Brazil’s position, a BRIC country. Cason’s theory does not address Mercosur’s inception but identifies compelling structural constraints on Mercosur’s capacity to deepen.

Constructivist theories dwell on socialization as an instrument of integration and the creation of common identities (Checkel 2001, 2005). In this view Mercosur evolved in tandem with a growing “common identification of risks and opportunities” (Oelsner 2003; Mera 2005). However, Mercosur’s peaks and troughs question the extent to which socialization or identity was a powerful driver. Furthermore, ideational forces pushing for integration were part and parcel of the Latin American experience well before Mercosur, never yielding the desired fruit.

Counter to many of these structural perspectives, another approach traces Mercosur’s “decline” to the character of domestic political institutions. Latin American presidentialism is seen as conferring, formally and informally, significant power to the executive. O’Donnell (1994) coined the term *delegative democracy* to describe cases such as Menem’s Argentina, where presidents obtained mandates (“delegation”) to pursue policies as they saw fit. Hyper-presidentialist systems lack significant checks and balances on presidential power (Rose-Ackerman, Desierto, and Volosin 2011) and explain Mercosur’s emergence (Malamud 2003, 2005; Domínguez 2007). Such systems give presidents popular legitimacy and enable them to ignore institutional veto points and political competitors so that they can negotiate agreements unilaterally and preserve them in *ad hoc* fashion. This reduces incentives to build supra-national institutions; preserving control gives presidents advantages as the “single, non-bureaucratic target” that others must lobby or appeal (Malamud 2003). This theory provides a compelling argument for Mercosur’s rise and decline but is incomplete. *Institutional* presidential power has not varied (de la Rúa and the Kirchners had the same executive decree prerogatives as Menem) and hence cannot explain variation in engagement with Mercosur. The same is true for other members. Rather, the variation in presidential preferences might explain approaches to Mercosur. The next section provides a theoretical framework for understanding such variation.

In sum, none of the approaches discussed can explain why Mercosur was created or why it expanded and then stagnated. Most integration and neoliberal institutionalist theories regard existing interdependence as driving intergovernmental cooperation, yet interdependence was rather trivial before Mercosur's creation. Constructivist identity theories do not explain temporal dynamics (ups and downs) or *why* ideational forces only blossomed in 1991. Structural and hyper-presidentialist theories address important antecedent and intervening conditions but do not display sufficient variance to reflect Mercosur's varying trajectory. We now turn to what we deem a crucial variable explaining Mercosur's checkered evolution.

Ruling Coalitions and Mercosur's Trajectory

Explaining how and why Mercosur expands and retrenches requires a theory that accounts for this variance in the dependent variable. The preferences and strategies of ruling coalitions—contingent on their varying approaches to the global economy—explain Mercosur's phases of expansion and retrenchment. Internationalizing (outward-oriented) ruling coalitions, primarily in Argentina and Brazil, incepted Mercosur as a way of enhancing their joint integration in the global economy. Ten years later, more inward-looking ruling coalitions in Brazil and Argentina turned Mercosur inward as well, foiling its original purpose.

Depending on their model of political survival (i.e., the manner in which they earn electoral support) ruling coalitions may be classified as "internationalizing" or "inward-looking." These are Weberian ideal types rarely found in pure form in the real world but are nonetheless useful analytical categories. Internationalizing coalitions base their political survival on economic performance, export-led growth, and integration in the global political economy (Solingen 1998, 2001). They seek fiscal discipline by freeing resources for domestic reform and abstaining from fiscally draining emphasis on military expenditures; they work to weaken their domestic political and institutional opponents; and they aim at attracting foreign investment and technology and expanding markets abroad. These synergistic objectives are well served by cooperating with regional counterparts. Regional cooperation reduces the marginal utility of military spending, creates further opportunity to expand export markets and investments, and enhances the prospects of politically and economically successful internationalizing reforms.

In contrast, inward-looking coalitions advance their political survival through statism, economic protectionism, self-sufficiency, and nationalism. Those who benefit from import-substitution industrialization favor price controls, wage increases, currency manipulation, protection of state enterprises, and import protection. Similarly, state bureaucracies involved in economic planning resist economic liberalization. Groups may also oppose market-based reforms as detrimental to society's well-being, social values or cohesiveness, or because such reforms deprive them of the ability to promote myths of nationalist self-sufficiency. The armed forces are frequently attuned to those objectives. Given their essence and composition, inward-looking coalitions have fewer incentives to engage in regional frameworks that advance engagement with the global economy and greater incentives to retain trade barriers and statist and military-industrial complexes.

The two ideal-typical coalitions have empirical referents in Argentina and Brazil, the dominant dyad at the heart of Mercosur. Although the Southern Cone has largely been at peace for most of the twentieth century, the dominance of nationalist inward-looking forces yielded military confrontations among enduring rivals (the Argentine-Chilean Beagle dispute), a war with a major power (Argentina against Great Britain), and nuclear competition (between Argentina and Brazil). Regional economic cooperation remained the prevailing rhetoric—an extension of nationalism writ large, cast at the regional level—but never transcended symbol and discourse. Only in the early 1990s was a brand-new regional order born in the Southern Cone—complete

with denuclearization and Mercosur. The rise of internationalizers bent on implementing a political-economic revolution at home through unprecedented integration into the global political economy was the necessary causal condition for these regional initiatives.

The military regimes that dominated the Southern Cone in an earlier era did not embrace genuinely internationalizing reforms or military retrenchment. They rather retained historical competition over territories, resources, and influence over buffer states together with serious expressions of mutual distrust. Competition with Brazil was a quasi obsession of Argentine geopolitical thinkers (Child 1990), and bilateral relations were more geared to "competitive schemes" (Hilton 1985, 27) than genuine integration. Military institutions exacerbated the cold relationship. Brazilian fears of Argentine aggression went back more than a hundred years—both fought their last war in 1825–28—and were high during Argentina's alignment with Axis powers in World War II, as Brazil joined the Allies' military efforts in Europe. Argentina and Brazil became important cases in studies of nuclear proliferation given decades of efforts to develop nuclear capabilities outside the global nonproliferation regime. By the late 1980s, of the more than 170 states, only a handful still refused to join the 1968 Non-Proliferation Treaty, and those included both Argentina and Brazil. What seemed like cooperation—Argentina's general Videla and Brazil's Figueiredo 1980 agreement establishing cooperation in fuel cycle development—was superficial and ephemeral though it laid some foundations for subsequent cooperation.

The sources of Mercosur are in the revolutionary shift to internationalization in the early 1990s, a product of international, extra-regional, regional, and domestic drivers: inducements by multilateral economic institutions, US influence, East Asian models, regional pioneers such as Chile, and the domestic collapse of "heterodox" programs perhaps overdetermined this radical departure from the past (Barros 1995; Haggard 1995). The ascendancy of new political coalitions does not take place in an international vacuum, but ultimately feeds on the domestic realignment of political forces and institutions. Political entrepreneurs use new external and internal realities to tailor the new agenda, as they did at the end of the 1980s by portraying the legacy of inward-looking statist-nationalism as one of bankrupt economies and failed polities. Exposing the old populist rhetoric and hybrid programs of civilian and military predecessors, these politicians "unmasked" the true beneficiaries of inward-looking models, either before or, most often, shortly after elections.

An iron triangle—the military and its state enterprises, protected industries, and Peronist labor—had strapped Argentina's political economy, either sequentially or in concert. This pattern led not only to its deindustrialization but also to its statist-nationalist emphasis. The magnitude of economic collapse by the 1980s strengthened the hand of internationalizing President Carlos S. Menem, who challenged Peronism from within and decimated the military-industrial complex. Menem reduced a Weimar-style inflation to single digits, balanced the budget, privatized many public services, attracted sizable foreign investment, led to an unprecedented embrace of liberal trade rules and the abandonment of Argentina's historical nationalist foreign policy (Russell 1992), neutralized sensitive nuclear facilities, and deepened privatization.

Statism and the military-industrial complex fared somewhat better in Brazil during the 1970s but also returned uneven growth and one of the worst income distribution records worldwide. Had the tradeoffs been slower growth accompanied by greater equity, politicians might have formulated political choices differently. However, the irrefutable performance of Asian tigers—growth-cum-equity—challenged all variants of inward-looking strategies. Thus, President Collor de Mello (1990–92) defeated Luis Inácio da Silva (Lula) with significant support from unorganized poor (but not unions and other beneficiaries of import substitution). Collor announced major trade reform and stabilization measures, replaced quantitative restrictions with

tariffs, lowered average tariffs, rescinded protectionist tools, downsized the state bureaucracy, eliminated budget deficits, privatized 22 of 26 state enterprises, slashed the military's share of the budget from 6 to 2.2 percent (1989–1990), denied salary raises to military personnel, purged military officers from important bureaucratic positions, and shut down presumed nuclear weapons test sites in Cachimbo (Solingen 2012). Brazil's Congress and the military opposed these reforms.

These shifts allowed Presidents Menem and Collor (and later Fernando H. Cardoso) to incept internationalizing strategies at the regional level. As argued, incentives to enhance regional cooperation and macroeconomic stability with an eye on the global economy ushered in explicit unprecedented agreements renouncing nuclear weapons and establishing mutual verification and inspection procedures. In the economic domain, Mercosur emerged as naturally compatible with unilateral policies of economic liberalization that deepened regional markets to enhance economies of scale in an “open regionalism” framework. Mercosur was thus an expression of internationalizing strategies and reinforced them domestically. In July 1990 Collor and Menem signed the Buenos Aires Act, accelerating the timetable for the establishment of an Argentine–Brazilian common market by December 1994, and instituting automatic tariff reductions across the board. Argentina, Brazil, Uruguay, and Paraguay signed the 1991 Treaty of Asunción, creating Mercosur, stipulating free circulation of goods and services and common external tariff by 1995, an automatic schedule for tariff reductions, harmonization of laws and regulations concerning rules of origin and dispute settlement, and coordination of macroeconomic policies. Mercosur was designed to strengthen internationalization at home, weaken groups and institutions opposed to reform, and increase the costs of reversal for potential domestic challengers. In contrast to all preceding integrative efforts, private entrepreneurial associations played a leading role in shaping Mercosur. In 1995 Brazilian business with investments in Argentina created a new lobby—Grupo Brasil—dedicated to defend Mercosur against protectionism.

Under Menem, Collor, and Cardoso, tariff reduction timetables were not merely met but in some cases implemented ahead of schedule. Regional integration was regarded as a building bloc and an accessory to the global logic of internationalization. In Cardoso's unequivocal terms,

“We see integration schemes as playing an important role in expanding world trade flows even further. They complement rather than substitute for international rules such as those of the World Trade Organization,” and “Brazil is a global trader, and it is important for us to keep this profile. Maintaining important trade flows with different regions of the world is less risky than relying on a single trading partner. Brazil is thus a country interested in strengthening the world system.”

(quoted in Hoge and Cardoso 1995, 66)

The shift toward internationalizing coalitions was thus a necessary condition for Mercosur's creation and initial performance. In time, however, strains in those coalitions became evident as industries that benefitted from state protection remained ensconced in special tariff protections and macroeconomic policies (Olarreaga and Soloaga 1998; Cason 2000; Baer, Cavalcanti, and Silva 2002). The ascent of Brazil's Itamar Franco—responsive to inward-looking constituencies—temporarily suppressed the drive toward a new regional political and economic order. Bouzas (2003) characterizes the late 1990s as a period of decreasing compliance and implementation of Mercosur regulations. Figure 19.5 uses data from Gómez-Mera (2009) to illustrate the increasing number and severity of trade disputes between Argentina and Brazil beginning in 1995 and through the 2001 Argentine crisis.

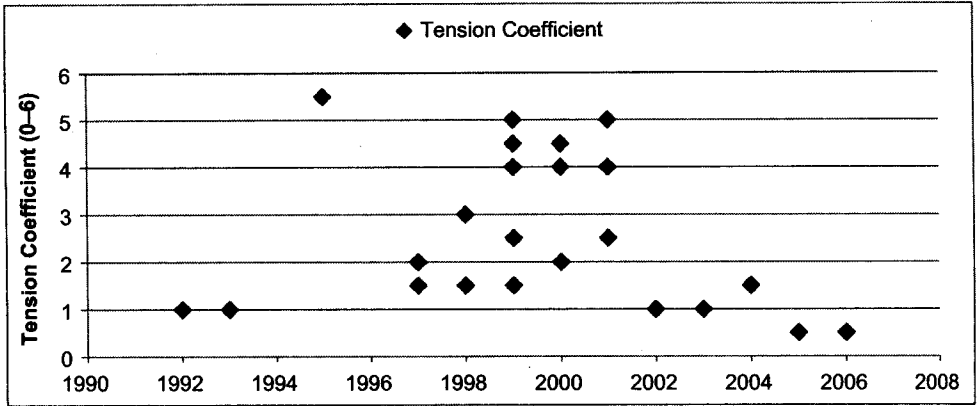


Figure 19.5 Argentine-Brazilian Trade Disputes

Source: Data taken from Gómez-Mera 2009; Graph is the authors. Scale is ordinal, with higher numbers signifying higher tension.

Mercosur resolved disputes at the interstate level, facilitating trade in Mercosur's early years but proving less useful as leaders' coalitional priorities shifted. Compromises between Menem and Cardoso prevented tariff exceptions from derailing Mercosur (Malamud 2005). However, Argentina's and Brazil's subsequent divergent macroeconomic policies, required to maintain domestic coalitional support, increased stress on the bilateral relationship as protectionist sectors became more vocal (Baer, Cavalcanti, and Silva 2002; Gómez-Mera 2009). Several critical disputes brought the future of Mercosur into question, including Brazil's 1999 and Argentina's 2001 devaluations. Brazil devalued the real to deal with its recession, making Brazilian goods cheaper relative to Argentina's, with its peso pegged to the dollar since 1991. While Menem and Cardoso managed the crisis, Argentina's recession deepened and severe riots forced newly elected president De La Rúa to resign in 2001. Five presidents were named and resigned over one December week; Adolfo Saá defaulted on Argentina's foreign debt and resigned; Eduardo Duhalde abandoned the Convertibility Plan pegging the peso to the US dollar. Argentine public support for Mercosur plummeted with declining support for internationalizing policies as Nestor Kirchner assumed the presidency in 2003 (Gallo 2012). The crisis accompanied and facilitated coalitional shifts in Argentina and Brazil. Brazil's and Argentina's responses to the crisis certainly affected the coalitions that followed. Brazil's devaluation, while not solely determined by domestic factors, reflected Cardoso's need to manage anti-inflation supporters. Argentina's crisis was deeper, and its subsequent macroeconomic policies emphasize "monetary autonomy and competitiveness over low inflation and external credibility" (Gómez-Mera 2011, 258). Devaluations played a crucial role, yet explaining Mercosur's decline merely as a product of economic crisis ignores two crucial facts. First, Menem and Cardoso managed tensions leading to the devaluations and maintained Mercosur as a potential customs union with a common external tariff despite built-in exceptions. Although not internationalizing purists, Menem's and Cardoso's coalitions sustained Mercosur against domestic opposition (Gómez-Mera 2009). Second, as with the 1989-1990 crises, coalitional responses following the 1999-2001 crises were not preordained. Menem, Collor, and Cardoso responded to crises through market liberalization and Mercosur's creation. The Kirchners and, to a lesser degree, Lula, responded differently because of the character of their supporting coalitions. Nestor sought support from groups that

opposed “neoliberal” policies (Etchemendy and Collier 2007). The crisis played a causal role in the shifting coalitional balance of power, but the coalitional effects on Mercosur do not arise solely from the crisis. The crisis may have soured views of internationalizing policies to a level that prevented a postelection about-face—à la Menem—that could sustain market-oriented reforms.

New ruling coalitions in Argentina and Brazil modified the so-called Washington Consensus, creating new hybrid models, combining an emphasis on exports with higher state intervention and protectionism (Panizza 2005, 2009; Weyland, Madrid, and Hunter 2010; Grugel and Riggiorozzi 2012). Nestor (2003–2008) and Cristina Kirchner (2009 onward) moved even more strongly toward inward-looking constituencies. Brazil’s “Lula” (2003–2010) and Dilma Rousseff (2011 onward) emphasized a greater role for the state but maintained macroeconomic stability and internationalization.

In broad terms, Lula maintained Cardoso’s macroeconomic policies (e.g., inflation targeting) but also enhanced statism. His was “a gradualist strategy backed up by minimal legislation and regulatory changes” but included strategic use of state-owned banks and infrastructure investment to support development (Morais and Saad-Filho 2011). Brazil continued to engage international financial institutions, repaying in 2005 the IMF debt incurred in its 2002 balance of payments crisis. As reflected in Figure 19.2, inward FDI as a percentage of Brazil’s GDP grew after 2002. Brazil’s foreign policy shifted toward regional dominance and a more marked global presence, and led efforts to defeat the US-sponsored FTAA (Carranza 2004, 2006; Burges 2007). Nestor Kirchner maintained positive relations with Brazil and relative economic stability (Wylde 2011). Lula and Kirchner fostered a different kind of cooperation within Mercosur than that envisaged by its creators, one more attuned to the resurgence of inward-looking (or hybrid) priorities. The shift in Kirchner’s orientation is evident from increased public spending (by 30 percent in 2007 alone) and price controls (Levitsky and Murillo 2008). Despite declarations at the 2003 presidential summit that the customs union project would continue, exceptions to the common external tariff (CET) multiplied, particularly during the late Nestor and Cristina Kirchner administrations (Inter-American Development Bank [IIDB] 2010, 113–115). Although not opposed to existing transnational investment in Argentina Nestor was more hostile to prospective ones and instructed state economists to massage inflation statistics. Christina continued the practice (the International Monetary Fund rejects Argentina’s official inflation statistics), implemented import and capital controls, retreated from a Mercosur–EU agreement genuinely facilitating mutual access, and unleashed what Uruguay’s Jose Mujica labeled an “autarkic project.”¹

Rousseff continued Lula’s policies, engaging with international institutions and projecting Brazil’s influence abroad, aiming for regional hegemony. Three areas of continuity include increased investments in state-owned and private energy and transportation; extending social provisions and consumer credit; and support for “national champions” at the domestic and international levels (Morais and Saad-Filho 2012). Brazil sent an envoy to discuss market protection policies with Argentina, including mistreatment of two Brazilian companies. Relationships among Mercosur members deteriorated, as with the Argentine–Uruguay dispute over pulp mills on the Uruguay River. Argentina argued that construction of two Uruguayan pulp mills on the Argentina–Uruguay border, worth approximately US\$1.7 billion, violated the Statute of the Uruguay River because Uruguay had not provided sufficient evidence to Argentina that the mills’ environmental impact would not affect Argentina. Uruguay denied this and argued that Argentina did not sufficiently deal with protests against the plant that had blocked roads across the river and that had impeded travel and trade. Importantly, Uruguay wanted to adjudicate the matter through Mercosur, while Argentina presented their case to the International Court of Justice (ICJ). The ICJ decision in 2010 ruled that Uruguay had breached the statute procedurally but

not *substantively*. After the ruling, newly elected Uruguayan president Jose Mujica met with Cristina Kirchner to calm tempers, at least cosmetically (IDB 2010).

Venezuela's accession provides further evidence for the inward-looking nature of a transmogrified Mercosur and for the dilution of Mercosur's commitment to democracy. Paraguayan and Brazilian opposition to full Venezuelan membership rested on Chavez's treatment of the press and concerns about Venezuelan democracy. Mercosur (alongside UNASUR and CELAC) suspended Paraguay on the grounds that President Fernando Lugo's 2012 removal by Congress was a "congressional coup." Mercosur's other members quickly used Paraguay's absence to admit Venezuela. Complying with few of Mercosur's original rules, Hugo Chavez—leading inward-looking entrepreneur—urged Mercosur to abandon so-called neoliberal priorities and embrace "socialist" ones (Solingen 2012). His own regional scheme, the Bolivarian Alliance for the Americas (ALBA), was designed to replace the FTAA. Chavez's successor Nicolas Maduro declared himself a Kirchnerite and Venezuela's second Peronist president.² Inward-looking Bolivia was allowed dual Mercosur/Andean Community membership (pending ratification), and Ecuador began negotiations for full Mercosur membership, smuggling additional ALBA members into Mercosur.

Other Mercosur members seek changes in or options outside Mercosur. Despite Brazil's opposition, Uruguay applied for membership in the Pacific Alliance, an internationalizing trading bloc composed of Mexico, Chile, Colombia, and Peru. Paraguay applied for observer status in the alliance. The private sector has been influential in shaping Alliance priorities, in contrast to Mercosur (*Economist*, May 18, 2013, 38). Mercosur's competition with the alliance is evident in Brazil's former foreign minister Antonio Patriota's statement labeling the alliance "a marketing success" that cannot deliver integration.³

Conclusion

Mercosur's evolution provides a window into the broader evolution of South America's ruling coalitions in recent decades. Mercosur emerged as a genuine integration effort with an eye on improved access to the global economy, steered by internationalizing ruling coalitions led by Menem, Collor, and Cardoso. The three enjoyed ample presidential prerogatives that enabled them to navigate through trade disputes and economic crises. Mercosur's intergovernmental institutional framework and reliance on *presidencialismo*, however, also enabled succeeding inward-looking presidents to revert its original purpose.

Economic crises abetted inward-looking turns in Argentina and Brazil. The demise of internationalizing models—particularly in Argentina—thus helps explain Mercosur's transformation into an inward-looking model writ regionally, one devoid of genuinely integrative purpose. By contrast, the widening Pacific Alliance has emerged as an internationalizing bloc posed to achieve what an inward-looking Mercosur could not. Unlike Mercosur, the alliance's founding members signed bilateral FTAs with both the US and the EU and are developing regulatory convergence in an "open regionalism" framework. The alliance's combined GDP is about US\$2 trillion (roughly equal to Brazil's), its annual GDP growth was 4.6 percent in 2011–2012 (to Brazil's 1.8 percent), and its exports to the world are twice as large (US\$545 billion) to Brazil's US\$245 billion. Chile and Peru are also part of the broader Trans-Pacific Partnership negotiations posed to create a massive transcontinental bloc accounting for 40 percent of global GDP. If successful, the latter would reward internationalizing models in Latin America and pose new challenges for post-commodity boom Mercosur that might render it a pale shadow of what its creators intended, yet another integration effort run amok. Mercosur, far from a supranational institution, is likely to remain a derivative of its members' evolving political-economy coalitions.

Notes

- 1 "Argentina's 'Autarkic Project' Worsens Bilateral Relations and Multiplies Problems," *Mercopress*, May 17, 2013, <http://en.mercopress.com/2013/05/17/argentina-s-autarkic-project-worsens-bilateral-relations-and-multiplies-problems>.
- 2 "Maduro Says He Is a 'Kirchnerite President' and Venezuela's 'Second Peronist President,'" *Mercopress*, May 9, 2013, <http://en.mercopress.com/2013/05/09/maduro-says-he-is-a-kirchnerite-president-and-venezuela-s-second-peronist-president>.
- 3 "Pacific Alliance in a 'Marketing Success' and No Concern for Mercosur, says Brazil," *Mercopress*, June 22, 2013, <http://en.mercopress.com/2013/06/22/pacific-alliance-in-a-marketing-success-and-no-concern-for-mercosur-says-brazil>.

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