Mercosur: A Common Market or an Incomplete Customs Union?

Elis Nascimento Lima
Edited by Rory Daly and Sebastien Villegas

AUTHOR'S NOTE

Written for a political economy class, the purpose of this paper was to examine the various weaknesses related to the negotiations and ratification process of Mercosur, a South American regional agreement. I wanted to thank Professor Baccini for sharing his expertise on political economy and making me realize that it is a topic about which I'm deeply interested. Sebastian and Rory, my editors, also deserve a huge thank-you for helping me elevate the quality of this paper through insightful suggestions and criticisms. I was blessed to grow up in a household where Brazilian and Canadian politics were always discussed, which instilled in me a strong interest in politics that I hope is reflected in this paper. I hope you enjoy reading the article!

Abstract

Globalization and, more broadly, trade liberalization have accumulated into a complicated network of bilateral and multilateral international agreements aiming to decrease traditional and non-traditional barriers to trade. One of the most successful models of economic integration is the European Union (EU), which is known as a common market. A common market is the deepest form of economic integration: the free movement of goods, capital, and labour. The EU served as a significant source of inspiration for Mercosur, the Southern Common Market, a Latin American initiative which aims to increase the region's bargaining power abroad while further increasing its regional integration. Despite its ambitions, Mercosur faces several persistent challenges which prevent meaningful reduction in trade barriers and damage its credibility. This paper analyzes the systematic challenges inhibiting successful trade liberalization in Latin America.

In 1991, the Brazilian, Argentine, Paraguayan and Uruguayan governments signed the Treaty of Asunción, which established the Southern Common Market: also known as Mercosur. According to the founding parties, this trade agreement was created to promote regional trade integration in Latin America and increase bargaining power at the global level (Mercosur Nd). To accomplish this, Mercosur aims for the free movement of goods, services, and factors of production through the elimination of tariffs, the coordination of macroeconomic policies, the implementation of a common external tariff (CET), and the harmonization of legislation (Treaty of Asunción 1991, article 1). In other words, the member states aim to accelerate economic development by minimizing taxes on imports, setting joint fiscal, monetary and exchange rates policies, and by providing cohesive legislation in relevant areas such as the agricultural or forestry sectors, all while setting uniform import duties against non-Mercosur members. However, despite the push for regional integration, several issues surrounding the common market have been present ever since its creation, especially around negotiation. This paper argues that the lack of strong, independent supranational bodies, conflicting national interests, as well as the pressure exerted by political and economic elites, are responsible for Mercosur's inability to produce meaningful results.

One of the reasons for the lack of ratification of agreements stems from an unwillingness to pay for cooperation costs, which has largely been caused by a lack of independent governing bodies. Abbott and Snidal argue that for an international organization (IO) to be efficient, it must be centralized and independent from its members (Abbott and Snidal 1998, 9). However, Mercosur has been criticized for lacking both independence and centrality due to the lack of supranational institutions. While a supranational Mercosur-level parliament exists, its authority is limited (Mukhametdinov 2007, 215). Furthermore, according to Mukhametdinov, Mercosur also lacks a central judicial system to enforce the agreement. Although there is a Dispute Settlement Mechanic (DSM), its decisions can always be appealed, resulting in the inconsistent practice of Mercosur's norms (Mukhametdinov 2007, 215). Hence, despite several institutional bodies, none remain entirely impartial. In addition, all institutions and procedures are directly overseen by the President chairing the bloc (Arnold 2016, 652). The President, who is elected for a six-month period, chairs the executive organ of the bloc: the Council of the Common Market (CMC). As such, because these presidents are ultimately accountable to their respective national parliaments, the Bloc lacks true executive independence.

The president and high-ranking officials also control the negotiation process and determine what policies are implemented, ultimately revealing the existence of asymmetries within the bloc (Caichiolo 2017, 123). This is because Presidents tend to implement policies that often benefit Brazil and sometimes Argentina at the expense of other smaller members. As a result, the bloc is often unable to cooperate and coordinate on macroeconomic issues. For instance, according to the authors Schiff and Alan, the structure of the CET was primarily determined by Brazil's preferences since it represents "at least 70% of Mercosur production in each of the 27 sectors considered" (Schiff and Alan 2003, 74). Additionally, it is argued that Brazil exploits Mercosur to consolidate its position as a regional and international power (Mukhametdinov 2007, 214). Given that Brazil and Argentina possess stronger economies and higher capabilities, they can sustain more prolonged periods of negotiation because of greater capabilities and usually reap higher economic benefits than Paraguay and Uruguay. In fact, relative market size can become a source of bargaining power. Due to its market size, Brazil can rely on its economy to exercise pressure on its trading partners and to pursue bilateral trade agreements with outsiders, which demonstrates its more independent relationship to Mercosur. As such, Brazil has the capacity to sustain longer periods of negotiations as it does not depend on the Bloc for trade.

Because Mercosur and its institutions are not independent, issues of distribution, information, opportunism and transaction costs occur, leaving states having difficulties solving them through official channels (Abbott and Snidal 1998, 7). One example of opportunism is how states find it more appealing to directly negotiate outside of the bloc, given that the cost-benefit ratio of pursuing unilateral agreements sometimes exceeds the benefits conferred by the agreement. Consequently, many members have been pursuing bilateral agreements with other countries without repercussions (Mander 2021). Furthermore, given that the DSM falls under the influence of the President, it gives it little legitimacy in the eyes of other members. Tensions have escalated to the point where Argentina's president, Alberto Fernandez, has told Uruguay's president to "take another boat [if we are burden]" (Gillespie and Parks 2021). Therefore, given the inability of enforcement mechanisms to constrain the behaviour of members, there is no incentive to pursue serious negotiations. Lastly, another result of weak institutions is that countries believe that their future interactions in the context of Mercosur are limited due to its nature as an "irrelevant or unprofitable [agreement]"'—a short "shadow of the future," as Fearon describes it in game theory terms (Fearon 1998, 26). A short shadow of the future implies a lack of cooperation because countries who do not expect to reap the benefits from cooperating in the long term will shorten the length and depth of bilateral and multilateral agreements. Thus, the result is a lack of long-term planning which prevents the bloc from clustering issues together in the pursuit of "mutually beneficial bargains" (Fearon 1998, 9). Since neither Brazil nor Argentina is willing to distribute significant gains from these agreements to other member-states, this undermines the long-term prospects of integration (Mattli 1999, 64).

To demonstrate the weakness of Mercosur's institutions, this paper looks at the Presidents' power over the DSM. Caichiolo argues that the President often replaces the DSM of the bloc while controlling the negotiations; indeed, he argues that: "they set the agenda, structure negotiations, administer voting, and summarize results" (Caichiolo 2017, 258). Given their increased power relative to other state leaders, this authority means an increase in information and power asymmetries within Mercosur. The President thus has direct and indirect control over the agreement and its institutions, which demonstrates the lack of impartiality of the bloc and reduces its legitimacy in the eyes of other states. While more efficient institutions such as forums, committees, and commissions would increase transparency, reduce the incentives to defect, and ensure Mercosur's future, its member-states have traditionally resisted further institutionalization (Caichiolo 2017, 124). Institutions thus tend to remain weak and under the direct control of the current President. Given that no institution is capable of systematically constraining the members, they are stuck with a situation that further feeds mistrust due to the continuous abuse of power. The lack of independent supranational bodies and the domination of national interests over Mercosur thus explains the lack of continuous regional integration. Therefore, members directly negotiate between heads of States with little regard to institutions.

The aforementioned distribution problems also highlight the important differences in preferences for each bloc member, further eroding its unity and cohesion. While Brazil and Argentina mostly see Mercosur as a tool to increase their bargaining power abroad, the smaller countries of Uruguay and Paraguay are much more dependent on it and, as an effect, have to support the interests of the bigger states. Evidence shows that weak institutions promote larger countries' preferences and allow them to determine Mercosur's policies. However, the country chairing Mercosur typically dictates the bloc's direction regardless of other members' preferences. For example, given Brazil's GDP size relative to the other members, it ends up implementing its preferences onto other members who have little power to resist even if they wanted to (Manzetti 1994, 123). This can be seen in Brazil's trade behaviours. Brazilian exporters' pressure on the government has also resulted in an increased influx of products into the other members' markets. Conversely, Brazil lags in lowering tariffs whereas other members have lowered their tariffs to between 7 percent and 11 percent, Brazil still has higher levels of tariffs at 14 percent (Manzetti 1994, 125). As a result, Brazil fails to import as much as it exports to the bloc, which creates important trade deficits that undermine the coherence of Mercosur and prompts tension amongst members.

This distribution and cooperation problems have led smaller countries to engage in "balancing strategies'" through seeking bilateral trade agreements with other powerful states, such as the US and China (Gomez Mera 2016, 303). One can argue that this attempt at balancing regional power is partly motivated by the domestic interests in the smaller countries. For example, weaker Mercosur members might seek to partner with other powerful actors to appease a displeased exporting sector. Indeed, the pressure from exporting sectors has forced smaller countries to seek larger external markets to increase profits. This explains Uruguay's attempt to pursue other Preferential Trade Agreements (PTAs) where trading conditions are more favourable given lower trade barriers. They have also been pushing for the Bloc to allow bilateral trade agreements outside of it: a proposition that has sparked tensions between members (Fernandez 2021). On the other hand, other members increasingly implement unilateral protectionist measures against stronger economies to appease an overwhelmed import sector. For instance, Argentina has consistently blocked Uruguay's and Brazil's demands to decrease the CET as an attempt to protect its domestic companies (Binetti 2021). Despite the latter's attempt to lower the tariff set with non-members, Argentina opts for a more protectionist approach where the CET remains higher to ensure foreign products do not overtake domestic industries. As such, divergent social and business interests, coupled with inconsistent political preferences, have diminished the prospects for further regional economic integration and cooperation. In fact, while Uruguay and Brazil actively advocate for greater trade liberalization – at least to the extent that it benefits them – Argentina struggles with important domestic macroeconomic issues, which pushes the latter towards protectionism. Thus, these factors reduce the prospect of greater economic integration.

Finally, the influence of the elite on economic policymaking impedes the general population from participating, which effectively excludes them from decision-making and underlines the unequal character of Mercosur. Doctor highlights what he coins the "state-centric nature" of Mercosur, where elites have input as opposed to the general public, creating a democratic and social deficit (Doctor 2012, 529). The business elites are also the primary factor in the aforementioned divergent preferences, illustrating the presence of what McGillivray and Smith call a small winning coalition in each country. McGillivray and Smith define the winning coalition as the number of people whose support is needed to retain power (2004, 569).

The role of the elites is also evident when examining Milner and Kubota's theory that democracies tend to favour trade liberalization, which at face value seems to be supported by Mercosur. After all, the Mercosur trade agreement was created following a wave of democratization in Brazil, Argentina, Bolivia, Chile, Nicaragua, Paraguay and Peru. More broadly speaking, Mercosur was created during the rise of globalization with the creation of several FTAs, such as NAFTA in 1992 and the addition of Eastern Europe to the EU in 2004. However, in contrast to the EU, which is a deeply integrated common market or ASEAN, a customs union, Mercosur is characterized by shallow integration.

This shallow integration conflicts with the winning coalition theory, which argues that democracies – which have a larger winning coalition and a bigger selectorate – typically pursue deeper cooperation (McGillivray and Smith 2004, 569). Here, the authors define the selectorate as the individuals that form the coalition. According to the winning coalition rationale, if a country possesses a large winning coalition, the leader must provide public goods to maintain power, whereas an autocratic leader must only satisfy a small winning coalition. As such, given that trade is assumed to increase welfare, a leader typically pursues free trade as a form of public goods. However, although Presidents attempt to appeal to the large selectorate, one can argue that the real power is vested in the elites, which prevents real trade liberalization and lowers cooperation. In fact, Doctor argues that "state preferences for integration are mainly shaped by political elites" (Doctor 2012, 528), which might explain the presence of suboptimal outcomes in negotiations. While the business elite may encourage regional integration, it is motivated by their own interests, rather than a concern for increased welfare. Research has shown that leaders in liberal democracies attempt to mobilize the population for electoral support. Indeed, presidents in each country seek re-election and require financial contributions for their electoral campaign, which can be obtained through protecting the interests of fellow political elites, as well as business elites (Fernandes de Oliveira 2003, 121). Given that their interests partially align to civil society's interests, Mercosur was able to engage in negotiations and ratify treaties that partially benefited the selectorate. However, in reality, "the active participation of Brazilian society – and the societies of other member states – has been very limited" (Caichiolo 2017, 123). One can argue that negotiations have been distorted given that members prioritize the interests of the winning coalition's members, rather than trying to improve social welfare with greater liberalization. Thus, total liberalization is constrained.

Lastly, in addition to the many negotiation issues, Mercosur's shallow integration is worsened by its unwillingness to ratify costly legal packages. Leaders use their signatures on treaties and agreements as an attempt to appeal to the electorate. In addition, they often glorify and refer to Mercosur as "the most transcendental political decision in our history"' or as their "destiny" (Gomez-Mera 2016, 303). In reality, the ratification of many treaties and agreements are subordinated to the state's political and economic preferences, which prevents the successful enforcement of Mercosur and, by extension, negatively impacts negotiations. Indeed, leaders heavily rely on empty promises. Despite their display of public commitment to the regional agreement, politicians do not intend on necessarily complying (Arnold 2017, 659). This strategy can be politically rewarding, given the lack of ongoing interest in negotiations by the general population. Presidents want to reinforce their image to the selectorate without paying for the many transaction costs involved. If they expect cooperation and the implementation of an agreement to be costly, they seek to avoid ratification and even veto these agreements (Arnold 2016, 644). As a result, many promises remain unkept whenever policy adaptation, and thus, deeper cooperation is too costly. Hence, respective members are not ratifying various legal packages, which makes them non-legally binding. Doctor contends that "only about half of Mercosur agreements had been incorporated into national legislation," which demonstrates the chronic absence of ratification in Mercosur. The lack of costly legally binding agreements explains many issues that Mercosur faces in terms of enforcement, negatively affecting the bargaining stage and weakening the bloc's legitimacy.

In conclusion, despite important progress since its implementation in 1991, Mercosur still faces significant challenges in terms of negotiations and ratification. The lack of independent institutions contributes to significant power asymmetry between members, which ultimately results in the abuse of power, distribution problems, the negligence of other preferences and the interest of the elite being the primary object of negotiations. In addition to these generated tensions, the lack of civil society's input and the overabundance of empty promises negatively impact the ratification of agreements, which decreases Mercosur's legitimacy and its commitment to free trade. These various issues have led many scholars to characterize Mercosur as an "incomplete customs union" or a free trade agreement rather than a common market (Bouzas, da Motta Veiga and Torrent 2002, 129). Thus, this paper sought to identify Mercosur's core weaknesses as an attempt to redirect attention to the issues that must be overcome to improve the Bloc's efficiency. With Mario Abdo Benítez getting elected as the new Mercosur's President, there are renewed negotiations and new expectations for the future. In an increasingly globalized world, Mercosur must overcome these shortcomings if it expects Latin America's economies to compete on a global stage.

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