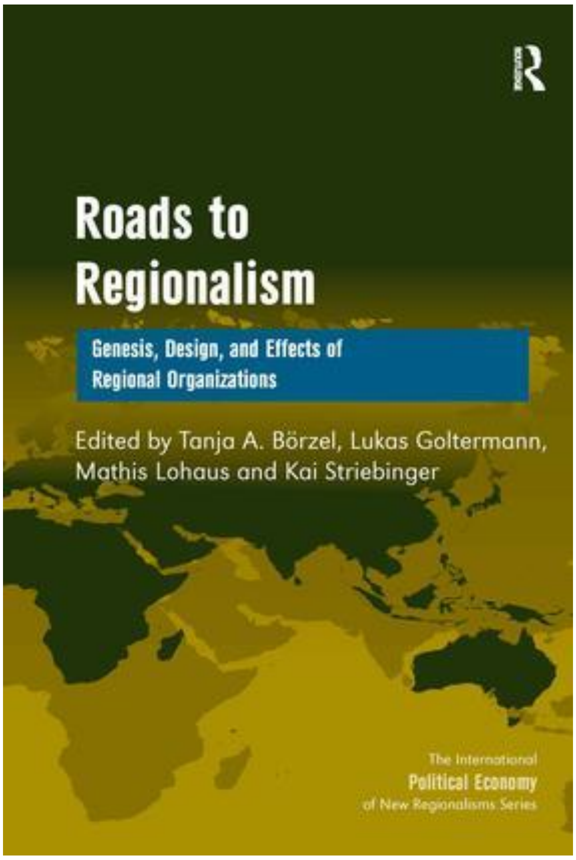

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Chapter 4

MERCOSUR: Integration through Presidents and Paymasters

Felix Hummel and Mathis Lohaus

Introduction

Which factors evoke attempts towards regional integration and influence their rate of success? In the case of the Southern Common Market (MERCOSUR), the most prominent theories in this regard seem to lack explanatory power. Neither the emergence nor the institutional development and outcomes of MERCOSUR are consistent with the assumptions made by intergovernmentalism and neofunctionalism. As one scholar puts it, "the sequence of interdependence–integration–institutions simply did not take place" (Malamud 2003: 59–61), thus limiting the applicability of the major theories. To account for regional integration in this case, a different approach appears to be necessary.

According to our hypothesis, Mattli's (1999) framework for regional integration will prove suitable. With regard to the emergence of MERCOSUR, the organization can be seen as a counter-union to balance external influences like the US-led Free Trade Area of the Americas (FTAA) or bilateral agreements. The subsequent (lack of) regional integration is best explained by a mixture of demand- and supply-side factors, combining arguments from economics and political science. Our main explanatory factors are the Latin American particularity of interpresidentialism and Brazil's role as a paymaster. These two factors supplement the supply side of Mattli's framework and explain MERCOSUR's relative success – despite limited demand and a low level of legalization. We will illustrate our argument with the examples of two major crises of MERCOSUR, namely the 1995 automobile crisis and the 2001 external tariff crisis.

A framework to analyze regional integration

With his analytical framework, Mattli sheds light on two phenomena related to regional integration: First, why do some attempts at it fail, while others succeed? In this context, the degree of success is defined as "the extent to which integration groups manage to match their stated integration goals with subsequent achievements." Second, how can we explain the process of outsiders becoming insiders? Regional integration evokes external effects on non-members, who can either try to gain membership or to constitute a group of their own. To resolve the shortcomings identified within strictly neofunctionalist or strictly intergovernmentalist explanations, Mattli (1999: 10-12) wants to account for regional integration by "bridging political science and economics."

Turning first to what Mattli calls the second puzzle of regional integration, we will briefly discuss the framework's assumptions about the effects of regional integration on outsiders (non-members). It is assumed that any successful process of integration between a group of countries will bring disadvantages to others. Examples include the loss of market access resulting from discriminatory trade policies, or the diversion of investment which is likely to concentrate within the group. When these "external effects are felt or are bound to be felt" by outsiders, they have two possibilities to react (Mattli 1999: 61). The first is to apply for membership. The second integrative response sees the outsiders create their own regional group. Mattli argues that the Latin American Free Trade Association and others were triggered by the establishment of the European Community, and that the subsequent deepening of European integration led to a "tidal wave of integration projects throughout the world in the late 1980s" (Mattli 1999: 61). Whenever countries choose to "experiment with their own regional schemes" they face the same conditions for success or failure that apply to the original group

(Mattli 1999: 62-63).

What is called the "demand for integration" in the framework is a consequence of the logic of economic gains. Technological progress, economics of scale, and competitive or location-based advantages will encourage transactions across national borders. Those, in turn, entail different types of costs, for example, uncertainty about public order in foreign countries or problematic behavior by commercial partners. As private contractual measures may not cover these risks sufficiently, the demand for an external safeguard, namely integrated governance, grows. A new governance structure is then likely to lead to more market integration, again pushing for increased political integration. However, this mechanism is not sufficient to evoke regional integration on its own: "If demand is not met by supply, no change will occur" (Mattli 1999: 47-50).

Generally, governments are most likely to sacrifice sovereignty in times of economic struggle, when further regional integration promises overall payoffs that outweigh special interests (Mattli 1999: 50-51). Given the uncertainty about member states' behavior in a regional organization, success then depends on so-called commitment institutions: Mattli's first condition of supply is that countries striving for sustained integration need to establish institutions responsible for "centralized monitoring and third party enforcement" (Mattli 1999: 53-54).

Whenever coordination is needed to share distributional costs, the choice between equally efficient options will be easier if there is one undisputed leader whose policies become the new standard because they require the "least costly change within the group." This leader is likely to act as "regional paymaster, easing distributional tensions and thus smoothing the path of integration" (Mattli 1999: 56). Hence, the existence of an undisputed leader is Mattli's second, and stronger, supply condition.

Accounting for the emergence of MERCOSUR

When Argentina and Brazil began negotiating the terms of closer economic cooperation and regional integration in the middle of the 1980s, they were able to build on earlier attempts, namely LAFTA and LAIA[1] (Vervaele 2005: 390). However, the area did not provide them with a successful experience of regional economic integration, but rather daunting examples of "how NOT to create an economic integration organization or a common market" (Porrata-Doria Jr. 2005: 10).

Low level of interdependence

According to intergovernmentalist and neofunctionalist strands of theory, the foundation of a regional organization would likely be motivated by an increase in trade flows, then leading to more interdependence and either a conscious decision by leaders to institutionalize cooperation or a functional demand for increasing integration (Malamud 2003: 59–60). The MERCOSUR experience contradicts these expectations.

On the one hand, the economies of the founding members of MERCOSUR were, in principle, more compatible than those in the case of earlier, unsuccessful attempts at integration (Bieling 2007: 191). On the other hand, there were only minor trade and investment flows between them at the beginning of the 1990s. One could argue that "in a context of relatively low interdependence the primary purpose of MERCOSUR was to raise economic intercourse rather than to administer its effects" (Bouzas and Soltz 2001: 14).

In the 1980s, regional trade represented only a minimal share in the balances of those states that would later constitute MERCOSUR. In 1986, trade within the region

[1] The Latin American Free Trade Association was created in 1960 and superseded by the Latin American Integration Association in 1980.

equated to 1.5 percent of Argentina's GDP, or 0.9 percent in the case of Brazil. Economic exchange between Argentina and Brazil had declined from 1.8 to 1.1 billion US dollars between 1980 and 1985, then reaching 1980 levels again in 1990 (Malamud 2003: 62). A closer look at the "intra-regional trade share" supports the impression that trade within the region was not very important. This indicator is defined as "intra-regional trade as a percentage share of the region's total trade (regional total imports plus regional total exports)," thus ranging from 0 to 100 (UNU-CRIS 2008: 5). In the decade before MERCOSUR was established, the share of intra-regional trade had stagnated and then moderately increased—a development that was by all means far from spectacular:

Table 4.1 Intra-regional trade share before the foundation of MERCOSUR

Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
ITS	8.57	8.19	6.78	7.98	7.17	10.3	9.00	9.00	10.95	11.28

Note: Intra-regional trade share (ITS) in percent for MERCOSUR founding members.

Source: Regional Integration Knowledge System (UNU-CRIS 2010).

Comparing MERCOSUR to other world regions, the low level of interdependence as indicated by the data is striking. At the end of the 1980s, the share of trade within the region was far smaller than elsewhere. A moderately positive trend after 1991 seems to support the argument that it was MERCOSUR's primary purpose to create trade in the first place (for a detailed comparison, see Capannelli et al. 2009).

MERCOSUR: the second integrative response

According to Mattli, MERCOSUR can be interpreted as a response to developments in the Americas and Europe. The enlargement and deepening of the European Union, the costs of German reunification, and the new situation in Eastern Europe were important factors: Latin American countries feared that deeper integration in Europe would hamper the chances for their imports and draw European investment and aid towards Eastern and Central European countries. Regarding both aid and investment, Europe had been a more important player than the United States. Concerning trade, it was the other way round: 20 percent of the Latin American exports at the end of the 1980s went to Europe, with twice as much going to the US (Mattli 1999: 152-153). Not surprisingly, two US-led initiatives triggered Southern American responses: negotiations on the North American Free Trade Agreement (NAFTA) in 1990 coincided with the formation of MERCOSUR, and talks about the FTAA "stimulated" MERCOSUR's common external tariff (Bouzas and Soltz 2001: 13).

Regional integration in South America has been described as "defensive developmental response," with MERCOSUR and North America competing for the leading role: While the Andean Community did not sustain a concerted policy, culminating in Venezuela's withdrawal after several members had started bilateral negotiations with the US in 2006, MERCOSUR resisted both the FTAA and bilateral offers (see Tussie 2009: 181–182). This may be seen as an indicator of how important the balancing of US interests has been and still is within MERCOSUR. The thesis that external events "played a key role in shaping the evolution of regional co-operation" (Bouzas and Soltz 2001: 13) is also supported by the preamble to the Treaty of Asunción. It states that the founding members have considered "international trends, particularly the integration of large economic areas, and the importance of securing their countries a proper place in the international economy," and that they believe "that this integration process is an appropriate response to such trends" (Mercosur 1991: 319).

Furthermore, negative domestic developments added to the perceived threat of other integration projects, as “external events coincided with a period of general economic decline in Latin America” (Mattli 1999: 154). External debt, technological and financial problems, declining trade volumes and plummeting prices for important commodities had led to a fear of marginalization and isolation: “In sum, the new regionalism in Latin America can be understood as an effort to reverse a decade of economic decline and to fend off the negative externalities of bloc formation elsewhere” (Mattli 1999: 155)[2].

Analyzing the development of MERCOSUR

The next section deals with the organization’s institutional design and evaluates to what extent the goals set in the treaties have been reached. This assessment will provide the point of departure for the analysis using Mattli’s demand and supply conditions. Additionally, the important role played by interpresidentialism will be examined in order to provide a more comprehensive account of how MERCOSUR has developed.

Institutional design (formal integration)

After MERCOSUR was established by the Treaty of Asunción in 1991, several amendments have been made to its setup. It was the Protocol of Ouro Preto in 1994 that gave the organization its institutional structure and legal personality. Next to those, which are the most important documents, there are the Protocol of Brasilia that established the first dispute settlement mechanism in 1991, the Protocol of Ushuaia that introduced a democratic clause in 1998, and the Protocol of Olivos to reform dispute

[2] In addition, MERCOSUR can be seen as “pluralistic security community” following Karl Deutsch (Malamud 2003: 63), although security matters are handled in separate treaties. Another factor is the policy convergence taking place in the region (see Domínguez 2010: 29–31). Both aspects are necessary preconditions for integration, but should be distinguished from the driving forces.

settlement in 2002.

MERCOSUR's setup can be characterized as strictly intergovernmental. There are three bodies relevant for regional decision-making, the highest being the Common Market Council (CMC), where the heads of states and ministers make the strategic decisions. It is supported by the Common Market Group (CMG), responsible for the executive aspects and comprised of national officials from ministries and central banks. The CMG also supervises many specialized working groups and committees (Pena and Rozemberg 2005: 2). A number of issues, for example, competition and consumer protection, are handled by the MERCOSUR Trade Commission (MTC), which also consists of delegates from the member states. Taken together, the decisions, resolutions and directives of those three bodies constitute the binding secondary law in MERCOSUR. Thus, the right of initiative lies exclusively with the member states, as they are the ones submitting proposals to the decision-making bodies (Vervaele 2005: 392). Decisions have to be taken by consensus, making them binding for member states to implement into national law (Vervaele 2005: 393–394).

Contrary to the EU and the role played by the European Commission, the MERCOSUR Secretariat is limited to administrative and technical tasks (Vervaele 2005: 392). Furthermore, there is the MERCOSUR Parliament, which occupies a consultative role. A recent initiative to furnish it with more authority and responsibilities has been turned down by the heads of state (Elsner and Alabor 2009: 3), the mode of electing its delegates is due to be revised by 2012 (INTAL 2009: 94–97). Several consultative bodies are comprised of national officials and delegates from the private sector see (Pena and Rozemberg 2005: 3–4).

Remarkably, there is no supremacy or direct effect of MERCOSUR law

(Porrata-Doria Jr. 2005: 78), but a "de facto form of superiority" (Duina 2006: 251–216) since member states are obliged to transpose decisions into domestic law. The only exclusion to the rule of consensus and national implementation is the dispute settlement, "although the mechanisms established by the Protocol of Brasilia have been called upon only ten times in 15 years" (Malamud and Schmitter 2007: 16). With the 2002 Protocol of Olivos, the Permanent Review Court was established as the ultimate level of jurisdiction, allowing claims by private or commercial actors from the member states. However, both parties of every settlement procedure will be represented by their respective national branch of the CMG, which is also responsible for bringing the case to charges. Under these circumstances, it seems very unlikely that any actor will be able to enforce MERCOSUR law against their own government (Azevedo Cunha 2007: 14).

According to the concept of legalization, international organizations can be characterized along a set of properties divided into obligation, precision and delegation (Abbott et al. 2000: 401–402). Applied to a regional organization, obligation means that community rules can be more or less binding for member states. As MERCOSUR members are obliged to implement law domestically while there is no direct effect, a dynamic has developed that "has made the effectiveness of the decisions … dependent on domestic mechanisms and interests" (Motta Veiga 2004: 13–14). In theory, MERCOSUR produces binding law, but in practice, member states defect frequently. We will return to this issue in the next section.

Regarding the aspect of precision, the initial Treaty of Asunción was characterized as "framework agreement" (Motta Veiga 2004: 11), with secondary law regulating the details. The initial mode of reducing tariffs is an important exception, because it determined "precise, obligatory [and] nearly universal" schedules

(Domínguez 2010: 31).

With respect to the matter of delegation, member states display a strong "reluctance to cede political sovereignty," keeping control of the process through their representatives at all times (Arieti 2006: 764). Even more so, the institutional provisions are characterized as "particularly weak," with many decisions being made at occasional meetings (Preusse 2004: 138). In fact, the organization also "depends exclusively on the national governments for enforcement, compliance and, in most cases, adjudication" (Malamud 2008: 127). As there is no full-fledged court of justice or any legislative body of supranational character, it is safe to say that the overall level of delegation is low.

Achievements (informal integration)

Let us now turn from formal integration, the institutional framework, to what may be called informal integration: the actual interactions and economic exchange in the region (see Mattli 1999: 72). The Treaty of Asunción states as its goal the establishment of a common market, consisting of four elements: free movement of goods, services and factors of production; a common external tariff; coordination of relevant policies between member states; harmonization of legislation (Mercosur 1991: 319–320).

With Annex I of the treaty, an initial Trade Liberalization Programme was introduced (Mercosur 1991: 326–329), which has already been mentioned under the aspect of precision. This part of the agreement was effective, accounting for the "most remarkable achievements of MERCOSUR" (Bouzas et al. 2002: 108). A very important aspect was its universal approach, allowing only some exceptions. It has been pointed out that by 1996, "99.4 percent of all trade items had been liberalized between Argentina and Brazil" (Domínguez 2010: 31).

Indeed, during the first years of the automatic tariff reductions, intra-regional trade grew by about 27 percent annually, much faster than trade with the rest of the world (Mattli 1999: 159). The share of intra-MERCOSUR trade over total trade rose significantly. Of course, this is reflected in the volume of trade: Before 1991, trade within MERCOSUR had added up to about 7 percent of combined GDP – by 1998 it grew to more than 11 percent: "The period 1991–98 may in the future be called the 'Golden Age' of MERCOSUR" (Malamud 2008: 120). Reaching the end of the 1990s, however, the growth of intra-regional trade was reversed due to "crises in the region" and Brazil's focus on trade with partners outside of MERCOSUR (European Commission 2007: 10–11).

Furthermore, the attempt to introduce a common external tariff (CET) for a wide range of goods, as planned in the 1995 Protocol of Ouro Preto, proved problematic as member states were allowed to define exceptions. Thus, the most important industries were excluded and the agreements were "imperfect and riddled with exceptions, so much so that leaders agreed to aim for 2006 as a target date for full deployment" (Duina 2006: 20–21). Again, this target has not been met, adding to MERCOSUR's failures regarding the liberalization of services, economic policy harmonization, and coordination of policies on foreign direct investments (Domínguez 2007: 110).

With a CET regime that is best described as "barely existing" (Domínguez 2010: 38) when it should be a key component of MERCOSUR, what can be said about the other aspects of MERCOSUR's external relations? Recalling that the Treaty of Asunción identified the necessity of securing a good position in the international economy (Mercosur 1991: 319), there is evidence of some success. MERCOSUR was perceived to have "done much to help its members feature on the world's map for the new century" fairly early in the process (Malamud 2003: 58). One indicator of diplomatic clout may be the free trade agreement with the European Union that is currently back on the agenda (see European Commission 2010). Moreover, MERCOSUR successfully acted to prevent an FTAA that would not have served the interests of the Southern American states (Tussie 2009: 182).

Last but not least, because most decisions have to be transposed into domestic law by all member states in order for them to come into effect, the issue of domestic ratification becomes relevant. Considering CMC decisions, CMG resolutions and MTC directives, the record gives cause for concern. In the period from 1991 to March 2006, roughly half of the norms requiring transposition to national law were not properly implemented by all member states. Thus, a regulation may be approved by the Council and several parliaments – but will only come into force once approved by the last national parliament (Malamud 2008: 129–130). In essence, this constitutes a second veto opportunity for governments, with different veto priorities leading to another counterproductive effect: While the average *individual* rate of implementation for CMG resolutions was between 71 and 79 percent, the *overall* rate reached only 49 percent (Bouzas 2008: 360). This implementation gap hampers integration in MERCOSUR and seems to be the organization's most problematic shortcoming.

Demand side – increasing, and then stagnating

How can we now try to account for the state of things as presented above? First of all, the initial level of interdependence in the region was extremely low. During the first years of MERCOSUR, however, increasing interdependence led to more demand, as uncertainty about "[a]mbiguous and unilaterally changeable rules" and disputes about the conditions for investment became problematic (Bouzas and Soltz 2001: 15). Indeed, the early years of MERCOSUR saw the emergence of a "powerful lobby in the private sector for deeper integration," displeased about the organization's shortcomings (Mattli 1999: 159). One early observer of the process concludes that "[in contrast to] previous Latin American attempts at integration, where the private sector deferred to government leadership, some entrepreneurial sectors have taken the lead in this integration effort" (Manzetti 1993: 115–116).

Nevertheless, the overall demand for deeper integration was weak, mostly due to asymmetries in size. In the case of Brazil, the biggest economy by far, trade within the region represented an even lower share than in the other member states, thus limiting the pressure "to shift the balance between the preference for flexibility as against to more formal and procedural institutions" (Bouzas and Soltz 2001: 15). To make matters worse, MERCOSUR countries have experienced stagnating or decreasing levels of interdependence since 1999, while their share of the world market is limited. Thus, "the prospects for further regional integration are very limited by a relatively small market size and a relatively narrow export basis" (Malamud 2008: 118). Recent trends suggest that economic exchange with the rest of the world will continue to grow faster than trade within the region, further reducing interdependence. This tendency manifests itself most visibly in Brazil, where the share of intra-regional trade has almost fallen to the pre-MERCOSUR level of 1990 (Malamud 2008: 121). All in all, the low level of interdependence, also in comparison to other regions, helps to account for MERCOSUR's "lean institutional design" (Bouzas and Soltz 2001: 15).

Supply side – reluctance and crises

As the governments in South America faced the "major challenge of restructuring their economies along market-oriented principles" at the start of the 1990s, the issue of trade liberalization was of great importance (Perales 2003: 93). First of all, political leaders needed to increase the credibility of their measures, which meant solving the problem that most of their proposals would normally be weakened by compromises in response to domestic pressure. Second, they needed to improve their bargaining position in general, because a good share of the private sector was "relatively unreceptive" to trade liberalization (Perales 2003: 93–94). Credibility of economic policy reform was increased by fixing the exchange rates in Argentina (1991) and Brazil (1993): With monetary policy taken away from the government's day-to-day control, economic policy became more predictable. The second aspect of credible reform, trade policy, was then taken to another level. By committing on the regional level, the governments facilitated predictions about trade policy and increased their credibility. At the same time, they addressed this problem by establishing a reciprocal regime in the region, which was meant to reduce the opposition in the private sector (Perales 2003: 94–95). Indeed, the major steps of integration taken in 1991 and 1994 occurred in the context of macroeconomic crises and domestic bargaining processes between business and governments in Argentina and Brazil (Perales 2003: 96), supporting Mattli's presumptions. This pattern re-emerged a decade later. After the economic crises in Argentina and Brazil, and the following electoral success of the political left in both countries, there was a new round of development in MERCOSUR. From 2003 onwards, the secretariat's competencies were somewhat extended, and the MERCOSUR Parliament was established. This can be seen as a new approach towards integration in the region (Bieling 2007: 194), again reflecting domestic political developments in reaction to crises.

Turning to Mattli's first supply condition, the creation of commitment institutions, it seems obvious that such bodies do not exist in MERCOSUR. Given the historical experiences in the region, it may have been a conscious choice not to adopt a highly institutionalized model of integration, as this could have raised problems of legitimacy (Malamud and Schmitter 2007: 24). Others believe that the lack of institutions is a result of Brazil's preference to "leave MERCOSUR in a state of latent institutionalization" (Flemes and Westermann 2009: 7) [3]. Weak regional institutions allowed the major players, Argentina and Brazil, to cooperate bilaterally and keep the process under executive control, again improving their bargaining position against domestic pressures (Perales 2003: 95). Moreover, the asymmetric composition of the bloc impedes the setup of institutions more supranational in character: the MERCOSUR Parliament, for example, currently includes the same number of delegates from every member state. At the end of the transitional period in 2014, a direct election is planned to take place in all member states. However, the final composition of the body still needs to be discussed: If Brazil were to send delegates according to its share of population, it would hold a permanent majority in the Parliament, which would certainly lead to dissent. Leaving the parliament without any decision-making power may be the only way to avoid a dispute about its composition (Malamud 2008: 126).

Contrary to the European experience, MERCOSUR's dispute settlement mechanism is very far from being a driver of integration. Seemingly, it does not even serve its core function of resolving disputes, as not one of the 283 disputes between 1995 and 1997 was settled via the rule-based mechanisms. During the years of economic troubles from 1998 to 2003, only nine out of 201 cases were solved using the institutionalized mechanism. Even after the Permanent Review Court was established in

[3] Interestingly, the United States' dominant position in NAFTA did not produce a similar result (see Kanthak in this volume).

2002, Argentina has continued to file claims against Brazil with the World Trade Organization, instead of using MERCOSUR's own bodies (Domínguez 2010: 35).

This lack of strong regional institutions could, however, be mitigated by another supply condition: According to Mattli, the existence of undisputed leadership in the region is a stronger condition for success than commitment institutions. After all, it was a lack of leadership that "crippled the Andean Pact," as none of the members "was willing to compromise or willing to bribe the others into acquiescence" (Mattli 1999: 64). Going one step further than the original framework, we want to analyze four possible types of leadership. Two of them focus on institutions: first, regional bodies can act as a broker; second, intergovernmental diplomacy can help to reach agreement. The next pair concerns leadership by financial means: third, a hegemonic member state can act as paymaster; fourth, regional funds can be used to steer the process of integration (Malamud 2008: 122–123).

The idea of a supranational institution as a broker largely overlaps with Mattli's argument on commitment institutions. While the Commission and Court of Justice play important roles in European integration, and consequently also in theories on the subject, there is no such dynamic in MERCOSUR (Malamud 2008: 124–126). A similar observation can be made regarding regional funds, the fourth type of leadership. Although MERCOSUR has recently established a so-called regional convergence fund (FOCEM), it is much smaller than the billions of euros redistributed annually by the European Union. The overall budget of the FOCEM is set to reach 400 million US dollars in 2010, with slightly more than a quarter of the money already allocated to running projects (Mercosur 2009: 4). Given the huge difference in size, scholars argue that "regional payoffs in MERCOSUR look little promising as an engine for integration" (Malamud 2008: 124).

Regarding the third type of leadership, Brazil is the potential paymaster to cover "a disproportionate share of the integration costs," similar to Germany in the EU (Malamud 2008: 122). However, it seems that during the first years of MERCOSUR, the country was "reluctant to use its economic and political position to assume active regional leadership." Short-term domestic interests were given priority over regional projects, for example, in the case of trade barriers leading to disputes with other members of the bloc, and the Brazilian government opposed to the creation of regional redistributive funds (Mattli 1999: 160). It has been argued that this changed under Lula, who seemed more willing to take the financial lead than his predecessors (Malamud and Schmitter 2007: 22). Concerning the measure of redistributive funds, however, the hegemonic commitment remains relatively weak. In 2008, Brazil provided 0.007 percent of its gross national income to FOCEM, in contrast to Germany committing 0.39 percent to the several European funds (Malamud 2008: 123).

Because of asymmetries between and within member states, financial transfers are "difficult to justify in the eyes of the underprivileged that live in the contributor countries" (Malamud and Schmitter 2007: 23). Low GDP per capita, high poverty rate and huge inequality in Brazil provide good arguments against transfers to the better-off neighbors in Argentina and Uruguay. But without the discretion to withhold or grant financial incentives, Brazil seems unable to steer the course of integration. As external donors give aid regardless of regional policy and Venezuela's petro-dollars are added to the equation, the situation seems unlikely to develop favorable to deeper integration (Malamud 2008: 123–124). Nevertheless, as we will discuss in the next section, presidential initiatives and the benevolence of an (indirect) paymaster in times of crises seem to have sustained MERCOSUR so far. Thus, we regard the second and (to a lesser extent) the third type of leadership as crucial for the case of MERCOSUR.

The particular role of interpresidentialism

Most students of MERCOSUR have not only put emphasis on its intergovernmental character, but also stressed the importance of presidential diplomacy, leading to a "highly personalized decision-making process" that worked well in the early years (Preusse 2004: 138). As the heads of states have played the dominant role in both the creation and day-to-day business of MERCOSUR, at the same time publicly stressing the huge importance of their endeavor, this "extreme type of intergovernmentalism" has been called "interpresidentialism" (Tussie 2009: 175–176).

Rules have been changed to accommodate special interests or circumstances, and "economic matters that got in the way" were disregarded for the sake of MERCOSUR's importance as strategic project, especially between Argentina and Brazil (Domínguez 2010: 34–35). Andrés Malamud, one of the proponents of the interpresidentialism thesis, argues that it is in fact the "hidden cause" for the success of MERCOSUR (Malamud 2003). In the context of Mattli's framework for regional integration, interpresidentialism adds to the supply side as one type of leadership via governmental diplomacy.

Without the presidents' dominant role in agenda-setting, the organization would not have been founded under circumstances of low interdependence and a reluctant private sector, and its development would have stalled completely (Malamud 2003: 63). Cooperation can be seen as the product of "executive preferences and political entrepreneurship," meaning that success is highly dependent on the presidents' initiative (Perales 2003: 93). The highly influential position of the heads of state is hardly a surprise, given that presidential decrees dominated domestic economic policy in Argentina and Brazil (Perales 2003: 96–98). Furthermore, Latin American presidents have always been heavily involved in shaping foreign policy, a pattern that was "reinforced by the new democratic regimes" in the years prior to the foundation of MERCOSUR – which explains why the political dimension of integration has dominated the economic one (Malamud 2003: 66).

Let us now further illustrate how MERCOSUR presidents gave political interests priority over economic ones, resulting in interpresidentialism as a driving force of regionalism. We will do so by drawing on two important conflicts in MERCOSUR's history: the automobile crisis and the external tariff crisis[4].

The automobile crisis

The 1995 automobile crisis can be seen as the first major clash of interests between the Brazilian and the Argentine government since the establishment of MERCOSUR. The automobile sector was given extraordinary importance in the negotiations to the Treaty of Asunción and the additional Protocol of Ouro Preto. Both agreements include a special clause that explicitly excludes the car industry from the greater liberalization process in the region. Instead, the member states agreed for the time being in decision 29/94 of the MERCOSUR Common Market Council on recognizing each other's domestic trade policies (Gómez Mera 2009: 20). Additionally, a common policy for the automobile industry should be established by the year 2000 (Wrobel 1999: 86).

However, in 1995, the aftermaths of the Mexican economic crisis demonstrated their impact on other Latin American countries (the so-called Tequila Effect) and caused a decline in the Brazilian and Argentine economy. The Brazilian government reacted by

[4] Other examples indicating the importance of interpresidentialism can be found in Malamud 2003.

unilaterally lowering trade barriers for raw materials and technology while at the same time raising tariffs for car imports, including those from its MERCOSUR partners and therefore Argentina. This change in Brazil's automobile policy constituted a breach of decision 29/94 and caused the biggest crisis of MERCOSUR to date (Malamud 2005: 143).

Although Brazil tried to justify its policies as adjustments to existing agreements that had favored the Argentine car industry, both Argentine officials and producers argued that the Brazilian behavior meant a breach of the Protocol of Ouro Preto. To support his car industry, Argentine president Menem decided to threaten his Brazilian counterpart with the boycott of a long planned presidential summit in Brazil (Malamud 2005: 145).

Menem's threat had the intended effect. Not only did the president of Paraguay and Uruguay offer to mediate between the conflicting parties, but Brazilian president Cardoso also postponed his plans to reduce car imports to his country by 50 percent in the second half of 1995 and contacted Menem personally, trying to convince him to attend the presidential summit (Malamud 2005: 145).

In the first bilateral talks between the presidents, Cardoso hoped to convince Menem to lower his objections "in order to restore a balance between the parts" (Malamud 2005: 145). However, with one of his strongest industries breathing down his neck, Menem did not buckle under the demands of his partner and insisted that the negotiations on a solution in the automobile regime could only take place on the basis of the earlier agreements between the two countries, namely Commission Decision 29/94.

The next day a solution was found. Argentina admitted that Brazil had been disadvantaged by the earlier agreements. In exchange Brazil committed to not implementing quotas for Argentine car imports. Furthermore, both parties agreed to establish a "definitive common regime that would last until 2000" (Malamud 2005: 146).

The automobile crisis illustrates well how a conflict that was caused by domestic economic short term interests could be resolved through presidential diplomacy and the political will in Brasilia to serve as paymaster for the sake of the continuation of MERCOSUR. After the start of a recession caused by the Mexican economic crisis and an unstable Brazilian economy, the domestic car industry pressured its government to lower the tariffs for technology and resources and raise the ones for car imports. The automobile branch, being one of Argentina's most important industries was highly affected by this breach of decision 29/94. It now pressured its government on its own part to regain access to one of its biggest selling markets. This disagreement on a trade issue brought MERCOSUR to the brink of collapse.

However, in the end the dispute was solved through presidential diplomacy and willingness of Brazil to bear the costs. The presidents of Brazil and Argentina agreed on policies that guaranteed the survival of MERCOSUR as a political project even though they conflicted with the powerful economic interest in Brazil since the quotas on Argentine cars were not established.

The External Tariff Crisis

At the beginning of the year 2000, the development of MERCOSUR generated optimism amongst supporters of the project. This was first and foremost because the Brazilian economy seemed to be recovering from an economic breakdown that had been caused by the earlier mentioned Tequila Effect. Therefore, it was commonly believed that the crisis of the Southern Cone had been overcome. The member states boosted this notion by announcing the re-launch of MERCOSUR in a meeting of the CMC. However, in the second half of the year Argentina started to suffer from setbacks that caused a recession in the national economy and threw the country into a deep crisis. Furthermore, Argentine producers were still suffering from the consequences of devaluation of the Real and the resulting competitive disadvantages. At the end of the year, Argentina could only be saved from bankruptcy with an international aid package of 39.7 billion US dollars by the International Monetary Fund and major changes in its external tariff policy (Carranza 2003: 84).

In the course of this policy change, the Argentine government raised tariffs on imported consumer goods like textiles and farming products, while at the same time eliminating those for capital investments from outside MERCOSUR, thereby breaking with the common external tariff of the organization. Furthermore, the Argentine Minister for Economic Affairs Domingo Cavallo repeatedly expressed his desire to downgrade MERCOSUR into a free trade area during the crisis, which would have allowed his country to take unilateral measures to re-boost the economy (Gómez Mera 2005: 30).

A Brazilian-style devaluation of the Argentine currency to foster the competitiveness of domestic producers was not an option for the de la Rúa administration because of the earlier adopted convertibility plan that kept the Peso on a fixed exchange rate with the US dollar. Furthermore, most big Argentine firms had received credits in US dollars and a devaluation of the Peso would have driven many of them into insolvency. In this context it is important to note that it was not one dominant economic interest group that called for help, but that the entire economy of Argentina was affected. Consequently, measures were implemented to rescue the domestic economy as a whole both on the investment and the production side (Carranza 2003: 84–86).

In the beginning of the economic crisis in Argentina, the Brazilian government was tolerant towards its neighbor's policies to rescue its economy, knowing that a collapse of the Argentine economy would also mean a major strike for its own companies. Not only did Brazil import many industrial and agricultural goods from Argentina but, with over 11 percent of all Brazilian exports going to its biggest neighbor, the collapse of the Argentine economy would have meant the loss of an important selling market as well. Therefore, president Cardoso allowed the Argentine government the temporary elimination of tariffs on financial goods to attract foreign capital from outside MERCOSUR. Brazil seemed to accept its role of being the paymaster of the organization because integration in the Southern Cone served Brazilian interests.

However, when Argentina decided to include telecommunication and technology products such as mobile phones and computers in the new tariff policy, products that many Brazilian firms had been selling to Argentina, the Brazilian producers protested heavily, fearing a large decline in Brazilian exports through the loss of the advantage MERCOSUR had provided (Gómez Mera 2005: 33).

Furthermore, with a new recession starting in Brazil in 2001 the Real underwent a second heavy devaluation, this time declining by another 32 percent. Additionally, Argentine economic minister Cavallo's idea to downgrade MERCOSUR into a free trade area caused a lot of anger amongst Brazilian officials who were hoping that a strong MERCOSUR would strengthen their bargaining position in bilateral talks with the United States and the European Union (Carranza 2003: 85).

At the peak of the crisis, Brazil pressured Argentina by "suspending negotiations over the common automobile regime and threatening to resort to retaliatory measures, this time by restricting imports of Argentine wheat and petroleum" (Gómez Mera 2005: 30). The Argentine government, on the other hand, replied with the threat of blocking MERCOSUR and accused Brazil of deliberately devaluating its currency and speculating on Argentine bankruptcy. Brazilian president Cardoso reacted to this insult with the cancellation of his planned trip to Argentina.

Finally, in the fall of 2001, both presidents met to resolve the disputes between their two countries. Eventually, both countries had to make concessions to keep the project alive. Brazil had to accept Argentina's need of keeping the tariffs for financial goods low and agreed to create a common safeguard regime in accordance with the directives of the World Trade Organization that it had rejected two years earlier. Argentina, on the other hand, was forced to exclude telecommunication and technological goods from tariff reduction (Carranza 2003: 85).

Concluding remarks

Just as in the case of the automobile crisis, the external tariff crisis could again be solved through bilateral talks between the presidents of Argentina and Brazil, which lead to concessions by both countries for the sake of the survival of MERCOSUR. Apparently, Brazil was willing to pay the price for Argentina breaking the CET rules, and even after the crisis had expanded into the technology sector, an agreement was reached between the heads of state.

All in all, we argue that MERCOSUR has proven more successful than conventional theories on regional integration lead us to expect, but displays certain particularities, such as its very limited institutional design and a troublesome record regarding the domestic implementation of regional decisions. The dominant role of presidents, especially those of Argentina and Brazil, and the low levels of economic interdependence help to understand these outcomes. It appears to have been presidential initiatives that allowed the regional organization to form despite adverse economic conditions, and to carry on throughout major crises. The latter were also mitigated by the third type of regional leadership, the role of dominant states as paymasters. Rather than through regional funds, Brazil appears to fulfill this duty indirectly, by making political concessions against its economic interests in critical situations.

What can be said about the compatibility of Mattli's framework with MERCOSUR? Although there has been little demand for integration and commitment institutions were not installed, the organization was more successful than predicted. Serving as a unique variant of regional leadership, interpresidentialism appears to have compensated for the lack of commitment institutions in MERCOSUR. In fact, interpresidentialism may be classified as a functional equivalent to regional institutions (Malamud 2003: 56). Given that there was just the Argentine-Brazilian axis for bargaining and presidential agreements, presidential power helped more than it could have in the face of "cross-cutting cleavages" such as in Europe (Malamud 2003: 67).

Turning to the chances for deeper integration, MERCOSUR's *modus operandi* of very light institutionalization has entailed the disadvantages of erratic implementation and dependence on diplomacy. The organization can neither rely on the help of centralized monitoring and enforcement, nor on the dynamics of spillover. Furthermore, there are reasons to believe that interpresidentialism and the paymaster effect may have lost momentum: First, the admission of Venezuela could weaken the power of interpresidentialism, as it adds a potential new cleavage and complicates the balance of powers. Second, Brazil's shift in trade priorities away from the region reduces the hegemon's incentive to invest in MERCOSUR. Considering that several previous efforts to renew the process of integration have been dismissed as a resort to "parchment institutions and rhetoric as a substitute for effectiveness and deepening" (Domínguez 2010: 38), there seems to be reason for doubt about MERCOSUR's future.

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