ANÁLISIS DE LA DESINTEGRACIÓN DENTRO DEL MERCADO COMÚN DEL SUR (MERCOSUR)

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Resumen

El objetivo de este estudio es determinar cómo han cambiado los incentivos para la integración entre los cuatro estados miembros fundadores del Mercosur, Argentina, Brasil, Paraguay y Uruguay. Los autores, Andrade et al, De Alemeida, Garzón, Mattli y Phillips han identificado condiciones de oferta y demanda para una integración regional exitosa. Sobre la base de la teoría proporcionada por los autores, la tesis explora algunos de los factores que podrían tener un efecto desintegrador en el proyecto regional, como el aumento emergente en el comercio extra-regional y una tendencia decreciente del comercio intrasectorial. Las crecientes oportunidades extra-regionales para los países del Mercosur presentan un nuevo desafío para los gobiernos nacionales, ya que sopesan el costo de seguir sus propias estrategias nacionales o fortalecer y transformar el proyecto regional. Un análisis de los datos disponibles desde la creación del Mercosur, y la literatura sobre la crisis del nuevo regionalismo, sugieren un estancamiento en los esfuerzos de integración, especialmente en la última década. Esto es evidente a través de la disminución concomitante de las condiciones de la demanda (las ganancias potenciales del intercambio del mercado con la región) y las condiciones de la oferta (la voluntad política para implementar las políticas existentes del Mercosur). La condición de la demanda altera los costos de implementación de las políticas del Mercosur y, por lo tanto, afecta el grado en que las políticas del Mercosur se aplican en cada estado. La tesis identifica áreas de política para fortalecer el proyecto regional considerando las condiciones cambiantes.

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ANALYSIS OF DISINTEGRATION IN THE COMMON MARKET OF THE SOUTH (MERCOSUR)

By

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Abstract

The objective of this study is to determine how the incentives for integration have changed among the four founding member states of Mercosur, Argentina, Brazil, Paraguay and Uruguay. The authors, Andrade et al, De Alemeida, Garzón, Mattli, and Phillips have identified supply and demand conditions for successful regional integration. Based on the theory provided by the authors, the thesis explores some of the factors which could have a disintegrative effect on the regional project, such as the emerging increase in extra-regional trade and a decreasing trend of intra-industry trade. The growing extra-regional opportunities for Mercosur countries present a new challenge for national governments as they weigh the cost of either pursuing their own national strategies or strengthening and transforming the regional project. An analysis of the data available since Mercosur's creation, and literature on the crisis of new regionalism, suggest a stagnation in integration efforts, especially this past decade. This is evident through the concomitant decrease in demand conditions (the potential gains from the market exchange with the region) and supply conditions (the political will to implement the existing Mercosur policies). The demand condition alters the cost of implementation of Mercosur policies and therefore, the degree to which they are applied by the member states. The thesis identifies policy areas for strengthening the regional project considering the changing conditions.

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TABLE OF CONTENTS

List of Tables

List of Figures

I. Introduction

The Common Market of the South (Mercosur) is a political and economic agreement created in 1991 through the signing of the Treaty of Asunción by Argentina, Brazil, Paraguay, and Uruguay, the founding members. The treaty called for the, "The free movement of goods, services and factors of production between countries through, inter alia, the elimination of customs duties and non-tariff restrictions on the movement of goods, and any other equivalent measures" (Treaty of Asunción). In addition to economic requirements, Mercosur maintains that all members must support democratic institutions. It provides benefits such as a "free residence area" allowing the citizens of its members and associated members to reside and work in any of the participating countries. There are currently seven associated states, which are, Bolivia, Chile, Colombia, Ecuador, Guyana, Peru, and Suriname. Bolivia began the process of full incorporation on July 2015.

Mercosur can be described as a project of new regionalism; whose goals are to achieve global compatibility between regional trade agreements, by forming a larger market that could be attractive to investors abroad. This 'new regionalism' refers to a phenomenon that began to emerge in the mid-1980s, as a "comprehensive, multifaceted and multidimensional process, implying a change of a particular region from relative heterogeneity to increased homogeneity with regard to a number of dimensions, the most important being culture, security, economic policies and political regimes (Hettne and Soderbaum 2). Mercosur grew out of the significant amounts of trade occurring between Brazil and Argentina, and the development of bilateral agreements which were created and signed by the two countries in the second half of the 1980s. The bilateral agreements were aimed at supporting the new democratic governments and for easing political and security tensions between the two countries. The bilateral approach grew into sub-regional cooperation aiming to harmonize policy areas, create trust between the two largest economies, and boost security relations in the region. The efforts of open regionalism assume that regional agreements become the practical building blocks for further global liberalization. The prospect of expanding the consumer market by creating organizations like Mercosur, encourages exporters from other regions to be enticed by the external tariff of the regional agreement and to also consider regional investment opportunities. Mercosur's initial goals for integration included the establishment of a customs union, a common market, and a currency, inspired in part by the levels of integration established in the EU. Mercosur countries agreed to the implementation of a Common External Tariff (CET) of 35 percent on certain imports from outside of the region, adopted a common trade policy toward extra-regional actors, and eliminated customs duties. In the 1990s, through liberalization and regulatory convergence, Mercosur countries increased tenfold intra-regional trade.

In the 2000s the region experienced economic crisis, and ideas of establishing a common market were deferred as the countries experienced political and economic fraying. Mercosur became aware of the necessity to counterweight the structural imbalances between states, such as those existing between Brazil and Paraguay. It was also necessary to address asymmetries in the market size of its members and ameliorate it through policy. In 2006, The Fund for Structural Convergence of Mercosur (FOCEM) started funding efforts for reducing asymmetries in an intergovernmental process by distributing funds[1] among members. Brazil as the largest economy funds the majority of FOCEM. The majority of the funding is allocated to Paraguay, then Uruguay, while Argentina and Brazil are entitled to smaller percentages. Mercosur has extended the abilities of the FOCEM project until 2025. The distribution of these funds may not address

[1] In 2020 the budget for FOCEM is $332,815,371.0 USD.

all asymmetries, but it has positive impacts for internal cohesion within Mercosur. To further deepen integration efforts in Mercosur, it is still necessary to take into account the policy and structural asymmetries that arise. Policy asymmetries are associated with differences in social preferences and institutional characteristics and are the result of a lack of coordination and convergence in rules and policies (Amoroso Botelho). Structural asymmetries are caused by factors that determine the ability of the state to benefit from the integration process, such as the economic dimension, the quality of institutions, and the level of socio-economic development (Amoroso Botelho). These kinds of asymmetries may also generate a loss of efficiency for furthering regional integration.

According to Garzón, the success of open regionalism projects such as Mercosur rests on two assumptions. The first assumption is that extra-regional partners "agree to negotiate with the regional grouping as a whole and abstain from pursuing a selective bilateral strategy" (Garzón 116). For example, for the success of regionalism, an extra-regional state like China should negotiate agreements with the Mercosur bloc, rather than constructing agreements with the individual members of Mercosur. The second assumption maintains that the bargaining leverage of one state remains relatively similar to that of its fellow cooperating regional states. A state whose market has a dominant weight within a bloc could, attract its own agreements with third parties.

Garzón's first assumption of open regionalism is being challenged as countries experience economic incentives to establish individual agreements with extra-regional actors. These incentives influence both the bigger and smaller states, who are able to attract capital, promote industrialization, and pursue their own national goals. Small states like Paraguay and Uruguay are normally in need of institutionalization in order to ensure global representation of their interests, but in 2018 both have proposed adjustments to the Mercosur status quo. States are calculating the different economic and political benefits of bilateral agreements. According to Aggarwal and Espach, the emergence of a willingness to form bilateral agreements with intra-regional actors has many political and economic advantages due to geographic, cultural, and historical similarities. Inter-regional agreements encourage trust, which bolsters regional security and political alliances[2]. Among extra regional actors, bilateral agreements can provide smaller states with the opportunity to engage in an adaptive form of foreign policy behavior, such as one that "seeks to minimize political costs while accessing the external resources they need – such as markets, investments, and aid" (Garzón). One possible downside to establishing agreements it that they usually favor the larger member with the most political and/or economic weight. Mercosur countries, Argentina, Brazil, and Paraguay were concerned about the creation of extra-regional agreements in 2005, during the Free Trade Agreement of the Americas (FTAA) initiative. In the end, it was determined to be not a treaty of integration but one of "annexation" based on the huge asymmetries existing between the countries in the North and South (De Alemeida 486). However, shortly after the idea of the FTAA was defeated and no longer considered politically viable in the Southern Cone, the United States began the negotiation of bilateral trade agreements in the region, and a network of free trade agreements has since been established with Chile, Peru, Colombia, Central American, and Caribbean countries" (De Alemeida 486).

The second assumption to open regionalism is currently challenged as Brazil's economy has become significantly larger (four times as large) than Argentina's, which is the second largest economy in the bloc. Brazil also attracts the highest level of Foreign Direct Investment

[2] (Aggarwal and Espach 23).

(FDI) inflows of all of the Mercosur countries. The bargaining leverage of Brazil has grown at a higher rate than the other states in the region. As the state with a significantly larger market, the possibility exists for Brazil to attract its own bilateral agreements with third parties. Historically, political and economic external forces have had a disintegrative effect in South America; however, the contemporary expression of these forces seems to be the perceived low opportunistic cost of establishing individual agreements with extra-regional actors and to forgo collective approaches. The establishment of individual agreements undermines the incentives for intra-regional collective decision-making as countries agree to the international opportunities that came their way and, "rarely challenge one another to get rid of such carve-outs" (Felter, Renwick and Chatzky). Under these conditions, it becomes much more difficult to establish a customs union. Hirst writes, "the expectations that negotiations for a myriad of bilateral accords, favoring a wider liberalization of hemispheric trade, make it difficult to consolidate MERCOSUL as a customs union" (Hirst 140). As the volume of trade increases with these external powers, the wealth and power of those parties within the Mercosur region increase as well.

Mercosur's stagnation becomes apparent when it implements policies for improving integration and the states contest implementation of these policies as they view them to be an interference to national priorities. There are several of these areas addressed in this study where the stagnation is visible and also damaging to the credibility of the level of integration in the region. The first is the operation of the customs union, which has been greatly eroded by the exceptions that each country has created to the Common External Tariff (CET). Second, in the last five years, there are instances of rising inter-regional tariffs. Third, the implementation of Non-Tariff barriers to trade, which impede inter-regional and extra-regional trade. Fourth, non-compliance with Mercosur Common Market Council (CMC) Decision 03/94: which concerns

Non-Tariff Restrictions. Lastly, Mercosur CMC Decision 32/2000 which is the regulation that stipulates the obligation of Mercosur states to jointly negotiate commercial agreements with extra-regional countries, has been challenged by the states. An evaluation of these polices areas is provided in the sections below.

How Have the Incentives for Integration Changed in the Mercosur Region?

The task for this study is to *inquire into precisely how integration incentives have changed over time in the Mercosur region*, as conceived and articulated over the 1990s. The supply and demand incentives selected to be studied are provided by the authors, Andrade et al, De Alemeida, Garzon, Mattli, and Phillips. The supply conditions favoring disintegration are instances when states choose to reject Mercosur policy, rather than choosing further regulatory convergence and integration. The demand conditions are considered the economic incentives shaping the region. Thus, the analysis of the conditions can determine a possible undermining of the incentives that once existed in favor of integration. See Table 1 below.

Table 1: Supply and Demand Conditions for Successful Regional Integration

Supply Conditions	Commitment Institutions (Third Party Enforcement).
	Bargaining leverage of one state remains relatively similar to that of its fellow cooperating regional states.
	An undisputed leader state-seeking closer regional ties and coordination.
	Commitment to remove barriers to full integration.
Demand Conditions	Inter-regional trade importance and inter-regional gains vs. Extra-regional trade
	The share of intra-industry vs inter-industry trade.

Hypothesis

The incentives for integration are being undermined by concomitant declines in 'demand conditions' (which are potential gains of market exchange with the region), and 'supply conditions' (the political willingness to accommodate integration demands)[3].

In the following pages, I present a review of the concepts of Regiopolarity and Decentered Multipolarity and explain how the conditions of Decentered Multipolarity are currently more present in the Mercosur region. According to the theory, conditions of Regiopolarity are more beneficial to the proliferation of regional organizations, and there are adverse effects on regional organizations when conditions of Decentered Multipolarity are more present. Conditions of Regiopolarity include, high inter-regional trade, and a high cost to establish agreements with extra-regional actors, which are the conditions most conducive for integration. To provide understanding of this condition for the case of Mercosur, data on current bilateral agreements, and the dates they were formed is provided. The demand conditions compare intra-regional trade data (imports and exports), vs extra-regional trade data for each Mercosur country brings further clarity to determining which conditions are more present. The UN Comtrade data bank[4] provides this data for the years 1990-2018. Comparing the two lines of intra vs extra-regional trade depicts a visual representation of the potential gains from intra-regional economic activity and the gains from extra-regional activity. The intra-regional gains, "must be perceived as high enough to generate a strong demand for integrated governance structures in the form or regional rules, regulation and policies" (Garzón 114). The second demand condition included in this study, is an economic indicator mentioned by Andrade et al,

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[3] Mattli identified two sets of necessary conditions for successful supranational integration: Demand conditions refer to the potential gains of market exchange within a region. Supply conditions refer to the conditions under which political leaders are willing and able to accommodate demands for functional integration (Mattli 50).
[4] UN Comtrade Database (United Nations).

which provides an understanding of economic integration and the potential direction of inter-regional trade. This indicator is a calculation of the share of intra-industry trade of each Mercosur country with the Mercosur region. This indicator is representative of economic integration in the sense that the underlying structures of production in the respective economies become more similar, or different to each other.

The supply conditions for integration according to Mattli refer to the "willingness of governments to respond to demand-conditions". This refers to the willingness of countries to voluntarily adopt policy decisions that result in the further harmonization of policy between Mercosur states. Policies not implemented due to a determination that the Mercosur policy was too great of a cession of sovereignty over national interests, undermine regional integration efforts. The supply conditions evaluated in this paper are the Mercosur policies forming the Customs Union, the inter-regional tariff, the Common External Tariff (CET), the Mercosur CMC Decision 32/2000 concerning the external relationship, and the heightened implementation of Non-Tariff Barriers (NTBs) within the region. The history of each within each Mercosur country will be evaluated for the past decade with data. The data, current events, and insight from the theory is evaluated to support or reject the hypothesis.

Justification

In the early 1990s, Mercosur experienced substantial growth in inter-bloc trade. Toward the end of the decade, the region was impacted by economic crisis, during which time inter-regional exports fell from 25% to 11.5%, while imports dropped from 21%-17%[5]. Mercosur in the 2000s focused on the removal of tariff barriers to trade and the successful attraction of FDI. In the 2010s Mercosur experienced decreasing inter-bloc trade and political disagreements,

[5] Mercosur: Economic Trends and Outlook (Averbug 1998).

which stunted the progress of its initial goal of developing a customs union. The most recent years have been marked by the emergence of individualized extra-regional trade, and the development of bilateral trade agreements with extra-regional actors. Extra-regional trade has increased significantly above inter-regional trade. This development in addition to slowed regulatory convergence is an invitation for external powers to create asymmetric influence in the region.

Political changes in Brazil and economic difficulties in Argentina mark this period of Mercosur. For the first time in the history of Mercosur the Brazilian government that assumed office in January 1, 2019, questioned the protection of the Common External Tariff (CET) which established Mercosur as a Customs Union. The relevance of intra-regional trade has fallen to levels close to 14-15% at present, well below the values registered in the European Union, North American Free Trade Association (NAFTA), or the Association of Southeast Asian Nations (ASEAN) (Rozemberg, Campos and Gayá 8). According to the Inter-American Development Bank (IADB), in 2018-2019 the four Mercosur countries have expressed dissatisfaction in relation to the integration process[6] and all partners have some type of claim or revision proposal for a reimagining of Mercosur (Rozemberg, Campos and Gayá 9). The current debate involves three central aspects that make the existence and valuation of Mercosur as a customs union and as a free trade zone. These include the CET, coordinated external negotiations, and deepening free intra-zone circulation of goods.

Given the frequency of the meetings for establishing bi-lateral agreements created this decade, this period of Mercosur would benefit from some clarity on the management of the external relationships of Mercosur countries, as Mercosur countries have prioritized bi-lateral

[6] (Rozemberg, Campos and Gayá 10)

trade and also bi-regional integration. Mercosur Decision CMC 32/2000 stipulates the obligation that negotiations of trade agreements with third countries or groups of countries must be done jointly. However, several Mercosur countries have concluded themselves that this decision imposes limitations and restrictions for the state in the exercise of its sovereignty in its commercial policy. There is a slow internal decision-making mechanism regarding extra regional actors, and as a result many have remained uncoordinated in their efforts of international insertion and reject Mercosur Decision CMC 32/2000.

The benefits of integration are a long-term strategy, however there are multiple perforations in the joint political strategy for Mercosur countries, such as the many exceptions to the integrity of the CET. According to the IADB "The customs union is imperfect and inefficient in terms of competitive development: high tariffs; relatively high staggering of inputs and intermediate goods; multiple perforations of the CET" (Rozemberg, Campos and Gayá 9). Brazil has expressed a reimagining of the Common External Tariff (CET), and it seems Brazil is especially enticed in the past two years to seek solutions to its economic needs from extra-regional actors.

Integration is not always the quickest solution to regional issues, but it is a worthy long-term approach with the potential to make significant regional impacts in all areas important to the region. This work seeks to evaluate some of the recent theories of disintegration and the crises of regionalism to contribute to the literature the incentives affecting the integration process. Although it cannot provide a fully elaborated alternative conceptualization of disintegration, it will point toward areas of decline for improvement. Understanding the dynamics that extra-regional actors have on Mercosur, can better inform policymakers of the tradeoffs of each country to form separate policies or choosing the alternative cost of harmonizing regional policies.

II. State of Affairs

Negotiations for integration in the region began in 1985 and arose due to the large volume of trade exchanged between Argentina and Brazil. In the first few years after its implementation, Mercosur made great strides in achieving its goals. From 1991-1996, a free trade zone and an imperfect customs union was developed, which were considered significant advances in a short period of time. The conditions in place aided the formation and approval of these new Mercosur policies. There are several authors who write of this existing set of supply conditions, which have been maintained since before Mercosur's development. The first is the long history of peace in the region. There are no serious expenditures of integration resources for maintaining regional security and peace, but rather reciprocal assistance between the armed forces of each country for the prevention and control of organized crime in the region. An effort to maintain integration could be easily undermined by rivaling countries which have a history of conflict. Mercosur remains a peaceful region, and there have not been any major armed conflicts between the countries for over a century.

A second condition is the similar shared regional culture. Hettne and Soderbaum write that in order for regionalism to be successful, there is a necessity for "a certain degree of homogeneity or compatibility of culture, identity and fundamental values" (Hettne and Soderbaum 9). The cultural, institutional and linguistic affinities that has existed among Mercosur countries is an advantage for the Mercosur project. Mercosur has also facilitated the further development of this regional identity through establishing compatibility in education, research, and in the workforce. For example, making curriculum methodologies compatible from a regional perspective, and promoting the exchange of workers, students, teachers and researchers.

A third condition is homogeneity in the level of economic development. Straubhaar writes, “If within an integrated area, some countries are much more developed than others, the gains from being integrated are very likely to be distributed unequally (Straubhaar 30). During the development of the Mercosur region, all countries were considered developing countries, and presently there is still a level of homogeneity in levels of development within each country. Therefore, there is equity in the distribution of integration benefits within the Mercosur region. If there was one country which was considered as a ‘developed’ country within the region, then this country might attract more new industries than those considered less developed, creating asymmetries with the extra-regional relationships formed, which is an inhibitor for integration.

A fourth factor, which aided the acceleration of the pace of negotiations during the time of creation, was an allowance for exceptions and flexible implementation of Mercosur policies with no supranational authority. This is a factor because, without flexible implementations, Mercosur might not have left the negotiations table, and cited as too radial of an idea. There was the recognition at the time of implementation that the customs union would be incomplete at first, with each member being allowed to create a substantial list of exceptions for a limited time, enough to protect their fundamental national concerns. In addition, decisions were always taken to avoid the creation of a permanent international or supranational agreement. In absence of a supranational agreement, Mercosur negotiations are conducted mainly by a decentralized structure of ten working subgroups. Because of this flexibility and allowances, Mercosur reduced tariffs and achieved an enormous increase in trade during the first five years, and from 1991 to 1999, intra-regional trade in the bloc went from 8.9% to almost 25% (Campos 2016). The increase of intra-regional trade during this time points to the success of this factor in Mercosur negotiations.

Conditions for Integration Affected by the Demand Conditions

The global transformation of regionalism has led to a study of 'the crisis of new regionalism', which describes how there are new dynamics, such as the demand variables identified in this study, which are affecting regional institutions and identities. Among the authors that have written about the factors in this crisis are, Mattli (1999), Philips and Prieto (2003), and Philips (2011), and Garzón (2016). The body of literature on new regionalism has implications for the furthering of regional integration for organizations like Mercosur. The following section identifies supply conditions which are more likely to become affected by the changing demand conditions analyzed in this study.

Convergence on Domestic Policies

A condition for integration which could be impacted by the demand condition is the level of convergence on domestic policies. Domestic policy convergence is an important pre-requisite or feature for improving integration between Mercosur states. This includes a convergence on all domestic policy areas, such as: environmental standards, tariffs, non-tariff restrictions, immigration, labor policies, etc. If there are growing extra-regional opportunities for individual countries in the region, and no serious effort is made to develop a further collective harmonization between states, then states can engage in a 'race to the bottom' by creating domestic polices with ever lower standards to achieve a competitive advantage over the other states in the region. There are domestic and international pressures on states which influence convergence on domestic policy harmonization to occur. Domestic pressures for convergence between states arise from experience with common issues such as inflation, debt, similar social movements, a similar nature of production, similar environmental concerns, etc. International pressures for convergence between states include similar factors of trade, treaties, legal agreements, supranational councils, or international organizations that each nation in the region has agreed to. These international factors which influence policy convergence may decrease a state's autonomy in relation to how it manages participation in financial markets and global capital. As extra regional trade grows it creates more pressure to form bi-lateral agreements, and domestic policy convergence is unlikely to occur to establish a deepening of integration between Mercosur countries. Capacity for distinctive domestic policy harmonization in light of extra-regional pressure, is a sine qua non for establishing commonalities and for deepening integration.

There are numerous factors which affect domestic policy convergence. The following section will address three areas which are affected by the demand condition identified in this study. These are, the development of economic crisis, the formation of National Tariffs (NTs), and the formation of bilateral trade agreements outside of the regional block. Phillips (2003) focuses on "two conjunctural factors" which highlight the crisis of Mercosur. The first of these is the financial and economic crisis which, "dominated the landscape of the Southern Cone since the late 1990s, first with the Brazilian devaluation of 1999, and then more profoundly with the Argentine default and devaluation on 2001, and its knock-on effects in Uruguay and Brazil in mid-2002" (Phillips 223). Macroeconomic stability is a necessary condition for sustaining a common market. The presence of economic crisis undermines the prospects for convergence on domestic economic conditions, because it fractures each country's consensus for implementing regional requirements for the Mercosur project. During times of economic crisis countries assume nationalistic tendencies to help their people and generate wealth. Socio-economic indicators on the current state of Mercosur are helpful to understanding if Phillips' first conjunctural factor can be applied to the current state of Mercosur. The indicators provided below might show some heterogeneity between members, but this heterogeneity is not considered a significant determinant in explaining possible failures within an agreement for integration. A socio-economic overview from 1990-2019 (or latest available data) of Mercosur's economic indicators through each decade is provided below.

Since 1990, there have been some solutions for poverty reduction, as all Mercosur countries have been able to significantly decrease poverty levels in the region. Table 2 provides the Poverty headcount ratio at $5.50 a day (% of population) and Inflation, GDP Deflator (Annual %) for all reported years of Mercosur. When Mercosur began, the percent of the population in Brazil living at $5.50 a day was 50%. In 2017 it has been reduced to 21%. The most historical data available for Uruguay begins in 2006, and it reveals that the percent of population living at $5.50 a day in 2006 was 17.1%, and is currently at 2.9%, a significant decline. Uruguay has significantly reduced poverty levels and has also successfully decreased inflation levels. Most notably, poverty levels measured at $1.90 a day for Uruguay, averaged well below 1% for all the Mercosur years where data is reported[7]. Based on the World Bank Poverty Indicators, Uruguay exhibits the lowest poverty level measured for all Mercosur countries.

Table 2: Poverty Headcount Ratio at $5.50 a Day (%) and Inflation GDP Deflator (Annual %)													
Poverty Headcount Ratio at $5.50 a Day (% of Population)							Inflation, GDP Deflator (Annual %)						
	1990-1999	2000-2009	2010-2015	2016	2017			1990-1999	2000-2009	2010-2015	2016	2017	2018

[7] World Bank Development Indicator, Poverty Headcount Ratio at $1.90 a day (2011 PPP) (% of population).

Argentina	19.0	23.9	9.4	8.5	7.7		Argentina	223.3	13.7	26.3	41.1	26.0	40.7
Brazil	50.0	36.0	20.3	20.7	21.0		Brazil	851.6	8.2	7.9	8.1	3.5	3.0
Paraguay	32.8	37.6	23.6	20.1	18.6		Paraguay	15.3	12.4	3.9	4.1	2.1	2.1
Uruguay	-	13.2	5.6	3.7	2.9		Uruguay	46.6	8.0	8.2	7.3	4.7	5.6

Table 2 Data from database: Poverty and Equity, (2011 PPP), Last Updated: 09/24/2019, and World Development Indicators, Inflation GDP Deflator (Annual %) Last Updated: 02/27/2020. Decade Averages Based on Authors Calculation.

Argentina the last five years has suffered through a very high level of inflation at 40.7% in 2018 and is now experiencing economic crisis. This crisis is likely to continue further, given the global slowdown of markets beginning in March 2020 due to the coronavirus outbreak. The current recession has had knock off effects on the levels of trade in Uruguay and Brazil. The presence of this crisis is undermining Argentina's bargaining power within the bloc, and increasing tension with Brazil, the largest economy in Mercosur. In 2018, all Mercosur countries except for Argentina, have been able to decrease inflation to a manageable level. In 2018, Paraguay experienced the lowest inflation rate at 2.1%. Decade averages are high for the 1990-1999 period for Argentina and Brazil, as inflation was recorded as high as 2078% for Argentina, and as high as 2700% for Brazil during this period, according to World Bank data.

Table 3 below provides Total Unemployment (% of all Labor Force) for the years of Mercosur where data is available. Since 1990, all Mercosur countries have decreased unemployment, except for Brazil, which experienced a jump in unemployment in 2016. However, these numbers are not representative of the amount of people that are hired informally. An official unemployment survey conducted in Brazil indicates that real unemployment figures are significantly higher, it shows that 28.3 million people are considered "under-utilized". This means that individuals are either not working or working less than they could[8]. In addition, in Argentina, after several years of crisis in a climate of high inflation, unofficial employment has become commonplace. In 2019, an employee who earns a salary of $ 16,600 ARS, will add an additional $ 9,500 ARS of labor costs to the employer (Chiesa). A global economic crisis in 2020 could increase further levels of unofficial and official unemployment in all Mercosur countries. The Mercosur Residence Agreement which allows for the free movement of residents of Mercosur countries and associated countries does alleviate such unemployment levels, as both high skilled workers and low skilled workers can work in the countries where their expertise is most desired; however, the different economic stressors make it difficult to provide a comprehensive regional solution.

Table 3: GDP Growth and Total Unemployment										
GDP Growth (Constant 2010 USD)						Total Unemployment (% of Total Labor Force)				
	Argentina	Brazil	Paraguay	Uruguay			1990-1999	2000-2009	2010-2015	2016
2017	2.7	1.3	5	2.6		Argentina	12.3	12.7	7.3	8.7
2018	-2.5	1.3	3.7	1.6		Brazil	7.0	8.9	7.2	11.6
2019	-3.1	1.1	0.7	0.5		Paraguay	5.7	6.3	4.6	5.3
2020	-1.3	2	3.1	2.5		Uruguay	10.0	12.1	6.7	7.8
2021	1.4	2.5	3.9	3.5						
2022	2.3	2.4	3.8	3.2						

Table 3 Data from database: Global Economic Prospects last updated: 01/08/2020, and database: Jobs, (modeled ILO estimate) last updated: 02/27/2020. Due to the drop-in global market's in March 2020 during the time of writing, estimates are likely to drop for 2020 and 2021. Decade averages based on authors calculation.

[8] (Export Entreprises SA)

Table 3 provides GDP Growth (Constant 2010 USD) and Total Unemployment (% of Total Labor Force) for the decades of Mercosur. In 2017, Mercosur countries experienced an expansion of GDP growth, and in 2018, activity slowed in Paraguay and Uruguay, in Brazil it improved only very slightly, and in Argentina GDP growth fell. It was expected that in 2019 and 2020, all partners register a GDP expansion, except for Argentina; however, given the drop in global markets in March 2020, these projections have changed to a less optimistic result. In Uruguay, GDP growth reached 2% in 2018, bringing the country's growth streak to sixteen years, the longest expansion in its history.

Table 4 and Figure 1 below provide GDP Per Capita (Current US$) data for all the years of Mercosur. Brazil is the largest economy and most populous country of Mercosur and although Brazil has the highest GDP, its GDP per capita remains lower than that of other regional states. The second largest economy in Mercosur is Argentina, whose economic size and population level are both about one-fifth of that of Brazil. Uruguay's GDP is about 2 percent of Brazil's and 10 percent of Argentina's. The country with the highest GDP per capita is Uruguay, at $17,278 USD in 2018. Uruguay achieved significant increases in its GDP per capita from 2010-2015 and has continued to climb, despite having a GDP of about one-fiftieth the size of Brazil, and one-fifth the size of Argentina. Paraguay is the smallest country in the region in terms of GDP and is also the country with the lowest GDP per capita in Mercosur at $5,822 USD in 2018. Between 2014 and 2017 Brazil experienced a decline in its GDP per capita growth rate at - 2.8 percent[9]. Argentina, Paraguay, and Uruguay maintained positive growth, but Argentina showed a decline in growth in 2018.

Table 4: GDP Per Capita (Current US$)

[9] (United Nations Teaching Material on Trade and Gender)

	1990-1999	2000-2009	2010-2015	2016	2017	2018
Argentina	7075	6066	12587	12790	14592	11684
Brazil	3973	5190	11688	8713	9881	8921
Paraguay	1728	2233	5383	5319	5681	5822
Uruguay	5543	6168	15137	15387	16437	17278

Table 4 Data from database: World Development Indicators, last updated: 02/27/2020. Decade Averages Based on Authors Calculations.

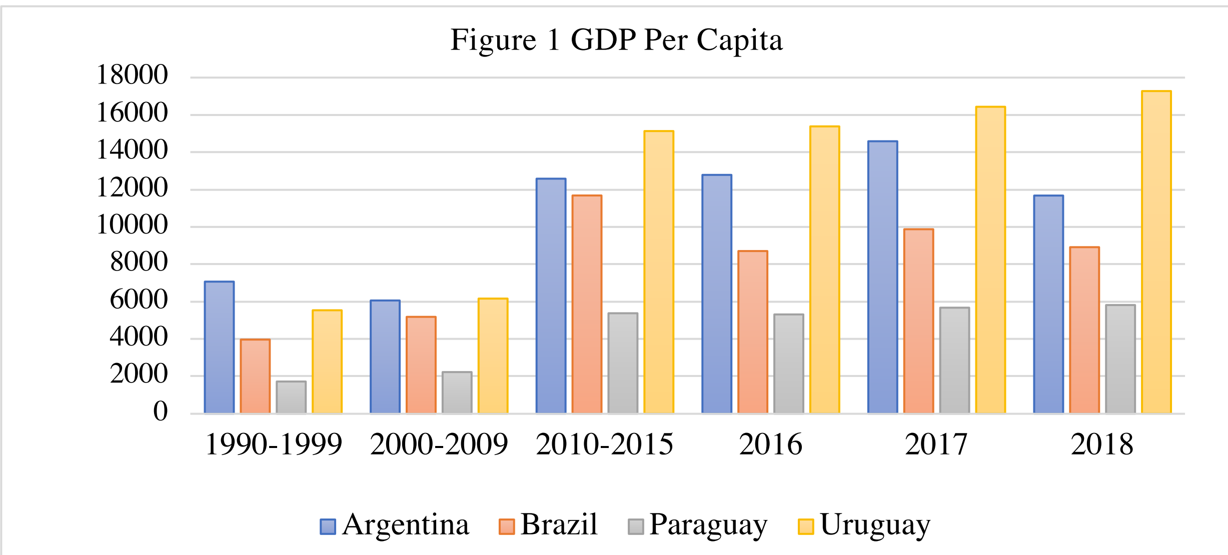
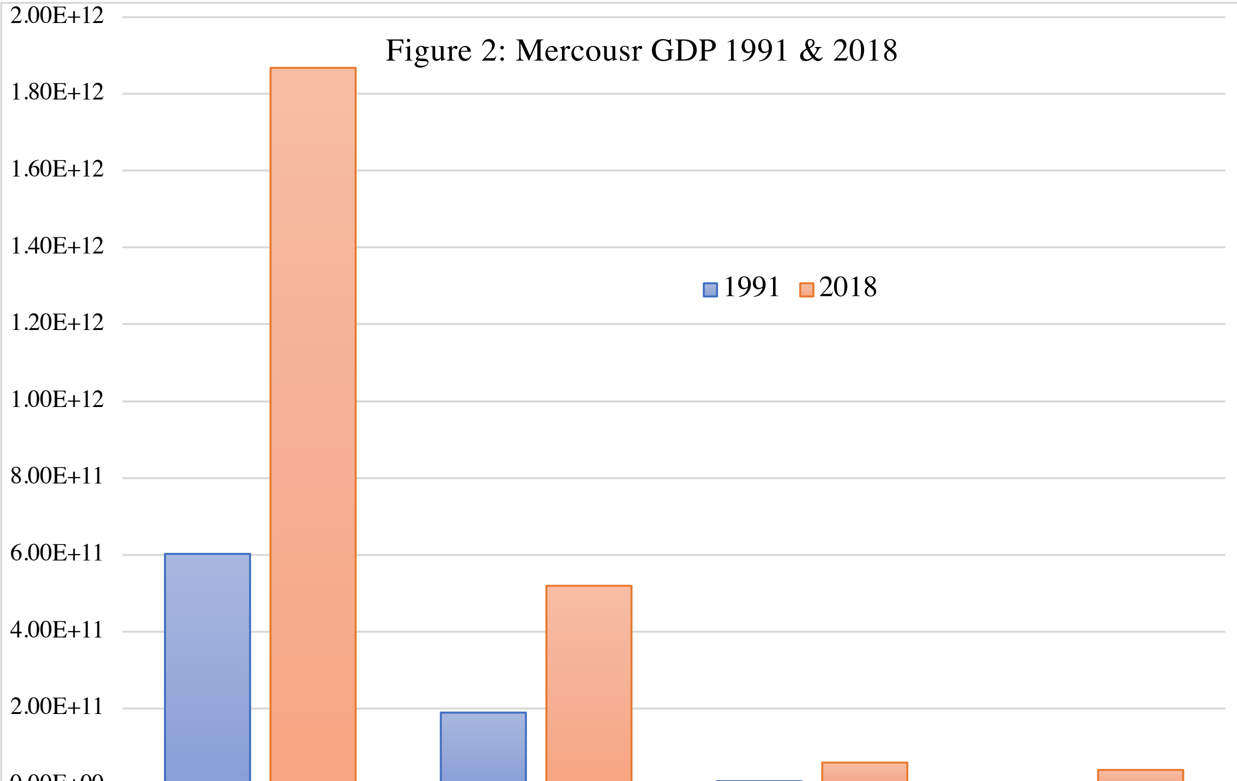


Figure 1: GDP Per Capita.

Data from Table 4.

As previously mentioned, the second assumption for the success of open regionalism according to Garzón is that the bargaining leverage of one state remains relatively similar to that of its fellow cooperating regional states. A state whose market has a dominant weight within a bloc could, attract its own agreements with third parties. Bargaining leverage could be political or economic. Figure 2 below provides the GDP of Mercosur countries for 1991 and 2018, which shows Brazils economic expansion in comparison to the other members of Mercosur.



	Brazil	Argentina	Uruguay	Paraguay
1991	6.03E+11	1.90E+11	1.12E+10	6.98E+09
2018	1.87E+12	5.20E+11	5.96E+10	4.05E+10

Figure 2: Mercosur GDP 1991 and 2018.

Data from the World Integrated Trade Solution and the World Bank. Data retrieved 3/28/2020.

During the beginning years of Mercosur, Brazil's GDP was three times as large as Argentina's. In 2018, Brazil's GDP has grown to four times as large as Argentina's, the second largest economy in the block. While, Brazil increased its position globally, Argentina's position has decreased. In 1991 Brazil's GDP was ranked at 11th largest in the world, and Argentina was the 21st largest. In 2020 Brazil's GDP is ranked at 9th largest in the world, and Argentina's GDP is ranked at 26th largest. If the disparity between the size of the economy in Brazil and Argentina continues to grow, Brazil will continue to develop bargaining leverage and will continue to hold dominant economic and political weight in comparison to the other members.

Figure 3 shows Mercosur Foreign Direct Investment (FDI) Net Inflows for the last three decades of Mercosur. Since 1990, Mercosur countries made strides in attracting FDI. Aggarwal and Espach (2003) write that the increase in foreign investment and economic growth over the 1990s in Mercosur "had more to do with these country's domestic reform programs, and the overall health of the global economy, than with effects directly accountable to Mercosur" (Aggarwal and Espach 33). Their conclusion indicates that a degree of national concern and national policies and initiatives is what aided the attraction of FDI to each country. This could be an explanation for why Brazil has consistently attracted more FDI in comparison to its Mercosur neighbors. This indicator for Brazil has been increasing even during times of crisis. In Argentina, FDI has decreased. For all years of Mercosur, Uruguay and Brazil have a positive projection of FDI, while Argentina and Paraguay have a negative projection. Uruguay receives the most FDI in the region relative to the size of its economy.

Table 5: Foreign Direct Investment, Net Inflows (% of GDP)

	1990-1999	2000-2009	2010-2015	2016	2017	2018
Argentina	2.6	2.2	2.0	0.6	1.8	2.3
Brazil	1.4	2.9	3.6	4.1	3.4	4.7
Paraguay	1.7	0.7	1.5	1.3	1.3	1.2
Uruguay	0.6	4.0	5.9	-0.9	4.7	4.5

Table 5 Data from database: World Development Indicators, Last Updated: 12/20/2019. Decade Averages Based on Authors Calculation.

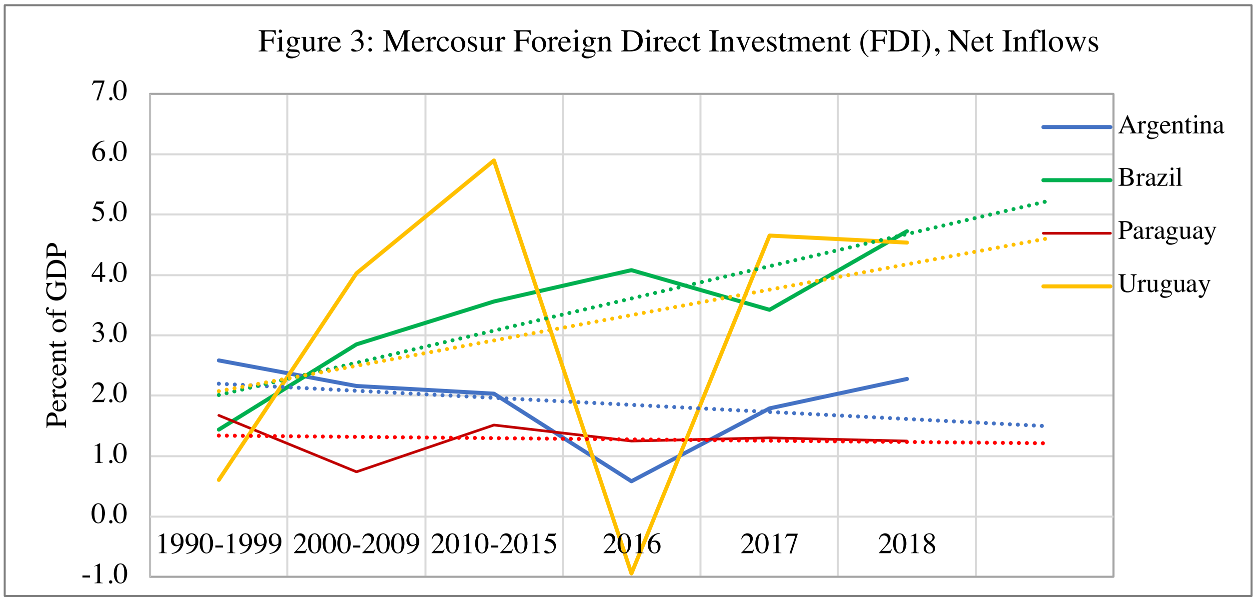


Figure 3: Mercosur Foreign Direct Investment (FDI), Net Inflows.

Data from Table 5. Data retrieved 3/10/2020.

Given the outbreak of the 2020 coronavirus, it is currently uncertain how FDI will move in these countries in the coming years. Based on the latest available data before the outbreak, Brazil has the largest economy, and FDI is projected to increase, while Argentina's FDI is projected to decrease. Countries showing greater dependence on the regional marketplace are likely to drive the integration efforts, and it is less likely that that this effort originates from Brazil. Based on a review of the economic circumstances alone, the likelihood is higher that an effort toward further integration originates from within second-largest economy, Argentina. Philips (2003) writes "In Argentina, the much greater dependence on the regional marketplace, together with the more pronounced dependence on and vulnerability to external capital flows, have meant that the participation in Mercosur has been dictated far more by economic necessity than was the case for Brazil (Phillips 221). Rather than threatening to leave Mercosur as Brazil's president remarked in 2019, Argentina has preferred expanding the membership of Mercosur, (For example, it extended membership in the past to Venezuela), it wished to extend the

Mercosur market, and open extra-regional markets though Mercosur negotiations[10]. Argentina's incentives are also different from Brazil due to the economic preponderance of agriculture in the Argentine economy. "Economically successful leaders are unlikely to pursue deeper integration because their expected marginal benefit from integration in terms of improved re-election chances (or simply in terms of retaining political power) is minimal and thus not worth the cost of integration" (Mattli 51).

From the data provided above, we can place Phillips first conjunctural factor for integration. There is currently a period of economic uncertainty, as global markets have fallen in March 2020, which may lead to further economic crisis in the region. Argentina in particular is likely to continue to experience high inflation. As countries experience this Macroeconomic instability, there is less incentive for supporting expenditures on sustaining a common market. Mercosur countries can assume nationalist tendencies to alleviate an economic recession, and the prospect for convergence on domestic economic conditions declines. Therefore, Phillips first conjunctural factor for integration is not currently met at this time for Mercosur.

Trade Agreements

Phillips writes, "The second conjunctural pressure on sub-regionalism stems from the hemispheric integration project. If existing sub regional arrangements are based on the extension of trade preferences to member countries, the construction of a [Free Trade Agreement for the Americas] FTAA will necessarily and logically remove the rationale for the smaller trade blocs it encompasses" (Phillips 223). Phillips' second conjunctural factor for the success of regional integration addresses the FTAA, which was an initiative that has since been defeated; however, the logic applies for the emergence of other regional organizations based solely on free trade

[10] Phillips (221).

agreements which would have a similar effect as the FTAA. This could include the formation of bilateral trade agreements, and the redundancy they could bring to the regional project. A free trade agreement would supersede the rational for Mercosur's existence, making sub-regional blocs redundant. As extra-regional trade grows, states are considering the cost benefit calculations of a regional trade strategy or a trade strategy based on domestic interests and bilateral agreements. The following section provides a current overview of Mercosur trade agreements to better understand the state of Phillips second conjunctural factor.

Figure 4 below shows all trade agreements by country and partner scope for Mercosur. The variable that stands out the most are the number of Bilateral Investment Treaties (BIT). A BIT establishes the terms for private investment by the citizens and companies of other states, which allows host countries to provide protections to foreign firms undertaking investment. BITs give investors better access to the domestic market by ensuring 'national treatment' which means that the foreign investors are treated the same as the domestic investors. Under a BIT, governments cannot create rules mandating companies to use locally made materials in their products or to transfer technology to a domestic company as a condition of investment[11]. In addition, companies own 100% of their operations, and can move capital freely in and out of the country which they have invested in. Swenson writes, that the BIT helps to intensify international connections, such as those related to the expansion of international trade[12]. BITs foster international connections through channels that are mediated by multinational firms, which might facilitate extra-regional integration on other dimensions. The figure shows that the BITs treaties for Mercosur countries are currently more geographically dispersed. In the figure below, dispersed agreements for Mercosur countries include countries that are located outside of South

[11] (US-China Buinsess Council)
[12] (Swenson)

America. Geographically concentrated agreements for Mercosur include trade partners within the neighboring countries in South America, (excluding Central American countries). See figure 4 Agreements by Country and Partner Scope.

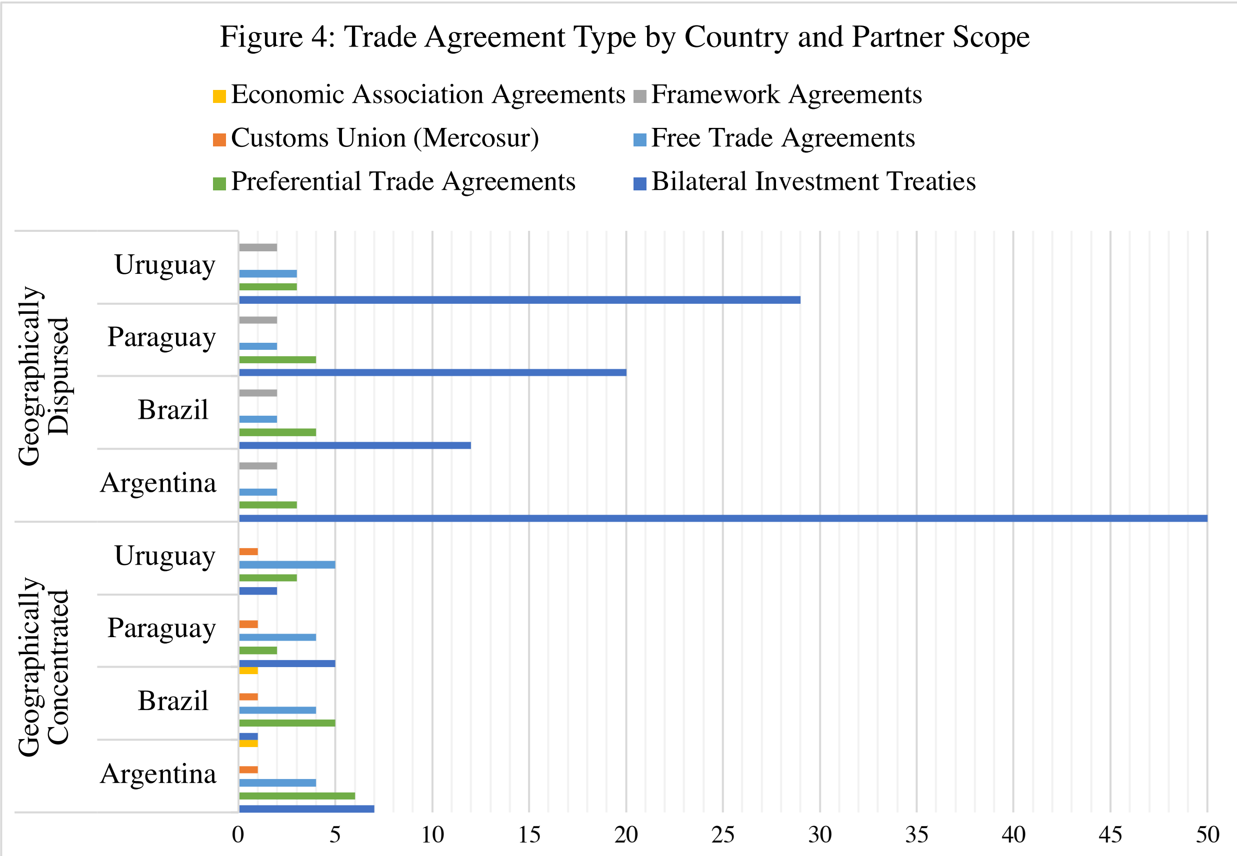


Figure 4: Trade Agreement Type by Country and Partner Scope.

Figure 4 Data from: Organization of American States Foreign Trade Information System (2020). Last updated 02/28/2020.

Notably, Argentina has the most BITs established out of the four Mercosur countries. Uruguay has created the second most of such treaties. Currently this kind of investment is individual for each Mercosur country. There is no Mercosur alternative, such as a harmonized development for BITs that builds on the existing Mercosur processes. A regional agreement concerning BITs might attract more of this kind of investment to the region, harmonizing the varying degrees of investment regimes. From the graph we can see that there are more geographically dispersed BITs which suggests how Mercosur countries are subject to investments coming from beyond the region.

Table 6 below presents a list of all of the Mercosur-Free Trade Agreements. There are free trade agreements signed by every country in Mercosur, and there are agreements signed only by one or two of the Mercosur countries, such as the Uruguay-Mexico (ACE 60) agreement, the Argentina-Chile agreement, and the Uruguay-Chile agreement. The Mercosur - Egypt free trade agreement was signed by Brazil, Paraguay, and Uruguay in August 2010, but has only been in force since September of 2017. The other recent free trade agreement signed by all individual members of Mercosur is the Mercosur- Colombia AAP.CE Nº 72 agreement signed in 2017. The following figure includes the most recent version of the free trade agreements signed by each of the countries in Mercosur. Thus far, the bloc has cemented free trade agreements with, Bolivia, Chile, Colombia, Egypt, Israel, Mexico, Peru, and Palestine. The table shows that there has not yet been much progress in terms of solidifying regional free trade agreements with more partners this past decade. There have been preliminary initiatives to establish these Mercosur-free trade agreements, which would be helpful in further defining the region, and could help to reduce the establishment of bilateral agreements with different Mercosur states. In the past two years, there have been serious preliminary discussions for establishing Mercosur-free trade agreements with: Morocco (2017)[13], New Zealand (2018)[14], Canada (2018)[15], Singapore (2018)[16], Japan (2019)[17], Bangladesh (2019)[18], S. Korea (2018)[19], Lebanon (2019)[20], and there are rumors that the UK

[13] (The North Africa Post)
[14] (Parker)
[15] (Government of Canada)
[16] (Ministry of Trade and Industry Singapore)
[17] (Machado)
[18] (Dhaka Tribune)
[19] (Eun-jung)
[20] (Government of Argentina)

(2020) is also considering the possibility in the aftermath of its withdrawal from the European Union.

Table 6: Mercosur Free Trade Agreements.

Country	Partner	Date of Signature	Entry into Force
Argentina	Chile	2-Nov-17	2-May-19
Uruguay	Chile	4-Oct-16	.
Brazil	MERCOSUR - Egypt	2-Aug-10	1-Sep-17
Paraguay	MERCOSUR - Egypt	2-Aug-10	1-Sep-17
Uruguay	MERCOSUR - Egypt	2-Aug-10	1-Sep-17
Brazil	MERCOSUR - Israel	18-Dec-07	.
Paraguay	MERCOSUR - Israel	18-Dec-07	.
Uruguay	MERCOSUR - Israel	18-Dec-07	.
Argentina	MERCOSUR - Palestine	21-Dec-11	.
Brazil	MERCOSUR - Palestine	22-Dec-11	.
Paraguay	MERCOSUR - Palestine	23-Dec-11	.
Uruguay	MERCOSUR - Palestine	24-Dec-11	.
Argentina	MERCOSUR - Peru (ACE 58)	30-Nov-05	30-Nov-05
Brazil	MERCOSUR - Peru (ACE 58)	30-Nov-05	.
Paraguay	MERCOSUR - Peru (ACE 58)	30-Nov-05	.
Uruguay	MERCOSUR - Peru (ACE 58)	30-Nov-05	.
Argentina	MERCOSUR -Bolivia (ACE 36)	17-Dec-96	28-Feb-97
Brazil	MERCOSUR -Bolivia (ACE 36)	17-Dec-96	28-Feb-97
Paraguay	MERCOSUR -Bolivia (ACE 36)	17-Dec-96	28-Feb-97
Uruguay	MERCOSUR -Bolivia (ACE 36)	17-Dec-96	28-Feb-97
Argentina	MERCOSUR -Chile (ACE 35)	25-Jun-96	1-Oct-96
Brazil	MERCOSUR -Chile (ACE 35)	25-Jun-96	1-Oct-96
Paraguay	MERCOSUR -Chile (ACE 35)	25-Jun-96	1-Oct-96
Uruguay	MERCOSUR -Chile (ACE 35)	25-Jun-96	1-Oct-96
Argentina	MERCOSUR -Colombia AAP.CE Nº 72	21-Jul-17	21-Jul-17
Brazil	MERCOSUR -Colombia AAP.CE Nº 72	21-Jul-17	.
Paraguay	MERCOSUR -Colombia AAP.CE Nº 72	21-Jul-17	.
Uruguay	MERCOSUR -Colombia AAP.CE Nº 72	21-Jul-17	.
Uruguay	Mexico (ACE 60)	15-Nov-03	15-Jul-04

Table 6 Data From: Organization of American States Foreign Trade Information System (2020), and PalTrade – Palestine Trade Center.

The majority of the free trade agreements emerged after 1996, and nine out of the twenty-five agreements appeared within the last nine years. If Mercosur is unable to focus efforts on establishing agreements within the bloc, countries with leverage will seek out their own bi-lateral agreements. Philips writes, if regional organizations are based solely on trade preferences, then the establishment of more free trade agreements in the future could render moot the economic rationale for Mercosur, making sub regional blocs redundant.

A recent development also worth mentioning are the Trade and Investment Framework Agreements (TIFAs). These are agreements that establish a political and legal commitment between the United States and the partnering country. TIFAs enhance bilateral trade through lowering tariffs for increased liberalization. Historically TIFAs are considered stepping stones to bilateral agreements and they lead to official bilateral agreements at a later date. For Mercosur countries, they are a creation that is flexible enough to be exempt from the establishment of free trade agreements that would violate Mercosur policy, but their existence suggests the preparation for a future bilateral trade agreement. Below are the TIFAs currently in place in the Mercosur region.

Table 7: Trade and Investment Framework Agreements (TIFA) with Mercosur Countries.

Country	Partner	Date Signed
Argentina	United States -TIFA	3/23/2016
Paraguay	United States - TIFA	1/13/2017
Uruguay	United States -TIFA	1/25/2017
Uruguay	United States - TIFA Protocol on Trade and Environment	8/2/2008
Uruguay	United States - TIFA Protocol on Trade Facilitation	8/2/2008

Table 7 Data from (The Office of the United States Trade Representative).

In the past decade, Argentina, Paraguay, and Uruguay signed TIFAs with the United States. The TIFA approach allows countries to deepen trade relations with the United States without compromising Mercosur commitments. Argentina's agreement was signed under the right wing "Cambiemos" government. In 2017, Paraguay's TIFA agreement was signed under the right-wing Horacio Cartes government, superseding the agreement establishing the United States – "Paraguay Bilateral Council on Trade and Investment" signed on September 26, 2003[21]. The reasons that a smaller state would sign such an agreement is not out born of a concern for asymmetries, the reasons are likely political. In the next decade, depending on the political leadership in Mercosur countries, these TIFA agreements could well become bilateral agreements. The agreements include a desirability to reduce non-tariff barriers and subsidies within the governments to facilitate trade. Brazil was presented with a document to "support a timely negotiation" of a TIFA in December 2009[22], but since that time no TIFA has been signed; however, in 2011, the United States and Brazil signed the "Agreement on Trade and Economic Cooperation" which similarly facilitates cooperation on trade and investment.

This past year, the president of Brazil, Bolsonaro and the president of the US Trump began discussions for a possible free trade agreement in July 2019[23]. A bilateral free trade agreement with the United States would undermine the Mercosur CET. Although, it seems these talks did not carry much weight, as later in the year, on December 2nd, 2019, the president of the US decided to raise tariffs on steel and aluminum imports from Brazil and Argentina[24], which created political divides between the two countries. It is unclear if Mercosur - US talks will continue. Therefore, with growing discussion around establishing more bilateral free trade

[21] United States Paraguay Trade Press Release (USTR).
[22] (US-Brazil CEO Forum)
[23] (Aljazeera)
[24] (Ramkumar and Zumbrun)

agreements, it would be important to the matter of integration for Mercosur to focus on consolidating its regional approach; however, the increasing politicization between Argentina and Brazil in the next few years can create new layers of institutional dysfunction and asymmetries.

A new integration effort, which has the possibility of undermining Mercosur, is the Pacific Alliance. The Pacific Alliance comprises, Mexico, Colombia, Peru and Chile, (these are also the countries that have already established free trade agreements with the United States). The Pacific Alliance stated the goal of achieving free trade among themselves by establishing bilateral agreements within a fixed time frame. The Pacific Alliance has attracted the interest of the two smaller members of Mercosur, Paraguay and Uruguay, this has caused concerns among Argentina and Brazil, as it undermines the regional integrity of Mercosur. In addition, Bolivia's former president Evo Morales, who was opposed to joining the Pacific Alliance, is no longer in office, and the new far right interim leader of Bolivia is politically aligned with the initiative, which indicates a possibility of Bolivia joining the Pacific Alliance in the coming years. These actions would undermine further the rational for Mercosur. The information above provides a view of how Phillips second conjunctural factor applies in the case of Mercosur. This factor, which concerns the redundancy of free trade agreements, is not yet in effect in Mercosur; however, the next decade will prove if the TIFA agreements do lead to bilateral agreements

Trade Shocks

Another effect which emerges as extra-regional trade grows is the substantial adjustment costs and distributional consequences of trade shocks. Autor, Dorn, and Hanson write that the benefits to expanded trade are obvious, but there are also significant costs which are not often discussed in the literature. For example, the costs of expanded trade are visible in local labor markets and in industries where foreign competition is the most concentrated. Their research observed the impact of imports from China on local industries, and they found that, “Adjustment in local labor markets is remarkably slow, with wages and labor-force participation rates remaining depressed and unemployment rates remaining elevated for at least a full decade after the China trade shock commences (Autor, Dorn and Hanson). Where there is a slight decline in the demand for local labor industries, and then foreign competition enters those markets, there will be further and drastic declines in these industries, and these industries are not likely to recover. They conclude that international trade is not generally Pareto improving. If the Mercosur region experienced a significant increase in extra-regional trade, not only with China but with other countries as well, Mercosur member countries are likely to be exposed to these adjustment costs in local labor markets. It is important to understand this impact on integration efforts. These trade shocks impact the potential level of growth for inter-regional trade. For example, if extra-regional trade increases, manufacturing employment in particular could decline in the Mercosur region, as more manufacturing imports arrive from other countries. Figure 5 below shows employment in industry during the years of Mercosur. Since 2014, all countries show a new declining trend in industry employment. For the region, the costs of expanded trade could be visible through declines in the percentage of employment in industry.

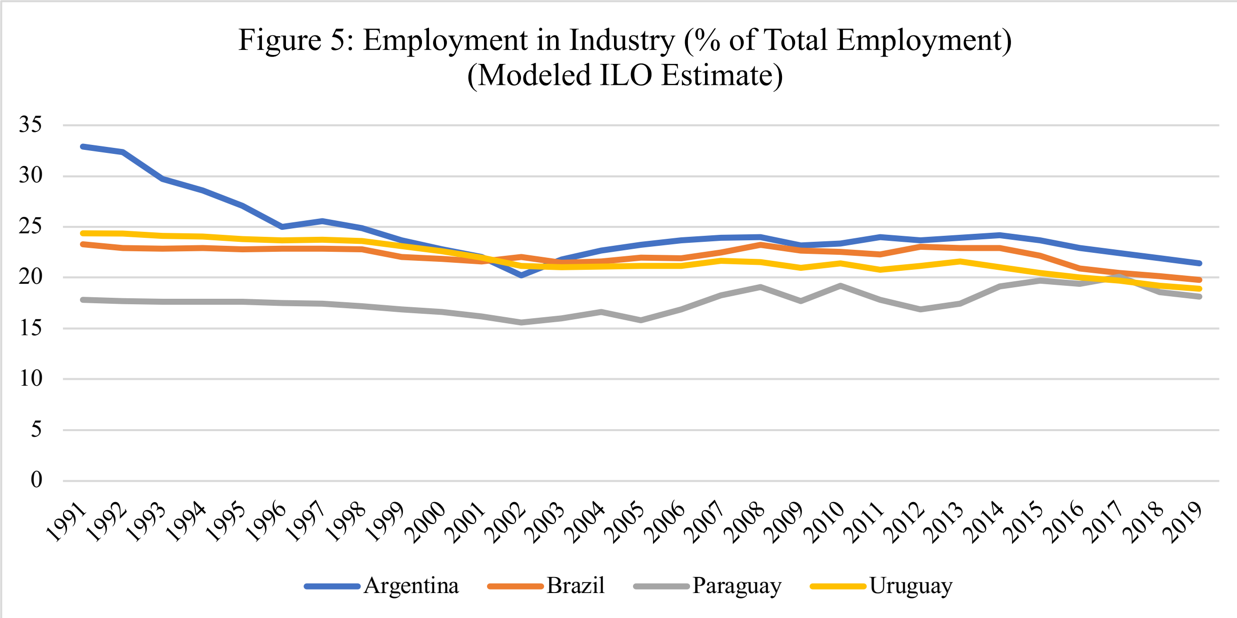


Figure 5: Employment in Industry (% of Total Employment).

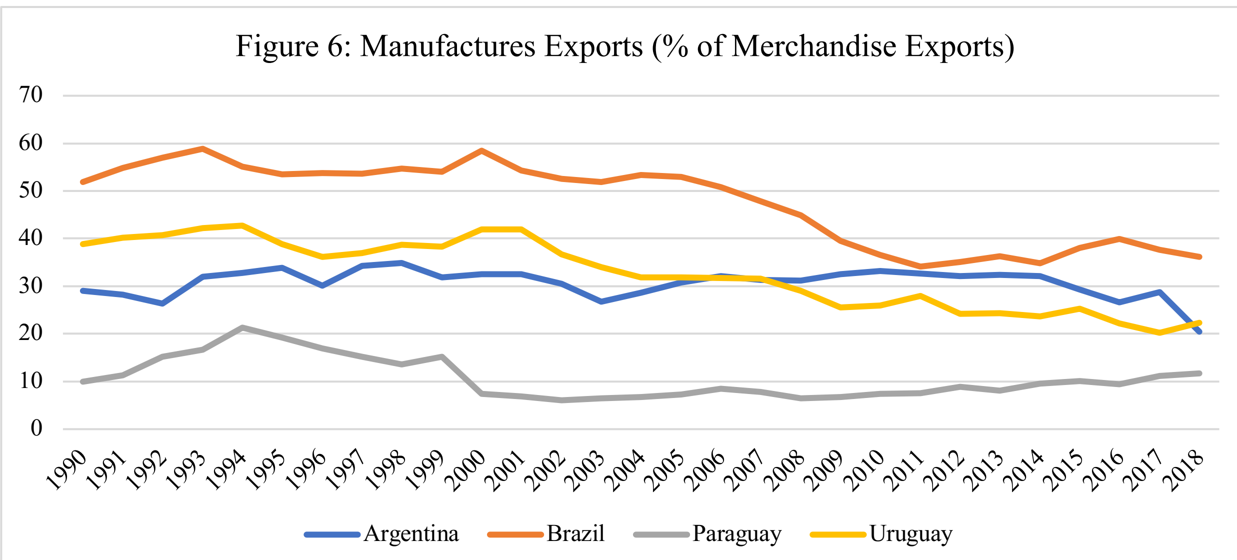


Figure 6: Manufactures exports (% of Merchandise Exports).

Figure 5 shows how employment in industry has declined for all countries. In 2015 there was a notable decline for Argentina and Uruguay. Declines in employment in industry has negative implications for inter-regional trade, because manufacturing generates more economic activity than other sectors. Figure 6 shows a decline in manufacturing exports originating from the region. Argentina experienced a decline in 2015, and Brazil in 2017. In addition, as the region imports more extra-regional products, demand for local industries experience a decline. Paraguay is the Mercosur country experiencing an increase in Manufacturing Exports. This also has affects for intra-industry trade. A declining intra-industry trade signifies that opportunities for regional specialization in these industries have declined between the state and the region. These industries in each country of the Mercosur region which could otherwise improve inter-regional trade dissipate, making the region more dependent on extra-regional trade.

International trade increases in a short time can make low-skilled workers continually worse off, and eliminate industries, not just temporarily as the foreign competition enters the market, but on a sustained basis. These ideas are explained further by Krugman and Obstfeld, who observed what happens to low skilled industries and workers in the United States. “Owners of a country’s abundant factors gain from trade, but owners of a country’s scarce factors lose... Compared with the rest of the world the United States is abundantly endowed with highly skilled labor and… low-skilled labor is correspondingly scarce. (2008, p. 64) (Autor, Dorn and Hanson). If low-skilled trade decreases in the Mercosur region, it means less opportunities for improving this trade intra-regionally, which reduces the economic incentives favoring the projects existence.

National Tariffs (NTs)

Another condition for integration which could be impacted by the demand condition is an increase in the number of National Tariffs (NTs) formed for generating income and protecting industries. For example, lobbying from the declining industries mentioned above could encourage the formation of NTs to support the declining industries. The formation of NTs go against the policies of the customs union, and there is no supranational authority to dissuade their formation. The Mercosur project was able to lower national tariffs because regional integration efforts were part of a broader policy course for economic reform in each of the national governments. Argentina and Brazil were able to negotiate and obtain preferential access to each other's markets; Argentina could access the Brazilian Market and vice versa. Brazil exchanged Argentina support for Brazilian international trade strategies. Hirst writes, "In Brazil, the preservation and modernization of industrial sectors, such as automotive, chemical, capital goods, and information technology have strengthened the neo-developmentalist drive within the government and business sectors. For Argentina, the comparative advantages of its association with Brazil are concentrated in the food industry and the energy sector" (Hirst 140). If extra-regional trade increases and preferential trading partners change, this kind of relationship between Argentina and Brazil could be redefined to one which considers the importance of negotiations with extra-regional actors. As a result, negotiation bodies change, and with extra-regional actors they are handled through diplomatic channels, and not through a Mercosur entity.

The economic reasons for Mercosur's existence are in the process of being undermined by the emergence of bilateral trade agreements, economic crisis, and the existence of shallower forms of economic regionalism, such as the Pacific Alliance. The efforts of these authors provide ample theoretical knowledge, of the impact of the extra-regional and domestic influences, that are generating the forces that are undermining the incentives for the further integration of Mercosur. Phillips and Prieto agree, "the new regionalism has essentially run aground as a force for structural transformation of the political economy in Latin America (Phillips and Prieto 2011, 116). If there are incentives for more bilateral trade agreements to emerge, it would create redundancies for Mercosur existence. The authors work, Mattli's 'regional integration theory' (1999), Philips and Prieto (2003), and Philips (2011), and Garzón (2016) are significant in pointing out how the incentives have changed for the region which was once focused on deepening integration, and each author explains the theory with evidence in Latin America.

III. Theoretical Framework

Authorship on the crisis of new regionalism provides an understanding of how recent transformations in regionalism are affecting institutions and identities. Institutions are experiencing a shift in the incentives for integration. Through understanding these incentives, an illustration of the dynamics undermining integration in each country in Mercosur can be formed. The 'regional integration theory' (1999) by Mattli introduces the idea of supply and demand conditions which determine incentives for integration. Integration is most likely to succeed when two supply conditions are satisfied in addition to the demand condition. He highlights two primary supply conditions: "first, "Commitment institutions" such as the centralized monitoring and third-party enforcement" and second, "…the presence of an undisputed leader state among the group of countries seeking closer ties serves as a focal point in the coordination of rules, regulations, and policies" (Mattli 99-100). This leader must help ease tensions that arise from the inequitable distribution of gains from integration (Mattli 42). According to Mattli, the European Union satisfies both of these conditions, possessing a far-reaching commitment institution, and an undisputed regional leader role, fulfilled by Germany, which provides institutional leadership, and eases distributional tensions through generous side-payments. There is also a promise of significant market gains from integration with uncontested regional leadership. The European Commission and the Court of Justice of the European Union, are the commitment institutions responsible for monitoring and enforcing community obligations, ensuring that individuals, companies, and member states do not act in ways which run counter to the treaties or EU secondary law. “It can take members states to task by demanding termination of an infringement, or by taking the matter to the Court of Justice for a final decision” (Mattli 100).

For Mercosur, the two supply conditions presented by Mattli, commitment institutions, and the presence of an undisputed leader state among the group of countries, are not easily satisfied. The highest decision-making body is the Mercosur Council which meets every six months with the four presidents present and is made of the foreign affairs and finance ministers of each Mercosur country. Each country holds the presidency of the Council for six months on a rotating basis. Beneath the Mercosur Council, are the Mercosur Group (the main executive body composed of officials from the four governments) and the Trade Commission which reviews trade policy and examines complaints. The complaint procedure is primarily solved through consensus. “The four partners will attempt to solve complaints and trade disputes through consensus. If there is no consensus, or a decision is not upheld, the complainant can initiate proceedings under the 1991 Protocol of Brasilia. Cases are then decided by a tribunal with one judge from each of the countries in dispute, and a third independent judge” (Mattli 159). The remaining decision-making groups are the Parliamentary Commission, which represents the four countries’ legislatures, a ‘Consultative Forum’ for private sector business and trade unions, and a purely administrative Mercosur secretariat based in Montevideo (Mattli 156). Hirst writes of the effects of Mercosur’s inter-governmental decision-making structure, “Mercosur lacks the necessary institutions for operating as an inter-governmental decision-making structure. For more than five years Mercosur has faced a trade agenda heaped with disputes, without being able to rely upon judicial instruments and institutions capable of effectively finding solutions for these controversies. This has negatively affected Mercosur’s credibility” (Hirst 138). Commitment institutions described by Mattli, enhance cooperation by acting as a constraint on member states, to prevent reneging of contractual obligations. The European Court of Justice has been a successful enforcement institution for the EU, and could possibly provide similar effectiveness for Mercosur; however, the development of such an institution, or supranational court has been severely opposed by Brazil. The Mercosur Council is not as an effective enforcement institution, and for bi-lateral trade opportunities with significant pull, it would not prevent reneging. De Alemeida writes that even if there was a supranational court for Mercosur, if national governments do not commit themselves to remove the most important barriers to full integration; they have always failed to comply with the agreements formally signed by them. Thus, the problem is not in the instrument, but in national governments (De Alemeida).

Currently, the dominant economy in Mercosur is Brazil[25], which makes it a likely candidate to fulfill the role of Mercosur's undisputed leader and regional paymaster; however, it has not assumed this role. Mattli writes, "[Brazil] has refused to pay heed to call for regional redistribution schemes, which may be of little surprise in a country that is used to one of the worlds least equitable distributions of domestic wealth" (Mattli 160). Brazil suffers from high levels of income inequality, and disparity of income between men and women. Its domestic policies are in part a representation of its foreign policy decisions towards the region. As the largest economy in the region, it maintains a scarcity mindset. Mattli writes, "Whenever short-term national interests are at stake, Brazil has relegated Mercosur to second place. For example, it has decreed investment incentives with little regard to their effects on the other members and has unilaterally imposed tariff and non-tariff barriers on imports whenever domestic developments demanded such actions (Mattli 160). Brazil could assume the necessary role of

[25] Percent of total Mercosur GDP.

regional leader- concerned with the proliferation of integration efforts but it does not assume this necessary role.

Political leaders deepen integration if it is expected to improve their chances of retaining power. This is one of the key supply conditions described by Mattli. Supply conditions are “the conditions under which, political leaders are willing and able to accommodate the demands for regional institutions at each step of the integration process” (Mattli 42). A deepening of power could be an action that leads to the improvement of domestic economic conditions (Mattli 42). If political leaders perceive that they are able to retain power by deepening integration, then they are more willing to accommodate the costs of integration for deepening regional institutions like Mercosur.

Mattli’s demand condition for successful integration concern the regional gains or the potential for more regional gain. “If there is little potential gain, perhaps because regional economies lack complementarity, or because the small size of the regional market does not offer important economies of scale, the process of integration will quickly peter out” (Mattli 42). If there is more potential for gains working with extra-regional partners, then there will be less interest in improving the potential for regional gain. If one country in the bloc remains economically prosperous, then the economic asymmetries between partners increase making the harmonization process between partners difficult. The market of the countries facing economic crisis will be less attractive for the most prosperous country in the region, diminishing the demand conditions for integration.

De Alemeida (2013) writes of two concepts for Mercosur which are the competing determinants of decision making: sovereignty and regional integration. If Mercosur states are to achieve policy harmonization, they must relinquish sovereignty over certain public policies, which might be in opposition to their national interests. In the book, "Latin America in the New International System", the author writes, "while there has been a rapid expansion of intergovernmental and translational links, the age of the nation-state is by no means exhausted. The territorial nation-state has suffered a decline, but the importance of nationalism and territorial independence and the desire to establish, regain, or maintain sovereignty does not seem to have diminished in recent times. Some of the world's most seemingly intractable regional crisis do not escape the pull of sovereignty" (Espach and Tulchin). A key example of this for regional organizations is the reluctance of the development of a supranational authority.

In Mercosur countries, there is a juridical tradition concerning sovereignty, beginning with the Calvo doctrine and the Drago principle and the principle of territorial sovereignty in interstate affairs, which was established after the Peace of Westphalia in 1648, and continues to reflect in domestic policy areas. Thus, there is a legal tradition of maintaining sovereignty while developing special mechanisms for protecting and ensuring that sovereignty is maintained at the national level or through international law. Brazil especially is one of the most influential supporters of sovereignty among South American states, the Hague Peace Conference in 1907 identifies its particular organizational structure and foreign policy disposition. National sovereignty is an evolving concept, and in the contemporary era it appears in the 1945 United Nations Charter, which fully respects the sovereign rights of states in domestic politics (Chapter 1, Part 1, and Article 2 of the Constitution).

In theory, the largest states do have the most influence on their regions through sheer will, but even the largest states cannot achieve security or amenity for their citizens without the cooperation of many participants in the system. Mercosur states express their sovereignty through projecting their national interest separately to achieve their goals; however, there must been some compromise between national interest and the initiatives for regional integration in order to provide security and amenity for their citizens. Brazil might not willingly assume position in Mercosur as undisputed leader of Mercosur, a condition Mattli identifies as a necessary supply condition for integration, because of this juridical tradition concerning sovereignty. Therefore there is a contradiction between the rhetoric of Mercosur countries willing to improve integration, and the defense of the sovereignty of Mercosur countries, which oftentimes opposes the integration processes, impacting trade, industrial policy, and other sectors (De Alemeida).

Although sovereignty was an established principle in international law, the concept was not respected by the colonial or imperialist powers acting in South America. The history of the region might explain why sovereignty is so defended in each country, based on the respective and intertwined histories of colonialism and dictatorship in the region. A marriage to national sovereignty may be responsible for the slowed interest in changing national policy for the sake of regional integration. Brazil and Argentina have not surrendered sovereignty over their fundamental economic policy in the macroeconomic sector which includes, fiscal, trade, and monetary policy, and industrial and trade policies in the sectorial realm (De Alemeida).

Unless there is a rejection of any degree of national political sovereignty over (at least part of) macroeconomic policies and some sectoral policies (especially industry, trade and agriculture), it is unlikely that a real integration process can be completely successful (De Alemeida). Signed agreements remain as ink on paper without concrete progress in integration such as the dismantling of nationally created barriers (like Non-Tariff Barriers (NTBs)), which are mentioned in nearly every Mercosur trade agreement. Bilateral free trade agreements are perceived as agreements which respect the ideas of national sovereignty in the sense that there is no supranational authority deciding which trade areas require a national compromise.

Many experiments of economic integration in Latin America have not effectively attained the objective and formally written goals and statements of their respective treaties, beginning with, Latin American Free Trade Association (LAFTA 1960), the Andean Group (1969), Latin American Integration Association (ALADI 1980), Mercosur (1991), the Bolivarian Alliance of the Peoples of Our America (ALBA 2006), or the Union of South American Nations (UNASUR 2010). When leaders, groups or initiatives attempt to build "regional integration" in Latin America, the processes are directly controlled by the most powerful national bureaucracies driving their national interest. De Alemeida writes, if there was an enforcement of supranational rules over national bureaucracies, and against domestic economic constituencies, the perception of failure for these organizations would have come earlier, with a total lack of credibility being exposed to the outside world, rather than the actual course of the events which was a slow and gradual slump into a practical irrelevance (De Alemeida). Once a regional organization is in place, it takes time to detect the underlying fear or unwillingness to sacrifice a national interest for integration.

Brazil took the initiative by proposing a community of South American Nations (signed in December 2004), which was later replaced by UNASUR. In the documents describing the purposes of the organizations, there are no precise instruments or explicit objectives for economic integration, such as trade liberalization schemes, formal mechanisms for the reciprocal opening up of economies, or even schedules or time frames around which to manage the stated goal of "integrating" the member countries (De Alemeida). The proposals were inspired by ambiguous political descriptions and rhetoric embedded in presidential statements, which may be impracticable for the application or development of specific goals for the objective of integration. De Alemeida writes that the basic governmental nature of many of the proposed efforts, UNASUR, ALBA, means that most of the possible interfaces for integration are considered on a special basis in bilateral cooperation schemes.

In addition to concerns over loosing autonomy, there is a limited capacity for governments to fulfil their own commitments in the signed agreements, is also a factor endangering regional integration. In Brazil, former president Lula Da Silva's foreign policy priorities included installing a permanent chair in the UN security council, the expansion of Mercosur, and the conclusion of trade negotiations in the WTO- however, the guiding principle that had to be upheld at all costs was the defense of Brazil's national sovereignty. The president mentioned that Brazil, was 'too submissive' to the compromises required by foreign powers, such as with the US and the IMF. The first endeavor was the defeat of the Free Trade Agreement of the Americas (FTAA), which was understood as an annexation of Brazil to the powers of the North. The underlying hinderance was the fear that "external powers" would be too controlling of some sectors, or entire areas, of Brazil. During this time, Mercosur was considered too commercial, and new "social" and "political" bodies were developed. A social institute, and a parliament was put in place (which deviated from the Asuncion Treaty) as a way of compensating for the lack of progress in the reciprocal opening up of economies to trade liberalization. The initial goals for the agreements were well intentioned, comprehensive, but also impracticable.

In sum, some of the failures of the integration process include adhering to a constructed concept of national sovereignty and as such a lack of commitment to remove important barriers to integration, the lack of an undisputed leader and paymaster which seeks closer ties and coordination within the region, the rejection of any kind of supranational institutions or processes for managing policy harmonization between members, comprehensive and impractical agreements, issues with the domestic enforcement of decisions made in diplomatic conferences, and issues with the application of deadlines.

Decentered Multipolarity

A model which can explain further why states are moving away from deepening regional integration is the Decentered Multipolarity Model. The model renders cognizable how Mercosur's supply and demand incentives for regional integration have run aground. As new powers emerge in different regions of the world, they develop a capacity or will to project economic power. This projection occurs with varying levels of intensity, depending on their capabilities, onto one or more world regions (Garzón 106-107). Through global power projection, political and economic linkages are created through cooperation and exchange. In Decentered Multipolarity, "these linkages transcend the region in all directions in which significant extra-regional power concentrations tune in to regional actors in ever-shifting issue areas of cooperation and exchange" (Garzón 106). All states can participate in global power projection to varying degrees, it is a function of economic resources and also political will. Smaller states do also engage in projections of power, while they also experience influences from other regions, which they can either welcome or adapt to.

The incentives for small states to form new relationships with extra-regional actors, rather than their intra-regional partners, is that these partnerships "minimize political costs while accessing the external resources they need- such as markets, investments, and aid" (Garzón 106). For these reasons, the presence of the conditions of Decentered Multipolarity renders arduous the prospect of persuading a state that is incurring the costs of regional integration, to sacrifice a degree of political autonomy to supranational agents. Political leaders choose not to deepen integration if they value political autonomy. Political autonomy is seen as an absence of interference by supranational agents.

In contrast to the theory that multipolarity strengthens the trend toward a more regionalized international order, Garzón argues that, "the emergence of a multipolarity may generate powerful centrifugal forces within regions, which would have adverse effects on well-known forms of complex economic regionalism that diverse regional groupings have been implementing so far" (Garzón 101). The theory could explain the forces operating on Mercosur countries, and the adverse effects undermining the incentives for integration through regional organizations. Garzón writes, 'the policies of established extra regional powers towards the region and the entrance of new (rising) powers into the regional scene have proved decisive in the de facto disruption of basic commitments supposed to sustain a strategy of open regionalism by giving individual states strong incentives to renege on the rules of cooperation in place since the 1990s- namely the collective negotiation of trade agreements and the coordination of a common external tariff" (Garzón 123). These two Mercosur policies, the Common External Tariff (CET) and trade agreements areas are evaluated further in this study with empirical and analytical data, as indicators which could show the reneging on the rules of cooperation.

Regional organizations create a socio-political, economic, and geographic filter for extra-regional power projection. These defined regions can serve as a filter for diminishing the power being projected onto them, however according to Garzón, "distance is the weakest insulator of the two as most of the instruments of foreign policy enjoyed for power projection, especially economic and diplomatic statecraft, easily surmount large distances" (Garzón). This has implications for the foreign policy behavior of both the larger and smaller states within

Mercosur. When power projection occurs, states are influenced by the possible benefits of working with extra-regional actors, even though they might not be the largest economies of the world. An example of this power projection is the way Brazil decided to direct more than half of its technical cooperation resources to Africa (Stolte 2012). Brazil's economy is emerging and yet it can project significant economic power to distant regions and impact other societies overseas. Under conditions of Multipolarity, smaller regional states may also prefer the relatively low political costs of cooperating and exchanging with distant powers over closely engaging with the neighboring regional (great) power (Garzón 117). Uruguay and Paraguay in very recent years have shown this preference for cooperation and exchange with distant powers through the singing of the TIFA agreements and other trade agreements.

The availability of extra-regional partners with extra-regional interests, "alters the cost-benefit calculations informing the strategies that smaller states usually follow in order to attain key foreign policy goals" (Garzón 109). This disincentivizes policy movement towards integration. Smaller states foreign policy behavior becomes, "a constant search for an acceptable point of equilibrium or trade-off between the often mutually exclusive goals of accessing external resources while maintaining political autonomy" (Garzón 110). For states, the tradeoff becomes a focus on their region, or a forfeiture of potential economic linkages which fulfil their national interest. The sub-regional market is still crucial for many industries in Mercosur and there are industries that are not prepared for an expansion of extra-regional trade. Argentina, Paraguay, and Uruguay do still benefit from the regional association, but in the past decade, extra-regional trade has grown and establishing these linkages is proving more beneficial to national interests.

Brazil as a regional leader could entice smaller states to work more exclusively with actors in the region, but the reality is that Brazil even as the larger state, cannot drive away the influence from extra-regional actors for the smaller states in the bloc. If there was an external power such as the US or China willing to assist Paraguay or Uruguay to leave Mercosur, Brazil would likely not inhibit this bid, as Brazil's current politics are leaning toward ignoring the Mercosur policies established prior to this decade. Brazil, the state with the largest GDP in Mercosur, is greatly affected by extra-regional actor influence. In 2019, because of the result of the election in Argentina, which came out in favor of a left-wing candidate, the right-wing president of Brazil (Bolsonaro), has threatened to leave Mercosur[26]. Politically, Mercosur is ridiculed by Brazilian entrepreneurs and some important political leaders as a 'vanishing bloc' that only impedes Brazil's integration into the world. This does not help efforts toward integration.

Regiopolarity

Deepening integration with Mercosur was more successful during the first decade, 1990-2000s, perhaps because the conditions of Regiopolarity were more present in the region. Regiopolarity assumes that, "major powers cannot or choose not to project economic power to distant regions, smaller regional states could not easily establish significant economic linkages with extra-regional powers, leaving them with no choice but to seek economic integration with their local regional power" (Garzón 115). During the first decade, because smaller states could not as easily sign bilateral trade agreements, there was more incentive to engage in regional problem solving and to find regional solutions to problems. Garzón writes, "contrary to decentered multipolarity, Regiopolarity may positively affect the values of the condition

[26] (Lopez)

variables that make a strategy of supranational regional integration more likely to succeed" (Garzón 115). During the first decade of Mercosur, there was less pressure from external powers, and more time for intra-regional states to coordinate on regional issues.

The existence of Regiopolarity positively affects Mattli's supply conditions for integration, which are the conditions under which political leaders are willing and able to accommodate demands for functional integration (Mattli 50). In Regiopolarity, smaller states are more dependent on their intra-regional partners. Under conditions of Decentered Multipolarity, smaller states are functional within the region but adapt to or welcome the benefit from the extra-regional linkages. For example, if there were more harmonized regional policies in Mercosur, such as a common Mercosur policy for Bilateral Investment Treaties (BIT), or a regional distribution mechanism for tariffs, there would be more dependence on intra-regional partners and the conditions of Regiopolarity would be more present. States have singed individual BITs, a form of an individualized agreement toward extra-regional actors, and this is more representative of the conditions of Decentered Multipolarity. In conditions of Decentered Multipolarity, leaders are less willing to work with regional partners do develop a collective solution and prefer to work with extra-regional partners.

Other factors involved in the development of a decline of the conditions of Regiopolarity is the growing presence of China in Latin America. In 2016, China published a framework document on its policy towards Latin America and the Caribbean where it expresses its desire to "explore the bilateral commercial potential" and specifically mentions the signing of free trade agreements (FTAs) with the countries of the region to achieve stable commercial relations (Koop). Phillips and Prieto write of this growing presence as a reason for the possible development of bilateral agreements in more recent years. It has impinged forcefully on the political economy of regionalism and heightened the imperative for countries to jump on the bilateral bandwagon[27]. As China emerges, Phillips and Prieto point to the tensions between the sub-regional, regional, and global dimensions of development strategies in the region. Referring to China, they indicate that:

> *"... It is of course the flimsiness of new regionalism in Latin America that explains why it is so easily supplanted: if the relationships featured the degree of complex interdependence and complex governance that characterize the EU, the effect would be rather different. However, because of the differing economic profiles, the emergence of China means different things for different economies... Consequently, the capacity for collective response is limited..." (Phillips and Prieto 124).*

China and other actors have become interested in Latin America's resources, provided FDI, developed infrastructure, and/or provided services such as banking within the region. While this occurs, the perspective of US strategy also changes. The potential of US bilateral trade agreements is considered, and this has emerged through the development of the TIFA agreements this past decade. The emergence of China in the region buttresses the propensity for a breaking down of Mercosur by creating competition for the development of bilateral trade agreements. As Phillips and Prieto write, "China is a crucial part of the picture and a reason for the eagerness of Latin American countries to also sign trade agreements with the US, that are widely recognized to be so manifestly at odds with their developmental interests" (Phillips and Prieto 125). Phillips and Prieto address the complex interdependence and complex governance that characterize the EU, versus the shallower forms of integration that are present in Mercosur. Because of the lack of complex governance, the approach of each Mercosur country toward

[27] (Phillips and Prieto 125).

China is different, and the region has yet to develop a collective response to its growing presence.

When considering the two theories mentioned above it is more likely that all states are currently experiencing the forces described by Decentered Multipolarity. The Decentered Multipolarity model (Garzón) captures much of the dynamics and incentives of the growing extra-regional focus in the Mercosur region. The model explains how the pattern of behavior of states projecting power extra-regionally alters the cost benefit calculations that inform foreign policy strategies of states. It emphasizes the centrifugal forces occurring within regions when states pursue trade with extra regional partners, reducing the likelihood to incur the political costs of integration with neighbors. Trade data is provided in the following section in order to further support this hypothesis.

IV. Operationalization of the Variables and Validation

Mercosur is undergoing a process of redefinition[28], as it does not seem to meet the supply and demand conditions mentioned in regionalism theory for successful supranational integration. Measurable evidence is provided in the following sections, which can further illustrate how the incentives for regional integration have changed, especially within the past decade.

Supply and Demand Conditions

According to Andrade et al. there are two indicators for economic integration. They write, "Economic integration is frequently measured by the shares of bilateral trade between the respective countries and, in particular, by the shares of intra-industry trade in total bilateral trade." These are both analyzed in this study. The share of bilateral trade, inter-regional vs extra-regional, is a condition which has the possibility of impacting the supply conditions in this study.

[28] (Phillips, The Rise and Fall of Open Regionalism? Comparative Reflections on Regional Governance in the Southern Cone of Latin America.)

The share of intra-industry trade is considered an additional indicator of economic integration. Data for these two indicators is presented for the Mercosur countries from 1991-2018. The visual representation of inter-regional vs extra-regional data can provide one story of Mercosur as a sub-regional bloc and identifies when the leveling of the hemispheric playing field[29] began occurring. This is when extra-regional trade became more economically important than intra-regional trade. The graphs bring new evidence of the greater commercial dependence of the Mercosur countries with the rest of the world and can show when the cost benefit calculations for Mercosur countries have shifted away from an inter-regional focus. The data is from the UN Comtrade database and includes the imports and exports on 'All Commodities Total Trade Value (US$)' for each Mercosur country.

The Grubel Lloyd index (1971) can be used to measure the share of intra-industry trade in total bilateral trade which is the second indicator of economic integration described by Andrade et al. According to Andrade et al, "An increasing share of intra-industry trade signals progress in the process of economic integration in the sense that the underlying structures of production in the respective economies become more similar to each other". For example, the index could show a current trend in the productive processes in each country that differs from beginning years of Mercosur. The share of intra-industry trade is calculated for 99 industry categories.

The Grubel Lloyd index can be calculated at different aggregate levels, measuring entire industries, or specific products within different industries. For example, one aggregate level could be a measure of intra-industry trade between an indicator of 'all vehicles', which includes cars and motorcycles which will provide one level of analysis. A more finite level of aggregation

[29] (Phillips 223).

would be the measurement between specific kinds of vehicles: cars, vs, motorcycles, vs trucks, etc. This involves calculations for each commodity, for each country, and year of Mercosur. The World Integrated Trade Solution (WITS), the World Bank, and the UN Comtrade database were searched for total trade by industry for the four Mercosur countries from 1990-2019. The database providing the most comprehensive trade data at differing industry aggregate levels was the UN Comtrade database. 99 Industries are available to select in a dropdown variable on the UN Comtrade website. Therefore, for this study, data describing 99 industry categories are calculated for each country to establish a measurement of intra-industry trade with the region. At this level of aggregation, there are some observable differences in the share of intra-industry trade during the duration of Mercosur. For further research, a more comprehensive analysis at another level of aggregation could include 1000 commodities.

The graphs representing the demand conditions, and an analysis of the supply conditions from key Mercosur policy areas, can describe how the incentives for integration have changed through the years of Mercosur. Cases of cessions of sovereignty to regional institutions, including the creation of new institutions, or compliance with resolutions, etc. is also evaluated. The two major policy areas that Mercosur countries have shown an interest in rejecting or improving are listed in Table 8 below. These are the bedrock policy areas of Mercosur to be analyzed.

Table 8: Supply and Demand Conditions Evaluated.	
Demand Conditions	
	Intra-regional trade vs. Extra-regional trade (imports and exports).
	The share of intra-industry trade vs. Inter-industry trade. Measured by the Grubel Lloyd Index.
Supply Conditions	

	The Customs Union, the Common External Tariff (CET) and Intra-Regional Tariff
	Mercosur CMC Decision 54/04: Elimination of the Double Collection of the CET and Distribution of Customs Income
	Mercosur CMC Decision 03/94: Non-Tariff Restrictions
	Mercosur CMC Decision 32/2000: External Relationship

Table 8: Supply and Demand Conditions Evaluated

Demand Conditions

To understand how the separate integration incentives have changed over time in the Mercosur region, this section analyzes the potential gains of market exchange with the region. The trade data for each Mercosur country as conceived and articulated over the 1990s, show a progressive withdrawal from the traditional regional partners, as countries seek external relationships with more advanced markets. This can produce commercial and financial losses in the Mercosur countries in the sectors where foreign competition has entered the market. The extra-regional vs intra-regional trade graphs throughout the years of Mercosur illustrate the growing importance and role of extra-regional trade for the coming decades. The graphs also show that for all countries, intra-regional trade has remained at nearly the same levels since the beginning of Mercosur, with just a slight increase. The graphs show how the conditions of Decentered Multipolarity are present, as smaller states are benefitting from the extra-regional linkages, rather than the conditions of Regiopolarity, when states are more dependent on their intra-regional partners.

Extra-Regional vs. Intra-Regional Trade

Argentina

During the nearly 30 years of Mercosur, Argentina's experience has been defined by the years of Menem and the influence of the Washington Consensus from 1991-1999, the economic crisis in 1998-2002, the Peronist leadership during the Pink Tide years from 2002-2015 which defended the proliferation of Mercosur, and a recession beginning in 2017. The figures below show the progression of intra-regional vs. extra-regional trade for Argentina on imports and exports throughout the nearly thirty years of Mercosur.

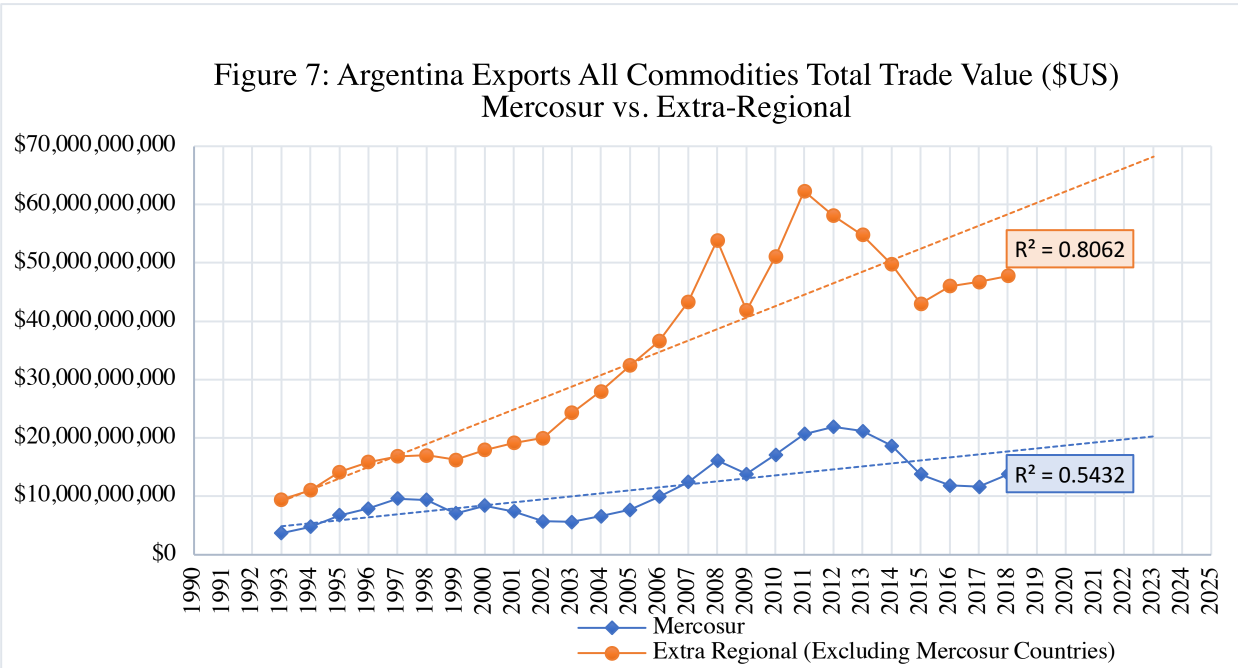


Figure 7: Argentina Exports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

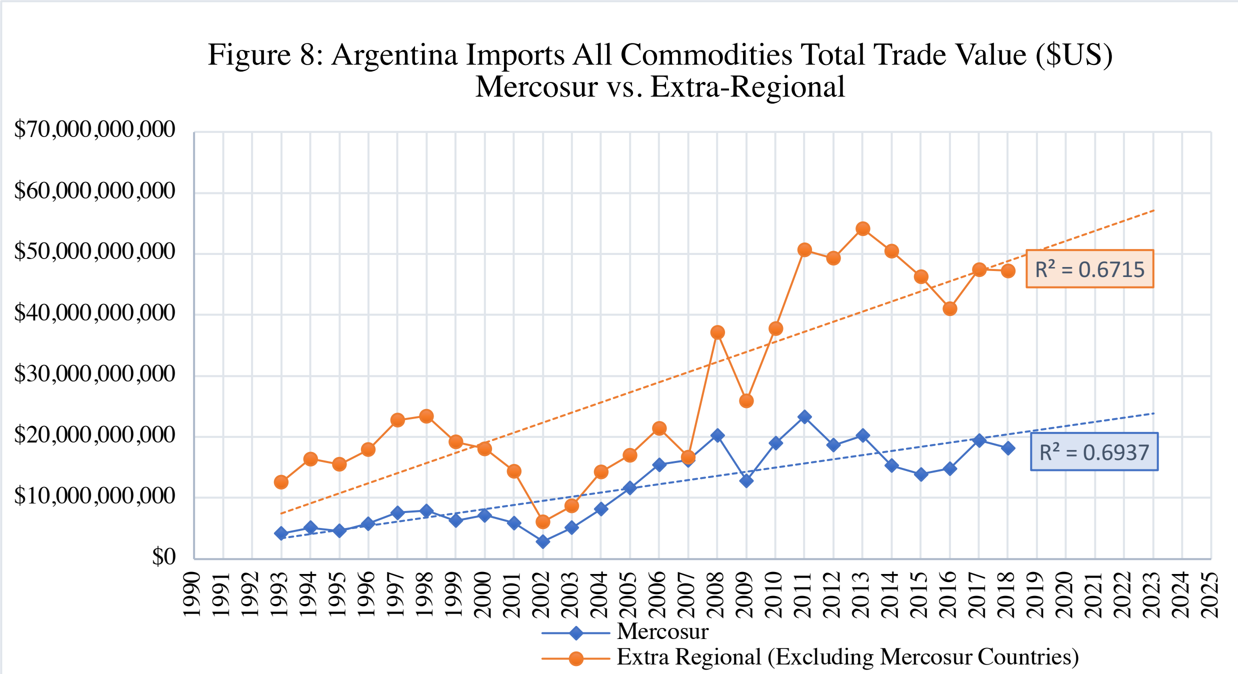


Figure 8: Argentina Imports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

The period of the Argentine crisis from 1998-2002 can be observed by a steady decline in imports in the figure above. There was a significant decline in extra-regional imports as the Argentine currency devalued. The economic recession from 1998-2002 re-opened the debate of implementing national tariffs and trade policies over the costs of integration. Thus, the recession slowed down the Mercosur integration process. There was a decline in intra-regional investment and trade as investors sought alternatives. Brazilian exports to Argentina fell by more than 60% in 2002 (Carranza 326). These occurrences are a possibility for Argentina in the coming years. The 2001 crisis in Argentina negatively affected the economies of the other Mercosur countries, but politically there was a positive impact as the crisis strengthened political solidarity among members[30]. The presidents of Brazil, Paraguay, and Uruguay (also Bolivia and Chile) united and

[30] (Carranza 326).

rallied the international financial institutions to provide the financial aid and fund the recovery program designed by the Duhalde government in 2002. After the crisis in 2002, the ideas of the Washington Consensus were discredited in the region (Carranza 327). The Argentine devaluation eliminated the trade conflicts between Argentina and Brazil, and there was political will to move toward developing a common currency. Figure 8 shows that after the year 2002, there was a significant increase in the amount of extra-regional imports. Intra-regional trade has increased slightly during the thirty years of Mercosur.

Figure 7 shows that the highest level of extra-regional exports was achieved in 2011, and this number has been on the decline since that time. The highest level of intra-regional exports occurred in 2012. From 2003-2015 intra-regional exports was the most successful within Mercosur. During the presidency of Nestor Kirchner (2003-2007) and Cristina Fernandez Kirchner (2008-2015), there was a corresponding period of a stable increase of intra-regional trade, and imports and exports within Mercosur reached their highest ever levels. Intra-regional trade was likely aided by the united political will of the Pink Tide in all Mercosur countries. Then in 2015, there was a decline in intra-regional exports, and an increase in extra-regional exports, coinciding with presidential changes. This is indicative of the effects of the recession, beginning in 2017 and likely continuing on through 2021.

Brazil

In the beginning years of Mercosur, Brazil implemented a series of price stabilization plans which resulted in very high inflation. Through the implementation of the 'Real Plan' in 1993, Brazil was able to curb inflation and correct its large federal deficit. In 1994 Brazil decided to peg its currency to the dollar and follow a monetary policy parallel to that of the United States. The differences between Brazils inflation rate, and the inflation rate in the US caused stress on

Brazil's currency system, and Brazil instead decided to implement a crawling peg system. This effort and the effort to curb inflation was successful and resulted in no inflation by 1998. Investors involved in the financial crisis in Asia and Russia in 1998 also choose to pull their investments out of Brazil. In 1999, Brazil was the eighth largest economy in the world and devalued its currency which initiated the first financial crisis. There was a decline in intra-regional investment and trade, and Brazilian imports from Argentina fell by about 26% (Carranza 326). The figure below shows that it was in 1999 that Brazilian exports began a steady upward increase. After this crisis, from 2003-2014, there was a significant decline in poverty, and the Gini coefficient dropped 6.6% during that time. The income level of the poor also increased during this time. Since 2015, this progress has become rather stagnant. Figure 10 shows that there was a steady increase in imports beginning in 2004, which is indicative of a rising consumer base.

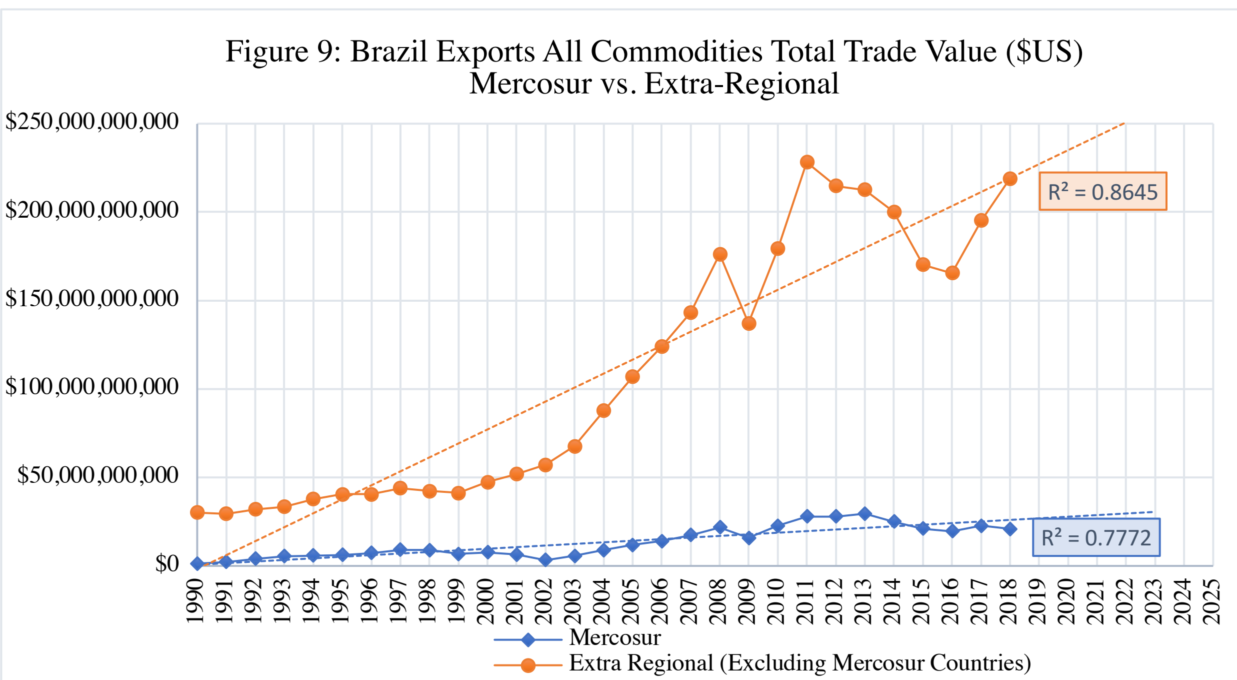


Figure 9: Brazil Exports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

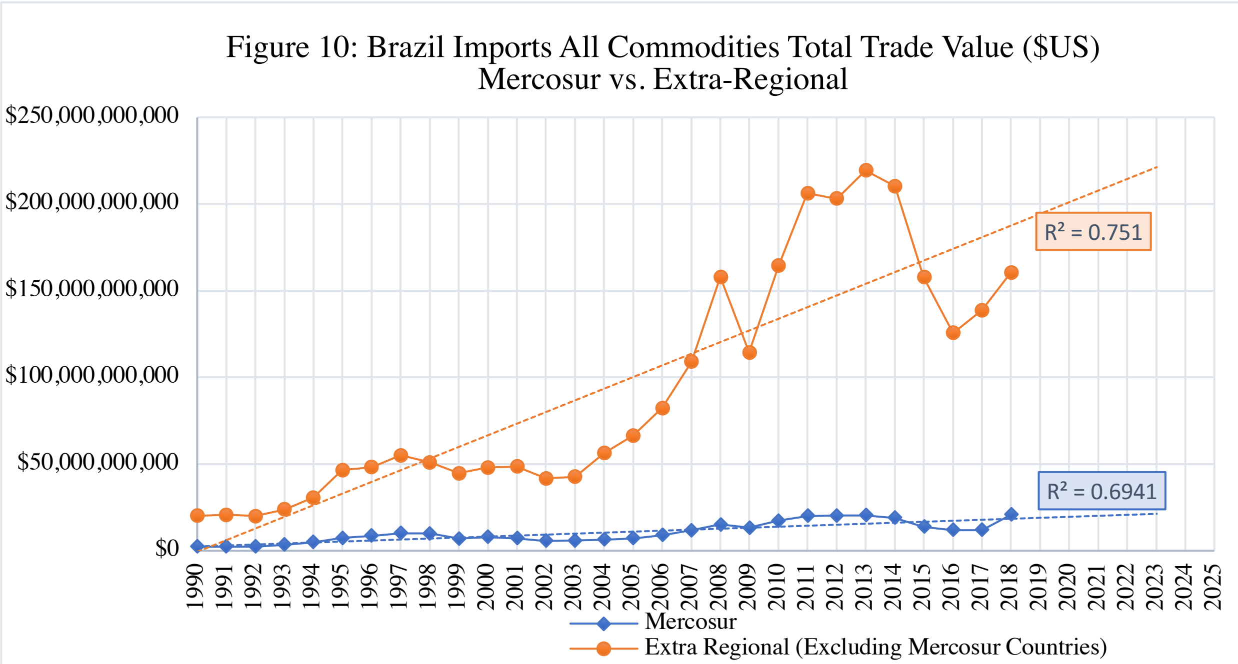


Figure 10: Brazil Imports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

In 2014, an economic crisis and political crisis emerged which resulted in the impeachment of president Dilma Rousseff. The unemployment rate was 6.7% in 2014 and began to rise to its highest recorded level, 11.6%[31] in 2016. Figure 14 shows how this reflects as a significant drop in imports from 2011-2016. From 2013-2015, Brazils GDP growth rate fell from 3% to -3%[32]. In 2015, Brazils GDP fell from 3.5%, and in 2016 it fell by another 3.3%. As productivity fell it damaged government revenues. Then there was a significant drop in imports

31 (World Bank Data: Jobs Modeled ILO Estimate)
32 (World Bank National Accounts Data: GDP Growth (Annual %) Brazil)

from 2014-2016, which is indicative of economic crisis. The economic crisis lasted until 2017. In 2018, Brazil’s economy has recovered and expressed a GDP growth rate of 1.2%[33]

Figures 9 and 10 show the great difference in levels of intra-regional vs extra-regional trade. The levels of intra-regional trade for Brazilian exports and imports has remained nearly the same for all years of Mercosur, despite the years of crisis. The distance between the intra-regional trade and extra-regional trade is indicative of the growing importance of Brazils relationship with extra-regional actors. There is more incentive for Brazil to maintain strong trade relationships with extra-regional actors, and much less incentive to improve inter-regional trade as this level has not increased significantly. Brazil has an extensive amount of Non-Tariff Measures (NTMs), more than any other Mercosur country, which increases the costs of intra-regional trade. If Brazil could reduce its NTMs, it could improve the importance of intra-regional trade for Brazil. In general, Brazil’s trade-to-GDP ratio remains among the very lowest in the world, but has slowly increased from 12 to 20 percent over the last 25 years (United Nations).

Paraguay

Paraguay is a landlocked country with a relatively large agricultural and industrial sector which is highly dependent on merchandise trade. Paraguay was interested in joining Mercosur in part to ensure its continuous access to its most important trading partners. Argentina, Brazil and Uruguay as members would reduce their duties on exports from Paraguay. In 1990, Mercosur was the recipient of over 70% of Paraguay’s total exports and the source of 29% of its imports (Cortes 7). Prior to Mercosur, Paraguay had the most protective trade regime among Mercosur countries (Cortes 5). Before Mercosur, unreported trade represented about 58% of exports and 31% of imports (Cortes 7). In an effort to reduce smuggling, Paraguay implemented a 7%

[33] (World Bank National Accounts Data: GDP Growth (Annual %) Brazil)

tourism tariff, and tariffs on imports from the neighboring countries prior to joining. Upon joining Mercosur, Paraguay was able to reduce tariffs more than any other Mercosur country. Paraguay faced the challenge of participating in Mercosur with its larger neighbors, significantly reducing its Non-Tariff Barriers (NTBs) and maintaining the lowest tariff structure out of any other Mercosur country. As Paraguay is a landlocked country in Mercosur, reducing NTBs, and keeping tariffs low is especially important. According to current Mercosur procedures, for any good imported into landlocked Paraguay via any other Mercosur country, the Common External Tariff (CET) on that good is effectively doubled. Paraguay's applied import tariffs tend to be much lower than the CET, ranging from zero to 30 percent, with an average applied tariff rate of 10.1 percent. Paraguay is permitted to maintain a list of 649 exceptions to the CET until December 31, 2019. [34] This ruling could be extended into 2020.

Figures 11 and 12 below show Paraguay exports and imports. Out of the four Mercosur countries included in this study, we can see how closely Paraguay exports are very dependent on the region in comparison to the exports demanded from extra-regional actors. Of all the Mercosur countries, Paraguay is the most dependent on intra-regional trade. Figure 11 shows how intra-regional exports, and extra-regional exports have been alternating in financial importance for the duration of all years of Mercosur. Paraguay is the only country that currently experiences a higher share of intra-regional exports than extra-regional. Paraguay's exports are more dependent on regional demand, than from the extra-regional demand for its goods. From 1999-2009, there was more regional demand for Paraguay's exports, than extra-regional. From 2009-2017, extra-regional demand exceeded inter-regional demand. Then in 2018, regional

[34] (United States International Trade Administration)

demand for Paraguay's exports was more than the extra-regional demand. Figure 12 shows that it was not until 2005, that extra-regional imports overcame the levels of regional imports.

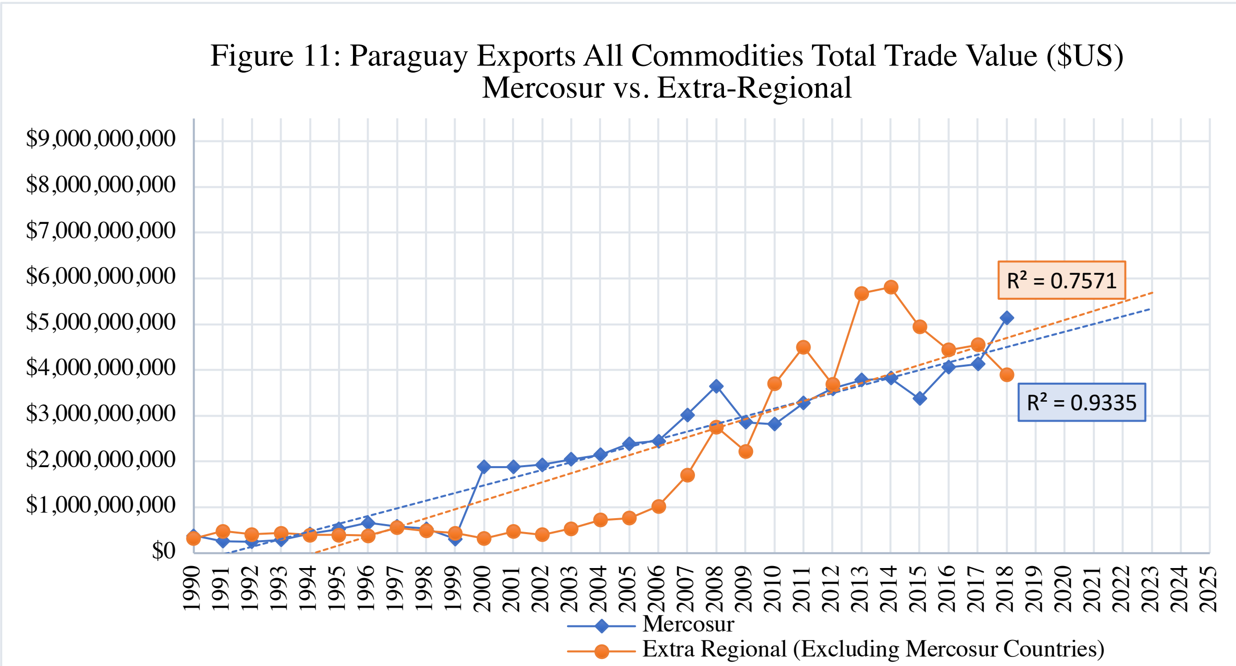


Figure 11: Paraguay Exports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

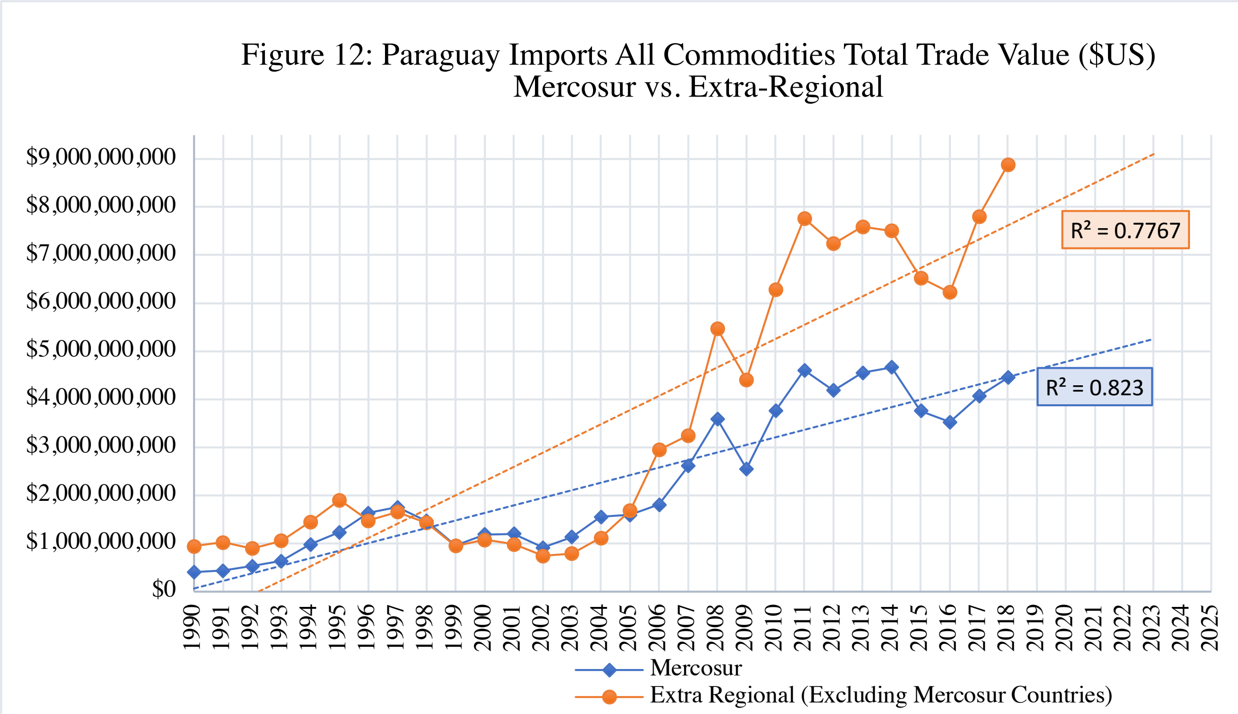


Figure 12: Paraguay Imports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

Uruguay

In 1990, with high inflation levels, Uruguay implemented wide sweeping structural adjustment policies which resulted in the almost closing of the very large leather, metallurgical and textile industries, in addition to a closing of the sectors serving the domestic market. Just a few years later, the industrial sector that was developed during the period of import substitution, was dismantled. As a result of these changes, unemployment reached a peak of 11.9 percent in 1996 and did not begin to decline until 1998. Uruguay was successful in reducing inflation levels from 12.3 percent in 1998, to 4.3 percent in 1999. In the 1990s, the trade to-GDP ratio fell slowly to under 30 percent, but then rose to 40 and 50 percent in the 2000s following currency devaluations.

Shortly after gaining some positive ground, the crisis in Uruguay exploded; affected by the 1998 Brazilian and 2000 Argentine crisis, Uruguay lacked the resources to stop another downward trend. In 2002, the central bank lost 75 percent of the country's reserves, and unemployment reached its highest ever recorded level at 16.9 percent and remained at this level until a decline to 12.9 percent in 2004. There is no data available on the poverty level in Uruguay during these years, however there are accounts of full soup kitchens and groups of poor raiding supermarkets. Uruguay had very low FDI inflows until the year 2003, when the IMF approved a loan of $1.5 billion to address the crisis. In figure 13 we can see that all imports declined until 2002, and then began a slow increase only after this year.

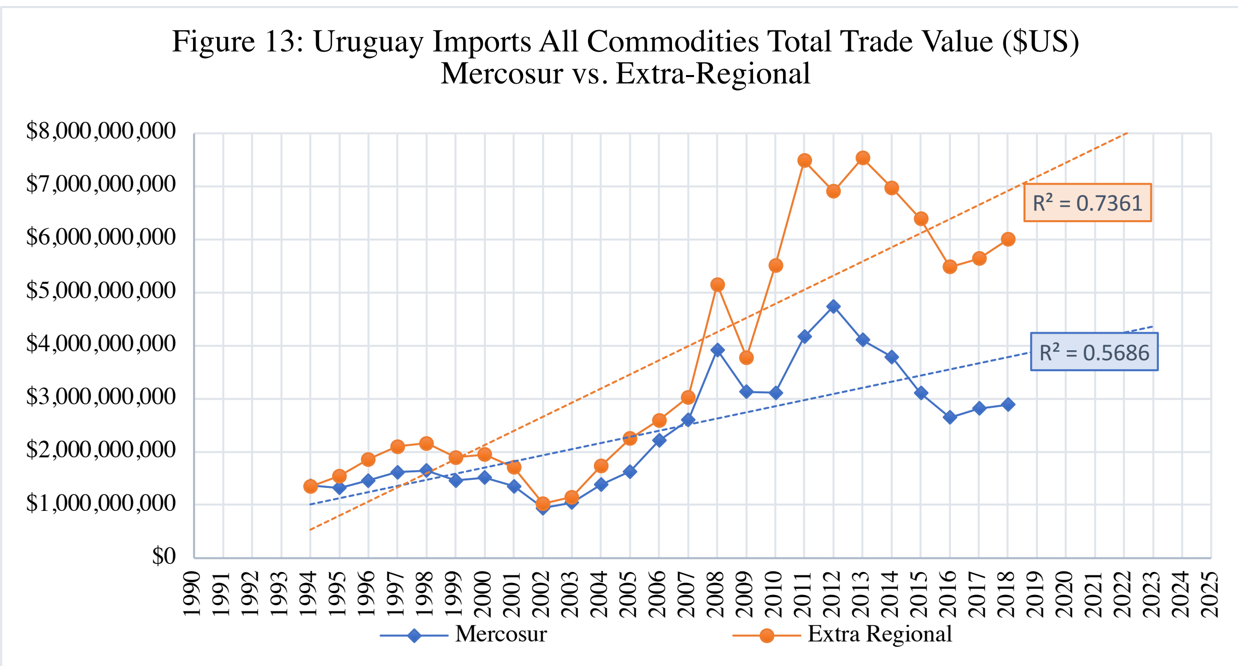


Figure 13: Uruguay Imports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

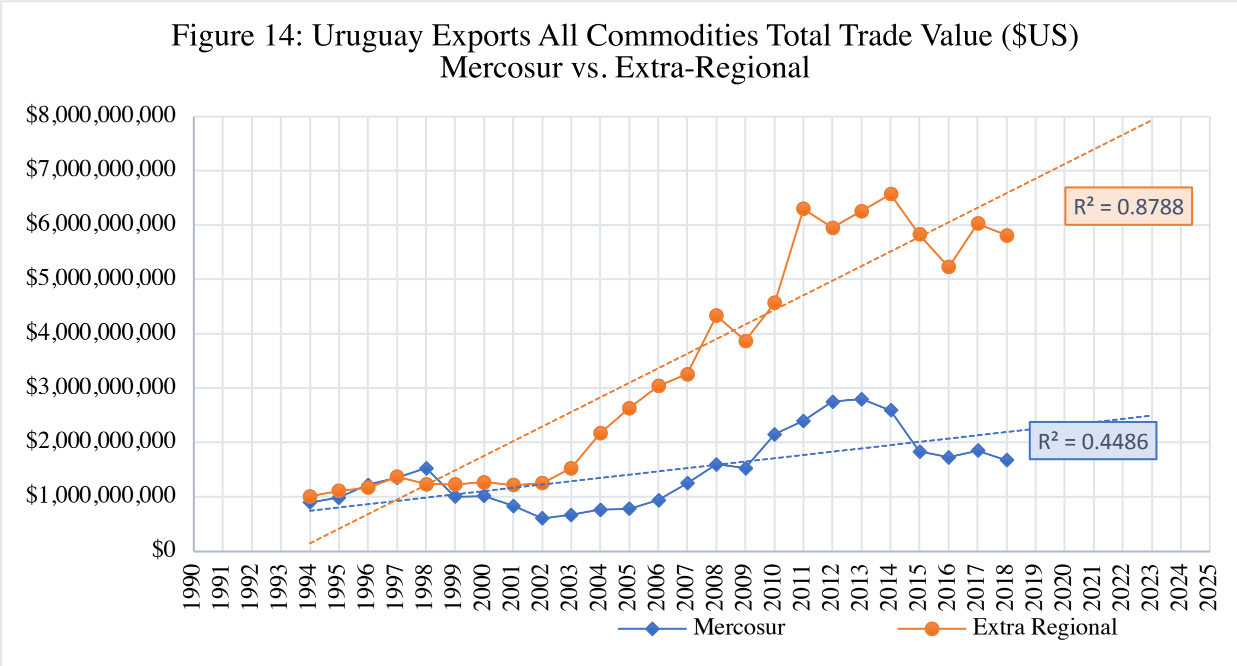


Figure 14: Uruguay Exports All Commodities ($US) Mercosur vs. Extra-Regional.

Data from UN Comtrade Database. Extra-regional vs. Intra-regional data based on authors calculation. Venezuela included 2012-2016, Paraguay suspended 2012-2013 (data included in Mercosur calculation).

Figure 14 shows that in the year 1999, extra-regional exports in Uruguay surpassed inter-regional trade. It can also be observed that since the year 2002, there has been a steady increase in the demand for imports from both extra-regional and inter-regional partners. Uruguay has had a substantial trade balance deficit over the last decades. From the highest deficit of 10 percent relative to GDP in 2008, the economy recovered to a deficit equivalent to less than 3 percent of GDP in 2014 (United Nations).

Together, figures 7-14 show that extra-regional trade has risen significantly over intra-regional trade since the years that Mercosur began, which poses new challenges for the regional project. Inter-regional gains in trade have less importance now more than ever for Mercosur countries. The graphs show that the conditions of Regiopolarity are not as present now, as during the beginning years of Mercosur. There is more pull for establishing agreements with extra-regional actors, which is less conducive for integration. For Argentina, Brazil, and Uruguay, exports are more dependent on extra-regional ties. Therefore, the conditions of the measurable demand condition do not signal progress for regional integration.

The Share of Intra-Industry Trade

The second indicator Andrade et al. mentions in the literature as a measure of integration is the share of intra-industry trade. An increasing share of intra-industry trade signals progress in the process of economic integration for the region because the underlying structures of production in the economies become more similar to each other (Andrade, Falcao Silvia and Trautwein 2005). As an example, similar economies, such as Germany and the UK can specialize in and exchange similar products, such as different brands of motorcycles. If there is intra-industry trade in a region, it is a positive indicator for higher levels of inter-regional trade. High intra-industry trade in a region can result in the facilitation of developing common regulatory schemes for similar commodity categories. When factors of production are more similar in a region, there are efficiency gains, specialization, and exchanges of labor. There is an economic benefit of having workers with fairly similar skills specializing in production, in a region because they can focus on particular parts of the value chain, creating intermediary products with higher value, for the region such as parts to a larger machine. For these reasons, a calculation of intra-industry trade with a country and the region, is an indicator for the possibility of deepening economic integration.

One method of measuring the share of intra-industry trade in total bilateral trade is with the Grubel Lloyd Index. The GL-index has values between 0 and 1. For example, if a country imports exactly as much of a good as it exports, then it's GL-Index for that commodity would be 1, meaning all trade for that commodity is intra-industry trade. If a country only imports a good, for example, computers, then the GL index for that commodity is equal to 0, meaning trade is inter-industry for the commodity. Countries with similar relative amounts of factors of production are predicted to have intra-industry trade, score 1; and those with different relative amounts of factors of production are predicted to have inter-industry trade, score 0. The GL-index is calculated in this study based on bilateral trade flows from one country to the sum of the bilateral trade flows of the other countries in the region to identify the share of intra-industry trade with the region. Thus, for any particular commodity i, an index of the extent of intra-industry trade in the commodity i between the reporting country X and the region R, is given by the following ratio:

$$C_{i\,XR} = 1 - \sum_{i} \left(\frac{|Ex_i - Im_i|}{Ex_i + I_{mi}} \right)$$

Where Ex_i is Exports to the region, Im_i is imports from the region and i is the particular commodity.

There is a degree of caution when comparing intra-industry results, as the measurement crucially depends on the detailed level of disaggregation that is chosen to be analyzed. The variable on the UN Comtrade database chosen for this study includes data at the 2-digit level, based on a sample of 99 commodities. The commodities falling under the category, "AG2-All 2-digit HS commodities" was used. As an example of the calculation, the figure below shows the Grubel Lloyd Index of one of these 99 commodities: 'Electrical, Electronic Equipment'. Figure 13 shows the index for the period 1993-2018, the years of Mercosur where data is available.

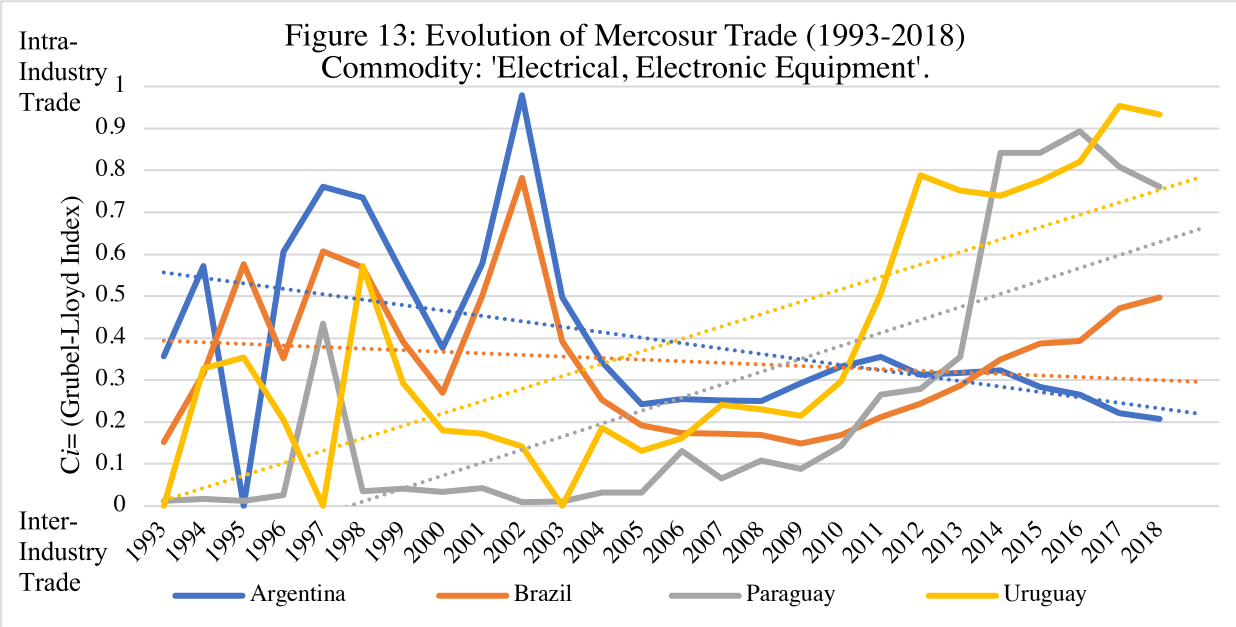
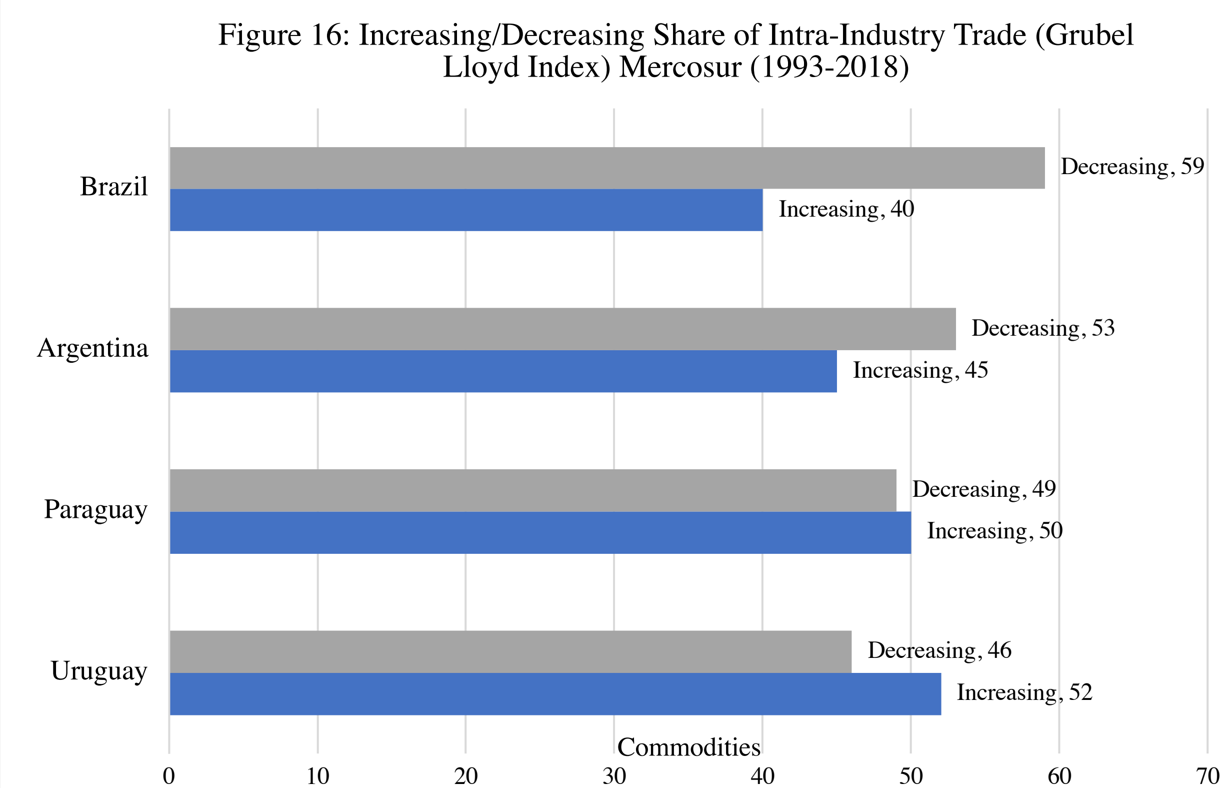


Figure 15: Evolution of Mercosur Trade (1993-2018) 'Electrical, Electronic Equipment'.

Data from UN Comtrade. Retrieved 02/28/2020.

Argentina has a peak in 2002, which means that it enjoyed a high intra-industry trade relationship with the region, for the commodity 'Electrical, Electronic Equipment'. Since that time, the commodity has become more inter-industry, meaning this commodity is either imported or exported from outside of the region. The figure shows how Uruguay and Paraguay in more recent years have a gradually increasing share of intra-industry trade with the region for this commodity, which signals progress in the process of economic integration with the Mercosur region. Conditions of intra-industry trade can suggest that there is an increasing variety of products between Uruguay and the region, and Paraguay and the region. Argentina and Brazil have a decreasing trend, which signals trade is becoming inter-industry, with diverging factors of production. A declining result could be due to, a declining discretionary income of the population that gives rise to a fall in demand for a greater variety of goods. Another explanation could be increased regional tariffs on the commodities studied.

The increasing or decreasing trend of intra-industry trade of the 99 commodities was observed. In the following figure, 59 commodities out of 99, in Brazil exhibited a decreasing trend of intra-industry trade scores over the years studied. In Argentina, 53 commodities out of 98 commodities exhibited a decreasing trend of intra-industry trade scores over the years studied. In Paraguay the results were neutral, with 49 commodities out of 99 commodities exhibiting a decreasing trend, and 50 commodities exhibiting an increasing trend. Uruguay is the only country where the majority of the commodities have an increasing trend of intra-industry trade, 52 exhibiting an increasing trend, out of the 98 studied. Figure 16 shows a summary of the 99 commodities studied and the results.



	Uruguay	Paraguay	Argentina	Brazil
Decreasing	46	49	53	59
Increasing	52	50	45	40

Figure 16: Share of Intra-Industry Trade (Grubel Lloyd Index) Mercosur (1993-2018).

Data from UN Comtrade. Retrieved 03/10/2020.

Intra-industry trade within the region can be improved if there could be an increase in the variety of products available from the other countries in the region. This could be aided by a lowering of non-tariff barriers, and inter-regional tariffs to reduce the prices of goods and services exchanged from within the region. These two actions could improve competition with the extra-regional goods. Additionally, attracting Foreign Direct Investment (FDI) and improving human capital and employment allows more countries to produce similar products and intermediate products. Uruguay has the highest number of commodities enjoying an increasing trend of intra-industry trade with the region out of the commodities sampled, and it also has the second highest levels of FDI for the region. The results for this indicator signify that Brazil and Argentina have the most declines in the conditions for economic integration, meaning they look elsewhere to have their trade needs met. While Uruguay has the conditions, which are the most favorable in the region for deepening economic integration. The results of this indicator suggest a declining condition for economic integration from the two larger economies in Mercosur, Argentina and Brazil.

Supply Conditions

This section analyzes the bedrock decisions which have formed Mercosur. This includes the policies created to form the Customs Union, adherence to the Common External Tariff (CET), other Intra-Regional Tariffs, and an increase in the creation of Non-Tariff Restrictions. In addition, due to the growing importance of extra-regional trade, the 'Mercosur CMC Decision 32/2000, is analyzed which concerns the how external relations should be managed for the Mercosur countries.

The Customs Union, the Common External Tariff (CET), and Intra-Regional Tariffs.

A method of beginning the process of regional integration is achieved through the creation of a free trade zone. The Treaty of Asunción signed in 1991, established the bases for creating a free trade area, the "Mercado Común del Sur", or Mercosur. The aim was to create a region which could benefit from the free movement of goods, services, capital, and people among its member states. The ultimate goal was to move a step closer to forming a common market. A common market is a group of countries imposing few or no trade duties on one another and implementing a common tariff on trade with other countries. The second major step in the integration process took place with the signing of the Protocol of Ouro Preto, on December 16, 1994. The protocol was created to define the economic policies for setting up the customs union and to define the institutional structure of Mercosur. The protocol indicated the formation of the following: The Council of the Common Market (CCM); The Common Market Group (CMG); The Mercosur Trade Commission (MTC); The Joint Parliamentary Commission (JPC); The Economic-Social Consultative Forum (ESCF); and the Mercosur Administrative Secretariat (MAS)[35]. Through these groups, the protocol provided the framework to transform Mercosur from a Free Trade Area to a customs union. The effort to create the customs union was intended to occur in mid-1994 with a period of conformation at the end of 2000, which was later extended until 2008. Then a rule was created that states that the customs union must be in force "no later" than January 1, 2019 (CMC Decision No. 10/2010) (Yoy 2018).

At the beginning of implementation there were three major concerns; the first was overcoming the challenge of defining a schedule for implementing the CET, the second was the asymmetrical economic experience of the countries and overcoming the macroeconomic

[35] (Protocol of Ouro Preto)

problems of the member countries, and the third was the difficulty of harmonizing policies and regulations between all countries (Cortes). Although the treaty was developed, and all parties agreed, there were many delays to implementation. According to the Treaty, by the "31 December 1994, all non-tariff restrictions shall be eliminated from the common market area" (Mercosur). Any change to the stipulated trade policies requires the consensus of the other members. All four countries were able to reduce tariffs and Non-Tariff Barriers (NTBs) during the first five years, but there were differences between each country's implementation. Argentina and Uruguay were able to reduce NTBs and the average tariff rate, while Brazil retained a higher tariff rate and kept national industries highly protected, especially the car and electronic industry (Cortes 5). This initiative was largely successful only after the year 2004, when it can be observed from the data in figures 17-20 below, the year that all inter-Mercosur tariffs had been reduced to zero.

The Common External Tariff (CET) was then established on January 1, 1995. This meant that all Mercosur members must follow a common external policy towards non-member countries. In this scenario, ideally, a good imported to Argentina would be charged a similar CET as a good imported to Brazil. The CET currently ranges from zero to 20 percent for most products. However, some products in the automotive sector can reach 35 percent. Although the CET is stipulated by the treaty of Asuncion, in practice, the CET varies widely in implementation from one county to another.

National Tariffs (NTs) vs. The Common External Tariff (CET)

National Interests were a concern during the signing of the treaty and during the negotiation process, and as such, each country has chosen varying paths of rejection of Common Market Council (CMC) decisions. Initially, the implementation of the CET did not include the entire range of products denoted in the protocol, and as a solution to the differences that arose during the negotiation process, countries began establishing their own exceptions for the CET,. National Tariffs (NTs) were created as a representation of the import needs of each country and were created in part by lobbying from domestic industries. The products each country 'temporarily exempts' on their own terms from the CET include goods which are considered high in need, such as information technology, equipment for agriculture, and capital goods. Countries can also apply a higher external tariff on higher-value-added imports[36]. These are goods that are more plentifully found within the Mercosur region and country. These separate exemptions that each country maintains to regulate national needs, and along with the number of special import regimes, have greatly eroded the bloc's CET. It then became the goal to converge National Tariffs (NTs) toward the levels of the CET within a time period mutually agreed upon by each Mercosur country. The economic crisis in Argentina and Brazil then created reasons for evading the commitments of moving the NTs to the levels of the CET. Countries coming out of economic crisis, also wished to continue to care for their productive sectors through the creation of NTs. The full implementation of the CET has been postponed on numerous occasions.

Brown and Tovar 2016, question the extent to which Argentina and Brazil really have formed a common external trade policy, given that each country implements a different tariff toward third countries independently from the other, resulting in substantial deviations from the CET (Bown and Tovar). They find that Argentina and Brazil were not applying the same external trade policy, because of national exemptions. Currently 3/4ths of the imports to the Mercosur region do not pay the official CET, a very large portion. For this reason, while Mercosur has made significant progress to becoming a customs union, it does not meet the

[36] (U.S. Commercial Service)

definitional requirement of a customs union, as the majority of the products within the region do not comply with the CET, and there are many national exemptions to the protocol that established the name "Mercado Común del Sur". The dynamic of national sovereignty, and commitments to domestic industries, as a factor inhibiting economic integration is visible in even the key policy areas defining Mercosur's existence.

One way to view CET rates for all countries of Mercosur is through the Most Favored Nation (MFN) data and the effectively applied tariff data; both variables are available on several databases. The MFN is the tariff rate added to the price of a good when the good originates from outside of the Mercosur bloc. The intra-regional tariff is the 'effectively applied tariff' indicator provided by the World Integrated Trade Solution (WITS). The effectively applied tariff is defined as the lowest available tariff. When a good is exported from one country to another, if a preferential tariff exists such as a customs union, it will be applied and observed through the effectively applied tariff. Otherwise, the MFN tariff will be used. The below figures show the evolution of intra-regional Mercosur tariffs, versus the external MFN tariffs on imports, to further describe the ideas mentioned in the paragraphs above. The graphs are helpful for understanding how a preferential trading area was created, the years it took to establish it, and provides a visual representation of the extra-regional vs inter-regional tariffs on imports. In the graphs below, MFN tariffs are normally applied to goods that originate from outside of Mercosur (extra-regional), and the effectively applied tariff shows the rate for goods originating from the other Mercosur countries (inter-regional).

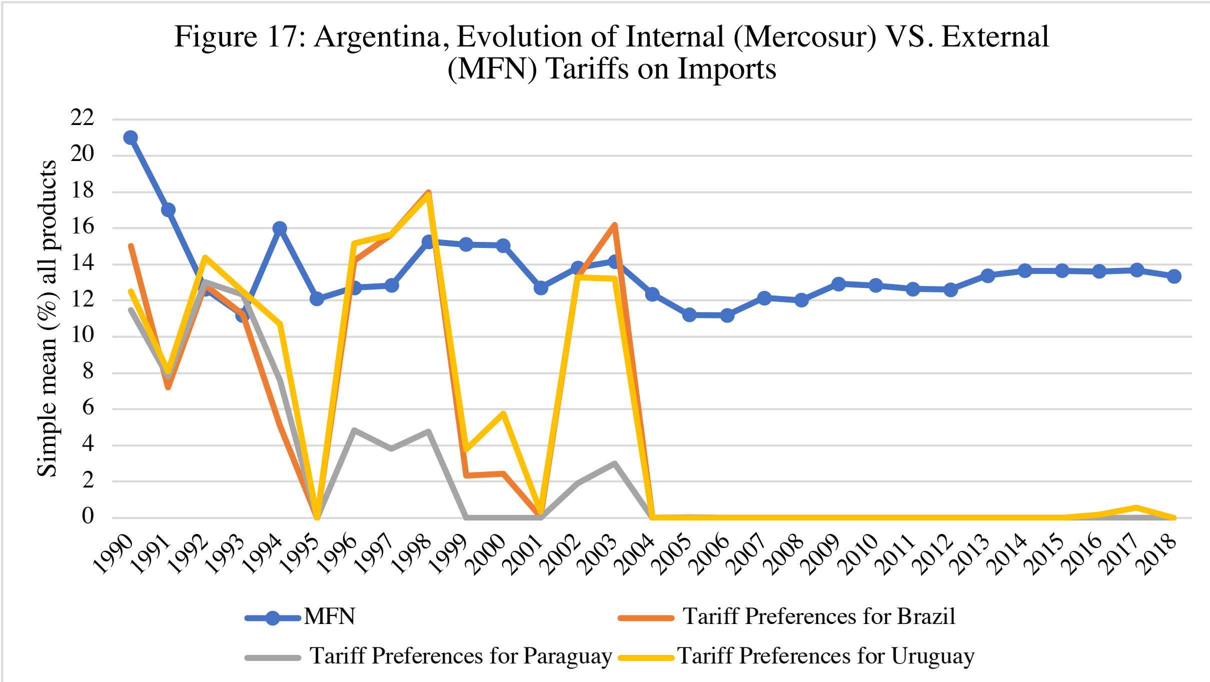


Figure 17 Argentina, Internal (Mercosur) vs. External (MFN) Tariffs on Imports.

Argentina MFN data (1990, 1991, 1994) from, Chad P. Brown and Patricia Tovar October 2016, (1992-1993) MFN data from World Bank Development Indicators , Tariff rate, most favored nation, simple mean, all products (%), (1995-2008) MFN Data from WITS, Argentina reporter WORLD MFN Simple Average (%); Tariff Preferences data[37] (1990-1995) Tariff Preferences data from UNCTAD - Trade Analysis Information System (TRAINS), and (1996-2018) data from Applied Tariff Preferences: WITS Argentina Product AHS Weighted Average from Brazil, in %.

[37] The data for 1995 for Argentina and Brazil was provided as 0 from multiple data sources.

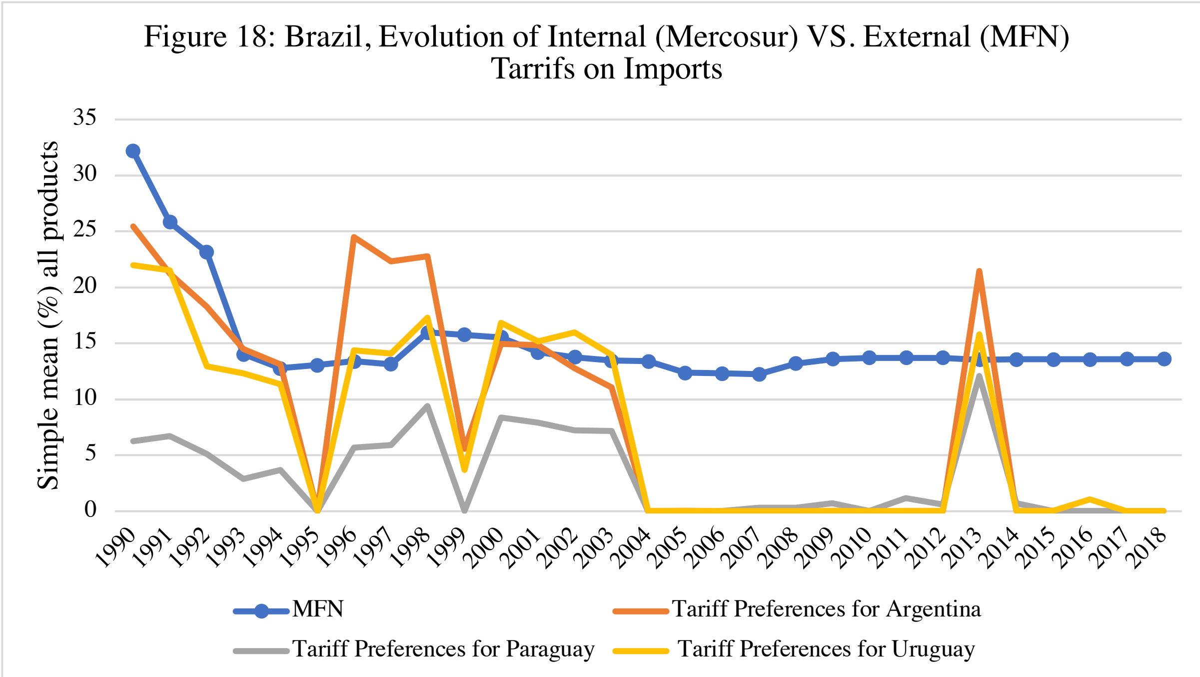


Figure 18: Brazil, Evolution of Internal (Mercosur) VS. External (MFN) Tariffs on Imports.

Brazil MFN Data (1990-1994) from World Bank Development Indicators, Tariff rate, most favored nation, simple mean, all products (%); (1994-2018) MFN data from WITS, BRAZIL reporter WORLD MFN Simple Average (%); (1990-2018) Tarif Preferences data from UNCTAD - Trade Analysis Info.

The graphs above show that the MFN tariffs (extra-regional goods) for Argentina and Brazil differ greatly before the customs union period (1995-2001) before converging around 1998. In 1990, Brazils MFN tariff was 32.17%, and Argentina's was 21%, which were at much higher levels than the period after reforms. This means that within the first five years (1991-1995) from the signing of the treaty, Argentina and Brazil were able to achieve a significant degree of integration between inter-regional and extra-regional actors benefitting from a lower MFN rate. In 2001 both countries converged their MFN rates to similar levels, Brazil (13.76%), and Argentina (13.8%), and generally have kept their rates at that level. In 2005-2006, Argentina's rate began to dip to 11% but then gradually increased up to the same levels as Brazil. Brazils tariff preferences for Argentina spiked in 1996, and Argentina's tariff preferences for

Brazil also spiked in 1996. From 1996- 2004, both countries seemed to be in a tariff battle, and the effectively applied tariff was much higher at times than the MFN tariff. This is due to a tit for tat tariff battle, and the creation of national tariff exemptions. Certain products also have a much higher tariff level than most of the other products, significantly raising the averages.

Despite the efforts for developing common regional policies, in practice each country has almost an autonomous management of its commercial policy. According to the US International Trade Administration, "Mercosur countries can set an import duty different from the CET until December 31, 2015, for specific products, using the so-called Exceptions List (pursuant to Mercosur CMC Decision 58/10). Information and Communications Technology (ICT) products are regulated by a separate tariffs schedule which expires on December 31st 2015 (US International Trade Commission). 78% of imports in Paraguay, 69% of imports from Brazil, 72% of imports from Uruguay, and 81% of total imports from Argentina are admitted for one of these lists, which give member countries an almost autonomous management of its commercial policy[38]. This scenario creates serious difficulties for integration efforts. If Mercosur countries had created a true customs union after 2004, there ideally would be no increases in tariffs for the other Mercosur countries, but the figures do show increases from zero. There are two moments of interest, from 2011-2016, when Brazils tariff preferences for all Mercosur countries left the zero level and spiked to levels above the MFN rate. Also, from 2016 -2017, Argentina's tariff preferences for Uruguay showed some increase from zero. When comparing the average MFN rate between Argentina and Brazil, and then Paraguay and Uruguay, ideally it would be identical, as the goal is for all extra-regional countries to be charged the same CET rate. Figures 17-20 show that the rates between Brazil and Argentina, and Paraguay and Uruguay show the current

[38] (Berlinski)

differences in CET. In the case of Brazil and Argentina, CET rates are at a higher average level, and the rates for Paraguay and Uruguay are at a lower average level than the CET.

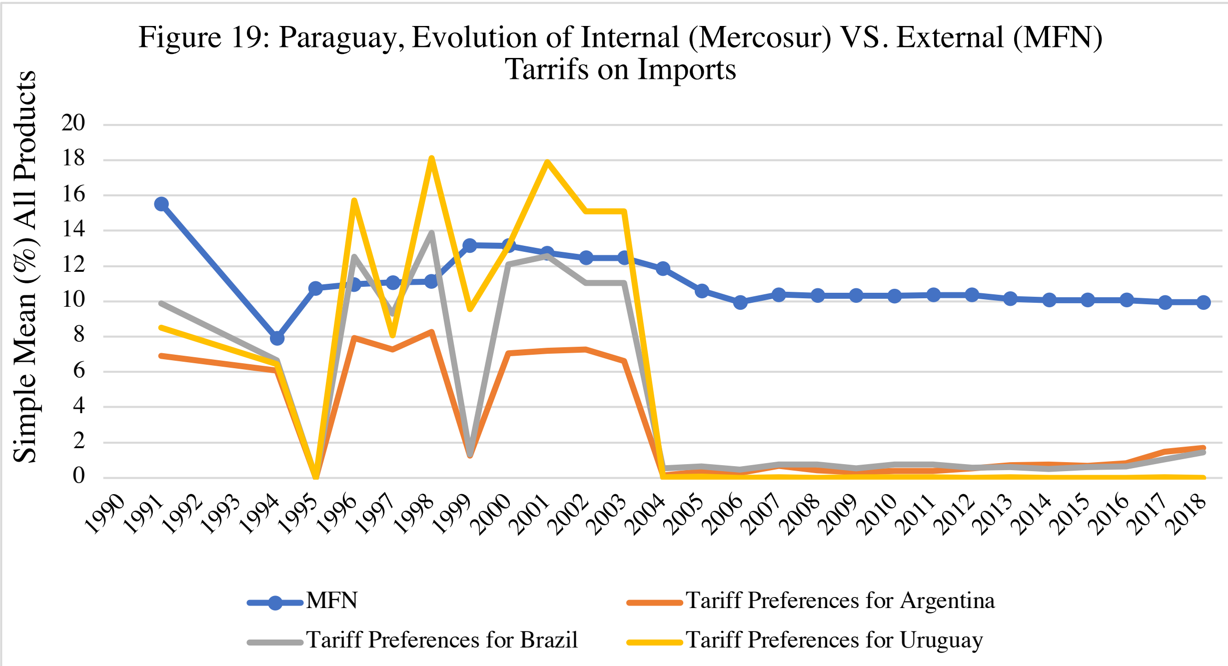


Figure 19: Paraguay, Internal (Mercosur) VS. External (MFN) Tariffs on Imports.

Paraguay MFN data from 1991, World Bank Development Indicators (1990-1994), Tariff rate, most favored nation, simple mean, all products (%), 1994-2008 WITS, Paraguay reporter WORLD MFN Simple Average (%); WITS Paraguay Product AHS Weighted Average, in % 1991, 1994-2018.

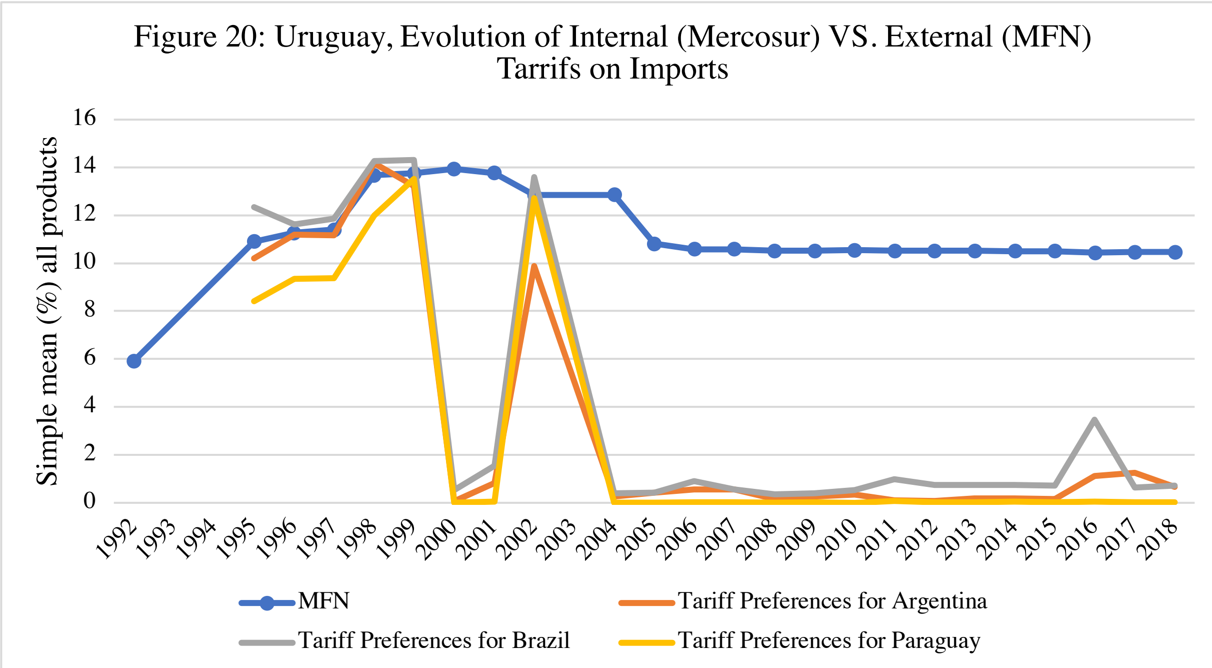


Figure 20: Uruguay Evolution of Internal (Mercosur) VS. External (MFN) Tariffs on Imports.

Uruguay MFN data from 1990-1994, World Bank Development Indicators, Uruguay reporter, Tariff rate, most favored nation, simple mean, all products (%), 1994-2008 WITS, Uruguay reporter WORLD MFN Simple Average (%); Trade Preference data (1995-2018) from: WITS Uruguay Product AHS Weighted Average, in %.

Since 2005, the MFN rate has remained at the same levels for Uruguay and Paraguay. Notably, Uruguay did not charge a significantly higher inter-regional tariff than MFN tariff in any period throughout the years of Mercosur. This is a contrast to the three other Mercosur members who did have moments of charging higher inter-regional rates. Paraguay had the most protective trade regime prior to Mercosur, but a de-facto open system due to widespread smuggling (Cortes 5). Since 1992, the data for Paraguay has expressed the lowest tariff structure in Mercosur with a maximum tariff of 10%, which can be observed in figure 19. Paraguay imposes low tariffs principally for consumer and electronic goods. Paraguay charged Uruguay a much higher tariff than MFN tariff, during the years 1996, 1998, and 2000-2003. After 2004, the tariff preferences for Paraguay and Uruguay charged to the other Mercosur countries dropped to 0, but in recent years, the rates have shown increases from 0.

Paraguay and Uruguay have kept their tariff preferences for each other at levels close to 0, but both are increasing their tariff preferences for Argentina and Brazil. Uruguay increased its tariff preferences for Argentina and Brazil in 2015, when a spike in increases can be observed. In 2016, Paraguay also increased tariff preferences for both Argentina and Brazil. In the past decade, there has been some inter-regional tariff creep (see figures 17-20). We can observe that all Mercosur countries have increased the inter-regional rate slightly from 0 in the last five years of this decade.

According to Levia and Carlos Ruiz Diaz, during the negotiation process for the creation of the CET, member countries had different positions regarding tariff levels. The smaller block countries wanted to maintain low CETs, while Brazil and Argentina preferred high-level tariffs that protect local products (Leiva and Carlos Ruiz Díaz). This can be observed from figures 17-20, as the MFN rate of the two smaller countries in Mercosur is lower than the MFN rate for the two larger countries. Paraguay being a landlocked country and following the CET, creates an additional trade barrier for goods within the region. When a product imported to Brazil from Canada for example, then gets imported to Paraguay, there is a double CET. It is charged Brazils CET rate, and then again when it reaches the border with Paraguay it is charged Paraguay's CET for the product. The business in Paraguay importing the good, is considering these additional CET costs to the consumer. Additionally, Bolivia is currently in preparation for becoming a member of Mercosur. Full membership for Bolivia would be problematic in the case that existing tariffs in Bolivia are lower than those of Mercosur. Bolivia would need to increase tariffs to join and participate in the CET, which is problematic for its industries.

Since all members are preferring national tariffs and exemptions to the CET, the policy is not as widely implemented or sustainable as its original intent. We can observe from the graphs above, that while Mercosur made significant progress from 1990, it still has some hold out and countries have not complied fully with the formal requirements of a customs union as defined in the Treaty. Countries held tariff preferences sometimes higher than the MFN rate for its inter-regional partners. Although the ideal goal was to establish a true customs union and create the same CET rate for all Mercosur countries, the union has chosen not to apply such uniformity. According to Gómez[39], full adoption of the CET would have a negative impact on the majority of the Paraguay's productive structure. As a solution, Gomez suggests that perfecting the idea of the customs union would involve the elimination of the double collection of the CET. For example, a good imported once into the Mercosur region, to Argentina for example, and then shipped to Brazil, would be considered as already originating within Mercosur. This would allow more basis for the free movement of goods within the region. This kind of policy would involve a reconsideration of the direction of the funds collected from the CET. Paraguay, Uruguay, and Brazil have been resistant to such a suggestion, and this resistance is motivated by the loss of nationally determined customs revenue, and reluctance to rely on a redistributive mechanism developed for Mercosur[40]. In 2019 Brazil has proposed a lowering of the CET, which might make it easier for Bolivia's integration, as Bolivia's tariffs are currently lower than the CET.

Mercosur CMC Decision 54/04: Double Collection of the CET and Tariff Distribution

The Common Market Council (CMC) decision 54/04 concerns three requirements. The first requirement is to grant 0% CET to all merchandise imported by a member country with 100% preferential tariffs under Mercosur agreements with third parties, and the second stage

[39] (Gómez Leiva)
[40] (Inter-American Development Bank, Integration and Trade Sector 72)

involved implementing this adjustment with the remaining goods. The third stage is the implementation of a customs union distribution mechanism[41]. The infrastructure for the third requirement was completed. The online platform was created for managing the funds of the customs union. The platform was called the Customs Register Information Exchange (INDIRA). It was in operation and available for all states to use. This was a great steppingstone for the eventual development of a supranational mechanism for distributing the CET revenues. If such a system of distributing funding among Mercosur members was in place, each country would benefit from the liberalized inter-regional trade, instead of consumers paying the additional CET of re-export costs. After the development of the infrastructure, the presidencies of Brazil, Paraguay, and Uruguay objected to such a system and ended their participation, which meant that the Mercosur countries did not make it to the second stage. Goods entering the four Mercosur countries must currently pay the CET to that country's customs authorities. The infrastructure of the INDIRA was a promising integration effort, and although it was developed, in the end it is not used.

In 2019 and 2018, all countries have submitted proposals to expand the exceptions to the CET, and there is ever increasing pressure from the growing levels of extra-regional trade, over the proportion of inter-regional trade (figures 17-20). According to the Inter-American Development Bank (IADB), "During the year [2019], all states parties have expressed themselves in some way in favor of enabling a debate on the revision of the CET" (Rozemberg, Campos and Gayá). The debate is weather to lower the bloc's external tariff (CET) over several years from an average 14% to around 5% or 6% in the long term. There are benefits to lowering the CET; however, when considering the theory, this action could make extra-regional products

[41] (Global Investment & Buisness Center 48)

less expensive, and competing with the prices of products originating within the region. Competition for lower prices is usually good, however within the context of regional integration it makes consumers more dependent on extra-regional trading partners. As such, a reduction of the CET would increase levels of extra-regional trade for all countries. A process to revise the CET was launched by Argentina and will take until 2020 to complete (Viga Gaier and Misculin).

There is some discussion of eliminating the CET at the beginning of 2020, which would erode at the idea of Mercosur altogether. According to the IADB, "while the option of unilateral exit offers the attractiveness of giving countries, the tangible 'possibility of recovering sovereignty', facilitating decision-making on different tariff policy issues, negotiating with other countries/blocs, establishing regulatory or promotional frameworks, etc., it must be weighed against that which is derived from the loss of the benefits of the Customs Union (Rozemberg, Campos and Gayá 13). Figures 17-20 above show the years it took to reduce inter-regional tariffs, which have benefited each country in the region. If the CET is completely abolished, it could become a free trade area similar to NAFTA or the Pacific Alliance. In another scenario, abolishing the CET might also incentivize countries to raise tariffs again in moments of economic crisis, undermining the 30 years of effort toward lowering tariffs.

Mercosur CMC Decision 03/94: Nationally Imposed Non-Tariff Restrictions

The CMC Decision 03/94 concerns non-tariff restrictions which include a wide variety of restrictions to trade. Non-Tariff Measures (NTMs) specifically, are defined as domestic political measures, in addition to regular customs tariffs, which may have an economic impact on international trade (UNCTAD, 2010). Mercosur has countless non-tariff restrictions aimed at overcoming the problems of national economic instability (United Nations). The United Nations Conference on Trade and Development (UNCTAD) database has collected data on NTMs for the duration of the years of Mercosur observed in this study (1990-2020). According to the UN, the impact of NTMs is approximately two to four times greater than the effect of tariff reductions. For this reason, they are considered as the main factor determining the possibility of growth and integration in the processes of production and trade. This makes the reduction of NTMs a crucial part of improving regional integration for Mercosur.

NTMs can be divided into two groups. The first can be considered the Non-Tariff Barriers (NTBs) which include traditional trade policy instruments such as quotas, licenses, or price controls on imports. The second group includes Technical Barriers to Trade (TBTs), and Sanitary and Phytosanitary (SPS) measures (United Nations, 2017). According to the World Trade Organization (WTO), Sanitary and Phytosanitary (SPS) measures are laws, rules, standards, and procedures that governments apply to protect people, animals and plants from diseases, pests, toxins and other pollutants. The SPS WTO Agreement came into force when the WTO was established on January 1, 1995. It relates to the application of food safety and animal and plant health regulations on imports. As there are important agricultural industries within Mercosur, SPS has a significant impact within the region. TBTs are technical regulations and standards for established to ensure safe and high-quality products, such as environmentally friendly products for protecting human safety or health. This includes labeling or packaging requirements, or standards for seatbelts in cars. These regulations are set in place with positive intent, but they do add additional costs for exporters.

The MFN graphs mentioned previously show how Mercosur inter-regional tariffs have been gradually lowered during the customs union process; however, the elimination of tariffs within the region is not enough to deepen economic integration as there has been an increase in the implementation of Non-Tarif Measures (NTMs) since the creation of Mercosur. Figure 21 shows which countries in Mercosur have been concerned with increasing or decreasing national import requirements through the decades of Mercosur's existence. We can observe that for all years NTMs have increased, with the exception of Paraguay.

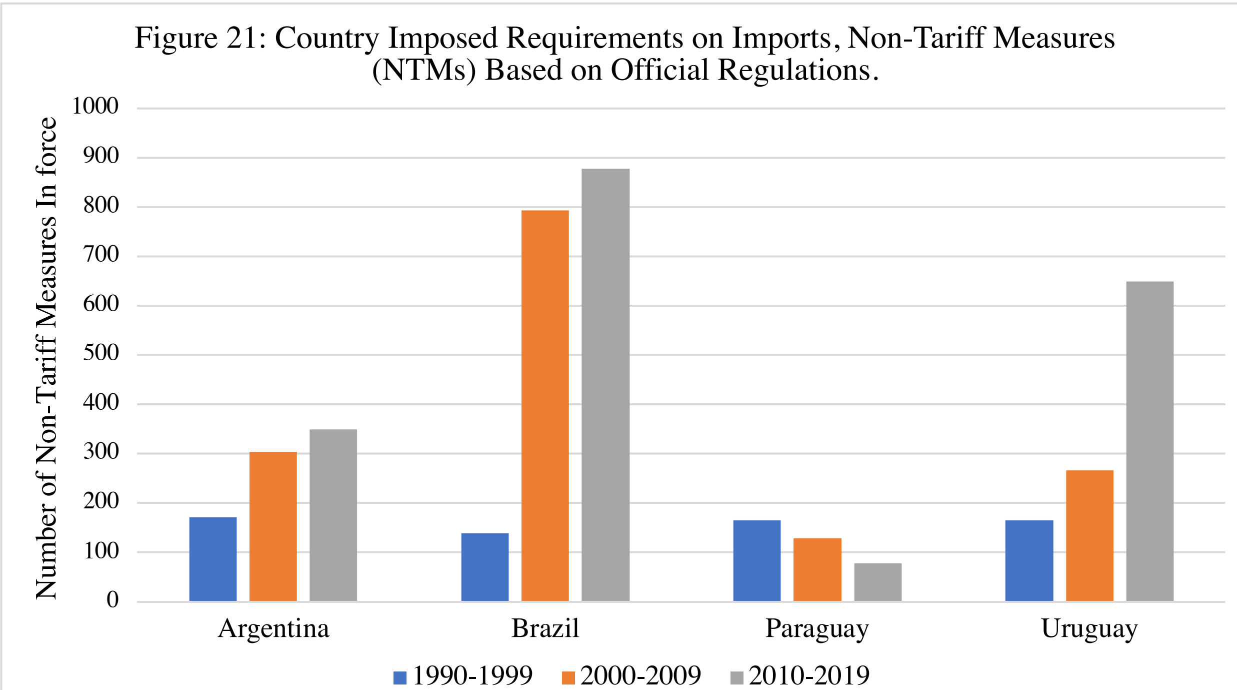


Figure 21: Country Imposed Requirements on Imports, Non-Tariff Measures (NTMs).

Data from TRAINS The global database on Non-Tariff Measures. Decade averages based on authors calculations. (TRAINS).

Mercosur has considered the regulation of NTMs an important policy area for the region to address since its inception in 1991. There have been several working subgroups and meetings for the purpose of resolving non-tariff restrictions on imports and exports by removing them or achieving harmonization of these among Mercosur members. The elimination of quotas and non-automatic licenses was planned; and Mercosur policy indicated for the harmonization of TBTs and SPS measures. Today, much remains to be done. Many barriers still exist, and national regulatory policies are diverging.

Understanding the formation of Non-tariff barriers provides an additional dimension for determining how national sovereignty has taken precedence over the frontier of regional integration. Article 10 of the Annex 1 of the Treaty establishing a common market states, “As of 31 December 1994, all non-tariff restrictions shall be eliminated from the common market area”[42]. This was not achieved for any year of Mercosur. Imposing national requirements within a customs union is a method of creating an intra-regional barrier to trade, which is contrary to the policies that create the Mercosur customs union. The regional and institutional approach to solving the problem of increasing NTMs has been unsuccessful, as NTMs have increased for almost all Mercosur countries each decade.

The UNCTAD TRAINS data from figure 21 shows that over the years, Argentina, Brazil and Uruguay have not followed article 4 of the CMC Decision 03/94 and have in fact increased their number of NTMs for each decade of Mercosur. Article 4 of the CMC Decision 03/94 stipulates, “Until the full harmonization of non-tariff restrictions is reached, the state’s parties undertake to not apply more restrictive conditions in the reciprocal trade than those in force for internal and external trade”[43]. Argentina, Brazil, and Uruguay have rejected this decision and have increased non-tariff restrictions for all years of Mercosur. Figure 21 shows that Paraguay is the only Mercosur country that has been successful in reducing its import requirements through the decades of Mercosur. Brazil has created the most import requirements. Uruguay has more than doubled its NTMs in the past decade. The NTMs counted in the graph include all available NTMs on the UNCATAD database, which are: Contingent trade protective measures, Export-related measures, Pre-shipment inspection, Price control measures, Quantity control measures, Sanitary and Phytosanitary (SPS), Technical Barriers to Trade (TBTs), and 'Other measures'.

[42] (Treaty Establishing a Common Market).
[43] (Organization of American States)

Non-Tariff Barriers (NTBs) are significant because when they are applied, they cause price increases and when they are removed, they facilitate inter-regional trade and reduce prices of goods exchanged within the region. The UN study found that for the years 2011-2014 (as a conservative estimate), NTBs cause price increases (of traded goods) of 3 to 4 percent in the Mercosur region and could be significantly higher (United Nations). In addition, the regulatory cost of each technical barrier to trade (TBT) within the Mercosur region is substantially reduced by regulatory convergence, especially on the occasions that a good is imported twice within the region. This could explain why Paraguay has actively reduced its NTMs, as it is the landlocked country within Mercosur whose consumers are paying a double CET and also double NTMs, as their products are imported 'twice' within the region.

A higher level of regulatory similarity on the industries most affected by NTMs in the region increases the ability of all countries to comply with foreign requirements. The UN scenarios found "significant welfare, trade and employment gains" and inter-regionally, the elimination of NTMs could raise regional welfare by US$ 2 billion. The UN study also provided figures for each country. These figures assume that NTBs generated government revenue, such as licensing fees or quota auction revenue. Therefore, even if governments were generating their own revenue through NTBs, if they were to remove them altogether, the estimated benefit for each country has been calculated. In this scenario, the UN calculated gains: "Argentina could gain US$ 585 million, Brazil US$ 1'109 million, Paraguay US$ 63 million, Uruguay US$ 145 million"[44] (2017). In addition, if no revenue was made on a particular NTB, and eliminating NTBs therefore does not imply losses, welfare gains are almost twice as high for Argentina and Brazil" (United Nations) . The language in the TIFA agreements, and other trade agreements

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[44] (United Nations)

signed by Mercosur countries all include a section concerning the reduction of NTMs. For these reasons, it is important to consider the reduction of the nationally imposed NTMs in order to receive the potential welfare effects of deeper regional integration.

Figure 22 shows areas of Non-Tariff Measures (NTMs) which are the most restricted by country, category, and the partner affected. Bilateral NTMs are the import requirements imposed on bilateral trade partners. The ‘All members’ category includes import requirements imposed on all trade members. In the context of Mercosur, each NTM could be considered a step in the opposite direction of regional integration within Mercosur, as higher levels of domestic regulation in this policy area means there is less harmonization of regional policy among Mercosur members. The differing regulation levels for each category among Mercosur countries can be observed in figure 22.

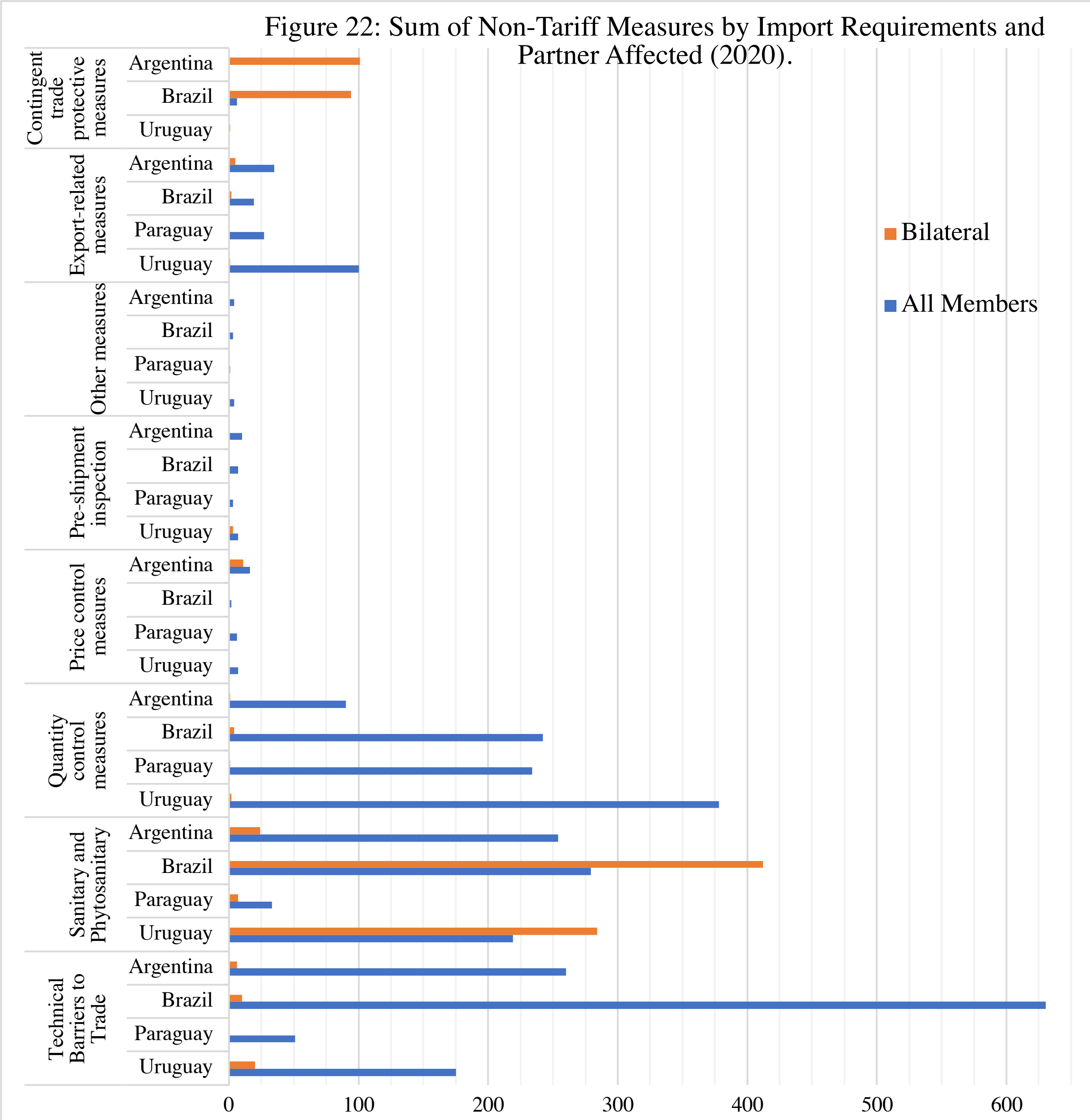


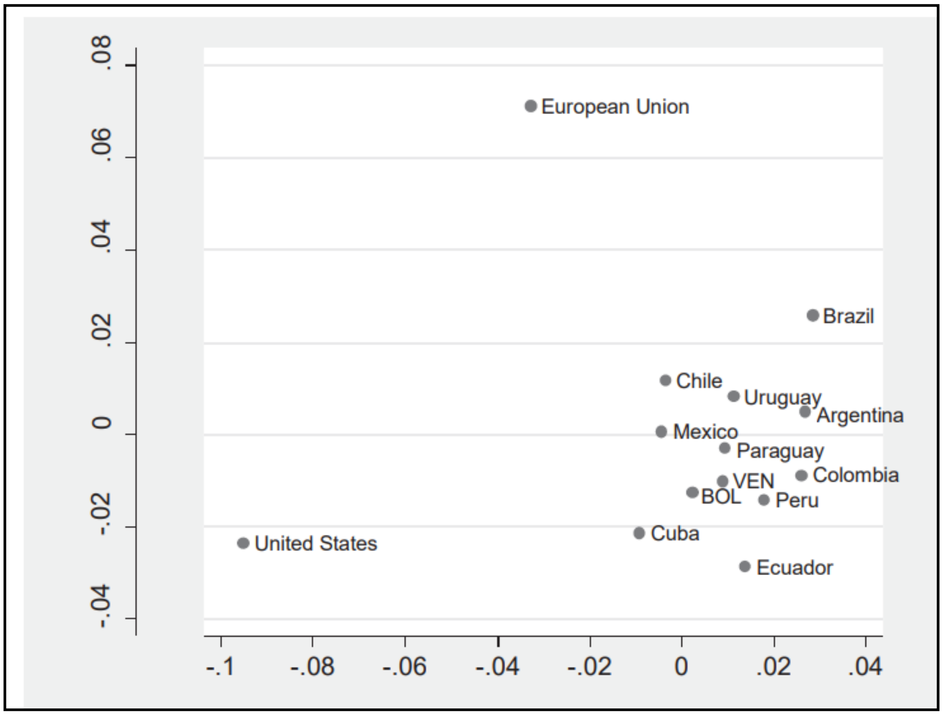
Figure 22: Sum of Non-Tariff Measures by Import Requirements and Partner Affected (2020).

Data Available from The Global Database on Non-Tariff Measures, Measures in Force. Last updated 08/03/2020 (TRAINS).

The figure above shows the differing regulation levels for each category among Mercosur countries. The most common barriers in Mercosur are 'Technical Barriers to Trade' (TBT), 'Sanitary and Phytosanitary (SPS)' regulations, and 'Quality Control Measures' (such as non-automatic licenses and quotas). There are few implemented ‘Price Control Measures’ and ‘Pre-Shipment Inspection Costs’ among members. TBTs within Mercosur countries have a greater impact on trade than any other type. Brazil especially, has created a very high number of these barriers imposed on ‘All Members’, and has imposed few on ‘Bilateral’ partners. The regulatory measures applied to the food and agricultural sectors fall under the category of TBT. These, along with the SPS regulations, increase prices on the whole population of food consumers. The United Nations calculation was, “(ad valorem equivalents, AVEs) of 10 to 15 percent in Argentina and Brazil, and between 5 and 10 percent in Paraguay, Uruguay. Quotas and Non-Automatic licenses are included under the Quality Control Measures category. Figure 8 shows that Mercosur applies a significant number of quotas and non-automatic licenses. Product-specific barriers affect more than 40 percent of Brazilian imports, 27 percent of Uruguayan imports and 19 percent of Paraguayan imports (United Nations).

The United Nations study calculated regulatory distance for all Mercosur countries using the NTM data. The years studied were 2011-2014 and they found that during this time, there was neither an increasing nor decreasing trend of regulatory distance for Mercosur. They compared this distance to countries in the ALADI group, and found that, “the overall depth of structural NTM convergence in Mercosur is not notably different from the entire ALADI group” (United Nations 19). This means that for the observed period of Mercosur, there is no observable regulatory closeness or distance for Mercosur countries when compared to ALADI countries. If there was a higher level of integration among Mercosur countries, there could be an observable closeness of their regulatory distance. The figure below is from this United Nations study. It shows Bilateral Regulatory Distances (only technical measures) for all sectors for several countries in South America, the EU and the United States.

Figure 23: Bilateral Regulatory Distances (Only Technical Measures), All Sectors



Data from: (United Nations) UNCTAD-ALADI NTM data. Abbreviations: The Plurinational State of Bolivia (BOL), Bolivarian Republic of Venezuela (VEN).

The graph includes only the regulatory distance of the Technical Measures. Based on the graph, it is notable that Brazil is the most distant from the other four Mercosur members. Argentina, Paraguay and Uruguay exhibit similar levels of regulatory distance, and are close to each other in the graph. Brazil and Argentina are fairly distant, more similarity is expected as they represent the two larger economies of Mercosur. The UN study found that for all agricultural-based sectors (which includes leather, woods, and chemicals) there is high regulatory distance. Mercosur countries have important agricultural industries, and if these sectors are heavily regulated within each country, there is typically high regulatory distance in the region. In the extraction-based sectors, such as minerals and metals, there is consistently less regulation by all countries – therefore regulatory distance is also low. Historically the development of these extractive industries in Latin America were created or greatly influenced by extra-regional actors that would not benefit from high levels of domestic regulation.

Considering the discussions about a trade agreement between Mercosur and the EU, the regulatory distance (of SPS measures and TBT) to overcome is immense. If regulatory convergence be expected in this area, it will be quite difficult to implement. Brazil might have difficulty sacrificing some of its national policies to achieve regulatory convergence with the EU. From the graph we can observe that the regulatory structure of the EU, is slightly closer to Brazil than the other Mercosur countries. There is also considerable regulatory distance between the Mercosur countries and the US. Although, the two members of the North American Free Trade Agreement (NAFTA) included in the graph, (Mexico and the United States), remains large. According to the UN study, NAFTA does have provisions on SPS- and TBT-related collaboration but does not envisage full harmonization and gives every member full freedom to impose the measures they see fit. As the NTM data shows, integration which doesn't require full harmonization, might be successful, as overcoming regulatory distance for Mercosur countries is not something that has been achieved.

A similar study of NTM data for the nearly 30 years of Mercosur is needed to see if there is an observable increasing or decreasing trend of regulatory convergence. An increasing trend would imply increasing integration, while a decreasing trend might show disintegration. This kind of study could also show when and which areas improved or decreased regulatory convergence for Mercosur.

Mercosur CMC Decision 32/2000: External Relationship

The first assumption for the success of open regionalism according to Garzón is that extra-regional partners "agree to negotiate with the regional grouping as a whole and abstain from pursuing a selective bilateral strategy" (Garzón 116). This means that an extra-regional state negotiates agreements with the Mercosur bloc rather than an individual member. The Mercosur CMC Decision 32/2000 address this aspect of open regionalism and stipulates, "Mercosur States Parties to jointly negotiate commercial agreements with third countries or groups of extra-zone countries in which tariff preferences are granted"[45]. Considering the rising interest in establishing bi-lateral free trade agreements in the past two years, Mercosur CMC decision 32/2000 has been subject to increasing debates and discussions among Mercosur members. Article 2 stipulates that "As of June 30, 2001, the States Parties may not sign new preferential agreements or agree on new trade preferences in agreements in force within the framework of ALADI, which have not been negotiated by Mercosur." This article requires joint understanding among Mercosur countries.

The Mercosur CMC Decision 32/2000 has come under particular scrutiny, as in the past decade extra-regional trade has grown and become a more significant portion of total trade for Mercosur countries. Brazil has completely rejected Decision 32/2000. The Brazilian Ministry of Foreign Affairs (MRE) decided that Decision 32/2000 "was not internalized by any Mercosur State Party, as it only regulates aspects of the bloc's organization or functioning". This interpretation has given rise to speculation that the obligation to have joint Mercosur negotiations with other non-regional areas or countries is false. Uruguay has also rejected the decision. The Uruguayan body of legal analysis concluded that CMC Decision 32/2000 has: a) no legal validity because it was not internalized by any of the States Parties; and b) at present, the States Parties maintain their respective independence in matters of commercial policy, that is, they have the legal capacity to negotiate and sign preferential trade agreements with third countries

[45] (Organization of American States)

individually, as a common commercial policy has not been formally adopted in the common market. There is a question to whether this decision needs to remain in force given the changes in circumstances that have taken place since its adoption in August 2000 until now, almost 20 years. In 2019, Bolsonaro the current president of Brazil, and minister Guedes have expressed that Brazil would undertake its own negotiations of free trade agreements with other countries without the presence of the other Mercosur countries. This would be considered a clear violation of this mandatory decision. The representatives of Brazil have prepared a proposed amendment to the Decision, and the eventual approval of this decision by the CMC could lead to possible negotiations of one or more members with third countries or groupings of countries, without affecting the provisions of CMC Decision 32/2000 and without neglecting the existence of the CET.

The political will to revitalize the project is developing in 1) areas that do not interfere with national policies, and 2) in areas that look beyond the internal market such as developing agreements with the EU. As these areas grow, compliance with all of the bedrock decisions forming the Mercosur project is on the decline. There are certainly potential benefits to fulfilling the commitments mentioned in the decisions above as observed through the data and the UN study.

On June 2019, the EU and Mercosur reached an ‘agreement in principle’, for a free trade agreement (FTA) (European Parliament). The agreement is in the process of legal review, then it will be presented to the Mercosur Council for signature and submitted to the European Parliament for consent. Then it will be presented to EU Member State parliaments for ratification. If the agreement is ratified, the EU-Mercosur FTA would create the largest free trade zone in terms of population; however, the EU agreement comes with its own set of commitments of regulatory harmonization and reductions on tariffs and NTBs. After a 10-15-year period of Mercosur gradual tariff eliminations, European companies would no longer pay the current CET rate to Mercosur countries. The EU has agreed to immediate tariff reductions for 92% of products imported from Mercosur countries[46]. Paraguay has signed a Generalized System of Preferences Plus (GSP+), with the EU which means that it can already export into the EU at a reduced rate or import at a zero tariff. There is still a growing number of NTBs in Mercosur countries, and it is possible that the tariff reductions do not happen on the Mercosur side for several decades from the implementation of the agreement, out of concern for national interests. The EU agreement is more demand on Mercosur countries in terms of, the work involved to reduce of NTBs, implementing a simplification of procedures, and expanding national commitments to EU – Mercosur regulatory harmonization. Mercosur countries have not achieved this through establishing more Mercosur policy, and time will tell if these changes are politically possible through the EU agreement.

V. Results and Future Considerations

This thesis inquired into how the incentives for furthering integration efforts have changed over time since the beginning years of Mercosur. The demand and supply variables analyzed in this study were provided by authors who address the newer socio-economic factors which have created disturbances for the goals of regionalist projects. The data observed from 1990 to 2020 show that it is likely that the socio-economic forces described by Decentered Multipolarity are affecting the cost benefit calculations of states who either decide to pursue regional integration or pursue their national interests. Decentered Multipolarity describes conditions which result in the creation of extra-regional linkages which “transcend the region in

[46] (Opertti)

all directions, and extra-regional powers acting on the countries in the region in varying levels of exchange" (Garzón 106). The data shows growing extra-regional trade, emerging especially this past decade, which is representative of the rising role of extra-regional actors engaging with Mercosur countries in varying levels of exchange. Should more bilateral agreements emerge out of these increased connections, the conditions become less favorable for the continued success of the regional project. The analysis shows that the level of extra-regional trade for all of the countries in the region has grown considerably over inter-regional trade. In addition, the analysis found that these extra-regional linkages are also growing bilaterally in other areas, such as through the creation of more Bilateral Investment Treaties (BITs), and Preferential Trade Agreements.

The development of more Mercosur trade agreements would help to consolidate engagements with extra-regional actors. The existing number of Mercosur bilateral agreements and regional trade agreements was provided in table 6. This past decade, there were only two regional Mercosur trade agreements created; with Chile and Colombia. As countries project their political and economic power to the different countries of the region at varying rates, Mercosur could benefit from collaboration on the creation of more regional trade agreements, as they represent a collective response to extra-regional actors, which would be helpful in promoting the existence of the regional project. In addition, I describe the Mercosur CMC Decision 32/2000 which was created to give priority to trade negotiations as a group, leading to the development of a common external trade policy. I describe that states have rejected this decision, as it is perceived to be an interference to how national governments maintain their respective independence in matters of commercial policy. Individual engagement with extra-regional actors occurs through diplomatic channels, rather than through Mercosur. Based on the theory analyzed in this study, for the continued success of the Mercosur project, trade coordination with extra-regional actors is the most important policy area in need of consideration in the coming years.

The second economic indicator presented in this thesis is a calculation of the Grubel Lloyd index to find the share of intra-industry trade between each country of Mercosur and their GL-score with the region. A relationship of 1 with some of the commodities indicates that there are similar relative amounts of factors of production within the region, and the countries are predicted to have intra-industry trade with the region. When each commodity is analyzed for the nearly thirty years of Mercosur, there is a declining trend in the number of commodities enjoying a relationship of 1. Uruguay was the only country enjoying an increasing trend of intra-industry trade with the region. In ideal conditions for integration, the region would become more specialized and there would be an increasing trend of the share of intra-industry trade for Mercosur commodities, meaning more commodities each year would have a GL score of 1. The implications of this analysis mean that countries in the region are becoming more dependent on extra-regional specialization and extra-regional trade, which further supports the hypothesis that the conditions of Decentered Multipolarity are more present, as countries look to establishing linkages with many extra-regional actors to fulfill their needs, rather than inter-regionally.

The region could benefit from an analysis of how to improve inter-regional trade levels, such as a reduction of national tariffs, an identification of import and export opportunities, identification of target markets, and increased participation or creation of regional trade promotion activities. If it is possible to employ methods to improve levels of inter-regional trade, it would strengthen the Mercosur project by increasing its economic importance within the scope of ever increasing extra-regional trade. One method for improving inter-regional trade is through the elimination or reduction of inter-regional tariffs. An analysis of inter-regional tariffs is provided in figures 17-20. The figures show that the project has been successful in reducing inter-regional tariff levels significantly since 1991, and they also show periods of inter-regional trade conflicts expressed as increases in tariffs for the other Mercosur members. Most interestingly, within the last five years, there has been some inter-regional tariff creep; all Mercosur countries have increased the intra-regional tariff above 0. A future analysis of why this has occurred after so many years of internal tariffs at 0, would be beneficial for preventing further creep and would strengthen one of the bedrock decisions of the Mercosur project.

Figures 17-20 also reveal the actual levels of the Mercosur Common External Tariff (CET) (the actual data on the CET is provided by the Most Favored Nation (MFN) variable). The MFN, which is the tariff charged to extra-regional partners, averages at 14% for Argentina and Brazil and at 10 % for Paraguay and Uruguay. In 2019 Brazil proposed lowering the CET, which might be beneficial for incorporating Bolivia, as Bolivia's tariffs are currently lower than Mercosur's CET levels. If the CET is lowered, extra-regional trade could increase further as extra-regional products become more affordable to consumers. Also, national industries which are most exposed to extra-regional competition might decline from the trade shock. In addition, the elimination of the double collection of the CET would be beneficial for all Mercosur countries as it would improve the free movement of goods within the region; however, it would involve a supranational method for collecting and administering tariff funds, which several countries have rejected.

Another method for improving inter-regional trade levels is through the elimination of Non-Tariff Measures (NTMs). NTMs are nationally created trade rules which are a hinderance to integration efforts and contradict the idea of the customs union, as they are created by the national governments and impede efforts for domestic policy convergence. By analyzing the number of NTMs in figure 21, it is discovered that the number has increased for all years of Mercosur, in all countries except Paraguay, despite the efforts to eliminate them during all years of Mercosur. Figure 22 shows that among Mercosur countries, the most common NTM categories in Mercosur are 'Technical Barriers to Trade' (TBT), 'Sanitary and Phytosanitary (SPS)' regulations, and 'Quality Control Measures' (such as non-automatic licenses and quotas). Domestic policy convergence is an important pre-requisite or feature for improving integration between states, and NTMs are an area for Mercosur where this had not happened.

Figure 23 shows regulatory distance among Mercosur countries. Improving regulatory distance between Mercosur countries could begin for example, with the regulations concerning 'Technical Barriers to Trade' (TBT). TBTs include areas such as product labelling requirements, measures for protecting the environment, and quality standards. Mercosur could launch an initiative to create a 'Mercosur Standard' for these areas which appear as the most common NTMs, in an effort to increase domestic policy harmonization among all Mercosur states. Future research could observe the regulatory distance for all Mercosur countries using the NTM data for the 30 years or Mercosur. This research could show further solutions for improving integration. Based on the finding of the UN study the removal of NTMs would have an effect which is approximately two to four times greater than the effect of tariff reductions. For this reason, they are considered as a main factor determining the possibility of growth and integration in the processes of production and trade.

VI. Conclusion

Mattli identified two sets of necessary conditions for successful supranational integration: demand conditions which refer to the potential gains of market exchange within a region, and supply conditions which refer to the conditions under which political leaders are willing and able to accommodate demands for functional integration (Mattli 50). The figure below provides a visual summary of the theory and some of the significant demand and supply variables analyzed in this study.

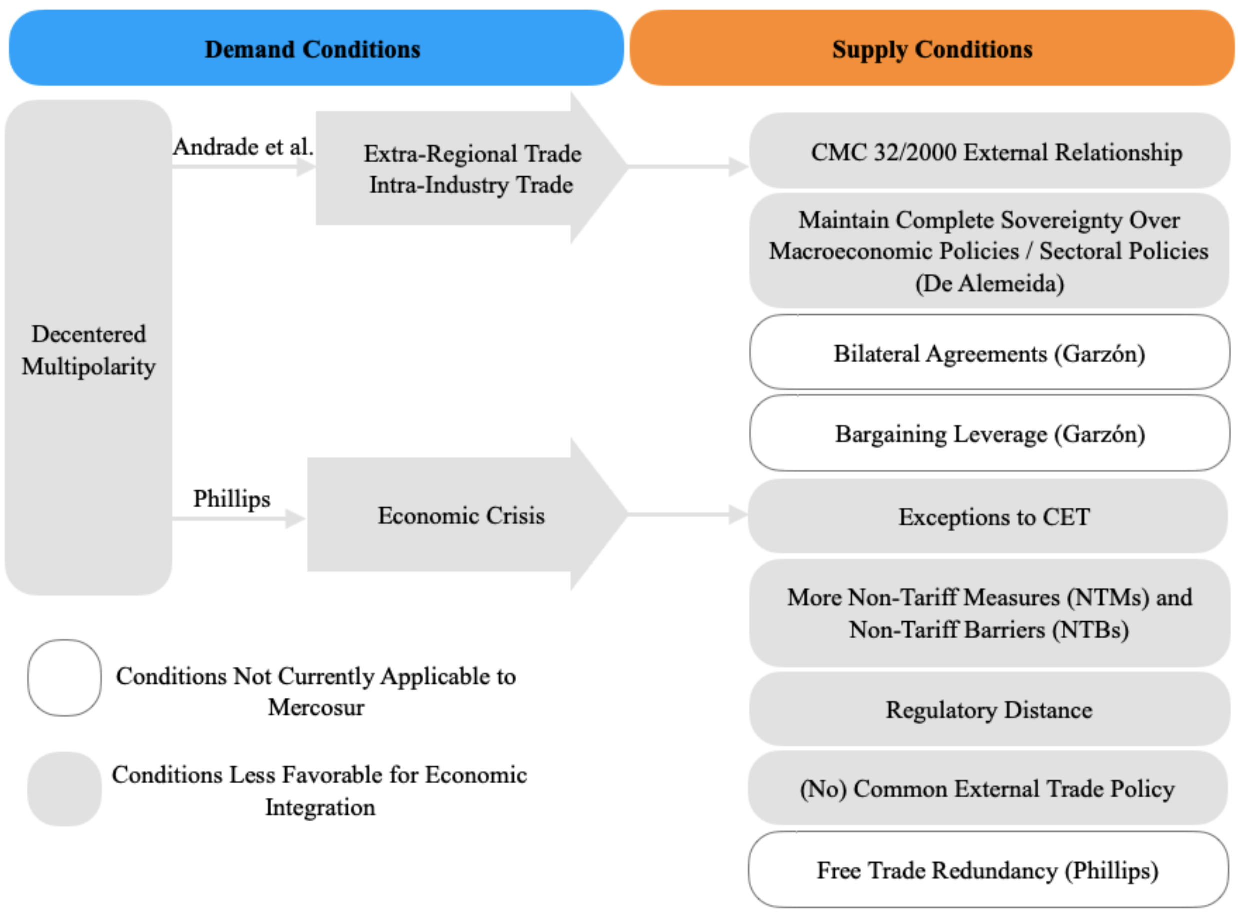


Figure 24: Summary of Results

The demand conditions analyzed were provided by Andrade et al, Phillips, and Garzón. The results of the two indicators for economic integration provided by Andrade et al., both point to circumstances which are less favorable for economic integration. Extra-regional trade is significantly higher than inter-regional trade, and there is a declining trend in the share of intra-industry trade based on the 99 commodities sampled. The figure shows these two indicators in grey as the analysis revealed circumstances which are less favorable for economic integration. Phillips presented two economic factors. The first factor concerned the presence of economic crisis. Given the recent slowdown of global markets in March 2020 it is likely that there will be knock off effects affecting the markets of Mercosur countries for the next year at a minimum. Argentina is experiencing a recession beginning in 2017, and in 2020 given the global slowdown in markets it will be difficult for Argentina to recover quickly. The other three Mercosur countries are likely to experience negative economic growth and a fall in GDP in the coming year. In moments of recession, countries are more likely to be interested in pursuing national strategies, rather than regional initiatives to help their people. Therefore, it is more likely that the decision making among Mercosur countries is henceforth constructed from the perspective of economic crisis. Phillips first factor is depicted in grey as it is currently not in favor of economic integration. Separate from economic considerations, it is possible, that the crisis strengthens the political solidarity among Mercosur countries, reviving in part the political will for its existence.

The supply conditions for integration according to Mattli refer to the "willingness of governments to respond to demand-conditions". This refers to the willingness of countries to voluntarily adopt policy decisions that result in the further harmonization of policy between Mercosur states. The supply conditions evaluated in this paper include, Garzon’s two assumptions for the success of open regionalism, Phillips second conjunctural factor, two conditions provided by De Alemeida (no regional paymaster and rejection of sovereignty over Macroeconomic and Sectoral policies), Mercosur policies forming the Customs Union, inter-regional tariffs, the Common External Tariff (CET), the Mercosur CMC Decision 32/2000 concerning the external relationship, and the heightened implementation of Non-Tariff Barriers (NTBs) within the region.

Phillips second conjunctural factor concerns the redundancy of the singing of free trade agreements or joining other regional initiatives based solely on free trade, which may undermine the existence of the regional project. Based on the current presidential leadership in Bolivia, Paraguay, and Uruguay, there is some concern that these countries may join the Pacific Alliance, which is an organization based largely on free trade. Should this occur, it is likely to undermine the regional integrity of Mercosur, as the Pacific Alliance requires that member countries must have existing bilateral trade agreements with all other member countries. Phillips second factor has not yet occurred, and so it is considered not currently applicable for Mercosur.

Garzon’s two assumptions for the success of open regionalism concern the formation of bilateral agreements, and significant bargaining leverage in one country over the other countries in the regional bloc. Mercosur countries have yet to sign bilateral agreements outside of the regional bloc; however, since 2008 all countries have signed TIFA agreements or a version of this with the US, which historically do lead to bilateral agreements. In 2019 there is also presidential rhetoric from Brazil threatening to make its own bilateral agreements outside of the regional bloc, but no agreement has yet been signed. Therefore, this first assumption, although a great concern, is not currently applicable for Mercosur, and therefore it is depicted in white in figure 24 above. Garzón’s, second assumption concerns the bargaining leverage of one state to be far greater than the leverage of the other states in the bloc. Figure 2 shows how Brazil’s economy is increasing in global position in terms of GDP over the other Mercosur members, but politically Brazil is still not yet on the path of pursuing its own bilateral strategy. Therefore, this condition is not currently applicable to the current state of Mercosur. The next decade will likely reveal if the remaining supply conditions provided in white in the figure above change to a less favorable result.

A common external trade policy has not been formed, as each country implements a different tariff toward third countries independently from the other, resulting in substantial deviations from the CET. The inter-regional tariffs were measured, and tariff preferences generally have remained at 0; however, within the past decade, all Mercosur countries have shown an increase from the zero level. Countries have rejected the Mercosur CMC Decision 32/2000 concerning the external relationship. All countries have increased the number of NTBs since the beginning of Mercosur, despite the initiative since 1991 to eliminate them. Each country has chosen varying paths of rejection of Common Market Council (CMC) decisions.

The thesis identifies a need to strengthen the regional project, in two important areas: promoting of inter-regional trade of the Mercosur countries, and developing regional agreements toward extra-regional actors. The demand and supply variables analyzed in this study point to a decline in the potential gains of market exchange with the region, and this has negative consequences on the political willingness to accommodate integration demands. According to the theory and the data, the effects of the increased extra-regional linkages on the success of the regional project has had adverse effects. As these extra-regional linkages grow, so will the reneging on the rules of cooperation in the region. The data shows that there is a progressive withdrawal from key Mercosur policy areas.

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