POWER FOR SALE:
Power asymmetries and informal influence in Mercosur

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A Thesis Submitted for the Degree
Bachelor of Science

May 15, 2017
Word count: 8763

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Figure 1: Presidents of Argentina, Brazil and Uruguay after the suspension of Paraguay in 2012.

[1] Marina Metamora, "Retrospective 2012: Visages de Dilma au exterior me 2012 privilege America Latina," *Do UOL*, accessed on 13 May 2017, https://noticias.uol.com.br/politica/ultimas-noticias/2012/12/14/viagens-de-dilma-em-2012-privilegiam-america-latina.htm?mobileDev&width=600?mobile.

Power for sale!

American philanthropist Walter Annenberg once said: “The greatest power is not money power, but political power.” This sounds like a beautiful statement about an almost utopian place in which money is not important, but looking at the reality, greed and wealth seem to shape the world. Economic power and political power are more interrelated than this statement suggests and the way it works together holds an important space within the debates on international cooperation.[2] In today’s world, where countries such as India and Brazil are gaining more economic power and becoming increasingly important on the global level, the question about the impact of economic power has become especially relevant.[3] To assess the way economic power and political power are related, this thesis will attempt to answer the following question:

How do economic power asymmetries affect the informal influence a state can exert within regional economic institutions?

Although every institution is designed a certain way and has procedures and rules about voting and policymaking, some states can exert informal influence outside of these formal arrangements.[4] An example can be found in Randal Stone’s book on informal influence exerted by the United States. He looked at the loans the IMF gave in three financial crises and found that in each case, it was the United States that was the biggest factor in determining the loans, even though it holds only 17% of formal voting power.[5] The importance of the research is therefore immediately clear: informal influence can shape policy in favor of the state with the most power, giving them an advantage in international cooperation.

The importance of this question also became clear with the emergence of economic regionalism, the “creation of greater economic opportunities through cooperation among states in the same geographical region”.[6] Regional integration can serve as a way for states to become indispensable in today’s global world and regional leadership can help a state in

[2] Randall Stone, *Controlling Institutions* (Cambridge: Cambridge University Press, 2011), xii.
[3] Sandra Estrada, “Regional Powers and their Strategies: Empire, Hegemony, and Leadership” *Review of International Studies* 36 (2010): 903.
[4] Randall Stone, *Controlling Institutions*, 1.
[5] Ibid., 142
[6] Andrew Heywood, *Global Politics* (New York: Palgrave Macmillan, 2011), 482.

becoming an influential player on the world stage.[7] An example of this can been found in Brazil, which was the driving force behind the creation of the *Mercado Comin del Sur* (Mercosur).[8] When looking at the four countries in this trading bloc, it becomes clear that Brazil generates the biggest part of the economic power the institution has. In 1990, a year before Mercosur was founded, Brazil's GDP was 462 billion US dollars. The three other states that joined Mercosur, Argentina, Uruguay and Paraguay, were clearly worse off, with GDPs at 141,4, 9,3 and 5,7 billion US dollars respectively.[9] When looking at Mercosur, a hierarchical order can be seen in the economic power each state possesses, with Brazil towering far above the other three

To answer the research question, the relations between Mercosur member states Brazil, Argentina, Uruguay and Paraguay will be assessed by looking at three incidents within Mercosur: The Brazil-Argentina automobile sector crisis, the pulp mill conflict between Argentina and Uruguay and Paraguay's suspension from the institution. By looking at these cases, I hope to make clear that economic power is an important factor within Mercosur, giving states the opportunity to manipulate processes to their own benefit.

Theoretical framework

In the introduction, a few concepts have been brought up that I will explore. This section will explain the concepts of go it alone power, economic power and informal influence. The general argument I will attempt to make is that economic power gives states the opportunity to manipulate outcomes to their own benefit by exerting informal influence, which happens by changing the status quo and using go it alone power.

Go it alone power

In 1648, the Peace of Westphalia created a definition of states that is still used today. The key element of this agreement was that all states enjoy sovereignty, meaning that they have control over everything that happens within their borders. International relations can only be carried out when this sovereignty is accepted by other states.[10] But, sovereignty is a

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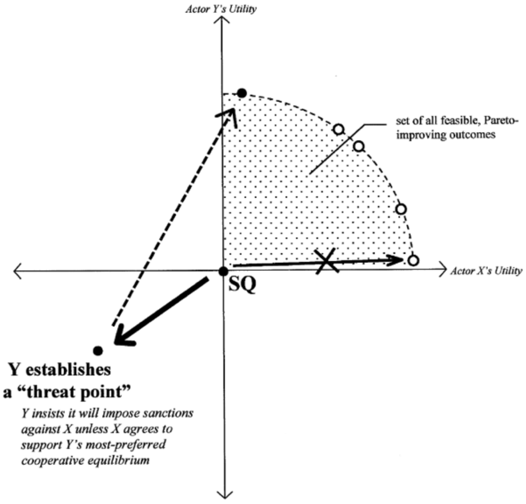
[7] Christian Arnold, "Empty Promises and No incorporation in Mercosur," *International Interactions* (2016): 9, accessed March 25, 2017, DOI: 10.1080/03050629.2016.1206391.
[8] Mikael Wigzell, "Conceptualizing Regional Powers' Geo-economics Strategies: Neo-imperialism, Neo-mercantilism, Hegemony, and Liberal Institutionalism" *Asia Europe Journal* 14 (2016): 144.
[9] "Databank – World Development Indicators," *World Bank*, accessed April 25, 2017, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on.
[10] Andrew Heywood, *Global Politics*, 5.

contested concept and states must deal with more and more actors that challenge their sovereignty. Especially in the contemporary globalized world, where international cooperation plays an important role, states sometimes must give up some of their sovereignty to join international institutions.[11] Within the field of international relations, different theories exist that give multiple reasons for states to join the international institutions. According to the realists, states work together to promote their own interests and to make sure their relative position in the world order improves, while the liberal theory believes that states work together towards a mutual goal where everyone is better off.[12] Both theories agree that states join international institutions to benefit from it, whether these benefits are relative or absolute.

Lloyd Gruber is not convinced that either of these theories is correct. He asks the question: "Why assume that multilateral institutions always and everywhere facilitate mutual gains?"[13] Every action taken within a nation affects people in other states as well. These spillover effects can be positive, but unwanted as well. When, for example, one currency devalues, this can create negative externalities to all its trading partners.[14] According to Keoghan, these negative externalities would cause states to coordinate policy so they both benefit from policies.[15] However, it is often not true that all states benefit the same amount or at all from international agreements, it appears the states that take the initiative for cooperation gain more than the states that go along.[16]

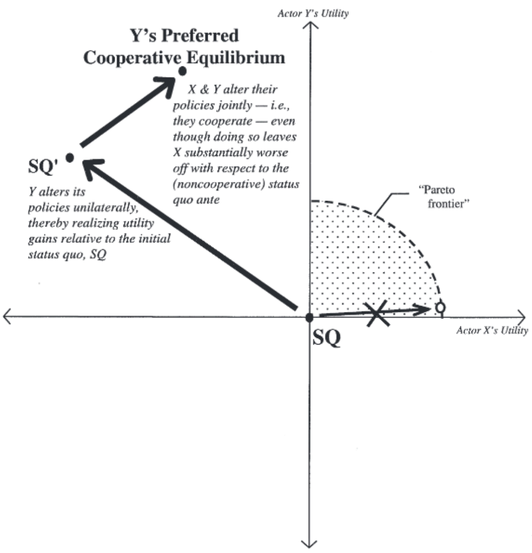
[11] Margaret P. Karnes, Karen A. Mists and Kendall W. Stiles, *International Organizations: The Politics and Processes of Global Governance* (Boulder: Lynne Reiner Publishers, 2015), 76.
[12] Volker Fritterer, Bernhard Zing and Andreas Cruck, *International Organization* (New York: Palgrave Macmillan, 2012), 16, 18.
[13] Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions* (Princeton: Princeton University Press, 2000): 16.
[14] Ibid., 17.
[15] Ibid.
[16] Ibid., 18.

In shaping international institutions and coordinating policy, states negotiate the options. The bargaining position of state is dependent on their potential gains and losses. If a state only has some potential gains and no risk of losing much, their bargaining position is much better, because they can afford to hold off on agreeing until they feel the agreement is good enough. But, if a state does have a lot of potential gains or losses, it cannot afford to do this because they risk losing a lot.[17]



Figuren 2: The thread point

Aside from bargaining, a state can also decide to use coercion to get another state to do what they want. Figure 2 shows the utility of state X and state Y and the options that lie on the Pareto-frontier. This frontier represents the options the two states have within their current status quo, in which neither party is dominant over the other. As long as the status quo stays in place, the frontier consists of the maximum utility each state can achieve.[18] When state Y decides it wants to increase its utility to a point outside of the Pareto-frontier, it can choose to try and coerce state X to go along by, for example, threatening state X with sanctions. If state X does not give in to the threat, state Y will lose something as well. This "threat point" can be seen in figure 2. When state X decides to ignore state Y's threat, the utility of both states will decrease.[19] This mechanism is what makes coercion an undesirable method to get another state to do what you want, since it is not always credible a state will take this risk when carrying out their threat.[20] A better way for state Y to improve its utility, is by coming up with



Figuren 3: The new status quo

[17] Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions*, 34.
[18] Alexander V. Lotto, V.A. Bisphenol and G.K. Kamenev, *Interactive Decision Maps: Approximation and Visualization of Pareto Frontier* (Boston: Kluwer Academic Publishers, 2004), 11.
[19] Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions,* 34.
[20] Ibid., 37.

unilateral policies, creating a new status quo.[21] Figure 3 shows the effect of the new status quo (SQ'): state Y's utility has been improved, while state X's utility has greatly decreased. After the creation of the new status quo, state Y can give state X the option to cooperate, which would lead them to state Y's preferred comparative equilibrium, as can be seen in figure 3. State X can agree, but if they do not want to, state Y will be able to go it alone and still end up with a much higher utility than before.[22] Chances are, state X will agree to state Y's proposed cooperation, since their setback will be much lower than when they do not go along.[23]

This way of looking at international cooperation shows that it is not necessarily true that everyone benefits from it. Sometimes, states are pushed into joining an institution even though it harms them, because the costs of being left out are much higher. This gives the state that can change the status quo a lot of power over the ones that need to go along, creating a circle in which the power asymmetries are maintained.

Economic power and dependency

"Power is like weather. Everyone depends on it and talks about it, but few understand it."[24] These famous words with which Joseph Nye opens his book on power show both the fundamental role of power and the difficulty of defining the concept. The debate on this concept has always been prominent in the field of globalization and cooperation. When observing international cooperation in international institutions, it seems that the more power a state possesses, the more benefits it gets out of the institution. Power is most widely understood as the capability of getting someone to do what you want and with that, being able to influence the outcomes of, for example, policy negotiations or getting states to go along with economic integration.[25] But what exactly is the source of the power that creates these asymmetries?

Talking about power traditionally meant talking about military power, which was measured by indicators as the size of a state's armed forces and their access to advanced weapons and technology. With the start of globalization, this definition of power was mostly

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[21] Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions*, 38.
[22] Ibid.
[23] Ibid., 20.
[24] Joseph Nye, *Soft Power: The Means of Success in World Politics* (New York: Public Affairs, 2004), 1.
[25] Andrew Heywood, *Global Politics*, 210.

left behind and economic power became more relevant.[26] Since the end of the Cold War, a new type of warfare emerged. Instead of inter-state wars, wars are now mostly fought against non-state actors.[27] In a world where war between major states has become unlikely, economic activity has probably become the most important source of power. In one of his works, Huntington states that "[in] the realm of economic competition, the instruments of power are productive efficiency, market control, trade surplus, strong currency, foreign exchange reserves, ownership of foreign companies, factories, and technology."[28] Another reason economic power is has taken a more crucial place in the world order, is the increasing amount of economic dependency that emerged alongside globalization. States with weaker economies have become more dependent on other states and international institutions.[29] This closely relates to the concept of go it alone as described before and the potential gains and losses for each state. Because of this, just looking at a state's GDP is not enough. It is important to look at the amount of trade between states and how much of the state's GDP is made up of that trade. If, for example, the sanction state Y wants to impose on state X is to stop all trade, this will not make a lot of impact if that trade only accounts for an insignificant part of a state's GDP. But, if this trade accounts for a big part of state X's economy, it is dependent on it and will not likely risk the chance of losing it.[30]

Economic power and dependency are important in answering the question posed at the beginning of this thesis, because the poor states simply cannot afford to lose the support of the rich. These asymmetries therefore play a big part in shaping international institutions, but it does not stop there. After the institution has been formed, richer states keep on using this power to go around the formal rules.

Informal influence

Every international institution has a formal design, setting out formal rules and procedures which member states must follow. Within these institutions, every state has a certain amount of control. An important factor of control lies in the voting arrangements of an institution.[31] In some institutions, all votes have the same amount of power while in other

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[26]Andrew Heywood, *Global Politics*, 212, 246.
[27] Ibid., 247.
[28] Samuel P. Huntington, "Why International Primacy Matters," *International Security* 17, no. 4 (1993): 72-73.
[29] Andrew Heywood, *Global Politics*, 357.
[30] Lloyd Gruber, *Ruling the World: Power Politics and the Rise of Supranational Institutions,* 40.
[31] Barbara Foremen's, Charles Lipson and Duncan Snidal, "The Rational Design of International Institutions," *International Organization* 55, no. 1 (2001): 772.

institutions, votes of some member states hold more weight than others.[32] Even though the voting arrangements in an international institution can be completely equal, giving the exact same amount of voting power to every state, states may have the power to exert informal influence, working around the formal rules to achieve their goals.[33] Sometimes, states know that following the rules will not benefit them. If they have enough power within the institution, they may be able to push for an exception on those formal rules to try and achieve a better outcome for themselves.[34] In the shaping of Mercosur, for example, Brazil wanted the institution to have a shared parliament, while Argentina did not. Brazil, being the most powerful state, got what they want.[35] Another way they can use this influence, is breaking an agreement but refusing to have the conflict that follows handled by the institution's dispute settlement system. The most powerful state will therefore get more out of the institution, increasing their own economic power. This causes the gap between the states to grow, bringing the weaker states in a vicious circle of losing control.

If the use of informal influence can harm the weaker member states, why do they not stop it from happening? This is where the concepts described come together. Because some states have less economic power, they become dependent on the richer, more powerful states. These powerful states usually have options outside of the institution, like cooperation with other states of going at it alone.[36] Because of the economic dependency, the richer states can exert informal influence, working outside the formal rules to manipulate the outcome so it benefits themselves the most. This influence can be used in creating policy, but also when breaking the rules. The weaker states will therefore receive smaller gains or maybe even lose, but the price of being left out is much higher.

Research design

The distribution of power among states and the way it changes has had a prominent place in the field of international relations. The way this distribution of power affected the relations between states became especially relevant with the start of globalization, when states

[32] Barbara Foremen's, Charles Lipson and Duncan Snidal, "The Rational Design of International Institutions," 772.
[33] Randall Stone, *Controlling Institutions*, 3.
[34] Ibid., 33.
[35] Maria Claudia Drummond, "The Evolution of the Competence and Functions of the Joint Parliamentary Committee of Mercosur," *Parliaments, Estates and Representation* 23, no. 1 (2003): 235.
[36] Ibid., 39.

started to become more interdependent.[37] States long for a powerful position in the world and one of the things they use to try and reach that, is regional integration. Economic regionalism, the "creation of greater economic opportunities through cooperation among states in the same geographical region" [38], can help states consolidate their regional leadership, making them indispensable on the world stage.[39] Because of this mechanism, where states use economic regionalism to consolidate their economic power, this thesis will focus its research around the distribution of economic power in regional economic institutions.

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Methodology and case selection

To establish a link between the concepts of economic power and informal influence, I will carry out a comparative case study by looking at three incidents that happened in the South American trading bloc Mercosur. The three cases are chosen based on a Most Similar Systems Design. In this type of design, cases are compared that are similar on all relevant independent variables, except for one. The difference in this variable will therefore most likely be the cause of the difference in the dependent variable.[43] In the case of Mercosur, all states share a comparable colonial history that shaped their political and economic landscape.

[37] Andrew Heywood, *Global Politics*, 5.
[38] Ibid., 482.
[39] Christian Arnold, "Empty Promises and No incorporation in Mercosur," 9.
[40] Andrew Heywood, *Global Politics* (New York: Palgrave Macmillan, 2011), 5.
[41] Ibid., 482.
[42] Christian Arnold, "Empty Promises and No incorporation in Mercosur," 9.
[43] Jason Sea wright and John Gering, "Case Selection Techniques in Case Study Research: A Menu of Qualitative and Quantitative Options," *Political Research Quarterly* 61, no. 2: 304.

They all knew long periods of authoritarian rule and protectionism.[44] The independent variable they do differ on, is their economic power.

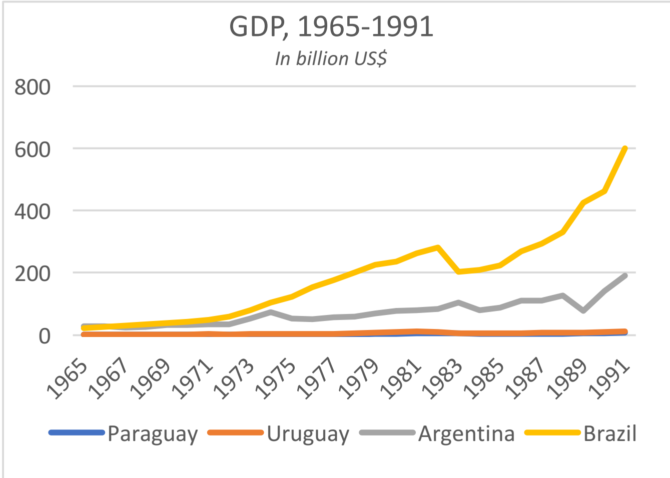

Figure 4: GDP of Mercosur member states between 1965 and 1991

The enormous differences in GDP and industrial capacities between the member states of Mercosur make them an interesting case when assessing the effect of economic power asymmetries on institutions. When looking at economic power, defined by the state's GDP and trade-to-GDP ratio, we can see the hierarchy that exists among these four states. Figure 4 shows the GDPs of the four states from 1965 to 1991, the year Mercosur was founded.[45] The graph immediately shows the enormous size of the Brazilian economy when comparing it to the rest. But, as discussed in the previous section, looking at the states' GDP is not enough, we also need to look at the trade-to-GDP ratio to assess how economically dependent each of the states is. This ratio is shown in figure 5.[46] The first thing that catches our eye is the line that represents Paraguay. It is positioned far above the other three, meaning that Paraguay is a lot more dependent on trade. Brazil has been the least dependent for most of the time, though they have been close to, and even above, Argentina from time to time.

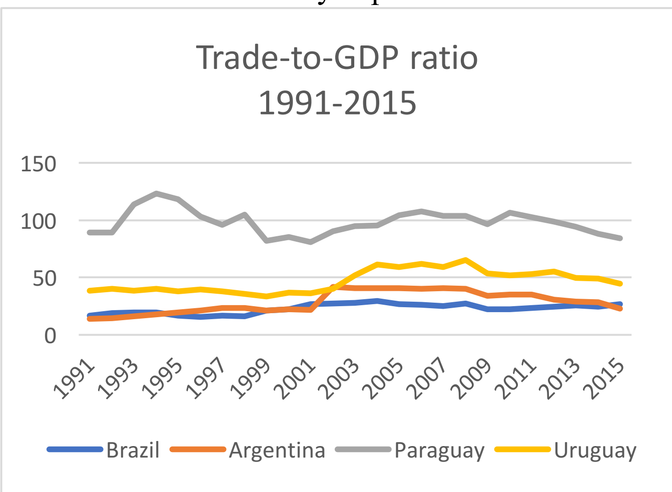

Figure 5: Trade-to-GDP ratio of Mercosur member states between 1991 and 2015

These two figures show a clear difference in economic power between the four states. Brazil clearly is the biggest player in town; its GDP took off and left the others far behind and its trade-to-GDP ratio has been the lowest for most of the time, meaning that it

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[44] Thomas J. Agostino, "Latin American Politics," in *Understanding Contemporary Latin America*, ed. Richard S. Hillman and Thomas J. Agostino (Boulder: Lynne Reiner Publishers, 2011), 69.
[45] "Databank – World Development Indicators," *World Bank*, accessed April 25, 2017, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on.
[46] "Trade (% of GDP)," *World Bank*, accessed June 9, 2017, http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2015&name_desc=false&start=2012

is the least dependent on the other three states. Paraguay, on the other hand, has by far the highest trade-to-GDP ratio, making it much more dependent on the other Mercosur member states. These numbers show a clear hierarchy between the four states, with Brazil on top, followed by Argentina and Uruguay and with Paraguay at the bottom.

To see how this economic power hierarchy translates into informal influence, three incidents that happened within Mercosur will be assessed. Each of these cases shows how the state with more economic power works outside of the formal rules to get what they want. The first case shows the power Brazil had over Argentina during the automobile sector crisis that started in 1995. Just after the signing of a treaty about tariff agreements, Brazil came up with a unilateral automobile regime that went against this treaty and caused great inconvenience to Argentina.[47] The second incident shows the position of Uruguay relative to Argentina, when the latter put up trade blockades which violated the rules of free trade. Even though Uruguay filed a claim against Argentina within Mercosur and won, nothing was done to make sure Argentina took down their blockades.[48] The last case that shows the power asymmetries within the institution, is the suspension of Paraguay in 2012, which was a contested decision. During this suspension, decisions were made without Paraguay, even though their vote would normally be essential. When Paraguay wanted to rejoin and they could, but only if they accepted all the changes that were made during their time out.[49]

By assessing these three cases, I hope to make clear that the differences in economic power cause a certain hierarchy within the institution, making sure the outcomes of most processes mostly favor the most powerful state involved.

Mercosur

The object of analysis in this thesis is the South American trading block Mercosur. Its economic inequality makes it an interesting case, but before we can get into that, I will first give an overview of the history of the four states and the entire process of economic integration.

[47] Laura Gómez-Mere, *Power and Regionalism in Latin America: The Politics of Mercosur* (Notre Dame: University of Notre Dame Press, 2013), 63.
[48] Inka Kaakinen and Ari Lehtinen, "A Bridge that Disconnects – On Shared and Divided Socio-Spatialities in the Pulp Mil Confilct between Uruguay and Argentina," *Forest Policy and Economics* 70 (2016): 106.
[49] Peter Lambert, "The Myth of the Good Neighbour: Paraguay's Uneasy Relationship with Brazil," *Bulletin of Latin American Research* 35, no. 1 (2016): 39.

Historical context and economic integration

Mercosur was chosen to answer the research question based on a Most Similar Systems Design. The four countries that founded the institution are all part of the same geographical region, South America, but they share more than that. After Christopher Columbus arrived in the Caribbean, a long period of colonization started. The Spaniards started conquering a lot of land and the Portuguese started fearing that the Spanish empire would become too powerful. To resolve this problem, the Treaty of Tordesillas was drawn up by the pope in 1494, dividing the world between Spain and Portugal.[50] Figure 6 shows the division that was made and it shows that the land that is now Brazil was awarded to the Portuguese[51]. As can be seen on this map, the Portuguese only had rights over the eastern bulge of the South America. After the conquerors settled in the area, they slowly started moving to the west, creating what is called a "living frontier", establishing a state that now covers almost half of the continent.[52] Despite the difference of being colonized by Spain or Portugal, the states all went through a similar process of colonization, giving them a shared history of struggling with the formation of their governments after independence, resulting in authoritarian rule and protectionism.[53]

Figure 6: The division of the world between Spain and Portugal because of the Treaty of Tordesillas in 1494

Economic integration in Latin America started early on, around the same time as it started in Europe. During the 20th century, multiple attempts of creating free trade areas in Latin America were made, but they all failed. The first was the Latin American Free Trade Agreement (LAFTA) in 1960. The goal was to create an area of free trade, but because of the authoritarian regimes and the protectionist ways in which most countries handled their

[50] Lyle N. McAlister, *Spain and Portugal in the New World: 1492-1700* (Minneapolis: University of Minnesota Press, 1984), 74.
[51] "Treaty of Tordesillas", *Encyclopeadia Brittanica*, accessed on April 30, 2017, https://www.britannica.com/event/Treaty-of-Tordesillas.
[52] Iêda Siqueira Wiarda, "Brazil: A Unique Country," in *Latin American Politics and Development*, eds. Howard J. Wiarda and Harvey J. Kline (Boulder: Westview Press, 2014), 100.
[53] Thomas J. D'Agostino, "Latin American Politics," 69.

economies in that time, LAFTA failed.[54] LAFTA's successor, the *Asociación Latinoamericana de Ingegración* (Latin American Integration Association, ALADI), was created in 1980 with the same goal in mind. Although ALADI was more flexible than LAFTA, it failed because of the widespread collapse of Latin American economies in the beginning of the 1980s.[55]

Things changed in the mid 1980s, when the wave of democratization that went through Latin America brought Brazil and Argentina together. In 1986, the two states signed the *Programa de Integración y Cooperacón Económica Argentina-Brasil* (Program for Integration and Economic Cooperation, PICE), which consisted of agreements on industrialization and trade.[56] In 1988, the Treaty of Integration, Cooperation and Development, creating a common market, was signed by Argentina and Brazil, but it was not implemented until a few years later.[57] In 1990, one of the biggest steps in the creation of Mercosur was made, with the signing of the Buenos Aires Act, which changed the approach to integration by setting up a judicial framework and putting a deadline for the creation of a free trade area: 1994.

The requirement of being democratic was an important factor of integration and because of that, Uruguay was invited to summits from 1985 onwards and joined PICE in 1990 while Paraguay, which did not democratize until 1989, was never part of the negotiations.[58] After the signing of the Buenos Aires Act, Uruguay made it known that they wanted to be included in the common market and went into negotiations with Brazil and Argentina.[59] Paraguay was excluded at first, but voiced their will to join after Uruguay became part of the integration process. Because it had just suffered around thirty years of dictatorship, its democratic institutions were weak and Paraguay was not to be found anywhere near the negotiations. Uruguay negotiated for them, but Paraguay ended up having to do a lot of concessions. But, because of its economic dependency, with these concessions they were still better off than they would be on their own.[60]

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[54] Lia Valls Pereira, "Toward the Common Market of the South," 8.
[55] Karl Kaltenthaler and Frank O. Mora, "Explaining Latin American Economic Integration: The Case of Mercosur," *Review of International Political Economy* 9, no. 1 (2002): 72-73.
[56] Lia Valls Pereira, "Toward the Common Market of the South," 9.
[57] Gian L. Gardini, "Who Invented Mercosur?" *Diplomacy and Statecraft* 18, no. 4 (2007): 806.
[58] Ibid., 818.
[59] Ibid., 819.
[60] Karl Kaltenthaler and Frank O. Mora, "Explaining Latin American Economic Integration: The Case of Mercosur," 88.

In 1991, the moment finally arrived: the presidents of Brazil, Argentina, Uruguay and Paraguay signed the Treaty of Asunción and Mercosur was founded. According to this treaty, a common market had to be in place by December 1994. Trade liberalization, common external tariff, coordination of macroeconomic policy and sectoral agreements were included in the treaties as means to reaching the goal of the common market.[61] The transition period between 1991 and 1994 consisted of a lot of negotiations and was wrapped up with the Protocol of Ouro Preto, which marked the creation of the Joint Parliamentary Committee (JPC), giving Mercosur and international juridical personality.[62] During the negotiations, Brazil was all for the creation of the JPC, while Argentina had its doubts. The creation of the organ therefore was a great accomplishment for Brazil.[63]

Since the customs union came into full effect in 1995, Mercosur has been affected by several challenges. One of the bigger challenges is the lack of enforcement of the institution. Mercosur does have a dispute settlement system, but it has been overlooked in many instances. The reason for this is usually said to be the reluctance of Brazil in establishing a system where all members are able to enforce agreements, meaning that weaker states would have the power to trump powerful states.[64] Furthermore, negotiations on policies seem to be centered around a framework of Brazil's internal economy, mostly complying with their needs and not the needs of the collective.[65] The biggest challenge Mercosur faced were the devaluation crises of Brazil and Argentina in 1999 and 2001 respectively. These had a big impact on Mercosur because the states needed to implement unilateral trade policies to save their own economies. Even though all states have benefited from Mercosur, one more than the other, the institution still needs to be improved in order to properly respond to member states' crises.[66]

[61] Karl Kaltenthaler and Frank O. Mora, "Explaining Latin American Economic Integration: The Case of Mercosur," 75.
[62] Maria Claudia Drummond, "The Evolution of the Competence and Functions of the Joint Parliamentary Committee of Mercosur," 235.
[63] Ibid.
[64] Lia Valls Pereira, "Toward the Common Market of the South," 16.
[65] Ibid., 17.
[66] Mario E. Carranza, "Can Mercosur Survive? Domestic and International Constraints on Mercosur," *Latin American Politics and Society* 45, no. 2 (2003): 86.

Economic power asymmetries

Before Mercosur

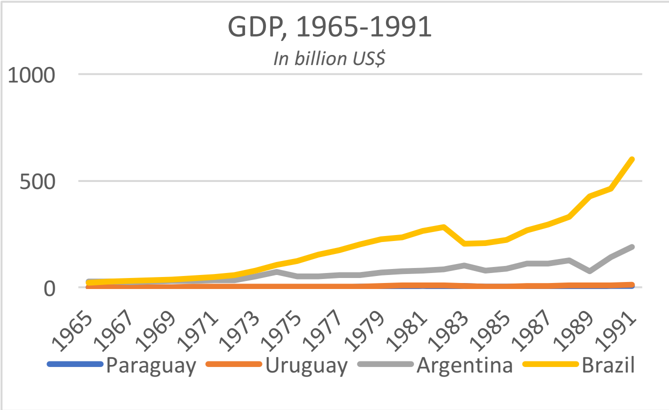


Figure 7: GDP of the Mercosur member states between 1965 and 1991

Brazil has been a strong regional power for quite some time now and it enjoys a lot more economic power than the other three Mercosur member states. The concept of economic power is measured by looking at the states' national GDP and its trade-to-GDP ratio to determine its economic dependency. Figure 7 shows the GDP levels of Brazil, Argentina, Uruguay and Paraguay from 1965 to 1991, the year Mercosur was founded.[67] It clearly shows the differences in the size of the economy between the four states. In 1965, Brazil and Argentina were around the same level but Brazil's economy slowly started to grow and left Argentina behind. Even during their drop in the 1980s, Brazil's economy was a lot larger than Argentina's. Uruguay and Paraguay have done a lot worse when it comes to the economy. Although their position in the 1960s was not that much worse than that of Brazil and Argentina, when the latter two took off, Uruguay and Paraguay did not. Figure 7 does not show a lot of difference between Uruguay and Paraguay, but when zooming in, it becomes clear that their economies are quite far apart. Figure 8 presents the economic position of Uruguay and Paraguay and it shows that Uruguay had a much larger economy than Paraguay.[68]

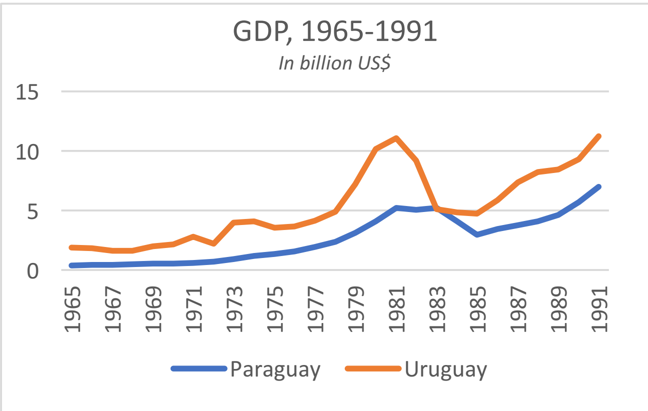


Figure 8: GDP of Paraguay and Uruguay between 1965 and 1991

Two things become clear when looking at these graphs. First, it shows a clear hierarchy between the four member states before Mercosur was founded. Brazil has definitely been on top and, especially in the last decade before the founding of the institution, took off and left the other three states far behind. The second thing that becomes clear, is the weak position of Uruguay and Paraguay. They both perfomed a lot worse than both Brazil and

[67] "Databank – World Development Indicators," *World Bank*, accessed April 25, 2017, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on.
[68] Ibid,

Argentina, but the differences between the top two and the bottom two are so immense that the asymmetries between Uruguay and Paraguay are barely even noticable, showing the large asymmetry between the top two and the bottom two. This does not mean that the difference between Uruguay and Paraguay is not important. Except for a short period of time in the early 1980s, Uruguay has performed a lot better than Paraguay.

Since the foundation of Mercosur

One of Mercosur's goals was to promote the economic performance of every member state and facilitate the competitive position in the world economy.[69] Figure 9 shows the changes in GDP between the founding of Mercosur in 1991 and 2015.[70] While all states benefited from Mercosur, Brazil benefited from the institution more than the other three states. Brazil's economy grew a lot more than that of the other three states. These asymmetries in increase of economy made sure the gap between Brazil and the rest got bigger, giving Brazil the upper hand. Figure 10 shows the percentages of the total GDP of Mercosur that each member state contributed in 2015.[71]

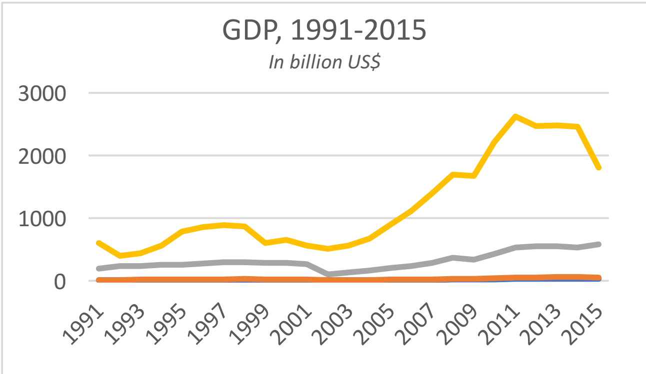
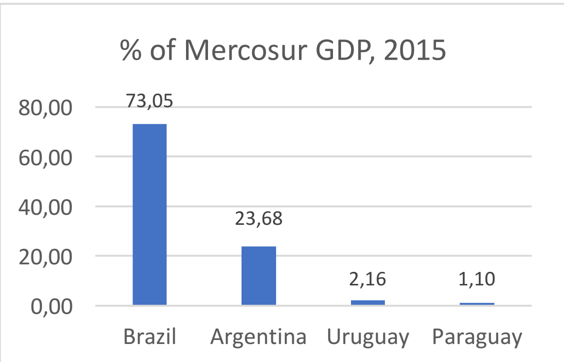


Figure 9: GDP of Mercosur member states between 1991 and 2015

Brazil is responsible for almost 75% of Mercosur's GDP while Uruguay and Paraguay together do not even account for 4%. These data leave no doubt about the enormous asymmetries in the size of the economy between the four Mercosur member states.



Figuren 10: Percentages of Mercure GDP

[69] Instituto de Relaciones Europeo-Latino Americanas, "Mercosur: Prospects for an emerging bloc," *Dossier n°61* (1997): 3.
[70] "Databank – World Development Indicators," *World Bank*, accessed April 25, 2017, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on.
[71] Ibid.

Figure 11, as seen in the section on case selection, shows the trade-to-GDP ratio of the four states between 1991 and 2015.[72] The graph shows that Paraguay's GDP is made up by trade more than is the case in the other three states. Therefore, Paraguay is more economically dependent on trade and has the most to lose. It is followed by Uruguay, Argentina and lastly Brazil, which is the least dependent on trade.

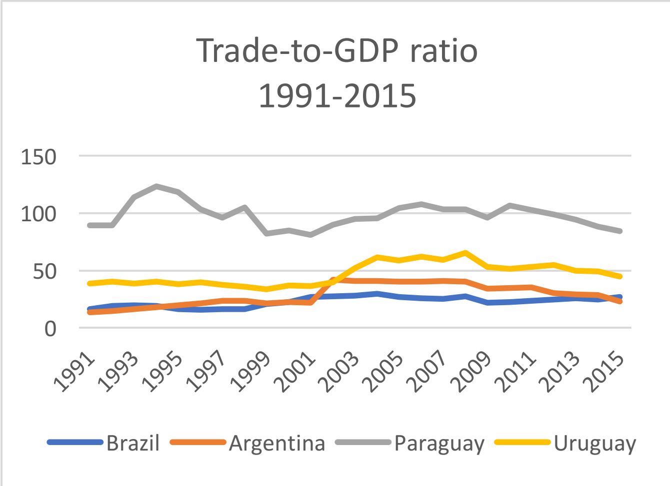


Figure11: Trade-to-GDP ratio of Mercosur member states

When combining the two indicators, GDP and trade-to-GDP ratio, we can see that a hierarchy has formed based on economic power: first Brazil, then Argentina, then Uruguay and Paraguay last.

Cases

Brazil-Argentina automobile sector crisis

Since the state became independent from Portugal in 1822, Brazil had taken on a protectionist economic stance. Policies created out of this protectionism created the Brazilian Miracle, increasing the size of the economy significantly.[73] It was not until after the state completed the process of democratization in 1985 that the state shed its protectionist ways, hopped on the train of globalization and strengthened economic ties with others.[74] Brazil took the lead in regional integration in the Southern Cone and in the formation of Mercosur. The only reason for taking on leading role in the region seemed to be their own economic gains, working together with Argentina, Uruguay and Paraguay was supposed to boost their economy and place them on the world map.[75] These intentions, centered around self-interest, become clear when looking at certain incidents and disputes in Mercosur.

[72] "Trade (% of GDP)," *World Bank*, accessed June 9, 2017, http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2015&name_desc=false&start=2012.
[73] Peter Kingstone, "Sobering up and Going Global: Brazil's Progress from Populism and Protectionism," *Law and Business Review of the Americas* 15, no. 1 (2009): 107.
[74] Iêda Siqueira Wiarda, "Brazil: A Unique Country," 99.
[75] Mikael Wigell, "Conceptualizing Regional Powers' Geoeconomic Strategies: Neo-imperialism, Neo-mercantilism, Hegemony, and Liberal Institutionalism," 144.

From 1991 to 1994, which is known as the transition period, the Mercosur member states negotiated all facets of the customs union they wanted to form. Rules on external tariffs were agreed upon in the Protocol of Ouro Preto, which was signed at the end of the transition period in 1994. In a few sectors, special agreements were reached. The automobile sector fell under one of these special agreements.[76] Decision 29/94 in the Protocol of Ouro Preto included the automobile sector and stated that Brazil and Argentina could not implement new unilateral regimes within their new area of free trade and that a common regime should be in place no later than the year 2000.[77]

Just one year later, Brazil experienced some financial setbacks and tried to alleviate some of their troubles by limiting the automobile imports in order to promote their own industry. This unilateral regime did not exclude the Mercosur partners which angered the other member states. [78] Table 1 shows the amount of Argentina's automobile exports and the amount of it that is exported to Brazil.[79] Clearly, Brazil was Argentina's most important partner in the trade within the automobile sector, so it is no surprise that Argentina was not amused with Brazil's new regime. After Brazil made it known that they were going to restrict automobile imports, Argentina immediately referred to decision 29/94, stating that Brazil broke the agreement. Brazilian president Cardoso agreed to postpone the new regime for thirty days, giving the states time to work out a new agreement. Though Argentina was happy that Brazil wanted to talk, their happiness was short lived when Cardoso announced that, while they were open to talks, the new regime was not negotiable. [80]

	Total exports *in million US$*	**Exports to Brazil** *in million US$*	**Exports to Brazil as share of total exports** (%)
1990	33.6	1.8	5.3
1991	71.7	36.6	51.0
1992	113.3	78.7	69.4
1993	299.9	225.2	75.1
1994	447.8	324.2	72.4
1995	733.9	661.2	90.0

Table 1: Argentine automobile exports between 1990 and 1995

[76] Lia Valls Pereira, *Toward the Common Market of the South: Mercosur's Origins, Evolution, and Challenges*, 13.
[77] Andrés Malamud, "Presidential Diplomacy and the Institutional Underpinnings of Mercosur: An Empirical Examination," *Latin American Research Review* 40, no. 1 (2005): 143.
[78] Ibid., 144.
[79] Laure Gómez-Mera, *Power and Regionalism in Latin America*, table 4.3, 84.
[80] Ibid., 63.

Negotiations were carried out between the presidents of the four member states, who all came together for a reginal summit which was followed by a bilateral summit with just the presidents of Brazil and Argentina.[81] During the negotiations, Brazil took a hard stance in its refusal to exclude their Mercosur partners from the regime. Argentina kept pointing out that this was not acceptable, since they deliberately went against decision 29/94. But, after the bilateral summit, things took a drastic turn when Argentina suddenly announced that it was going to respect Brazil's new regime, even though it clearly favored Brazil while Argentina suffered the economic costs.[82]

In this case, we can clearly see the go it alone power Brazil holds because of their economically powerful position. After the signing of the agreements during the transition period, Brazil felt it did not benefit from the new automobile regime. They decided to change the status quo, bettering themselves and hurting Argentina. Argentina had two options: go along or not. Brazil would not budge on their new regime, so Argentina knew that if they did not go alone, Brazil would simply go it alone and leave them behind, so going along would minimize their economic loss.

Argentina-Uruguay pulp mill conflict

In 2005, Finnish company Metsä-Botnia invested in a large pulp mill in Uruguay. This pulp mill, an important part of the process of turning wood into paper, was built in Fray Bentos, a city along the Uruguay river, which constitutes the border between Uruguay and Argentina.[83] This occurrence marked Uruguay's largest foreign direct investment and it was received with open arms in Fray Bentos because of all the job opportunities it would create.[84] On the other side of the river, in the Argentine city of Gualeguaychú,

Figure 12: Map of the conflict region

[81] Andrés Malamud, "Presidential Diplomacy and the Institutional Underpinnings of Mercosur: An Empirical Examination," 143.
[82] Laura Gómez-Mera, *Power and Regionalism in Latin America*, 81.
[83] Jussi Pakkasvirta, "From Pulp to Fiction? Fray Bentos Pulp Investment Conflict trough the Finnish Media," *Journal of the Nordic International Studies Association* 43, no. 4 (2008): 422.
[84] Inka Kaakinen and Ari Lehtinen, "A Bridge that Disconnects – On Shared and Divided Socio-Spatialities in the Pulp Mill Conflict between Uruguay and Argentina," 108.

people were not as pleased with the new mill. Their first concern was that the pulp mill would seriously pollute the river, causing undesirable ecological effects. Their other concern had to do with the Las Cañas beach, which can be seen in figure 12 [85], a popular tourist attraction for both Argentines and Uruguayans, but also people from all over the world.[86] The people of Gualeguaychú, united in a group called *Asamblea Ciudadana Ambiental Gualeguaychú* (Citizen's Environmental Assembly of Gualeguaychú, ACAG), started their protests at the end of April 2005. During this time, Uruguayan citizens also supported the protests in hopes of saving the environment, but as time progressed, most of them started to support their government and protests were solely carried out by Argentine citizens.[87]

Nestor Kirchner, president of Argentina, supported the local movement of Gualeguaychú and did everything he could to fight the construction of the pulp mill. He even went as far as to sue Uruguay in the International Court of Justice, claiming that Uruguay violated the Bilateral Treaty of the Uruguay River. According to that treaty, both states had to agree to anything concerning the river that may harm it and Argentina claimed that Uruguay did not hold its end of the bargain with the construction of a pulp mill that would possibly pollute the river.[88] The International Court of Justice did not give in to Argentina's demands, stating that there was no proof that the pulp mill would pollute the river. With this ruling, Argentina had to find another way to stop the pulp mill from being constructed. Argentina and Uruguay are connected by several cross-border bridges and these bridges are essential in transnational trade. Because of the importance of the bridges, the ACAG saw them as a means in their cause and they put up road blocks, closing the bridges and hindering trade.[89] The Treaty of Asunción states that Mercosur member states are obligated to facilitate a free circulation of people and goods.[90] With the road blocks on the cross-border bridges, trade between Argentina and Uruguay was made almost impossible, causing Uruguay to appeal to the Mercosur dispute settlement system. The ad hoc tribunal that was set up for this case

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[85] Jussi Pakkasvirta, "From Pulp to Fiction? Fray Bentos Pulp Investment Conflict through the Finnish Media," 423

[86] Luigi A. di Martino, "Institutional Deficit for Cross-border Conflict Resolution: The Conflict over the Construction of a Pulp Mill near the Uruguay River," *Journal of Borderlands Studies* 24, no. 3 (2009): 115.

[87] Ibid., 121.

[88] Inka Kaakinen and Ari Lehtinen, "A Bridge that Disconnects – On Shared and Divided Socio-Spatialities in the Pulp Mill Conflict between Uruguay and Argentina," 106.

[89] Ibid., 109.

[90] Emilio J. Cárdenas and Guillermo Tempesta, "Arbitral Awards under Mercosur's Dispute Settlement Mechanism," *Journal of International Economic Law* 4, no. 2 (2001): 338.

unanimously agreed that Argentina violated the Treaty of Asunción, but when Uruguay asked for measures to stop the blockades, Mercosur did nothing.[91]

The trade-to-GDP ratio shown before makes clear that Uruguay is very dependent on trade. In 2005, when all of this went down, 59% of their GDP was generated by trade against only 41% in Argentina.[92] This made the settlement of this dispute important to Uruguay, as they needed to be able to use the cross-border bridges for their imports and exports. Argentina did not have that much to lose and kept fighting until the bitter end, not willing to give in to the building of the pulp mill. This case, again, shows how the state with the better economy has the informal power to do what they want without consequences, even after being condemned for doing it.

Paraguay's suspension

After becoming independent from Spanish rule in the nineteenth century, most Latin American countries struggled with the formation of their own governments, which led to widespread authoritarianism in the region.[93] The region got caught in a wave of democratization in the 1980s, and slowly all states left their past of military rule behind them. Argentina was the first of the Mercosur member states that held democratic elections in 1983. They were followed by Brazil and Uruguay in 1985 and Paraguay joined them in democracy in 1989.[94] Because of the problems the region knew with military regimes, democracy was institutionalized in the Declaration of the Democratic Agreement and the Protocol of Ushuaia. According to the latter, member states must maintain a democratic system and when they fail in doing so, the other states have the opportunity to suspend them.[95]

Paraguay's democratic landscape consists of a multiple party system with two main political parties: the conservative Colorado Party and the Liberal Party. The Colorado Party had always been dominant, until Fernando Lugo was elected as the first liberal – and more

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[91] Luigi A. di Martino, "Institutional Deficit for Cross-border Conflict Resolution: The Conflict over the Construction of a Pulp Mill near the Uruguay River," 126.
[92] "Trade (% of GDP)," *World Bank*, accessed June 9, 2017, http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2015&name_desc=false&start=2012.
[93] Thomas J. D'Agostino, "Latin American Politics," in *Understanding Contemporary Latin America*, ed. Richard A. Hillman and Thomas J. D'Agostino (Boulder: Lynne Rienner Publishers), 69.
[94] Anna van der Vleuten and Andrea R. Hoffmann, "Explaining Enforcement of Democracy by Regional Organizations: Comparing EU, Mercosur and SADC," *Journal of Common Market Studies* 48, no. 3 (2010): 746.
[95] Ibid.

importantly, non-Colorado – president in 2008.[96] Lugo had to deal with strong opposition from the Colorado Party and had to work with a weak coalition that was mostly interested in keeping the Colorado's out. The Colorado Party tried to impeach the president on more than one occasion, but they did not succeed, until 2012.

A group of landless peasants had claimed a piece of land in the city of Curuguaty and the local police attempted to evict them in June 2012. During the eviction, thing escalated, shots were fired and 17 people died. The Colorado Party accused Lugo of being the cause of the crisis and called for impeachment based on a "poor performance of duties".[97] After the killings, Lugo replaced the chief of national police and the interior minister. The man he appointed to the latter position, Rubén Candia Amarilla, was part of the Colorado Party. This lost him the support of his own party, making the impeachment successful and at the end of June, Lugo's presidency was over.[98] Even though the impeachment was carried out legally according to the 1992 constitution and Lugo accepted it and stepped down, both national and international actors claimed it to be an 'institutional coup' because the decision was made hastily and Lugo got less than 24 hours to prepare his defense.[99] The other three Mercosur members came together after the impeachment and decided to suspend Paraguay for breaking the democratic agreement. Paraguay was allowed to enter again after they held new elections.[100]

During this suspension, a lot happened that was contested by the Paraguayan government. The most questionable was the admittance of Venezuela little more than a month after Paraguay was suspended. [101] The other three states knew that Paraguay did not want Venezuela to be part of the institution and as a reaction, Paraguay filed a claim with the Mercosur court. They argued that allowing Venezuela to enter violated article 20 of the Constitutive Treaty, which states that all requests for accession must be agreed upon unanimously.[102] The court issued its decision without looking at the merits of the case and Paraguay drew the short straw. They had to wait to re-enter the institution until democratic

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[96] Leiv Marsteintredet, Mariana Llanos and Detlef Nolte, "Paraguay and the Politics of Impeachment," *Journal of Democracy* 24, no. 4 (2013): 112.
[97] Ibid, 110
[98] Peter Lambert, "The Myth of the Good Neighbour: Paraguay's Uneasy Relationship with Brazil," 113-114.
[99] Ibid., 39.
[100] Leiv Marsteintredet, Mariana Llanos and Detlef Nolte, "Paraguay and the Politics of Impeachment," 114.
[101] Ibid.
[102] Geraldi Vidigal, "Enforcing Democracy at the Regional Level: Paraguay's Suspension before the Mercosur Court," 346.

elections were held in 2013 and under the strict condition that they accepted Venezuela as a full member.[103]

In this case, the three most powerful member states made a dubious decision by suspending the weakest link and making all kinds of decisions during the suspension they otherwise could not have made. The status quo was changed and Paraguay had the option of rejoining the institution on new terms or letting the other three states go it alone. Since Paraguay is so economically dependent on trade, with a trade-to-GDP ratio of 99% in 2012, it had to fold and rejoin the institution and it was made clear that their place was still the bottom.

Discussion and analysis

When looking at the relations between the Mercosur member states since the beginning, after they became independent, one thing has become clear: Brazil has always been the big brother, determining the ways and directions of economic integration. When the states had just become independent, Brazil had the upper hand and, together with Argentina, dominated Uruguay and Paraguay. When economic integration started, it was Brazil and Argentina who set everything up and invited Uruguay and Paraguay to join, as long as they complied with their ideas. Brazil had a big say in the institutional buildup of Mercosur and their national economy was the main framework around which policy was made. The process of the foundation of Mercosur shows the first signs of go it alone power, because Brazil and Argentina created the framework, changing the status quo in a way that Uruguay and Paraguay had to go along to minimize their losses.

My theoretical argument stated that each state has a certain amount of economic power, determined by GDP and trade-to-GDP ratio. This is largely based on economic dependency, because when a big part of a state's GDP is determined by trade, it becomes very dependent on the relations with the states it trades with. If a state has a lot of economic power, it has the option to exert informal influence within international institutions. It can act outside of the formal rules and shape the outcome to benefit themselves. Economic power can give a state the opportunity to change the status quo. If this new status quo disadvantages other

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[103] Leiv Marsteintredet, Mariana Llanos and Detlef Nolte, "Paraguay and the Politics of Impeachment,": 115.

states, they can either go along or let the powerful state go it alone. States will mostly choose to go along in order to minimize their loss.

The cases, summarized in table 2, discussed in this thesis seem to agree with the theory. In the first case, Brazil violated the formal rules of the institution by implementing a unilateral trade regime concerning the automobile sector. A large part of Argentina's automobile exports went to Brazil and since Mercosur partners were nog excluded, Argentina was greatly harmed. Because Brazil had a lot of economic power, they got away with changing the status quo, more or less forcing Argentina to go along with their new regime in order to limit their losses. The second case showed the importance of economic dependency in international cooperation. Uruguay has been very dependent on trade, so when Argentine activists closed the cross-border bridges between Uruguay and Argentina, hindering international trade, Uruguay was in trouble. Argentina did not have a lot to lose, so the government did nothing to put an end the blockades the activists put up. Again, the state with the most economic power won. Case number three showed how the state with the least economic power was shut out by the other three with a controversial suspension. Brazil,

Dispute	Process	Outcome
Brazil-Argentina automobile sector crisis	Brazil implemented a unilateral automobile regime, going against the Mercosur agreements. The new regime disadvantaged Argentina and the two states negotiated the new regime outside of the formal dispute settlement system.	Brazil stated it would not budge on its new regime, creating a new status quo that disadvantaged Argentina because of its dependence on automobile trade with Brazil. Argentina had the option to go along or not. If they would not go along, Brazil had the economic power to go it alone. Either way, Argentina would lose, but by going along with Brazil's new regime their loss would be less severe.
Argentina-Uruguay pulp mill conflict	In Uruguay, a pulp mill was built along the river that borders Uruguay and Argentina. The Argentine people protested it and blocked the cross-border bridges out of protest, hindering trade to and from Uruguay. This went against Mercosur rules, so Uruguay filed a complaint with the dispute settlement system.	The Mercosur dispute settlement system ruled that Argentina was at fault, but they did nothing to stop the trade blockades. Uruguay, being very dependent on international trade, suffered great disadvantage due to the blockades. Argentina depends a lot less on trade and fought to the bitter end, going against the rules without any consequences.
Paraguay's suspension	After the Paraguayan president was impeached, the state was suspended from Mercosur. This was questionable and during the suspension, decisions were made behind Paraguay's back. Paraguay fought the suspension and the decision that were made during it in the Mercosur court.	The court ruled against Paraguay, meaning it could only rejoin the institution if it accepted everything that changed during their suspension. Paraguay therefore had the option of rejoining under conditions that did not favor them or not rejoining, letting the institution go it alone, which would have brought them even more disadvantage because of their economic dependency.

Table 2: Overview of the cases

Argentina and Uruguay made some decisions during this suspension they would not have been able to make if Paraguay had been present. In the end, Paraguay was allowed to rejoin, only if they accepted the changes that had been made. In this case, the three most powerful states changed the status quo and Paraguay had two options, just like Argentina in the first case: go along or let the institution go it alone. Paraguay would lose either way, but their losses would be smaller if they went along so a year after their suspension, they rejoined Mercosur.

When assessing these three cases, we can see that Brazil, the state with the most economic power, trumped Argentina, Argentina, as second in line, trumped Uruguay and all three states together trumped Paraguay, the weakest link. Economic power gives a state the upper hand because other states are economically dependent on it. Because of this dependency, weaker states cannot afford to lose their relations and have to go along with the new status quo created by their superiors.

One of the big difficulties in this research, is that it is hard to draw any hard conclusions on the effect of economic power, because it is not always clear what the rationale of decisions was. There is a clear correlation between economic power and the outcome of disputes, but more extensive research should be conducted to further assess the causality of this mechanism. Besides that, this thesis had not paid a lot of attention to the member states' domestic affairs. Looking at the internal pressures from citizens or politicians may provide us with more insight on the choices the states made. Another thing further research should focus on, is the effect of economic power on a wider level. Here, I chose to look at regional power but the same effects may be present on a global or transnational level. But, shortcomings put aside, one thing has become clear: economic power matters and it appears the utopian world of Walter Annenberg, where money power is irrelevant, is nothing but a fairytale.

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