Brazilian Regional Power in the Development of Mercosul

by

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President Fernando Henrique Cardoso's government presided over three critical junctures in the development of the Common Market of the South (Mercosur): the attempted military coup in Paraguay in 1996, the devaluation of the Brazilian real in 1999, and the Argentine economic crisis in 2002. Its responses to these events were critical to the development of Mercosur because of Brazil's unique position as the largest country in the bloc. Many theories of free trade and regional integration hold that economic integration requires a regionally preponderant power that acts as a core provider of collective goods for member states. When such a power provides benefits, satisfaction among the member states increases and the likelihood of integration is increased. An examination of the Cardoso governmen's policies during the three critical junctures suggests that regional integration declined when Argentina incurred costs during the Brazilian currency crisis and increased when Cardoso's government provided aid during the Argentine economic crisis and helped defeat the attempted coup in Paraguay.

Keywords: Mercosur, Regional integration, Regional power, Interdependence, Economic cooperation

The establishment of the Mercado Comum do Sul (Common Market of the South or Mercosur) in 1991 is one of the most significant foreign policies adopted by Brazil since the country's democratization in 1985. The Fernando Henrique Cardoso government was responsible for a good part of its evolution. During the eight years (1995-2002) of the Cardoso presidency, Mercosur experienced three challenges to its development and tested the Cardoso government's commitment to its survival and progress. These critical junctures include the attempted military coup in Paraguay in 1996, the devaluation of the Brazilian currency in 1999, and the Argentine economic crisis in the early 2000s. We argue that the Cardoso government's responses to these events were critical to the development of Mercosur because of Brazil's unique position as the largest economy in the regional bloc (see Figs. 1 and 2).

Much of the literature on free trade and regional integration argues that trade liberalization and economic integration require a regionally preponderant power that acts as a core provider of collective goods for member states (see Krasner, 1976; Gilpin, 1987; 2001; Haggard, 1997; Efird and Genna, 2002; Genna and Hiroi, 2004). According to this literature, larger trade partners are willing to incur disproportionate costs because they expect the benefits from

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cooperation to outweigh them. In addition, their larger size allows them to take on these costs. Therefore, they help their partners in the free-trade area to achieve greater benefits from free trade. In addition, larger countries can use the economic dependence of smaller countries to enforce regional agreements such as a commitment to democracy or neoliberal economic policies including free trade. In contrast, the decline of a leading power's capabilities may lead to stagnation or weakening of regional integration. Thus, the behavior and
capabilities of the preponderant power critically influence the progress of integration, increasing or decreasing the level of satisfaction among member states. If the preponderant power provides benefits, these benefits increase satisfaction among members and improve integration. When its capabilities diminish, its behavior may be costly for other member states. Costly behavior on the part of the preponderant country hampers its leadership ability, and as a result dissatisfaction grows and integration stagnates or regresses. In short, the preponderance of one country is a necessary but not sufficient condition for regional integration. Integration also requires satisfaction.

We analyze and evaluate the Cardoso government’s Mercosul policies from this perspective. Specifically, we examine those policies at three critical junctures—the attempted military coup in Paraguay in 1996 and the Brazilian and Argentine currency crises in 1999 and 2002, respectively. Evidence shows that regional integration declined when Argentina incurred costs during the Brazilian currency crisis but improved when Brazil provided aid during the Argentine crisis and helped to defeat the attempted coup in Paraguay. While the Cardoso government improved relations with its regional partners by rendering aid to them, its decision to devalue the real without regard for its Mercosul partners produced dissatisfaction and reduced integration. At the same time, its assistance in the Argentine crisis shows that Brazil was willing to provide benefits to Mercosul partners even if it proved costly for the country in the short run. This behavior demonstrates Brazil’s commitment to promoting regional integration.

HOW BRAZILIAN POLICY MAKERS VIEW MERCOSUL

Mercosul is a departure from earlier ideas of economic cooperation in Latin America, which focused on regional self-reliance through import-substitution industrialization. By contrast, it emphasizes greater integration into the world economy through specialization of production, freer flows of goods and services, and fiscal and monetary stability. In addition to economic goals, it has political objectives, one of which is the consolidation of democracy in the region. In fact, Mercosul was one of the measures that the first Brazilian civilian president after democratization, José Sarney, pursued to promote democracy in the country (Correio Brasiliense, 2005), and the founding agreement, the Treaty of Asunción, was signed in 1991 by his successor, Fernando Collor, and his counterparts in Argentina, Paraguay, and Uruguay.

Brazilian officials' give the following reasons for Brazil’s interest in maintaining Mercosul. First, Mercosul is seen as a mechanism for ending the cycle of military coups in the region. The Cardoso government’s response to the attempted coup in Paraguay is a demonstration of this commitment. Second, Mercosul is regarded as a possible alternative to the terms of the international trade regime, which many feel are biased toward developed countries’ preferences. As a result, Brazil needs to keep Mercosul developing so that member states can speak with one voice in trade talks with the European Union and the United States. In the talks that began in 1995 for a future Mercosul-EU Free Trade Agreement and those that began in 1994 for a future Free Trade Area of the Americas, Brazil insisted that negotiations be held through the
regional group (Valls Pereira, 1999). Indeed, the greatest benefit that Mercosul offers to Brazil, in Brazilian officials’ view, is the bargaining leverage that the economic bloc can give to the country vis-à-vis countries of other regions during international trade negotiations. If Brazil, the largest country in Mercosul, is willing to take more responsibility for its sustenance and advancement than other member countries, the latter are likely to follow its lead. However, if Mercosul partners feel that it is acting in its own interest at their expense, then they are less likely to align their preferences with Brazil’s. These motivations and attitudes underlay the actions of key policy makers both in the Cardoso government and in those of the other member countries at the three critical points under study.

AN ATTEMPTED COUP IN PARAGUAY

In April 1996 Mercosul received a challenge to its commitment to democracy with the threat of a coup led by General Lino César Oviedo against Paraguayan President Juan Carlos Wasmosy. Signs of a threat to Paraguay’s fledgling democracy had begun earlier, coinciding with Cardoso’s inauguration in 1995, and Cardoso had offered total support to President Wasmosy (United Press International, 1995). After meeting with Wasmosy, he promised that any extra-constitutional change in Paraguay would mean its complete isolation within Latin America, politically and economically.

General Oviedo’s grievances against the Wasmosy administration stemmed mainly from its effort to end the contraband trade and implement neoliberal reforms (United Press International, 1995). In addition, Oviedo considered Wasmosy beholden to him because he had been a key player in Wasmosy’s rise to power and therefore felt slighted when Wasmosy refused to transfer Oviedo’s chief rival during the mass restructuring of the military (Washington Post, 1995). The attempted coup began on April 22, 1996, when Wasmosy dismissed Oviedo as the commander of the army. Instead of accepting the president’s decision, Oviedo barricaded himself at the First Army Corps headquarters and claimed that he would give up his command only if he was named defense minister (Writer, 1996). Threats of a coup surfaced after Oviedo’s successor, General Oscar Delmas, refused to accept his new command and sided with Oviedo, along with 29 other generals (Writer, 1996).

President Cardoso, anticipating a coup attempt on Oviedo’s dismissal, created an ad hoc emergency cabinet consisting of the heads of the military, the secretary of strategic affairs, and the secretary-general of the Ministry of Foreign Affairs to monitor the evolution of the crisis (Istoé, 1996a). While Wasmosy sought refuge in the U.S. embassy, Brazilian Ambassador Mário Paulo de Oliveira Dias served as a mediator between the president and the defiant general. Ambassador Dias reported to Oviedo that Brazil, the Mercosul partners, and the rest of the international community would not recognize his rule and that he could expect complete isolation (Washington Post, 1996). Brazilian Army Minister Zenildo de Lucena also attempted to dissuade Oviedo from overthrowing the democratically elected president (Valenzuela, 1997).

The list of threatened sanctions that Dias delivered to Oviedo would have crippled the Paraguayan economy (Istoé, 1996a and 1996b). First, Brazil
warned that it would sever ties immediately and then seek Paraguay’s expulsion from Mercosul. While Paraguay’s exports to Brazil in 1991 had amounted to a little less than 20 percent of its gross domestic product (GDP), by 1995 the figure had increased to over 50 percent (International Monetary Fund, 2004), and therefore the severing of ties with Brazil would have meant serious economic damage for Paraguay. Second, the Cardoso government threatened to close the Ponte da Amizade (Friendship Bridge) and the ports of Santos and Paranaguá, all of which were major conduits for Brazilian-Paraguayan commerce. Finally, payments for electricity generation at the Itaipu Dam, which represented 26 percent of the Paraguayan government budget, would be suspended. In sum, these sanctions amounted to cutting off the “oxygen” of the Paraguayan economy (Istoé, 1996b).

In addition, the Cardoso government offered various forms of assistance to Paraguay’s pursuit of economic development based on regional integration, all of which would end if Oviedo took over. For example, it had made funds available through the Banco Nacional de Desenvolvimento Econômico e Social (Brazilian National Bank of Economic and Social Development—BNDES) to establish car-parts manufacturing plants in Paraguayan border regions with investors coming mainly from auto industries in the Brazilian state of Paraná (legislative adviser to the Brazilian Senate, interview, July 2, 2003). It had also eliminated the so-called double taxation, leaving investors to be taxed only by the host country (Paraguay). This arrangement was effectively a Brazilian subsidy to Paraguay. At the same time, breaking off trade with Paraguay would have harmed certain sectors of the Brazilian economy, and effectively shutting down the Itaipu generator would have meant cutting 25 percent of Brazil’s electricity (Itaipu Binacional, 2005). Given Paraguay’s economic dependence on Brazil and the Cardoso government’s demonstrated commitment to maintaining democracy among the member states, Oviedo’s followers recognized the futility of their actions, and Oviedo surrendered himself on April 24. Brazil, speaking for the Mercosul bloc, had played a crucial role in maintaining constitutional order in Paraguay and contributed to the consolidation of Mercosul (Istoé, 1996b).

DEVALUATION OF THE REAL

In contrast to the prevention of a coup in a partner country, the Cardoso government’s management of the country’s currency crisis had negative repercussions for the other Mercosul countries. On January 13, 1999, in the midst of strong pressures on its currency and dwindling foreign exchange reserves, the government widened the exchange-rate band and effectively devalued its currency. By the end of January the real had lost 42 percent of its value against the Argentine peso and was still falling (Fig. 3). The devaluation adversely affected Mercosul members, especially Argentina. Because the economic deterioration of the years leading up to the devaluation—negative balances of payments, large budget deficits, and effectively no economic growth (Fig. 4)—had severely reduced the government’s capacity to make amends, the Argentine authorities responded to the crisis with retaliatory action.

The Cardoso government’s decision to devalue and then freely float the country’s currency was based solely on the impact of its effects on the domestic economy (officials of the Central Bank, interview, June 17, 2003). Nothing was done to inform the Argentines or any other members of Mercosul, and little consideration was given to the impact of the devaluation on trade within the bloc. No formal structure of macroeconomic policy coordination was in place at the time, and therefore there was no legal obligation to consult or to inform any Mercosul member about the decision.

After the devaluation announcement, Argentina quickly requested formal discussions. Over a quarter of Argentine exports in 1998 ended up in Brazil, and the bulk of Argentine imports was Brazilian. Of this trade, the most significant for Argentines were agricultural exports and capital-goods imports. Wheat was of primary concern to Argentina, given that Brazil did not produce enough for domestic consumption but could easily switch to less expensive producers in the wake of the currency devaluation. Also of concern was extra-Mercosul trade in soya and beef because of the heavy competition between the two countries in Asian and European markets and the new price advantage that Brazilian producers would now enjoy (Inter Press Service, 1999a). The devaluation worried Argentine policy makers because of the price advantages it gave Brazilian vis-à-vis Argentine producers in third countries. Furthermore, import of Brazilian capital goods had promoted a development dependency for Argentina that had been at the center of disputes during the formation of Mercosul. The common external tariff on capital goods agreed upon by the two countries was viewed as mutually beneficial given the higher prices from non-Mercosul countries and the fixed exchange rates that would promote stable prices (Valls Pereira, 1999).

At first, the Argentine-Brazilian discussions were calm, but Argentine officials’ attitudes soon became antagonistic and discussions became more heated. Felix Peña, then Argentine undersecretary for foreign trade, initially underscored the Argentines’ confidence that a solution was possible within the Mercosul framework by stating that the crisis needed “more Mercosul” (Inter Press Service, 1999b). The pressure to resolve any impending trade problems quickly came from Argentine producers. The main pressures were from the agricultural sector, but the producers in the capital-goods sector also voiced concerns (Inter Press Service, 1999b; Gazeta Mercantil, 1999a). These producers demanded that Brazil stop subsidizing its exports, especially when the Brazilian central bank announced on January 16 that the real would freely float, leading to worries about further depreciation against the peso. Although the Cardoso government agreed to review its export-financing practices, this did not alleviate the feeling that the currency devaluation was benefiting Brazilian exporters at the expense of Argentine producers. Soon the Argentine central bank announced a planned dollarization of the economy by 2002, implying Argentina’s possible distancing from Mercosul in favor of a closer relationship with the United States (Gazeta Mercantil, 1999b). Argentine Economic Minister Roque Fernandez also proposed a tariff on Brazilian imports equal to the size of the devaluation, which would be used to subsidize Argentine exports (Página 12, 1999).

While shaky from the start, negotiations produced some partial solutions. The first ministerial-level meeting was marked by a great deal of dissatisfaction in both camps. Brazilian Development Minister Celso Lafer called the
dollarization initiative "an attack on the spirit of Mercosul" (Buenos Aires Económico, 1999). Argentine International Economic Relations Secretary Jorge Campell said that the Brazilians' promise to review the export subsidies was unsatisfactory (Buenos Aires Económico, 1999). The second ministerial-level meeting, which was opened by both President Carlos Saúl Menem and Cardoso, proved more productive: Cardoso agreed to end export subsidies, except on capital-goods for Mercosul members (Globo, 1999a), and to provide other aid. By late February the real was at about 48 percent of its predevaluation value against the peso. The continuing depreciation prompted action by the Brazilian central bank to aid Mercosul importers by establishing special rules for financing their transactions (Globo, 1999b).

Although these settlements were welcomed by all members, the devaluation episode continued to strain Argentine-Brazilian economic relations. As was noted by a member of the Brazilian Ministry of Foreign Relations (interview, July 1, 2003), negotiations for the development of Mercosul stagnated in 1999-2000. Brazil continued to run a trade deficit with Argentina for most of the postdevaluation period (Fig. 5), but various key industries in Argentina were hit hard by the devaluation (Economist, 1999a). The Argentine government, pressured by domestic producers, took retaliatory action (Latin America Weekly Report, 1999), including the imposition of antidumping duties on Brazilian steel, announced on April 19, 1999, and the review of all Brazilian imports for evidence of unfair trade practices (New York Times, 1999). It also imposed import quotas on cotton textiles but later rescinded them under Brazilian pressure (Inter Press Service, 1999c). In response to these actions, the Cardoso government suspended negotiations, including those aimed at a common external tariff on automobiles (New York Times, 1999; Economist, 1999b), and began bilateral negotiations with
members of the Andean Community (Economist, 1999b). This, in turn, prompted Argentina to begin free-trade negotiations with Mexico (Cambridge International Forecasts, 1999). Both sets of bilateral negotiations put the aim of Mercosur's customs union in question.

At the Montevideo Common Market Council meetings in December 1999, the Mercosur presidents decided to establish what Cardoso called "a mini-Maastricht" agreement (Economist, 1999c). The point of the agreement was to view the real's devaluation as an important lesson and to develop a method for coordinating fiscal and monetary policy among members somewhat similar to the European model adopted in the Maastricht Treaty. The idea was to produce policy harmonization and improve the likelihood of a Mercosur common currency. It was also seen as a way of persuading the new Argentine president, Fernando de la Rúa, to scrap the dollarization idea promoted by his predecessor (Economist, 1999c).

However, not much has come of this agreement to date. A coordinating committee known as the Grupo de Monitoramento Macroecômico (Macro-economic Monitoring Group—GMM) was established in 2000 in order to compile harmonized data, and a monetary institute was established to study the creation of a common currency. GMM officials do have regular meetings, but these discussions have not led to the adoption of common macroeconomic policies (officials of the Brazilian Central Bank, interview, June 17, 2003). One of the problems in creating a common currency in Mercosur is that while some targets are established, it is up to the individual countries to figure out how to achieve them through their individual efforts. Commitments to joint decision making do not exist, and targets are never met, partly because there are no sanctions for noncompliance. The four member countries of Mercosur did negotiate a dispute settlement tribunal treaty (the Olivos Protocol), but Brazil, under Cardoso, did not ratify it. According to central-bank officials, compliance is unlikely to be achieved because there is no consensus among member states on how to deal with chronic problems of economic instability such as inflation. The Real Plan did bring down inflation, but it did so while maintaining an overvalued currency, leading to devaluation. The same can be said regarding the Argentine peso currency board. The bankers agreed that Brazilian economic stability would be a useful incentive for policy homogenization and for enabling the real to operate as a credible anchor for a regional currency. In sum, during the 1999–2000 period Mercosur not only did not make much progress but also experienced some setbacks in economic relations among its member states.

**THE ARGENTINE ECONOMIC CRISIS**

The onset of the peso devaluation in Argentina in 2002 marked another decision point that would determine the fate of Mercosur. This episode was in great contrast to the earlier one with regard to Brazil's response to the crisis. Although Brazil's economy continued to stagnate after its currency crisis, the country's balance of payments improved significantly, and inflation was under control (Fig. 4). By the early 2000s there was evidence that the once
internationally hailed currency board in Argentina (established by the Convertibility Law) was no longer working. The economic crisis peaked during the presidency of Menem’s successor, Fernando de la Rúa, whose government struggled unsuccessfully to put the Argentine economy in order. The de la Rúa government lost the confidence of the Argentines, and the president resigned. The Argentine economic crisis subsequently caused a serious political crisis, and no successor to de la Rúa seemed to have an effective answer to the economic difficulties facing the country.

On January 1, 2002, the Argentine Congress named Eduardo Duhalde (the fifth president in about two weeks) to finish the presidential term begun by de la Rúa. The economic crisis that Duhalde inherited was, of course, his first priority. While he claimed to be developing “Peronist” solutions, news quickly leaked on his first day as president about the devaluation of the peso from the one-to-one dollar fixed exchange rate and the eventual complete abandonment of the currency board (Gazeta Mercantil, 2002a). On January 6 the Congress rescinded the 10-year-old Convertibility Law and approved a dual exchange rate that fixed the currency at 1.40 pesos per dollar for government and foreign transactions and a free float for domestic transactions. However, it soon became clear to the Argentine authorities that it was difficult to maintain even a partially fixed exchange rate, and under IMF pressure they adopted a fully floating exchange-rate regime on February 11, 2002. Various estimates by private trade associations projected an approximate 30 percent decline in Brazilian exports to Argentina as a result of the devaluation and increased Argentine agricultural exports to Brazil (Globo, 2002a).

The peso devaluation marked a new chapter in Argentine-Brazilian relations. First, a new explanation of the country’s economic woes shifted away from the devaluation of the Brazilian currency. Duhalde now blamed the country’s economic problems on the overvaluation of the peso, which he declared was due to the U.S.-backed neoliberal reforms of the 1990s (Facts on File World News Digest, 2002). This was a major shift in Argentine attitudes given the strong relations that former presidents Menem and de la Rúa had attempted to foster with the United States. These “carnal relations” also included the proposed dollarization scheme and possible membership in the North Atlantic Treaty Organization. However, the United States took a hands-off approach to the Argentine crisis early on, leading to the conclusion that it was not going to be in Argentina’s corner. Second, Duhalde sent Córdoba Governor José Manuel de la Sota to meet with Cardoso for the purpose of outlining the devaluation strategy (Globo, 2002b). Given the price shifts that the devaluation would produce and the strong interdependence developed through Mercosul, Duhalde recognized the need to obtain support from Brazil. By presenting the planned devaluation prior to its execution he was signaling this need. Other symbolic actions included his sending the Argentine presidential jet to pick up the new Brazilian ambassador, Jose Botafogo Gonçalves, and clearing his calendar to make the meeting with the new ambassador his top priority (Associated Press, 2002).

The Cardoso government’s actions during the peso crisis focused on the urgent need to use the episode to mend the relations damaged by the earlier currency devaluation in Brazil. One of the first Brazilian actions within days
of the announced peso devaluation was its donation to Argentina of approximately 13 metric tons of insulin (Chemical News & Intelligence, 2002). Given the uncertainty of the peso's value, Argentine pharmacies had become unable to procure the drug needed by an estimated 300,000 diabetics. Although it had no economic effect, this assistance had symbolic significance. In economic terms, the BNDES opened lines of credit for Brazilian foreign direct investment in Argentina (Jornal do Brasil, 2002a), and the government removed non-tariff barriers on the importation of Argentine rice (Gazeta Mercantil, 2002b).

Important at this juncture was the use of Brazilian clout in the international arena to solicit financial aid for Argentina. Members of the Cardoso administration lobbied on behalf of Argentina for easing of requirements and further aid at the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (Clarín, 2002). Development Minister Sérgio Amaral, for example, made a public appeal for assistance at the 2002 World Economic Forum, claiming that an Argentine economic failure would have an adverse contagious effect on the region in both economic and political terms (Folha de São Paulo, 2002a). This public plea came only days after Minister of Foreign Relations Celso Lafer and Central Bank President Armínio Fraga made similar appeals to the United States (Folha de São Paulo, 2002a). Cardoso also suggested how the United States could help Argentina in IMF negotiations during his meeting with U.S. President George W. Bush (Folha de São Paulo, 2002b).

What the Cardoso government did not do during this period is also important. If it had wished to use the provisions found in various General Agreement on Tariffs and Trade (GATT) accords and Mercosur agreements, it could have abandoned the common external tariff on wheat, which would have caused Brazilian buyers to switch from Argentine to relatively inexpensive Canadian or American wheat. Brazilian buyers had pressured their government to do this, because the tariff meant that they were paying about US$50 a metric ton more for Argentine wheat. They maintained that the Argentine wheat was overvalued because of the fixed exchange rate and therefore refused to buy wheat until the announced devaluation went into effect (Gazeta Mercantil, 2002b; Folha de São Paulo, 2002c). Second, the Cardoso government could have held Argentina accountable for its modification of the tariff (legislative adviser and official of the Ministry of Foreign Relations, interviews, June 12, 2003). Argentina frequently added items to its list of exemptions—an action it could take only after negotiating with other members. It had also removed capital goods from its list, an arrangement that had been important for Brazilian development. Finally, the Cardoso government could have imposed antidumping duties on Argentina in response to a call for these by Brazilian milk producers (Estado de São Paulo, 2002). Argentines were now switching from Brazilian products to relatively inexpensive Chinese and Southeast Asian products while Brazilians continued to consume Argentine agricultural products. The results were seen in lower trade flows between the two countries from mid-2002 on and dramatic increases in the Brazilian trade deficit with Argentina (Figs. 3 and 5).

These actions and inactions continued during a year of negotiations on two accords that were important for further integration. On February 7, 2002, Brazil's Development Minister Sérgio Amaral announced the reopening of bilateral trade talks with Argentina on a reciprocal payment and credit agreement
and automobile tariffs that had been suspended since the devaluation of the real (Gazeta Mercantil, 2002c). On February 14 Amaral met with a group of Argentine ministers and entrepreneurs to begin laying out key preferences for these accords (Folha de São Paulo, 2002d). He argued that these accords were necessary to make Argentina more competitive and that a more competitive Argentina would be good for Mercosul (Jornal do Brasil, 2002b). The ministers agreed that the primary need for such accords was to limit the Argentine inflation caused by the new floating peso (Folha de São Paulo, 2002d).

Presidents Cardoso and Duhalde signed an automobile accord in late September 2002. One of its main motivations for the Cardoso government was to increase regional efficiency in production and turn Mercosul into a platform for exporting automobiles to outside markets (Folha de São Paulo, 2002e). The new accord now would allow each country to export to the other twice the volume of vehicles it imported from the other free of duty, with the objective of developing a completely free-trade zone for vehicles by 2006 (Japan Economic Newswire, 2002). In other words, for every US$1 worth of vehicle imported, US$2 was allowed to be exported duty-free. This new pact was expected to increase the amount of tariff-free exports by 525 percent when compared with the prior agreement. That agreement had been set to be renegotiated in 2000, but negotiations had been postponed because of the rift created by the Brazilian currency devaluation. Both negotiating teams saw the accord as providing greater benefits to Argentina than to Brazil; the prior accord had severely limited Argentine automobile exports to Brazil, and the depreciation of the peso relative to the real would mean more Brazilian vehicle imports. The signing of the accord also coincided with the abandonment of Argentine antidumping measures on Brazilian poultry.

Moreover, the reciprocal payment and credit agreement, which was signed at the same time as the automobile accord, guaranteed payment to Brazilian and Argentine exporters by the Brazilian and Argentine central banks, respectively. Under this arrangement, the central banks of each country would be responsible for payments to their exporters in local currency, making the agreement a clearinghouse for foreign transactions (Jornal do Brasil, 2002a).

CONCLUSIONS

Many scholars of regional integration and economic cooperation have long argued that the existence of a country with a large economy is necessary for the development of economic cooperation. These scholars argue that such a country will be able to lead smaller countries in economic cooperation by taking on the costs of integration disproportionately. The actions of the preponderant country toward other members are therefore the key to understanding successes and failures of integration. Actions that aid member states improve the level of satisfaction, and this increases the likelihood of integration. However, the opposite also holds: actions by the regional power that are costly for member states reduce satisfaction and the likelihood of integration. By investigating the actions taken and not taken by the Cardoso government during critical points in the development of Mercosul, this article has demonstrated the importance of Brazilian leadership in the evolution of the regional
bloc and in establishing a new trend in the neoliberal approach to regional economic cooperation.

The role Brazil played in defeating the attempted coup in Paraguay in the mid-1990s demonstrated its ability to promote democracy—a celebrated principle in Mercosul—in the region. By using its economic leverage and diplomatic instruments, the Cardoso government was able to convince Oviedo that the days of economic populism and military rule were over. In this episode, Cardoso announced that Brazil would be the regional leader for promoting freer trade and safeguarding democracy. Oviedo's alternative would be to rule over an economy that would lose about half its output overnight. Given this alternative, Oviedo chose not to challenge democratic rule, and Mercosul's democratic commitment was maintained.

The crises in Argentina and Brazil showed that the progress and stagnation of Mercosul were intricately linked to Brazil's capacity to play a leadership role and recognize the implications of domestic neoliberal economic reform for the continent's economy. The currency crises forced the two neighbors to make critical decisions about their relationships under Mercosul. The first crisis, which arose from the devaluation of the real, diminished the Cardoso government's ability and willingness to reduce Argentine dissatisfaction regarding the economic fallout. As a result, Argentina adopted retaliatory measures for its trade with Brazil and sought to deepen its relationship with the United States. Mercosul cooperation weakened during this period. When an economic crisis hit Argentina in the early 2000s, however, Brazil's economy was in better shape. The Cardoso government was able to provide various economic and political benefits to Argentina and support its economic recovery. This support not only helped to mend the Argentine-Brazilian relations damaged by the earlier currency crisis but also led to the signing of a series of new accords.

Finally, these episodes indicate that Brazil was willing to provide benefits to Mercosul partners even when it was costly to do so in the short run, demonstrating its commitment to promoting regional integration. The sanctions against Paraguayan General Oviedo would also have harmed sectors of the Brazilian economy because of the cessation of trade and the closure of the Itaipu facilities. Although suffering economic setbacks due to the real crisis, it was willing to provide some assistance to Argentina to mitigate the economic fallout. Instead of protecting itself from the Argentine currency crisis, Brazil not only tolerated many unilateral measures that harmed the Brazilian economy but also provided assistance to its neighbor.

NOTE

1. Interviews were conducted with the secretary of the Mercosul Joint Parliamentary Committee, Brazilian Congress (May 29, 2003), the chairman (June 10, 2003) and former chairman (June 25, 2003) of that committee, the legislative adviser to the Brazilian Senate for foreign relations and Mercosul (June 12, 2003), members of the External Debt and International Relations Department of the Brazilian Central Bank (June 17, 2003), the chairman of the Senate Foreign Relations and National Defense Committee (June 25, 2003), the assistant director of the Mercosul Division of the Ministry of Foreign Relations (July 1, 2003), and an adviser in the Special Office of External Affairs, President of the Republic (July 2, 2003).
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