



# Effects of EU Activities and Cooperation with Mercosur on Regional Democracy Building

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## Abstract

Mercosur – a regional trade organization between some South American countries established in 1991. It stands for the Common Market of the South. It intends to pursue an European-like integration process and form the basis for a South-American wide free trade area, but it has not yet fully implemented its customs union.

However, Mercosur is not a carbon copy of the European process, and it will never work in the same way. The quality of the democratic architecture in Mercosur countries is defective and dysfunctional. These democratic regimes, albeit stronger than in the past, are of poor quality (generalized corruption, social inequalities, shortcomings in political representation, low growth and difficulties in social development due to excessive state intrusion in economic life), but democracy is not currently the main priority of Mercosur.

Despite advances during its first 10 years, Mercosur's drive towards commercial liberalization and a unified economic space in the Southern Cone has stalled, and perhaps even receded since 1999. The customs union has no single authority or uniform application, mainly due to economic instability and diverging economic policies. Also hindering it is a reduced political commitment to undertake the necessary reforms to put the existing working agenda of Mercosur in line with Treaty of Asuncion's objectives.

Political and technical cooperation with the EU was important during the first phase of Mercosur's existence. Currently, nationalistic stances in some countries and pro-state public policies in others are challenging the democratic nature of the integration process. Mercosur's negotiations with the EU, for instance, could be jeopardized by the admission of President Hugo Chavez's Venezuela as a full member state.

Recommendations include a return to the basics of the integration process – economic opening and trade liberalization, investments in infrastructure and logistics – and needed reforms, in and every each country, for the political and economic stability of the group. This must be achieved with the full preservation of the democratic nature of

the overall process. The EU could have a stake in this process, but democracy building, in itself, is not at the center of the inter-regional cooperation process.

## Summary of Recommendations

The first priority for the consolidation of the institutional architecture of Mercosur is to perfect its free-trade zone and achieve the original objective of a full customs union. The EU could cooperate by offering a technical consultative mission to diagnose the current situation, and then provide a plan to complete the tasks set forth in the first article of the Treaty of Asuncion.

A second mission for the EU could be assisting Mercosur efforts towards physical integration of infrastructure and logistics. An integrated system would provide better conditions for intra-trade links and reduce perceived imbalances between member countries.

The third task would be to reinforce the democratic requirements of Mercosur membership in order to block authoritarian experiments like those developing in Chavez's Venezuela. The current democratic clause of Mercosur (Ushuaia Protocol) is too feeble to guarantee full democratic status inside the bloc.

## 1. Institutional Development of Mercosur

The integration processes of Mercosur and the EU seem to run in parallel for most of the second half of the 20th century. As Europe started its long journey towards a political union in the 1950s, South American countries formulated their first integration schemes with an eye to the European progresses arising from the Treaty of Rome of 1957. Their integration drive was limited to the Latin American Free Trade Association (ALALC–Montevideo Treaty of 1960), which never delivered its promises for general trade liberalization.

With the return to civilian and elected systems in Argentina (1983) and Brazil (1985) came a new emphasis on economic integration. But the European model was too ambitious for South American countries, which were in a de facto preferential trade area. A second Montevideo Treaty in 1980 offered a flexible bilateral trade network between the members of the Latin American Integration Association (ALADI).

Argentina and Brazil decided to establish a full common market within a 10–year period and signed an Integration Treaty in 1988. Shortly afterward, Brazil and Argentina adopted a free-trade area model to speed up the integration process. The time frame approved in 1988 for the common market was reduced to half by the Buenos Aires Act (July 1990), which also altered the gradual liberalization process for an automatic tariff elimination point to a free-trade area in four years, as the first step towards a common market by 1995.

A very important move at that stage, and the one that defined the start of European cooperation with Mercosur, was the decision to enlarge the process with the acceptance of Paraguay and Uruguay. Chile, which also had been in negotiations to join, did not adhere to the Treaty of Asuncion (26 March 1991), because of its single tariff, which clashed with the diversified tariff structure Brazil and

Argentina wanted. Paraguay decided to join after a military coup that ended a 40-year dictatorship.

The European Union limited itself to assisting with the technical aspects of building a customs union. An inter-institutional cooperation agreement was signed in 1992 between the European Commission and Mercosur with the objective of establishing dialogue and technical cooperation between the two.

Despite strong support by the presidents themselves, the objectives established in the 1st article of the Treaty of Asuncion were not attained. The four member countries advanced towards a free-trade zone, but some exceptions were maintained, notably for sugar and automobiles. Also, many national exceptions were substituted for the Common External Tariff, going up or down from the official rate.

Despite those shortcomings, the countries proceeded to try to establish a customs union, without any big changes in the institutional architecture of Mercosur. Mercosur acquired status as an entity under international law, which upgraded its relationship with the EU. After preparatory ministerial meetings throughout 1995, the two blocs signed a joint declaration of inter-regional economic cooperation in December 1995. The objective was to pursue a political association and render possible trade liberalization between them. Over time, Bolivia and Chile (1996) and Peru (2003) joined Mercosur as associate members.

The international environment, though, was not very cooperative. Mexico's insolvency in 1994, the Asian financial crises in 1997 and 1998, and Russia's moratorium and Long Term Capital Management crash in 1998 impacted Mercosur countries, especially Brazil, which had accumulated huge imbalances in its current accounts. Argentina's crisis between 1999 and 2002 affected Mercosur's ability to sustain its pace.

Mercosur still suffers from economic fragilities and from protectionist instincts in its two major members. Argentina often imposes unilateral safeguards against imported products, including those from Brazil, its most important partner. To accommodate Argentinean susceptibilities against 'disloyal competition', Brazilian diplomatic authorities agreed to a Mechanism for Competitive Adjustment, a proxy for monitoring and controlling imports.

Since the attempt at a customs union in 1995, no substantive advances were accomplished in commercial integration; more restrictions were introduced than promises of trade liberalization were realized. The free-trade zone among member countries works more or less on the same basis that was established between 1991 and 1994. The customs union covers fewer products than was the case at the beginning: according to some observers, less than 10 per cent of imported items within Mercosur is traded under the official rates established by the Common External Tariff (CET).

The EU maintained negotiations in order to conclude trade liberalization and association agreements. The bi-regional Free Trade Agreement between Mercosur and the EU was derailed as soon as the proposed Free Trade Area of the Americas was sabotaged by Argentina, Brazil and Venezuela (November 2005), and probably for the same reasons: divergences among the partners in connection with European farm protectionism, and

resistance from Mercosur countries in industrial, services and intellectual property matters.

## 2. Constraints and Characteristics of Democracy Building in Mercosur

Each advance in the European integrated political body and a common economic arena has caused a desire to reproduce the same initiative in Latin America. But even under democratic governance, the usual pattern of economic policies followed in the region – substitutive industrialization, with plenty of protectionist devices and inward-looking specific policies. In turn, any integration initiatives that had been superficially agreed upon among Latin American countries were hindered.

It was just after the double democratization process in Argentina and Brazil, between 1983 and 1985, that the most important integration experiment was launched and took impulse, first as a bilateral project for a common market, then as the quadrilateral Mercosur initiative. As in the European model, the democratic principle was clearly reaffirmed, even if at that initial stage there was no formal and explicit clause requiring democratic institutions to be part of the experiment. Later, a tentative

military takeover in Paraguay in 1996 led the presidents of Mercosur countries to frame a democratic declaration in support of the elective representative system within the bloc. Two years later, in the Ushuaia Protocol, the four member countries and the associates (Chile and Bolivia) adopted a formal democratic clause, requiring a democratic regime as a condition for membership in Mercosur.

The true test for the democratic clause within Mercosur is currently represented by Venezuela's request for full member status. The decision was completely political in nature, as

Venezuela, under the peculiar economic policy of Chavez's regime, has departed further from the market rules that governed the integration process in the Southern Cone.

It remains to be seen whether the current administration in Caracas will fully comply with the requirements of an integration process, and formally negotiate with prospective partners in liberalization trade agreements or in multilateral talks for trade liberalization. On the political side of this venture, many legislators in Mercosur countries question whether Venezuela complies with the democratic clause of the bloc, as superficial as it may be. In fact, the clause itself is directed to the interruption of 'institutional normality', so it seems to apply only to coups d'état or other breakdowns of democratic regimes. As it stands currently, the democratic clause of Mercosur has no power to exert any kind of pressure against the gradual erosion of the normal functioning of a democratic regime.

The participation of the Chavez regime in Mercosur institutions represents a direct challenge to its economic rationality and the democratic adherence that supposedly

guides its construction. Indeed, Mercosur's institutional coherence is less valued today, when governments in some of the member countries have little allegiance to liberal

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ideas and instead show a preference for economic nationalism, political progressivism and moderate anti-imperialism.

In Mercosur and elsewhere in South America, the emphasis on commercial liberalization and economic opening is weakening. With this in mind, it is difficult to foresee an easy negotiating process between Mercosur and the EU. Differences in economic and trade policies inside the bloc are likely to grow, making policy coordination more complicated.

### **3. Suggestions for Democratic Strengthening in Mercosur**

Mercosur is a factor for the economic and technological modernization of the member countries, as well as for their insertion into the world economy. Further strengthening of the integration process in the Southern Cone would be a relevant stage towards the creation of a free trade area in South America. This should be based on the fundamental assumption of the continuity of democratic regimes – a condition which, in some countries, is far from assured.

What must be done? First, Mercosur countries must consolidate their integration process, by the completion of their customs union, and then establish the tools for a future common market. After almost 20 years, Mercosur remains what it was at the beginning: a project for a future single market. This goal, which is the very essence of Mercosur, depends on coordinating macroeconomic policies between the member countries and streamlining national policies in strategic sectors. To achieve these objectives, Mercosur has to strengthen its institution – not a simple task, as it touches the heart of the ‘sovereignty instincts’ of each member country. Retreating into national sovereignty still has a powerful attraction.

Second, Mercosur members have to continue and deepen tax reforms, fiscal and exchange reforms (including currency convertibility), sectoral reforms (industrial and trade policies), and labor and administrative reforms. The constitution of a single market would be impossible without these changes. Some countries are undergoing some of these reforms, but they are taken on a purely domestic basis, with no coordination with other member countries. Some countries, like Argentina (industrial policy) and Brazil (tax reform) are reforming in a direction that is totally contradictory to Mercosur’s No. 1 objective: the common market.

Third, these structural reforms have to be accomplished with another objective in mind: an economic opening to the world, and continuity of trade and investments liberalization. Since the 1995 inception of the CET, which required a prior domestic reform of national tariffs, trade policies in Mercosur and its member countries have taken the road of closure, restriction, tariff escalation and other restrictive devices. As a result, Mercosur has become more, not less, protectionist. The average rate of effective protection since 1995 has moved up and is slightly incremental as a whole, but is openly protectionist in some sectors.

Difficulties on the road to a common market in Mercosur could be classified into two areas: structural impediments and contingent factors. Among the latter are the natural limitations of the national processes of macroeconomic stabilization. Years of hyperinflation, external crises associated with excessive foreign debt, volatility of

capital flows, currency debilitation, stagnation, and political and social crises have all contributed to the delay.

On the structural side, the countries themselves are unequal in population, land mass, and economic prowess. Brazil, with its technological advances, represents some 70 per cent of the 'atomic mass' of Mercosur in gross domestic product. Its economic capabilities give Brazil extraordinary power among Mercosur members. Investors also look at Argentina and Uruguay, which have higher education levels than Brazil and Paraguay. Those structural unbalances and the political perception of asymmetries between Mercosur countries are hindering deep integration within Mercosur and with world markets.

Member countries share equally in the decision-making process. Each member has the same vote and veto power. Thus, Uruguay, with its 3.5 million inhabitants, has the same influence on Mercosur's policies as Brazil, with its population of 197 million. Mercosur's Parliament admits 18 designated representatives from each country, who will eventually be elected directly, under a less than proportional appointment, but will have no real power over the bloc.

#### 4. How the EU Can Help

Democracy building in Mercosur is too complex a process to be influenced by external forces. The pressures and inducements of technical and political cooperation with the EU represent a positive, but feeble, factor in the process.

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Mercosur will preserve its intergovernmental institutional architecture, and, consequently, will refuse any jump into full integration as a single market. Even though this is a contradiction, it is a reality that European Commission policy planners must consider regarding the future of bilateral cooperation.

Bilateral cooperation between the European Commission and Mercosur has covered only technical and administrative sectors. Few, if any, of the EU-Mercosur cooperation projects touch the question of democracy building, and this should remain as is. There are other areas for regional technical cooperation, such as the environment, technical standards and regulatory policies, as well as capacity building, either in member countries or inside the Secretariat in Montevideo. There are many ongoing projects – in communications and information equipment, public relations, statistics, education, biotechnology, and macroeconomic monitoring – for which financing from the EU is as high as 80 per cent of the total costs.

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In some areas, the return for this bilateral financing is doubtful; for instance, in the case of Mercosur's Parliament, whose competence for the inner core tasks of the integration process is superficial. In other areas – dispute settlement mechanisms, sustainable production, infectious diseases, sanitary measures – practical returns can be higher, but the bureaucratic obstacles and delays are burdensome, compounded by the intergovernmental nature



of Mercosur. The EU has been as generous as possible towards an experiment that has many shortcomings.

## 5. Time for a New Bi-regional Agenda

If Mercosur wants to succeed, it has to go back to its most important foundational principle: starting a customs union.

The 'old' European Community took less than the scheduled 12 years time frame to arrive at its customs union in 1968. However, establishing a customs union in the Southern Cone is well beyond the limited capacity of the bilateral technical and political cooperation between the two blocs.

The EU should take a consultative role in developing this project, which should not be modeled on the European experience. The EU's mission is to serve as a technical and financial support in devising as many options as possible for Mercosur's specific needs.

From a realistic Mercosur perspective, the EU model is an impossible dream, at least in the foreseeable future. However, a serious investigation by EU officials, acting with the agreement of Mercosur authorities, could arrive at a realistic report, stating clearly if a customs union is possible in Mercosur under current circumstances and taking into account foreseeable conditions for institution building in the Southern Cone. An EU technical mission could prepare the ground for decisions by political leaders in the next few years.

One possible conclusion might be a departure in terms of institutional choices between a strong free-trade zone and an incomplete and unmanageable customs union. A technical mission from the EU could have a dispassionate view on that matter and make appropriate recommendations.

Mercosur's democratic clause should be strengthened so it is not a passive device ('curtail democratic ruptures') but an active tool for state institutions to function properly, based on sound democratic concepts.

**Political cooperation between EU and Mercosur could have an important symbolic impact in trying to strengthen Mercosur's democratic clause.**

Political cooperation between EU and Mercosur could have an important symbolic impact in trying to strengthen Mercosur's democratic clause. Democratic regimes seem established in the Southern Cone. The real question is the quality of the democratic institutions, rather than the democratic system itself. As is well known, there is widespread malfunctioning of democratic regimes in the region, with corruption and patrimonial practices everywhere. So, the main task should be the betterment of the state apparatus, rather than democracy building. Such an agenda is more domestic than focused on regional integration. Even so, EU cooperation could cover studies on the 'deepening' of the democratic process in Mercosur decision making, as it could be a means to reinforce good governance throughout the integration buildup. As it stands now, provided that Chavez does not resort to a coup d'état, he can continue indefinitely to erode democratic institutions in Venezuela without being sanctioned by other Mercosur leaders.

State institutions and state companies in Mercosur (as in the EU) are vulnerable to

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corruption. There are opportunities for cooperation in government procurement practices and monitoring devices for activities financed by central authorities.

A renewed focus on the mechanics of the integration process itself could serve as a lynchpin in a new phase of this relationship. What every country needs is a concentrated effort to improve infrastructure and logistics (transport, communications, energy), because they will serve the cause of integration. These tasks also encompass domestic reforms, especially regarding the regulatory framework for these huge undertakings, which involve public procurement and attracting foreign direct investment. In so doing, the dynamics of cooperation should strengthen the political and economic stability of each country and within the bloc itself. The EU has vast expertise in for example coordinating financial, engineering and administration

mechanisms and linking them to infrastructure works, and that expertise could be put on the cooperative agenda.

The EU should resist the temptation to offer itself as an example to Mercosur; rather, a strategic partnership between the two blocs is needed. Mercosur is not, and will not be, a mirror of the European integration process, either in its economic foundations or in its political institutions. Correction measures for existing country differences, for instance, or convergence mechanisms for under-average per-capita income are better tackled by market forces within Mercosur, rather than by centralized bureaucratic schemes.

The EU and Mercosur should be strategic partners, and not only for democracy building, but also for the political links and material flows that interest economic agents as well as leaders in both blocs. Conditions and requirements for establishing a common agenda should take into account not only the similarities but also the structural differences and differing historical paths in the two continents. A realistic assessment of the possibilities for strengthening this relationship is needed given the current global crisis that threatens every economy in our interdependent world.

Other prospective fields for EU-Mercosur cooperation are energy, agricultural development, industrial technology, technical education and professional training, health and sanitation measures (human, animal and food products), transportation and communications, and administration and public governance. Answers on each side will probably not be the same, but some common ground may be found, as the two blocs certainly share the same objectives of peace and prosperity for their people.

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