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*Power Preponderance and Domestic Politics:  
Explaining Regional Economic Integration in  
Latin America and the Caribbean, 1960-1997*

-Gaspare M. Genna and Taeko Hiroi



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# POWER PREPONDERANCE AND DOMESTIC POLITICS: EXPLAINING REGIONAL ECONOMIC INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN, 1960-1997

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## Introduction

The promotion of regional integration is one of the more significant decisions in the post-WW II international political economy. Regional integration is a process in which two or more nations within a geographical region voluntarily adjust economic and other policies to produce a fusion of their economies and political institutions. This results in a slow pooling of nation-state sovereignty in evolving supranational institutions. The variation of this pooling is wide. Large amounts of sovereignty to date have already been pooled by Western European countries in the European Union (EU). At the opposite end of spectrum, we see nations of Latin America and the Caribbean in the same process but not having reached the same level of regional integration. The purpose of this paper is to explore the conditions conducive to regional economic integration in Latin America and the Caribbean. A review of the literature points to two fundamental conditions: domestic and regional. These conditions comprise the incentives and the disincentives for the propensity of country pairs to integrate.

We examine Latin American and Caribbean integration for three reasons. First, we wish to explore the dynamics of the process of integration in the developing world. Second, the western hemisphere is a unique laboratory for integration. In the latter half of the twentieth century, four regional economic integration projects emerged in Latin America and the Caribbean: the Southern Cone Common Market (Mercosur in Spanish or Mercosul in Portuguese); the Andean Common Market (also known as the Andean Pact); the Central American Common Market (CACM), which later became the Central American Integration System (SICA); and the Caribbean Community (CARICOM).<sup>1</sup> Due to the longevity of some projects, the off-again and on-again traits of others, the uneven pace of development of regional institutions, and the mix of different sized countries, we have a variation along many dimensions. Third, the recent discussions for the resurrection of the Free Trade Area of the Americas (FTAA) warrant an examination of Latin American and Caribbean integration to determine the feasibility of the FTAA.

At first, regional integration stands at odds with the conventional wisdom of political science. Kenneth Waltz,<sup>2</sup> Joseph Grieco,<sup>3</sup> and other (neo)realists have argued

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<sup>1</sup> In addition, Mexico joined a free trade agreement with the United States and Canada, forming the North American Free Trade Agreement (NAFTA).

<sup>2</sup> Kenneth N. Waltz, *Theory of International Politics* (New York: McGraw-Hill, 1979).

<sup>3</sup> Joseph M. Grieco, "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism," *International Organization*, 42: xx, 1988.

that international cooperation is difficult to achieve in the anarchic world of the international system. In the absence of a central authority in the international system, they contend, states behave competitively; they attempt to maximize relative gains in order to assure their survival. Moreover, most militarized disputes have arisen between geographically contiguous countries. In this light, regional economic integration poses an interesting puzzle because it occurs among countries that are geographically proximate and because the economic gains accrued from economic cooperation to one or more of the constituent states may be used against another member-state in the future. Hence, regional economic integration requires an explanation. Under what conditions is regional economic integration possible and likely to progress?

Stimulated by the desire to explain the deepening of European regional integration, explanations of regional integration have proliferated in the last two decades. Put simply, there are three strands of research tradition in integration theories. One includes the (neo)functionalist and (neo)institutionalist schools. Another of these strands stresses international dimensions: the (neo)realist. The final perspective looks to domestic forces of regional integration. The present research draws heavily upon (neo)realism—particularly power transition theory—and the domestic politics approach to understand the initiation and deepening of regional economic integration. We argue that regional integration is an outcome that emerges out of the interaction between international and domestic forces. We will show, by using panel corrected standard error OLS and Cox proportional hazards regression models on a sample of Latin American and Caribbean regional integration projects, that economic integration is most likely to proceed when relative economic power of integrating states are asymmetrical *and* they share common economic policy preferences.<sup>4</sup> Conversely, our empirical analyses indicate that the effect of economic power asymmetry on the level of integration becomes progressively negative for countries with dissimilar foreign policy preferences at given levels of mutual trade interests.

This paper proceeds using the following organizational format. The second section reviews theories of regional integration. The third section discusses the model, hypotheses, and data used to test the main arguments of this paper. The fourth section presents data analyses, and the final section concludes.

## **The Literature on Regional Integration**

Although the literature on regional integration and cooperation abounds, general theories of regional economic integration are still at the nascent stage. In addition, most of these works either focus on European integration or were inspired by it. Theories of regional integration can be roughly grouped into three perspectives: (1) (neo)functionalism and (neo)institutionalism; (2) (neo)realism; and (3) domestic politics and intergovernmentalism.

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<sup>4</sup> Power preponderance and asymmetry are used interchangeably in this paper.

In the first group, (neo)functionalism posits that regional integration arises due to increasing technological, economic, and other complexities and problems that countries can no longer effectively solve at the nation-state level.<sup>5</sup> According to this perspective, governments are likely to enter cooperative arrangements in order to cope with various functional needs, such as the improvement of economic welfare for their citizens. Once the political elite establishes a cooperative arrangement, the theory predicts that integration would become self-perpetuating through a “spillover” process.<sup>6</sup> Through this mechanism, success in one functional area increases demands for cooperative arrangements in other functional areas. While (neo)functionalism was influential in the 1950s and 1960s, it has been criticized as being a *post hoc* theory having difficulties in generating testable hypotheses. Not only is it difficult to identify *a priori* exactly what issue-areas and what levels of significance of problems command regional cooperation or integration, but also functional needs do not necessarily pre-determine the direction of change that countries choose to pursue.<sup>7</sup>

Neoinstitutionalism, which emerged in the 1980s, inherited the thinking of the (neo)functionalist school. Put simply, neoinstitutionalists argue that international institutions promote international cooperation by helping constituent members overcome collective action problems. By lengthening the shadow of the future and by increasing transparency and enforcement of cooperation, international institutions facilitate issue-linkages and strategies of reciprocity and make international commitments more credible.<sup>8</sup> Keohane,<sup>9</sup> for example, claims that it is possible to create and sustain, even after the decline of the power of a hegemonic state, international regimes in order to cope with market failures, reduce transaction costs, and respond to other problems that are difficult to be managed at the national level. With respect to European integration, “supranational” institutionalists have studied the impact of the European Union institutions on the decision-making process, such as the agenda-setting power of the European Parliament.<sup>10</sup> On the other hand, Garrett and Weingast argue that institutions perform other roles and are not simply the facilitators of efficiency gains in the process of regional integration.<sup>11</sup> These scholars maintain that institutions may provide focal

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<sup>5</sup> Ernst B. Haas, *The Uniting of Europe: Political, Social and Economic Forces 1950-1957* (Stanford: Stanford University Press, 1958); David Mitrany, *The Functional Theory of Politics* (London: Martin Robertson Press, 1975).

<sup>6</sup> Haas, *The Uniting of Europe*.

<sup>7</sup> Charles Pentland, *International Theory and European Integration* (London: Faber and Faber, 1973).

<sup>8</sup> Robert Axelrod and Robert O. Keohane, “Achieving Cooperation under Anarchy,” in Kenneth Oye (ed), *Cooperation under Anarchy* (Princeton: Princeton University Press, 1986); Lisa L. Martin, *Coercive Cooperation: Explaining Multilateral Economic Sanctions* (Princeton: Princeton University Press, 1992); Beth A. Simmons, “International Law and State Behavior: Commitment and Compliance in International Monetary Affairs,” *American Political Science Review* 94: 819-835, 2000.

<sup>9</sup> Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton: Princeton University Press, 1984).

<sup>10</sup> George Tselis, “The Power of the European Parliament as a Conditional Agenda Setter,” *American Political Science Review* 88: 128, 1994; Geoffrey Garret and George Tselis, “An Institutional Critique of Intergovernmentalism,” *International Organization* 50: 269, 1996.

<sup>11</sup> Geoffrey Garret and Barry R. Weingast, “Ideas, Interests, and Institutions: Constructing the European Community’s Internal Market,” in Judith Goldstein and Robert O. Keohane (eds), *Ideas and Foreign Policy* (Cornell: Cornell University Press, 1993).

points—precedents and symbols around which actors’ behaviors converge—that help determine particular choices made at critical decision points.

Neoinstitutionalism has stimulated important research on international cooperation and integration. However, applying this research to understand non-European regional integration has been limited. This dearth of research may be due to the weak supranational institutional developments outside of Europe. Moreover, the degree of institutionalization itself is a variable that needs explication, but neoinstitutionalism, except for resorting to the functionalist argument of efficiency gains, has a difficulty explaining the emergence of supranational regional institutions. Yet, efficiency-based arguments cannot tell why institutions came into existence when they did. Furthermore, researchers have criticized neoinstitutionalism for its focus on absolute gains, neglecting the possibility of absolute losses<sup>12</sup> and relative gains.<sup>13</sup>

Realism and neorealism stress the distribution of power among states as a central factor influencing international outcomes. The principal proposition of Waltzian structuralist realism is that the asymmetric gains from exchange tend to hinder international cooperation.<sup>14</sup> However, many (neo)realists do not completely rule out such possibilities. For example, some neorealist theorists argue that commercial liberalization is more likely among states that are political and military allies than among states that are actual or potential adversaries.<sup>15</sup> According central importance to relative gains, Grieco advanced a “relative disparity shift” hypothesis: a trend of a shifting relative disparity in the capabilities of states within a region is likely to lead disadvantaged states to oppose the development of formal regional institutions while relative stability of capabilities tends to foster the establishment and deepening of such regional arrangements.<sup>16</sup> Grieco’s study comparing relative capability change and the development of regional integration in Western Europe, East Asia, and the Americas largely supports his hypothesis.

Hegemonic stability theory likewise emphasizes the importance of power for international political and economic outcomes. The early version of hegemonic stability theory concerned the rise and maintenance of liberal international economic order.<sup>17</sup> Proponents of hegemonic stability theory argued that the presence of a hegemonic state (that is capable of and committed to promoting economic liberalism) was a necessary

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<sup>12</sup> Thomas Oatley and Robert Nabors, “Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord,” *International Organization* 52: xx, 1998.

<sup>13</sup> Grieco, “Anarchy and the Limits of Cooperation.”

<sup>14</sup> Waltz, *Theory of International Politics*; Grieco, “Anarchy and the Limits of Cooperation.”

<sup>15</sup> Joanne Gowa and Edward D. Mansfield, “Power Politics and International Trade,” *American Political Science Review* 87: 408, 1993; Joanne Gowa, *Allies, Adversaries, and International Trade* (Princeton: Princeton University Press, 1994); Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001).

<sup>16</sup> Joseph M. Grieco, “Systemic Sources of Variation in regional Institutionalization in Western Europe, East Asia, and the Americas,” in Edward D. Mansfield and Helen V. Milner (eds), *The Political Economy of Regionalism* (New York: Columbia University Press, 1997).

<sup>17</sup> Stephen Krasner, “State Power and the Structure of International Trade,” *World Politics*, 28: 317, 1976; Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987). The other focus of hegemonic stability theory has been international peace and conflict.

condition to sustain liberal international commerce. The erosion of hegemony, by contrast, tends to give rise to protectionism. In line with this argument, Robert Gilpin recently advanced a thesis that the existence of one or more powerful states committed to integration is the key to a success of the evolution of regional economic institutions.<sup>18</sup>

Like other (neo)realist theories, power transition theory focuses on the relative power of countries in the international system. Unlike other (neo)realist theories, however, power transition scholars stress the satisfaction with the *status quo* relationship between dyads of countries and the dynamics of a power transition that occurs when a subordinate power approaches and exceeds a preponderant power in capabilities.<sup>19</sup> As applied to international conflict, power transition theory posits that conflict is likely to occur when subordinate and preponderant powers are at near parity and are dissatisfied with the *status quo* relationship. In contrast, a peaceful transition occurs if both powers share compatible preferences and are therefore jointly satisfied with the *status quo* relationship. Efird and Genna (2002) extended the theory and argue that the development of regional integration after a power transition between two satisfied powers improves because the formerly less powerful country has a vital interest in not only maintaining but also furthering and institutionalizing the arrangements that it believes to have contributed to its rise.<sup>20</sup> Efird and Genna's statistical test provides strong support for their hypothesis.

Yet, power transition theory, as well as other perspectives in (neo)realist schools of thought, is conspicuously silent about the sources of states' preferences regarding regional economic integration. Given a central role that states' preferences are expected to play in regional economic policy formulation, rather than leaving states' preferences ambiguous and generic, we should identify which preferences matter in determining the propensity for regional economic integration. In other words, we need to identify where joint satisfaction originates.

The final group of regional economic integration research stresses the importance of domestic politics and intergovernmental bargaining. By "taking preferences seriously,"<sup>21</sup> this literature emphasizes the distributional consequences of economic policies for domestic societal groups and the desire of political leaders to hold onto power. At its core, the scholars working with this approach contend that governments' economic policies are strongly influenced by distributional conflict among societal groups; that groups that expect to lose from integration will oppose it and those that

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<sup>18</sup> Gilpin, *Global Political Economy*.

<sup>19</sup> A.F.K. Organski, *World Politics*, 1<sup>st</sup> edition (New York: Alfred A. Knopf, 1958; A.F.K. Organski, *World Politics*, 2<sup>nd</sup> edition (New York: Alfred A. Knopf, 1968; A.F.K. Organski and Jacek Kugler, "The Costs of Major Wars: The Phoenix Factor," *American Political Science Review*, 71: 1347, 1977; A.F.K. Organski and Jacek Kugler, *The War Ledger* (Chicago: University of Chicago Press, 1980); Tammen *et al.* *Power Transitions: Strategies for the 21<sup>st</sup> Century* (New York: Chatham House, 2000).

<sup>20</sup> Brian Efird and Gaspare M. Genna, "Structural Conditions and the Propensity for Regional Integration," *European Union Politics* 3, 2002.

<sup>21</sup> Andrew Moravcsik, "Taking Preferences Seriously: A Liberal Theory of International Politics," *International Organization* 51: 513, 1997.



anticipate to benefit from it will support it; and that economic policies often reflect the preferences of the more powerful and better organized interest groups within society.<sup>22</sup>

Interest group politics, however, is not the whole story. Politicians have their preferences and interests. In this literature, politicians' desire to retain office is assumed to be the crucial guiding principle of policy making. Moreover, competition among interest groups vying to influence governments' policies is not unstructured. Domestic political institutions are argued to shape the patterns of interactions between domestic groups and whose interests will be represented in governments' policies.<sup>23</sup>

Similarly, intergovernmentalism posits that economic interests are the driving forces of regional integration. Moravcsik argues that commercial interests of leading domestic producers, macroeconomic preferences of ruling governmental coalitions, bargaining among powerful national governments over the distributive and institutional issues account for the developments of European integration.<sup>24</sup> Haggard generally agrees with Moravcsik's thesis. Haggard contends that the more powerful states largely shaped the bargaining agendas in economic integration in Asia and the Western Hemisphere. However, the interests of weaker states also affected—although to a lesser degree—the regional economic agreements on the agenda.<sup>25</sup> What is crucial, in Haggard's view, for economic integration to proceed is the convergence of preferences among parties to regional agreements that facilitate the bargaining and construction of regional economic blocs among member-states. According to Haggard, the difference between the developments of East Asian and Latin American regional integration is accounted for by the difference in the convergence or divergence of preferences of member countries about the direction and extent of economic integration. In Latin America, severe economic crises of the 1980s promoted preferences in various countries for deeper regional economic integration, whereas the lack of a similar crisis in Asia (until very recently) has kept economic and institutional preferences of Asian nations relatively diverged. In addition, Yi Feng and Gaspare Genna also find that homogeneity of preferences among member countries not only facilitates integration, but that integration promotes greater homogeneity among members.<sup>26</sup> This mutually reinforcing mechanism not only explains

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<sup>22</sup> Jeffrey A. Frieden, *Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965-1985* (Princeton: Princeton University Press, 1991); Jeffrey A. Frieden, "Who Wins? Who Loses?" *Foreign Policy* September 1998: 25, 1998; Helen Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988); Helen Milner, "Industries, Governments, and the Creation of Regional Trade Blocs," in Edward D. Mansfield and Helen V. Milner (eds), *The Political Economy of Regionalism* (New York: Columbia University Press, 1997); Ronald Rogowski, *Commerce and Coalitions* (Princeton: Princeton University Press, 1989); Moravcsik, "Taking Preferences Seriously."

<sup>23</sup> Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42: 427-460, 1988; Geoffrey Garrett and Peter Lange, "Internationalization, Institutions, and Political Change," *International Organization* 49: 627, 1995.

<sup>24</sup> Andrew Moravcsik, *The Choice for Europe* (Cornell: Cornell University Press, 1998).

<sup>25</sup> Stephan Haggard, "Regionalism in Asia and the Americas," in Edward D. Mansfield and Helen V. Milner (eds), *The Political Economy of Regionalism* (New York: Columbia University Press, 1997).

<sup>26</sup> Yi Feng and Gaspare M. Genna, "Regional Integration and Domestic Institutional Homogeneity: A Comparative Analysis of Regional Integration in the Americas, Pacific Asia, and Western Europe," *Review of International Political Economy*, 10, 2003 (forthcoming).

the level of integration in Latin America, Southeast Asia, and Europe, but also explains the varying pace of integration in each case.

Although very informative about the sources of states' preferences, the explanations that focus on domestic politics have little to say about the dynamics of change in international power relations in the process of regional integration. These approaches convincingly explain economic policy choices by national governments; however, regional integration, by definition, is an outcome of joint decisions by two or more countries. Over the long run, because of the differential rates of growth, relative strengths and bargaining positions of countries change.<sup>27</sup> Hence, any account of regional integration must take into consideration both country preferences and international power relations.

### **Explaining Regional Integration through Power Relations and Domestic Influences**

Each of the prior perspectives provides useful insights into the sources of regional integration. At the same time, the complexity of regional integration renders none of these approaches as complete explanations. Our aim in explaining integration is modest. Drawing upon the existing literature, we will formulate testable hypotheses with specific reference to Latin American and Caribbean integration. The list of hypotheses will not be exhaustive; nonetheless, taken as a whole, they tap into the core propositions raised by the extant literature. In so doing, we will focus on (neo)realist propositions and domestic politics hypotheses. The central question is why integration occurs in some places at certain times but not in others. The focus on states' preferences and international power relations are best suited to answer this question.

The central hypothesis of this paper is:

*Regional integration is more likely to develop as the relative economic power of countries in such arrangements is asymmetric and they share similar or compatible preference profiles.*

This hypothesis derives from the notion that the interaction of the variables (power asymmetry and preference similarity or compatibility) explains the increased propensity for integration. Each alone tells us little. When there is parity in economic capabilities, neither country has the capability to coordinate liberalization. Since both have similar strengths, it would be difficult for each to bare the burdens of readjustment. While this situation is not present under preponderance, the preponderant economic power may see no or few benefits in investing resources to promote integration with small neighboring countries when preferences are not similar. However, as the distribution of economic

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<sup>27</sup> Organski, *World Politics*, 1958; Organski, *World Politics*, 1968; Organski and Kugler, "The Costs of Major Wars;" Organski and Kugler, *The War Ledger*; Tammen *et al*, *Power Transitions*. See Douglas Lemke, "Small States and War," in Jacek Kugler and Douglas Lemke (eds), *Parity and War* (Michigan: University of Michigan Press, 1996 and Douglas Lemke, *Regions of War and Peace* (Cambridge, UK: Cambridge University Press, 2001) for application to local hierarchies.

capabilities between countries grows more asymmetric, it makes more sense for these states to enter negotiations about economic cooperation *if* both parties jointly find it in their interest to do so. In addition to the efficiency gains expected to result from economies of scale and the expansion of the market, states with asymmetric power and common interests may pursue a strategy of economic integration in order to increase their competitiveness vis-à-vis powers outside the region.

What interests do states have to have in common in order to enter negotiations over regional integration? The political economy of international economic policy literature suggests that there must be sufficient interests among domestic groups in regional economic integration. One powerful source of integration interest is private businesses that anticipate gains from the expansion of a stable market. Consumers are also potential beneficiaries from integration because increased competition and economies of scale will supply goods and services of higher quality at more competitive prices. However, the diffusion of consumer interests promotes greater problems of collective action than certain business interests that have stakes in promoting or stalling integration. In the subsequent data analysis, we examine mutual trade interests as one source of states' interests in regional economic integration. We can now restate the general hypothesis of this research:

*H<sub>1</sub>: The level of regional economic integration is higher between pairs of countries when their economic sizes are asymmetrical and they both have strong mutual trade interests in expanding and securing their markets.*

Moreover, a number of (neo)realist scholars argue that economic integration is more likely among countries that share similar foreign policy preference profiles. Hence, by measuring countries' foreign relations preference profiles by alliance portfolios:

*H<sub>2</sub>: States with similar alliance portfolios are more likely to pursue integration than those with dissimilar ones under power preponderance.*

Finally, we consider the timing of integration. We can explain the start or a change in the level of integration as a discrete event given the relative power between any two countries. After a power transition, research has shown that the probability of conflict initiation increases. In contrast, when two countries are jointly satisfied with their dyadic relations, peaceful transitions ensue.<sup>28</sup> We therefore pose the following:

*H<sub>3</sub>: The initiation of regional integration and change in its level are more likely to occur when economic powers of countries to such arrangements are more asymmetrical and they both have mutual trade interests.*

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<sup>28</sup> Carole Alsharabati, *Dynamics of War Initiation*, (Ph.D. Dissertation, Claremont Graduate University, 1997); Efrid and Genna, "Structural Conditions and the Propensity for Regional Integration."

Joint satisfaction due to similar alliance portfolios is also expected to produce the same results:

*H<sub>4</sub>: The initiation of regional integration and change in its level are more likely to occur when economic powers of countries to such arrangements are asymmetric and they both have similar alliance portfolios.*

The data analysis tests these hypotheses against the achievement of integration between pairs of Latin American and Caribbean countries from 1960 to 1997. The data set includes all politically relevant dyads (defined as contiguous states or those within 250 miles if separated by a body of water). During this period, four regional economic integrations were observed: Mercosur/Mercosul, the Andean Pact, CACM/SICA, and CARICOM.<sup>29</sup> Table 1 presents information on member-countries and the years in which they joined these regional economic agreements.

**Table 1: Regional integration in Latin America and the Caribbean**

<b>Group</b>	<b>Full Name</b>	<b>Member Nations</b>	<b>Year</b>
ANCOM	Andean Common Market	Bolivia	1969-1981, 1992
		Chile	1969-1976
		Colombia	1969
		Ecuador	1969-1992, 1993
		Peru	1969-1992, 1993
		Venezuela	1973
CACM	Central American Common Market	Costa Rica	1960-1969, 1990
		El Salvador	1960-1969, 1990
SICA (est. 1992)	Central American Integration System	Guatemala	1960-1969, 1990
		Honduras	1960-1969, 1990
		Nicaragua	1960-1969, 1990
		Panama (SICA only)	1992
CARICOM	Caribbean Community	Anguilla	2000
		Antigua & Barbuda	1968
		Bahamas	1968
		Barbados	1968
		Belize	1968
		Dominica	1968
		Grenada	1968
		Guyana	1968
		Haiti	1998

<sup>29</sup> This list excludes NAFTA.

		Jamaica	1968
		Montserrat	1968
		St. Kitts & Nevis	1968
		St. Lucia	1968
		St. Vincent & the Grenadines	1968
		Suriname	1996
		Trinidad & Tobago	1968
MERCOSUR	Southern Cone Common Market	Argentina	1991
		Bolivia (FTA member)	1997
		Brazil	1991
		Chile (FTA member)	1997
		Paraguay	1991
		Uruguay	1991

The basic version of the OLS model to estimate levels of integration is:

$$Y_{DYADi,t} = \alpha + \beta_0 Y_{DYADi,t-1} + \beta_k X_{DYADi,t-1} + \beta_z D_{PROJECTSi,t} + \varepsilon_{DYADi,t}$$

where  $Y_{DYADi,t}$  is the dependent variable of this study—the integration achievement score (IAS)—for dyad  $i$  during year  $t$ ,  $Y_{DYADi,t-1}$  is the lagged dependent variable,  $X_{DYADi,t-1}$  is the vector of lagged independent variables, and  $k$  equals the number of independent variables.  $D_{PROJECTSi,t}$  is the vector of dummy variables representing regional integration fixed effects, with  $z$  representing the number of integration projects minus one. This latter group also includes a dummy variable that represents dyads that are not members of integration projects. We look at regional integration fixed effects instead of dyad fixed effects to control for differences among projects instead of among dyads. In each equation, the Andean Pact is the excluded group.

We measure economic integration by the degree of integration between dyads of countries based on six Guttman scale categories: (1) mobility of goods and services; (2) capital mobility; (3) labor mobility; (4) supranational institutional building; (5) monetary policy coordination; and (6) fiscal policy coordination. We assign each category a value between 0 and 5 (with higher values indicating greater integration). These values are then summed across all six categories and averaged to generate the integration achievement score (IAS). The IAS's possible range is from the minimum of 0 to the maximum of 6.<sup>30</sup> The IAS for the four Latin American and Caribbean economic integrations is summarized in Table 2. The appendix provides the IAS's coding scheme.

<sup>30</sup> The score was first developed in Gary C. Hufbauer and Jeffrey Schott, *Western Hemisphere and Economic Integration* (Washington, DC: Institute for International Economics, 1994) and further developed in Genna, *Changing Power, Sovereignty, and Loyalty in the European Union* and used in Efird and Genna, "Structural Conditions and the Propensity for Regional Integration," and Feng and Genna, "Regional Integration and Domestic Institutional Homogeneity."

**Table 2: Integration achievement scores (1960-1997)**

Group	Year	G&S	Cap	Lab	SI	MC	FC	IAS
ANCOM	1969-70	2	1	0	1	0	0	0.667
ANCOM	1971-77	2	2	0	1	0	0	0.833
ANCOM	1978	2	2	0	1	1	0	1.000
ANCOM	1979-83	2	2	0	2	1	0	1.167
ANCOM	1984-90	2	2	0	2	2	0	1.333
ANCOM	1991-93	2	3	0	2	2	0	1.500
ANCOM	1994-95	3	3	1	3	2	0	2.000
ANCOM	1996-97	4	3	1	3	2	0	2.167
CACM	1963-89	1	1	0	1	1	0	0.667
CACM	1990	1	1	1	2	1	0	1.000
CACM/SICA	1991-92	1	1	1	2	1	0	1.000
CACM/SICA	1993-97	2	1	1	2	1	0	1.167
CARICOM	1965-72	2	1	0	1	0	0	0.667
CARICOM	1973	2	1	0	2	0	0	0.833
CARICOM	1974-82	3	2	0	2	0	0	1.167
CARICOM	1983-88	3	2	0	2	2	0	1.500
CARICOM	1989-90	3	3	0	2	2	0	1.667
CARICOM	1991-95	4	3	0	2	2	0	1.833
CARICOM	1996-97	4	3	1	2	2	0	2.000
MERCOSUR	1991-93	1	0	0	1	0	0	0.333
MERCOSUR	1994	1	1	1	2	0	0	0.833
MERCOSUR	1995-97	4	1	1	2	0	0	1.333

Note: See Appendix for the description of the coding scheme.

We operationalize the independent variables as follows: power preponderance is the natural log of absolute difference in Gross Domestic Product (GDP) of pairs of countries, plus one (in current US dollars):

$$Power\ Preponderance = \ln (|GDP_i - GDP_j| + 1)$$

This generates a variable that ranges from 0 to 27.43. This allows us to interpret the variable, “preponderance,” as follows: larger values indicate greater economic power asymmetry. The value of 0 represents a complete parity in economic power of two paired countries, while 27.43 is the highest degree of asymmetry in our sample.

Mutual trade interest is the total volume of exports among country dyads as a percentage of the dyad GDP (in millions of current US dollars):

$$MutualTradeInterest = \frac{Exports_{ij} + Exports_{ji}}{GDP_i + GDP_j}$$

The variables preponderance and mutual trade interest are then interacted to test hypotheses H<sub>1</sub> and H<sub>3</sub>. We are interested in the degree of integration when the economic power of one country is relatively preponderant over the other given different levels of mutual trade interest. The data on GDP are collected from the *Global Development Network Growth Database* (2000). The bilateral trade figures come from International Monetary Fund statistics.

The S correlation computed by Curtis Signorino and Jeffrey Ritter captures the similarity of alliance portfolios between dyads.<sup>31</sup> Since the purpose of this research is to explain regional integration, we use the S measure for regional affairs. The S measure was also interacted with the preponderance variable. We used the *EUGene* data program to aggregate the alliance portfolios in a dyadic format.<sup>32</sup>

We evaluate the arguments of this paper with the panel corrected standard error (PCSE) OLS regression method using time-series cross-section data and the Cox proportional hazards regression method using event history data of Latin American and Caribbean dyads for the years 1960-1997. We use PCSE OLS regression because it makes it possible to correctly estimate the sampling variability of the OLS estimates even when panel heteroskedasticity and contemporaneously correlated errors are present. PCSE regression also generates conservative estimates of standard errors. The inclusion of a lagged dependent variable in the regression equation corrects for serial correlation. It also models the dynamic aspect of time.<sup>33</sup> We control for relative market size by including a variable that measures the dyad's total population. We expect the relationship between the total population and the level of integration to take a negative sign because larger populations translate into larger domestic markets and might therefore have a lesser interest in integrating with other markets. Finally, the proportional hazards model is especially designed to test the influence of the independent variables on the timing of integration initiation and/or its increase. We code each change in the level in the IAS as an event. The hazard ratios of each independent variable are interpreted as the percent contribution during the timeframe leading toward the event.<sup>34</sup>

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<sup>31</sup> Curtis Signorino and Jeffrey M. Ritter, "Tau-b or Not Tau-b: Measuring Similarity of Alliances and Interests," *International Studies Quarterly* 43: 115-144, 1999. The S measure was downloaded from Richard Tucker *The Similarity of Alliance Portfolios, 1816-1984*, Version 2.50 <http://www.fas.harvard.edu/~rtucker/data/alliance/similar.html>, 1999.

<sup>32</sup> See Scott D. Bennett and Alan Stam, III, *Expected Utility Generation and Data Management Program (EUGENE)*. <http://wizard.ucr.edu/cps/eugene/eugene.html>, 1999.

<sup>33</sup> Nathaniel Beck and Jonathan N. Katz, "What to do (and not to do with Time-Series Cross-Section Data)," *American Political Science Review* 89: 634, 1995.

<sup>34</sup> Hans-Peter Blossfeld, et al, *Event History Analysis* (New Jersey: Lawrence Erlbaum Associates, 1988); Kazuo Yamaguchi, *Event History Analysis* (Newbury Park: Sage, 1991).

## Regression Results

**Table 3: OLS regression on level of regional integration**  
(Panel corrected standard errors, autocorrelation corrected, fixed effects models)

<b>Independent Variables</b>	<b>Alliance (I)</b>	<b>Alliance (II)</b>	<b>Trade (I)</b>	<b>Trade (II)</b>
<b>preponderance, t-1</b>	-.0032** (.0016)	.0022* (.0016)	-.0036* (.0020)	.0023* (.0013)
<b>alliance, t-1</b>	-.0689** (.0326)	-.0275 (.0240)	--	--
<b>mutual trade interest, t-1</b>	--	--	-34.9*** (12.7)	-22.2** (10.03)
<b>preponderance×alliance, t-1</b>	.0037** (.0015)	.0010** (.0005)	--	--
<b>preponderance×trade interest, t-1</b>	--	--	1.66*** (.590)	.972*** (.465)
<b><u>Controls/Corrections</u></b>				
<b>integration level, t-1</b>	1.009*** (.0149)	.7853*** (.0368)	1.006*** (.0144)	.7448*** (.0340)
<b>total population</b>	--	-1.03×10 <sup>-10</sup> (6.33×10 <sup>-11</sup> )	--	-1.30×10 <sup>-10</sup> ** (5.63×10 <sup>-11</sup> )
<b>no integration membership</b>	--	-.3637*** (.0585)	--	-.4033*** (.0605)
<b>CACM/SICA</b>	--	-.0757 (.0540)	--	-.0886 (.0579)
<b>CARICOM</b>	--	-.0019 (.0455)	--	.0284 (.0455)
<b>MERCOSUR/MERCOSUL</b>	--	.0922 (.0606)	--	.0661 (.0610)
<b>Constant</b>	.0851** (.0392)	.3167*** (.0644)	.1008** (.0482)	.3509*** (.0694)
<b>R<sup>2</sup></b>	.964	.975	.961	.974
<b>Wald <math>\chi^2</math></b>	6968.91***	7323.29***	5986.84***	6871.71***
<b>number of observations</b>	3660	3660	2866	2866
<b>number of groups</b>	115	115	115	115

Notes: First entry is the unstandardized coefficient, followed by the standard error in parentheses.

\*\*\*p≤.01; \*\*p≤.05; \*p≤.10.

Table 3 presents the results of the first set of PCSE OLS regressions. All independent variables included in the causal argument are lagged by one year. Overall, the results indicate that the level of integration among country pairs is higher when a power

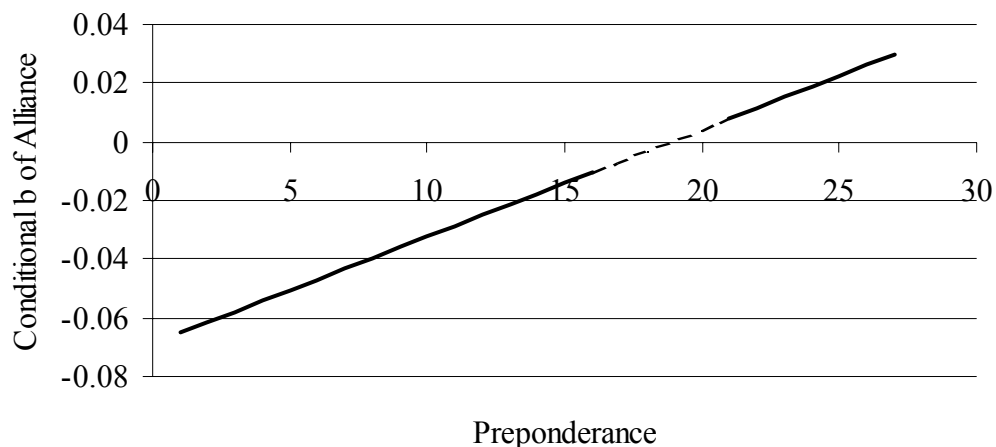


asymmetry exists and alliances are complementary. The first two models focus on power relationships and alliance portfolios. The first equation, Alliance (I), has a negative sign for both the preponderance variable and the alliance variable, but a positive sign for the interactive term (all three are significant at the  $p \leq .05$  level). When preponderance equals zero (i.e., a parity condition), perfectly correlated alliances (a value of one) reduces the level of integration by .0652 point, holding all other variables constant. When alliances are not correlated (a value of zero), a one-point increase in preponderance scale still increases the level of integration, but very slightly ( $b = .0005$ ). With the inclusions of fixed effects and total population size (see Alliance (II) Model), the sign of preponderance becomes positive but those of both alliance and interactive term remain the same. Total population is not significant, indicating that the population size of the country dyad is not a significant factor affecting integration when considering power relationships and alliances.

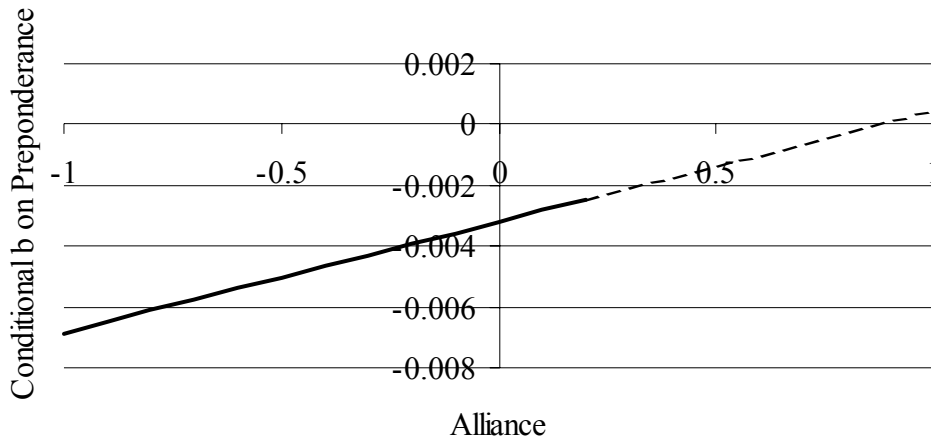
The next two equations substitute the mutual trade interest variable for the alliance variable, with similar results. In Trade (I), we see a negative sign on the preponderance variable and the mutual trade interest variable, but a positive sign on the interactive term. When parity exists (preponderance = 0), mutual trade interest alone reduces the level of integration ( $b = -34.9$ ). Also, when there is no mutual trade interest, preponderance also reduces the level of integration ( $b = -.0036$ ). However, the coefficient of the interactive term indicates that the simultaneous presence of preponderance and mutual trade interest may increase the level of integration. This interactive result stands even when controlling for population size and individual integration project fixed effects, as seen in the Trade (II) equation. In this equation, the preponderance variable carries a positive sign, and the interactive term remains significant and positive. Total population size is significant and carries a negative sign; as total population size among the dyads increases, the level of integration decreases when we control for mutual trade interest.

**Figure 1: Graphical depiction of conditional coefficients for the OLS regression models**

**(a) Conditional coefficients of alliance at varying levels of preponderance**



**(b) Conditional coefficients of preponderance at varying levels of alliance**



The previous results can be further examined by analyzing the conditionality of each variable in the interaction terms of the Alliance (I) and Trade (I) equations found in Table 3. We calculated conditional coefficients and standard errors.<sup>35</sup> Figure 1, (parts a and b), is a graphical depiction of the conditional coefficients for the Alliance (I) model. The black line segment represents the portion of the conditionality that remains significant at the  $p \leq .10$  level, while the dashed line segment represents the portion that is not significant. Figure 1a depicts the conditional coefficients of alliance at varying levels of preponderance. As the level of preponderance increases, the alliance coefficients become increasingly positive. For example, when the value of preponderance is 10, the coefficient of alliance is negative .03 (a one-point increase in the S correlation *decreases* the level of integration in terms of IAS by .03). However, when preponderance is 25, then the coefficient of alliance is positive .02 (a one point increase in the S correlation increases the IAS score by .02). The values of preponderance between approximately 16 and 21 are not significant, meaning that values in this range do not significantly influence the level of integration.

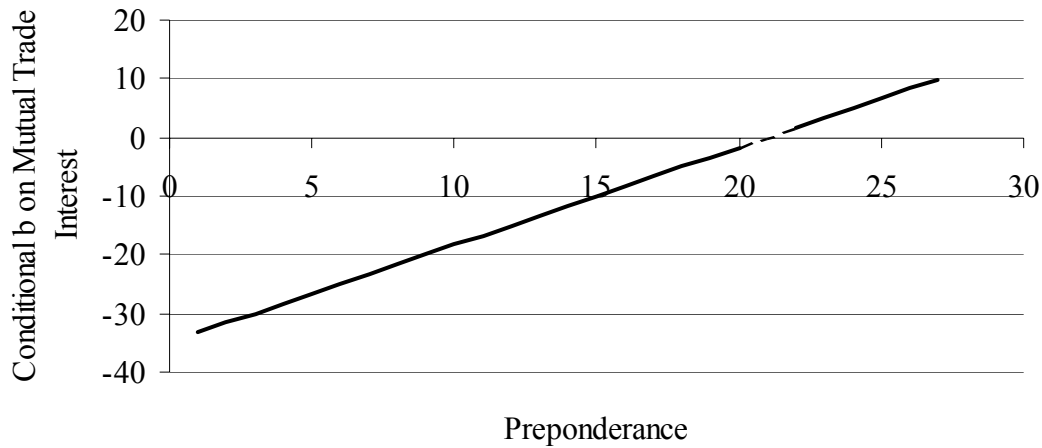
Figure 1b depicts the conditional coefficients of preponderance at varying levels of the alliance variable. The results here are more interesting. As in figure 1a, as the values of the alliance variable increase the negative impact of preponderance diminishes. While the coefficient of preponderance is significant between the alliance levels of -1 to

<sup>35</sup> Let  $Y = a + b_1X + b_2J + b_3XJ$  be a model for one interaction term where the conditional effect of X on Y is given by:  $\partial Y / \partial X = b_1|J = b_1 + b_3J$ . The conditional standard error is computed by:

$$se\ b_1|J = \sqrt{\text{var } b_1 + J^2 \text{ var } b_3 + 2J \text{ cov } b_1, b_3} \quad (\text{Clark 2001}).$$

0.3, it loses significance with alliance values greater than 0.3. This means that greater asymmetry in power under the condition of alliance portfolio incompatibility reduces the level of integration. When alliances are aligned, however, power preponderance has no statistically significant impact on integration. This explains why perfectly correlated portfolios and a large degree of power asymmetry, in the prior discussion, did not generate high estimated levels of integration. Since the alliance portfolio alignments are not significant beyond 0.3, a perfectly correlated portfolio would not be a good predictor for integration in Latin American and the Caribbean during 1960-1997.

**Figure 1: Graphical depiction of conditional coefficients for the OLS regression models (continued)**  
**(c) Conditional coefficients of mutual trade interest at varying levels of preponderance**



**(d) Conditional coefficients of preponderance at varying levels of mutual trade interest**

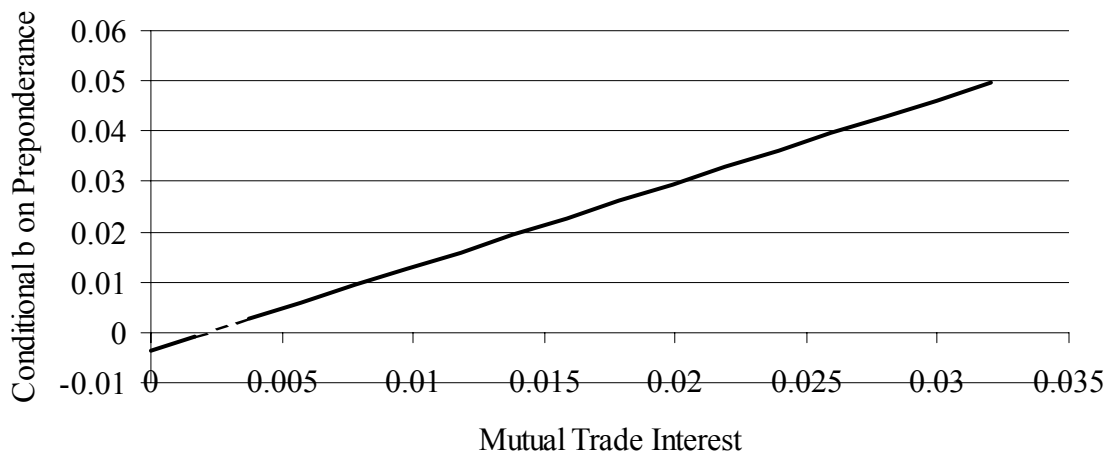


Figure 1, (parts c and d), is a graphical depiction of the conditional coefficients for the Trade (I) model. Figure 1c depicts the conditional coefficients of mutual trade interests at varying levels of preponderance. Figure 1c indicates that the greater the presence of mutual trade interests, the greater the levels of integration when the values of preponderance are 22 and higher. When preponderance equals 22, the impact of mutual trade interest on integration is positive but slight. However, when preponderance is approximately 25, a 0.01 increase in the mutual trade interest variable leads to a corresponding 5 point increase in the level of integration. Mutual trade interest has no significant effect on integration between the range of 20 to 22 on the preponderance scale. Figure 1d, however, stands in marked contrast to figure 1b. Preponderance has significant effects on integration at almost all ranges of bilateral trade interests. The narrow range of nonsignificant values lies in the lower end of possible values (approximately .002 to .004). Since the range of values are small and lie in the lower end, prior conclusions hold: increases in mutual trade interests among country dyads have an increasing effect with preponderance on increasing the level of regional integration.

**Table 4: OLS regression on level of regional integration  
(Panel corrected standard errors, autocorrelation corrected, fixed effects models)**

<u>Independent Variables</u>	<u>Full (I)</u>	<u>Full (II)</u>
<b>preponderance, t-1</b>	-.0056*** (.0016)	.0018* (.0016)
<b>alliance, t-1</b>	-.0701 (.0508)	-.0140 (.0394)
<b>mutual trade interest, t-1</b>	-30.41** (12.79)	-22.14** (10.34)
<b>preponderance×alliance, t-1</b>	.0035 (.002)	.0004 (.0017)
<b>preponderance×trade interest, t-1</b>	1.437** (.5961)	.9740** (.4801)
<u>Controls/Corrections</u>		
<b>integration level, t-1</b>	1.006*** (.0145)	.7451*** (.0400)
<b>total population</b>	--	-1.08×10 <sup>-10</sup> * (6.33×10 <sup>-11</sup> )
<b>no integration membership</b>	--	-.4051*** (.0603)
<b>CACM/SICA</b>	--	-.0884 (.0580)
<b>CARICOM</b>	--	.0265 (.0453)
<b>MERCOSUR/MERCOSUL</b>	--	.0649 (.0685)
<b>Constant</b>	.1419***	.3661***

	(.0412)	(.0625)
<b>R<sup>2</sup></b>	.961	.974
<b>Wald <math>\chi^2</math></b>	7482.96***	7064.30***
<b>number of observations</b>	2866	2866
<b>number of groups</b>	115	115

Notes: First entry is the unstandardized coefficient, followed by the standard error in parentheses.  
\*\*\*p $\leq$ .01; \*\*p $\leq$ .05; \*p $\leq$ .10.

Table 4 completes our explanation for the level of regional integration. In these equations, both alliance and mutual trade interest variables are entered simultaneously. Full (I) indicates that alliance portfolios are not a significant predictor of integration, either independently or by an interactive term with preponderance, when included with mutual trade interests, which remain significant both independently and by the interactive term. Therefore, the condition of preponderance with increasing levels of mutual trade interest is a better explanation for the levels of integration. Full (II) adds the population control and fix effects variables and is not very different from Trade (II) equation, which shows the robustness of our findings. When attempting to explain the level of regional integration, domestic factors, such as mutual trade interests, are more significant than regional factors such as alignments of alliance portfolios.

**Table 5: Cox proportional hazards regression for the timing of regional integration**

<b>Independent Variables</b>	<b>Hazard Ratio (standard error)</b>	<b>p-values</b>
<b>preponderance</b>	.637 (.047)	.000
<b>alliance</b>	.007 (.012)	.004
<b>mutual trade interest</b>	.028 (.040)	.011
<b>preponderance <math>\times</math> alliance</b>	1.276 (.100)	.002
<b>preponderance <math>\times</math> trade interest</b>	1.215 (.080)	.003
<b>log likelihood</b>	-1118.30	
<b>LR <math>\chi^2(5)</math></b>	144.84	.000
<b>number of observations</b>	315	

Note: p-values are for two-tailed tests

Table 5 presents the results of the hypotheses regarding the timing of integration through the use of the Cox proportional hazards method. Mutual trade interest is expressed as a percentage to improve interpretability of the results. The results support our hypotheses that the probability of initiating integration or increasing its level is enhanced when preponderance, mutual trade interests, and aligned alliance portfolios all increase in value. Individually they diminish the probability of initiating or increasing the level of integration, as indicated by the hazard ratios being less than one. When included as interaction terms, they improve the odds of the timing of integration, as indicated by the ratios being greater than one. Under a condition of neutrality (alliance = 0), and no mutual trade interest, the probability of initiating or increasing integration decreases by 36.3% ( $(0.6368 - 1) \times 100\%$ ) for every unit increase in preponderance. Under parity, and no mutual trade interest, the probability of initiating or increasing integration decreases by 99.3% for every unit increase in alliance. Under parity and neutrality, the probability of initiating or increasing integration decreases by 97.2% for every percent increase in mutual trade interest. However, when preponderance, alliance similarities, and mutual trade interest are present, they increase the probability of initiating or increasing integration. There is a 27.6% probability of initiating or increasing integration for every increase in level of the product of preponderance and alliance. In addition, there is a 21.5% probability of initiating or increasing integration for every increase in level of the product of preponderance and mutual trade interest. Therefore, probability improves the more asymmetrical the power relationship between country pairs, the greater their mutual trade interests, *and* the more similar their alliances.

## Conclusion

The political elite of many countries initiated integration projects in Europe, Asia and the Pacific, Latin America, the Caribbean, Africa, and the Middle East, marking a surge of integration in the latter half of the twentieth century and moving into the twenty-first. A number of economists and political scientists from a diverse set of intellectual traditions have sought to explain this new development in the international political economy. Each of these schools has contributed to our understanding of the dynamics and consequences of regional economic integration. The present research joined this intellectual exchange on the determinants of regional economic integration by proposing a set of testable hypotheses and conducting a regression analysis using Latin American and Caribbean data from 1960 to 1997.

The results of the data analysis largely confirmed the central argument of this paper. Namely, the propensity for regional economic integration increases when economic capabilities of a pair of countries in such arrangements are asymmetrical *if* they have mutual trade interests and similar alliance portfolios. These results stayed significant even when controlling for dyad population size. We also found that domestic factors are a stronger predictor in explaining the levels of integration. While misaligned alliances proved to be helpful in explaining why dyads have particular levels of integration, aligned alliance portfolios proved to be not significant. Moreover, when included in the same equation, alliance portfolios were not significant while mutual trade interest

remained significant. Therefore, the strength in explaining the level of Latin American and Caribbean integration lies in mutual trade interest among country pairs (as well as power asymmetries) more so than region-wide alliances. Finally, the timing of integration's initiation or change is also explained by the interaction of preponderance with alliance portfolios and mutual trade interest.

This research can benefit from further sophistication. First, the sources of state preferences may include more nuanced measures of the relative strength of pro-integration and anti-integration forces. Data on the strengths of manufacturing, financial, agricultural, and other sectors may be used to construct such variables. Second, it may be fruitful to consider preferences of government leaders regarding integration. For example, what are the ideological positions of state leaders and ruling parties on integration issues? Why do they sometimes pursue policies that favor some societal groups over others in a way that is not accounted for by pluralism? How do institutions shape interest representation and decision-making processes in a polity?

Finally, studies in (neo)functionalism and neoinstitutionalism have generated many interesting propositions and implications that can be tested with regional integration projects around the world. Have such projects promoted efficiency gains and facilitated cooperation among member-countries by helping to overcome collective action problems and by offering information and transparency as anticipated? Have there been unanticipated costs and benefits arising from earlier moves towards economic integration? Regional integration offers a number of interesting topics for future research.

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## **Appendix: Integration Achievement Score (coding system)**

### **1. Trade in Goods and Services**

- 0 = No agreements made to lower tariffs and non-tariff barriers
- 1 = Preferential Trade Agreement
- 2 = Partial Free Trade Area
- 3 = Full Free Trade Area
- 4 = Customs Union
- 5 = No barriers among member countries

### **2. Degree of Capital Mobility**

- 0 = No agreements made to promote capital mobility
- 1 = Foreign Direct Investment allowed in limited form
- 2 = Capital withdrawal allowed
- 3 = Full access for foreign investment and capital withdrawal, except for national government procurement
- 4 = Full capital mobility expect for large scale merges and acquisitions
- 5 = Full capital mobility without restriction

### **3. Degree of Labor Mobility**

- 0 = No agreements made to promote labor mobility
- 1 = Right of movement granted for select professions
- 2 = Full right of movement
- 3 = Transferability of professional qualifications granted
- 4 = Transferability of pensions and other retirement devices
- 5 = Full freedom of movement

### **4. Level of Supranational Institution Importance**

- 0 = No supranational institutions
- 1 = Establishment of nominal institutions
- 2 = Information gathering and advisory role
- 3 = Ability for institutions to amend proposals
- 4 = Ability for institutions to veto proposals
- 5 = Supranational institutions operate as primary decision node

### **5. Degree of Monetary Policy Coordination**

- 0 = No monetary policy coordination
- 1 = Consultation regarding policy
- 2 = Commitment to maintain parity
- 3 = Coordinated interventions
- 4 = Regional Central Bank establishment
- 5 = Single currency

### **6. Degree of Fiscal Policy Coordination**

- 0 = No fiscal policy coordination
- 1 = Consultation regarding policy
- 2 = Commitments regarding deficit spending and taxation
- 3 = Sanctions regarding breaking commitments
- 4 = Uniform tax code
- 5 = Single budget