

ERASMUS UNIVERSITY ROTTERDAM

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**Impact of Venezuela's MERCOSUR Membership: Economic and Political Dynamics from
2005 to 2022**

Christoforos Malakates

Student ID number: 658268cm

Thesis Supervisor: Prof. dr. B. Visser

Second assessor: Dr. Aksel Erbahar

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This study explores the economic and political effects of Venezuela's membership and subsequent suspension from MERCOSUR from 2005 to 2022. Using an event study methodology, the research examines variations in economic indicators, such as GDP per capita growth and current account balance, and political indices, including political stability, government effectiveness, and corruption perceptions. The findings reveal that Venezuela's inclusion in MERCOSUR had a complex impact on the economic and political landscape of the country. While GDP per capita growth showed positive trends after the membership period, the current account balance deteriorated post-suspension, highlighting economic vulnerabilities. Politically, the suspension led to decreased stability and effectiveness within MERCOSUR, raising concerns about the bloc's credibility. Future research should consider broader geopolitical dynamics and informal economic activities to provide a more comprehensive analysis.

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1. Introduction

In the last decades, many trade agreements have been signed between countries to collaborate effectively and spur economic and social development. An example to understand this trend is the North American Free Trade Agreement (NAFTA), which was renegotiated and replaced by the United States-Mexico-Canada Agreement (USMCA) in 2020¹. The change aimed to solve modern trade issues and tackle the imbalances of the original agreement. Similarly, the United Kingdom's exit from the European Union, commonly known as Brexit, marked a significant change in regional trade dynamics, leading to the establishment of new trade agreements between the UK and other nations outside the EU. However, most of these decisions are taken under long-lasting meetings and official conversations between countries' executives. In the case of Brexit, this process of exiting the European Union lasted more than 7 years. In January 2013, British Prime Minister David Cameron promised to hold an in-out referendum on EU membership if the Conservative Party won the next general election². The referendum took place on June 23rd, 2016 where 51.9% of voters chose to leave the EU. Finally, the United Kingdom officially exited the European Union on January 31st, 2020. This example highlights the importance of such decisions and shows why countries and such organizations need to act with a proper timeline in these international talks. But not for MERCOSUR. The South American trade bloc decided in December 2006, after a common decision of the Argentinian, Brazilian, Paraguayan, and Uruguayan authorities to suspend Venezuela from its status as an official member. The decision was primarily due to Venezuela's failure to comply with the bloc's trade and human rights standards. Specifically, Venezuela had not fulfilled economic, democratic, and human rights requirements set by MERCOSUR, which include the adoption of key trade agreements and respect for democratic principles. The suspension was part of the tensions and dissatisfaction with the Venezuelan government's behavior. Initially, Venezuela accused the other members of conspiring against them, with the government rejecting the suspension and accusing MERCOSUR of being politically motivated³. This move isolated Venezuela internationally and created a concern about a possible political and economic crisis in the region. Following the suspension, Venezuela's attempts to regain its status were unsuccessful, and the country faced continuous diplomatic and economic challenges, while MERCOSUR tried to maintain its democratic and economic standards among the remaining member states. The exclusion from the bloc meant that Venezuela lost preferential trade benefits, which damaged its already struggling economy. The suspension also highlighted Venezuela's isolation from other South American countries, leading to extremely low political influence in regional matters.

¹ United States-Mexico-Canada Agreement. (n.d.). United States Trade Representative. <https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement>

² BBC News. (2013, January 23). David Cameron promises in/out referendum on EU. <https://www.bbc.com/news/uk-politics-21148282>

³ BBC News. (2016, December 15). Venezuela Mercosur: Battle of rooms at Latin American summit. <https://www.bbc.com/news/world-latin-america-38328489>

Other organizations and countries adopted a strict stance against the Maduro regime. For instance, the Organization of American States (OAS) made several statements about Maduro's government and the risks that it puts the people of Venezuela⁴ in. Furthermore, the European Union increased its pressure on Venezuela by using sanctions and diplomatic measures, to get the government to restore the democratic values within the country⁵. The sanctions included arms embargo that prohibited the sale, supply, transfer and export of arms and related material to Venezuela and also travel bans and asset freezes against Venezuelan executives that were responsible for the violation of human rights and democratic principles.

Domestically, Venezuela's political crisis deepened, with protests and economic hardships affecting the population. The government faced increasing internal disputes, leading to political turmoil, including the controversial re-election of Maduro in 2018, which many international organizations and Venezuelan opposition groups denied.

This paper aims to address the impact of being included in a regional economic trade bloc compared to before and after the inclusion by using an event study strategy. The strategy will help the reader understand how the economic and political factors were affected in three different periods. The first period is the period 2005-2011. This period was characterized by important changes not only in the region but globally. The financial crisis occurred in 2008 and had many consequences for the global economy. The crisis of 2008 also changed the political landscape of many countries that tried to avoid the consequences. As for MERCOSUR, this period was mostly a good period for the organization and many of its members after leaving the catastrophic events of the previous decades and the recessions of the early 2000s such as Argentina's financial crisis in the past. For Venezuela, this period was a period that could signal improvements for the country on many levels, as the political unrest of the 1990s seemed to be forgotten and because the global environment created some good expectations after the increase in oil prices. I will refer to the 2005-2011 period as the pre-event period, as Venezuela was not an official member of the bloc. The second period that will be discussed is the 2012-2016 period. This period is named the reference period, as it will serve as the event that will be compared with the pre-event and post-event periods. During these years, important political events took place globally. However, this study will focus only on the importance of the Brexit referendum in 2016 and the combination of this event with the deep economic crisis in the European Union, as these events motivated me to study this topic in a different geopolitical concept. For MERCOSUR this was a vivid period, as Venezuela entered the bloc in an attempt to strengthen the relationships in the area, but at the same time, many political events took place that affected domestic affairs. Hugo Chávez died in 2013, which brought upset to the Venezuelans and undermined Venezuela's political stability. Many riots

⁴ Statement of OAS Secretary General Luis Almagro to U.S. Senate hearing on Venezuela. (n.d.). OAS - Organization of American States. https://www.oas.org/en/media_center/press_release.asp?sCodigo=S-020/17

⁵ Council of the European Union. (2017, November, 13). Venezuela: EU adopts conclusions and targeted sanctions. <https://www.consilium.europa.eu/en/press/press-releases/2017/11/13/venezuela-eu-adopts-conclusions-an-targeted-sanctions/>

started within the country, and subsequently, the country lost its political orientation. Brazil also faced political challenges after the impeachment of Dilma Rousseff in 2016. Finally, the last period of the analysis is the post-event period (2017-2022). I chose this period because it can capture the aftermath of Venezuela's suspension from MERCOSUR. This way, we can see if the exclusion of a country from a trade bloc and its privileges (tariff reduction, market access, economic integration) had significant effects on both the suspended country and the rest of the members. The main purpose of this paper is to compare the political and economic effects of the reference period to those of the pre-event period and post-event period. The main question of this paper is the following:

“How did the political and economic indices of the MERCOSUR members change before Venezuela's inclusion and after Venezuela's suspension relative to Venezuela's years in MERCOSUR?”

The results align with what one can expect to happen when a country leaves a trade bloc and present a comprehensive image despite some statistically insignificant variables. However, one needs to be very careful when discussing the results, as many other factors need to be considered. The numbers might be useful, but some critical knowledge is essential to understand that many unobserved factors can influence our analysis. All in all, this could be an important paper for policy research as we enter a period of big economic and social integration in many regional trade blocs. Also, this paper can be a useful guide in examining the impact of Bolivia's inclusion in MERCOSUR.

In the rest of the introduction, I will give a good geopolitical image of the region. First, I am going to present the main historical events that took place in the 20th century to make it easier to understand how politically complex and vivid South America is. After introducing the main historical and political events, I will show how these events led to the creation of a new trade bloc that would spur economic integration and development. Then, I will continue with an introduction to MERCOSUR and its evolution through the years. After showing how the countries were affected after being included in the trade bloc, some important clauses of MERCOSUR and the differences between the associate with the official members will be explained. Similarly, I will then talk about Venezuela's history. I will present the main political events of Venezuela before joining the South American Trade Bloc, before moving on to Venezuela's years in MERCOSUR and the years after Venezuela's suspension. Lastly, the last paragraph will emphasize the consequences of the hyperinflation in Venezuela. In the next section the literature on this topic and the main sources that can help us understand the complexity of the region will be analyzed. In the third section, the methodology will be analyzed and explained. In this part the regression specification will also be presented as well as the independent, dependent and control variables. Afterwards, the sources of my data will be listed before moving to the political and economic results and their interpretation. In the last part of this paper I will conclude with the main findings of the paper.

1.1 MERCOSUR and South America

In this section, I will explain some of the main historical events that occurred in South America and more particularly in the countries that the research mostly focuses on. I will start by giving some important historical events regarding the political background of the MERCOSUR countries and how they finally made it to establish democratic principles. In the next parts, the analysis will focus on the specific example of Venezuela, in order to understand the complexity of the country and the governmental and political instability through the years.

1.1.1 South America in the 20th century

The 20th century was politically vivid for most countries of South America. In 1960, Brazil had a lot of social unrest within the country. In 1961, João Goulart became the president of Brazil after Jânio Quadros resigned. Goulart's reform agenda, which included land reform, nationalization of industries, and labor rights, polarized the Brazilian society. He faced opposition from conservative sectors of society, including the military, business elites, and right-wing political parties. The United States interfered in Brazil's internal politics to prevent the spread of more radical ideologies within the country. As a result, on March 31st, 1964, some parts of the Brazilian military, with the help of conservative forces and the business elites, launched a coup against Goulart's government⁶.

Argentina faced many difficulties after the 1950s and several coup attempts occurred over a 30-year span (1955, 1962, 1966 and 1976). The most pronounced one was in 1976, when the military took power by overthrowing President Isabel Perón⁷. The coup resulted in a brutal military dictatorship known as the "Dirty War", characterized by state-sponsored violence, forced disappearances, and human rights abuses targeting political opponents. The dictatorship lasted until 1983 when Argentina transitioned back to democracy. However, the country continued to face political instability, with many unsuccessful coups having been attempted. Despite its instable political history, Argentina has made efforts to restore democracy and to address the authoritarian ideals⁸.

Uruguay experienced a military coup in 1973, which resulted in the establishment of a civilian-military dictatorship that lasted until 1985. The coup overthrew President Juan María Bordaberry and suspended civil liberties, dissolved Congress, and implemented authoritarian rule⁹. The dictatorship ended with the return to democracy in 1985, following a period of civil resistance and international pressure. Since then, Uruguay has made significant evolution in

Durão, R. (2024, April 1). Understand the US participation in the military coup of 1964 in Brazil – and what may still be revealed. Brasil De Fato. <https://www.brasildefato.com.br/2024/04/01/understand-the-us-participation-in-the-military-coup-of-1964-in-brazil-and-what-may-still-be-revealed>

⁷ Argentina Declassification Project - The "Dirty War" (1976-83) | CIA FOIA (foia.cia.gov). (n.d.).

<https://www.cia.gov/readingroom/collection/argentina-declassification-project-dirty-war-1976-83>

⁸ Argentina's dirty war and the transition to democracy. (n.d.). <https://adst.org/2014/10/argentinas-dirty-war-and-the-transition-to-democracy/>

⁹ Krause, C. A. (2023, December 22). Uruguay's army leaders ease authoritarian rule. Washington Post. <https://www.washingtonpost.com/archive/politics/1979/10/27/uruguays-army-leaders-ease-authoritarian-rule/76a52eca-5e24-4150-bd1d-16602acd3313/>

fixing democratic values, promoting human rights, and facing the history of undemocratic regimes by promoting social policies.

Many other countries of the region faced similar political upsets in their recent history, like the junta in Peru in 1968 when General Juan Velasco Alvarado led a military coup against President Fernando Belaúnde Terry and in 1992 when President Alberto Fujimori dissolved Congress and assumed dictatorial powers. In 1973, Augusto Pinochet led a military coup against President Salvador Allende, who died during the coup. Pinochet's dictatorship resulted in widespread human rights violations, including torture, disappearances, and executions.

Finally, Venezuela experienced many coup attempts in the 20th century. The first one occurred in 1908 when Gómez led a coup against the government of Cipriano Castro and established himself as dictator. He ruled Venezuela until he died in 1935. The second one started in 1945 by Marcos Pérez Jiménez against the democratically elected government of Rómulo Gallegos. Finally, Hugo Chávez led the coup attempt in Venezuela in 1992. Even though the coup was unsuccessful, it kept Chávez in the spotlight for many years.

1.1.2 MERCOSUR's creation

The previous cases show why this region is very complex politically and socially unstable. MERCOSUR's main goal was to promote economic collaboration between those countries that were excluded from the open market principles for so many years¹⁰. The main principles of the trade bloc have to do with the promotion of democracy and economic development. Furthermore, the bloc tries to take into account other labour, social and cultural characteristics of the South American region. As a result, in 1991, the treaty of Asunción was signed between the four members that comprise Mercosur until today. Argentina, Brazil, Paraguay and Uruguay agreed on the legal framework and established a common market. The treaty of Asunción that established MERCOSUR followed two important treaties that had been signed before. The Treaty of Montevideo (1960) established the Latin American Free Trade Association (LAFTA) and set the goals for creating a common market by reducing tariffs and quotas and by promoting economic integration¹¹. However, due to big differences in the goals and the economic capabilities of the member states, the treaty was not successful and changed twenty years after in 1980. The new Treaty of Montevideo (1980) established the Latin American Integration Association (ALADI) and tried to face the problems of the previous treaty¹². They created a better environment to promote the economic and social integration of countries by setting trade policies that would increase cooperation between the countries. This new treaty also became the foundation of the Treaty of Asunción 11 years later.

¹⁰ CFR.org Editors. (2023, December 18). Mercosur: South America's fractious trade bloc. Council on Foreign Relations. <https://www.cfr.org/backgrounder/mercosur-south-americas-fractious-trade-bloc>

¹¹ U.S. International Trade Commission. (1960). *Treaty of Montevideo*. Retrieved from <https://www.usitc.gov/publications/other/pub60.pdf>

¹² SICE - Montevideo Treaty - ALADI. (n.d.). http://www.sice.oas.org/trade/montev_tr/montev1e.asp

MERCOSUR members gradually opened up to trade with each other. This was achieved by creating free trade areas within the organization, and over the years, MERCOSUR made agreements with other unions like the EU to reduce tariffs for small and medium-sized companies¹³. The FTA was signed in June 2019 and was associated with many investments. Another free trade agreement was also signed between MERCOSUR and Egypt. This FTA reduced tariffs by 90% and cut all duties on agricultural products¹⁴. MERCOSUR's other important trade agreements were the one with Israel in 2007 that reduced tariffs on various products, and the preferential trade agreement with the Southern Africa Customs Union signed in 2016¹⁵. These free trade agreements and preferential trade agreements show that MERCOSUR has made significant steps during the last decades to overcome past problems and become an important player in global trade. Most of its members have seen positive results after globalizing their economies. In Figure 1 below, it can easily be seen that the creation of MERCOSUR led to an increase in GDP per capita in those countries over the years. This helped the countries create better living standards for their residents.

Starting from 1985, the countries of South America have witnessed a cumulative increase in GDP per capita. However, there were some periods when GDP per capita declined for most countries during these 30 years. More specifically, in 2002, most countries saw the GDP per capita fall significantly. This can be attributed to various factors related to economic instability but the most important one is the devaluation of the Argentinian peso in 2001-2002 followed by the debt default¹⁶. Through spillover effects, Argentina's crisis affected Uruguay's economy. Many investors tried to withdraw their deposits which led to bank runs (De la Plaza & Sirtaine, 2005). The responses of the Central Bank of Uruguay were good enough to stop the crisis and to recover quickly. In 2014, the Brazilian economy entered 2 years of recession that was accompanied by high unemployment rates and high inflation. One of the main reasons was the fact that China's economy slowed down, which affected the prices of Brazilian products. The country also witnessed high levels of corruption, including the involvement of the President of the country and business elites in scandals¹⁷. Finally, the most recent shock of the region, which also reduced the levels of GDP per capita is the Covid-19 crisis. The pandemic reduced global trade and slowed economic growth through supply and demand shocks. Also, the policy responses that the countries had to take were costly for most countries including the MERCOSUR members. Venezuela has a clear image, as the levels of

¹³ EU-Mercosur. (2023, December 7). Trade. https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/mercosur/eu-mercosur-agreement_en

¹⁴ State Information Service. (2022, November, 27). <https://www.sis.gov.eg/Story/172997/Egypt-Mercosur-Free-Trade-Agreement?lang=en-us>

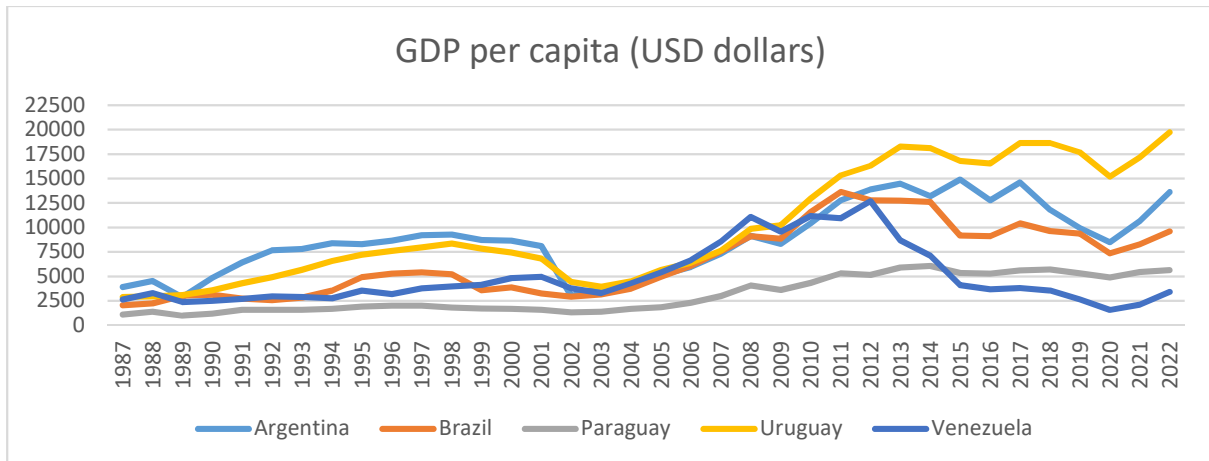
¹⁵ SICE: Trade Policy Developments: MERCOSUR-Southern African Customs Union (SACU). (n.d.). http://www.sice.oas.org/tpd/MER_SACU/MER_SACU_e.asp

¹⁶ The role of the IMF in Argentina, 1991-2002, Issues Paper/Terms of Reference for an Evaluation by the Independent Evaluation Office (IEO), July 2003. (2003, June 30). <https://www.imf.org/external/np/ieo/2003/arg/index.htm>

¹⁷ BBC News. (2017, March 7). Brazil's recession worst on record. <https://www.bbc.com/news/business-39193748>

GDP per capita fell massively after 2012, leading to a deterioration of the economic activity and the living standards.

Figure 1: GDP per capita of MERCOSUR members (1987-2022)



1.1.3 MERCOSUR's main clauses

MERCOSUR was first created in 1991 after Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asunción in the capital of Paraguay. The main clauses of MERCOSUR promoted economic integration and collaboration between the main members. This would be achieved by the free movement of goods, services and production capital. To do this, it was necessary to establish a common reduced tariff in the area and to adopt certain trade policy standards for all of the members. Furthermore, the bloc promotes the collaboration from a macroeconomic perspective between the different sectors of the countries involved. In an attempt to achieve these goals and to commit to the guidelines, member countries are forced to commit to the legislation regarding the integration process. This legislation requires them to be in line with specific democratic and economic standards.

MERCOSUR is a bloc that affects the whole South America region, but only four members are seen as official members. Argentina, Brazil, Paraguay, Uruguay and Venezuela (up until its suspension) have the right to vote and participate in the decision-making processes. They are the only members that are able to change the legislation and the future of the bloc. At the same time, Bolivia, Chile, Colombia Ecuador, Guyana, Peru, and Surinam are the associate members of the organization. They are members of the Latin American Integration Association (ALADI) and they also participate in the bloc through trade agreements and benefit from them. However, they do not have any voting rights despite being able to participate in MERCOSUR's meetings. These members do not play a role in MERCOSUR's decision-making.

The members of MERCOSUR can suspend other members from the bloc. The decision has to be made collectively by the other official members of MERCOSUR to ensure that it is according to the bloc's goals. For a member to be suspended, they must have violated the bloc's

democratic norms. According to Annex III of the Southern Common Market Agreement, the states need to solve any disputes through direct talks. However, if there is no solution, the members need to refer the dispute to the Council of the common market to settle the complaints and to make the final decision¹⁸.

1.2 MERCOSUR and Venezuela

In this part, the main political and economic events of Venezuela over the years will be presented. I will start discussing many years before Venezuela was included in MERCOSUR to point the dependence of the country on the oil revenues. The analysis will continue with more current events in the same way as I did with the other MERCOSUR countries in the first part of the introduction. In the last part, I will talk about hyperinflation in Venezuela, a catastrophic phenomenon for the country.

1.2.1 Venezuela before MERCOSUR

Between 1960 and 1980, Venezuela experienced important economic growth, mostly driven by the oil industry. The discovery of oil reserves in 1914, made Venezuela one of the main exporters in the oil industry for the next decades. During this period, Venezuela was perceived as an “economic miracle” and saw significant increases in oil exports, development projects, and welfare programs. Money coming from the oil industry was mostly used to finance infrastructure projects. Also, the country was stable politically, and authoritarian regimes were absent from the political system¹⁹. In the Yom Kippur War, Venezuela reached the top of the iceberg in 1973, which led the prices to rise from \$2.90 a barrel before the embargo on the United States to \$11.65 a barrel in January 1974²⁰. During this period, Venezuela had the highest GDP in the region. However, the national economy became heavily dependent on oil revenues and thus was unable to tackle the fluctuations in global oil prices. As a result, when the oil prices declined sharply in the 1980s Venezuela lost a big part of the revenues. It thus experienced a severe currency and debt crisis that deteriorated the economy. Also, the country borrowed from international lenders who financed the big infrastructure projects and the welfare programs. As a result, its fiscal position became worse in this decade. At the same time, as global interest rates rose and the value of the Venezuelan bolívar fell significantly, the country struggled to service its external debt, leading to a debt crisis. The currency devaluation together with high inflation and economic instability, had profound social and economic consequences, leading to poverty, unemployment, and social unrest in Venezuela. The crisis showed the vulnerabilities of an economy that was highly dependent on oil

¹⁸ World Bank. (n.d.). Clauses of Mercosur. Retrieved from <https://wits.worldbank.org/GPTAD/PDF/archive/MERCOSUR.pdf>

¹⁹ Corrales, J. (n.d.). Venezuela in the 1980s, the 1990s and beyond. ReVista. <https://revista.drclas.harvard.edu/venezuela-in-the-1980s-the-1990s-and-beyond/>

²⁰ Corbett, B. M. (n.d.). Oil shock of 1973–74. Federal Reserve History. <https://www.federalreservehistory.org/essays/oil-shock-of-1973-74>

revenues and highlighted the need for reforms to promote economic independency and fiscal stability²¹. The financial and political instability of the 80s could not be reversed in the 90s despite the attempts by the government. The Caracazo riots in 1989 had a clear impact on Venezuelan politics also in the early 1990s. The people protested against the neoliberal policies and the austerity measures implemented by Carlos Andrés Pérez's government. The riots started in Guarenas but quickly escalated and reached Caracas. The demonstrations resulted in many damages and caused political unrest for the next years²². The riots were a significant factor in the rise of Hugo Chavez in Venezuela's public view. The cocktail of poverty, government instability, and inequality, mixed with the austerity measures, gave political space to anti-establishment movements that challenged the existing political order²³. In February 1992, the Revolutionary Bolivarian Movement-200 (MBR-200) and its leader Hugo Chávez attempted to overthrow corruption in the political spectrum and implement social and economic reforms inspired by the ideals of Simón Bolívar, the Venezuelan independence hero. As a result Chávez launched a coup attempt against the government of President Carlos Andrés Pérez. The coup failed, but it kept Chávez and his movement in the spotlight. Chávez televised a speech acknowledging responsibility for the failed coup, but also stating that his objectives had not been achieved "for now". This gave him the necessary fame to rise in the public's perceptions and thus win the elections of 1998²⁴. Chávez's election represented a rejection of the traditional political elite and a desire for change among many Venezuelans. Following his election, Chávez initiated a process to rewrite Venezuela's constitution, resulting in leading a new constitution in 1999. The new constitution, which aimed to decentralize political power, strengthen social programs, and promote participatory democracy, departed significantly from Venezuela's previous political framework. The new constitution was the first big milestone in Chávez's era and the implementation of his socialist agenda. It was the first of most political changes that would follow the next years that would transform the country according to the socialist principles set by his party²⁵. However, polarization and unrest emerged, as more political opponents disagreed with the measures taken and the departure from the neo-liberal policies, and in 2002 they attempted a coup against Chávez. The coup attempted by military executives with the support of PDVSA (Petróleos de Venezuela S.A.), which overthrew Chávez from power for two days, reflected the deep divisions within Venezuelan society and the struggle for political control. However, popular resistance and international pressure led to Chávez's return to power²⁶. The United

²¹ Corrales, J. (n.d.-b). Venezuela in the 1980s, the 1990s and beyond. ReVista.

<https://revista.drclas.harvard.edu/venezuela-in-the-1980s-the-1990s-and-beyond/>

²² Lmkoerner. (2023, August 18). Venezuela's Caracazo: state repression and neoliberal misrule. Venezuelanalysis.

<https://venezuelanalysis.com/analysis/11868/>

²³ Jazeera, A. (2003, November 12). Relief for Venezuelan riot-hit families. Al Jazeera.

<https://www.aljazeera.com/news/2003/11/12/relief-for-venezuelan-riot-hit-families>

²⁴ Lee, B. (2017, May 1). Venezuela's Chavez era. Council on Foreign Relations. <https://www.cfr.org/timeline/venezuelas-chavez-era>

²⁵ Venezuela (Bolivarian Republic of) 1999 (rev. 2009) Constitution - Constitute. (n.d.).

https://www.constituteproject.org/constitution/Venezuela_2009

²⁶ Who is to blame for polarisation in Venezuela? | LSE Latin America and Caribbean. (2019b, September 27). LSE Latin America and Caribbean Blog. <https://blogs.lse.ac.uk/latamcaribbean/2019/02/12/who-is-to-blame-for-polarisation-in-venezuela/>

States kept a critical position on Chávez's government during this period, and despite being in favour of the interim government, after the international pressure, they emphasized the importance of political stability in Venezuela. However, Chávez's re-election in 2006 and the proposed constitutional changes in 2007 created dissatisfaction which was reflected in the results of the regional elections in 2008 where PSUV won the regional elections but was second in Caracas and this outcome signalled a shift in the political landscape²⁷. Finally, in the 2012 presidential elections, PSUV took 55.07% of the total votes and won the elections²⁸. However, Chávez underwent multiple surgery operations for his illness and the Venezuelan population did not have any updates on Chávez's health condition. His death caused an upset in the political system of Venezuela over the next years.

1.2.2 Venezuela's MERCOSUR years

It took Venezuela 9 years to become an official member of MERCOSUR before finally joining in 2012²⁹. In 2003 Venezuela, Colombia, and Ecuador signed the MERCOSUR Economic Complementation Agreement. In 2004, Venezuela became an associate member of MERCOSUR despite this decision not being in line with the agreed timetable. In 2006, the Protocol for Venezuela's accession into MERCOSUR was signed by Uruguay and Argentina. In 2009, Brazil approved Venezuela's entry but Paraguay did not let Venezuela join the Southern bloc. Only after Paraguay was suspended from MERCOSUR because of Fernando Lugo's impeachment, did Venezuela get the green light to join the organization³⁰. The years in MERCOSUR were years of social unrest, political instability, and change in the political environment. After Chávez's death, the country had to find a new leader after 11 years. The country had an interim government under Nicolás Maduro who also won the national elections on the 14th of April 2013³¹. The transition from Chávez's era to Maduro's era was not smooth. The financial condition of many households in Venezuela was deteriorating over the years and this resulted in many protests against the government³². A potential crisis could be seen on the horizon, and Maduro announced a governmental program to tackle the consequences of inflation and currency devaluation³³. The measures aimed at stabilizing and treating trade in the country. However, the measures were unsuccessful as the protests in the country intensified, leading to big anti-government demonstrations that put social cohesion in danger. At the same time, Amnesty International informed about the risk that

²⁷ Carroll, R. (2017, May 8). Chavez party dominates in Venezuela regional elections. The Guardian. <https://www.theguardian.com/world/2008/nov/24/venezuela-regional-elections>

²⁸ Presidential elections in Venezuela : Towards 20 years of Bolivarian revolution ? | Think tank | European Parliament. (n.d.). [https://www.europarl.europa.eu/thinktank/en/document/EXPO-AFET_SP\(2012\)491457](https://www.europarl.europa.eu/thinktank/en/document/EXPO-AFET_SP(2012)491457)

²⁹ Embassy of the Bolivarian Republic of Venezuela in the US. (2012, July, 31). http://www.sice.oas.org/whatsnew_pending/VEN_adhesion_MERCOSUR_e.pdf

³⁰ BBC News. (2012, June 29). Mercosur suspends Paraguay over Lugo impeachment. <https://www.bbc.com/news/world-latin-america-18636201>

³¹ Watts, J. (2017, December 1). Nicolás Maduro narrowly wins Venezuelan presidential election. The Guardian. <https://www.theguardian.com/world/2013/apr/15/nicolas-maduro-wins-venezuelan-election>

³² Watts, J. (2013, April 15). Protests in Venezuela as opposition disputes Nicolás Maduro's victory. The Guardian. <https://www.theguardian.com/world/2013/apr/16/protests-venezuela-capriles-nicolas-maduro>

³³ Greg. (2023, September 3). Venezuela announces measures to soften impact of devaluation. Venezuelanalysis. <https://venezuelanalysis.com/news/7763/>

Venezuela was put in with the protests, and many countries decided to change their approach regarding Venezuela completely³⁴. The United States declared Venezuela a threatening country due to the high levels of political violence and social unrest. Also, they put into practice a sanctions program on Venezuelan officials. This made the relationship between the two countries even worse, especially after Maduro reacted to Obama's measures by describing the USA as an "imperialist threat"³⁵. The condition in the country could not reverse the rising inflation despite Maduro's recovery plan and in May 2016, Maduro declared a state of emergency as the economic crisis persisted³⁶. At the same time, polarization increased even more after the opposition's coalition won the Congress elections³⁷. In December 2016, as the financial and social crises deepened, the other members of MERCOSUR including Argentina, Brazil, Paraguay, and Uruguay decided to kick Venezuela out of the bloc³⁸. The main reason for this decision was the violation of the standards that the Regional Economic Union sets about adapting to the democratic principles of the members of the Union. Argentina's Foreign Minister compared Venezuela's situation to a dictatorship. On the other hand, the foreign minister of Venezuela referred to the suspension as a coup attempt³⁹. In general, the country entered a big financial and social crisis in the years after joining the Southern bloc. We cannot say that entering MERCOSUR made things worse, as many other factors could influence Venezuela's situation. Chavez was a stabilizing factor in the country and his death put Venezuela into a crisis that could not be handled by a newcomer like Maduro.

1.2.3 Venezuela after MERCOSUR

The years following the exclusion from MERCOSUR were very intense and full of political unrest. Starting from March 2017, Venezuela's Supreme Court cancelled its decision to dismiss the opposition-controlled National Assembly of its powers after accusing the government of moving towards dictatorship. It is questionable whether this decision was legal. Attorney General Luisa Ortega emerged as a notable critic within Maduro's government, condemning the court's actions as unconstitutional. Despite the reversal, the opposition and international organizations remained skeptical about the restoration of democratic principles in Venezuela⁴⁰. As this became a big political issue in the country, it led to big anti-government

³⁴ Amnesty International. Venezuela: Human rights at risk amid protests. (2014, April).

<https://www.amnesty.org/en/wp-content/uploads/2021/06/amr530092014en.pdf>

³⁵ New York Times. (2015, December, 6). Venezuelan Opposition Claims a Rare Victory: A Legislative Majority. New York Times. <https://www.nytimes.com/2015/12/07/world/americas/venezuela-elections.html>

³⁶ Continuation of the national emergency with respect to Venezuela. (2024, March 7). Federal Register. <https://www.federalregister.gov/documents/2024/03/07/2024-05036/continuation-of-the-national-emergency-with-respect-to-venezuela>

³⁷ Reporter, G. S. (2015, December 9). Venezuela election: opposition coalition secures "supermajority." The Guardian. <https://www.theguardian.com/world/2015/dec/09/venezuela-election-opposition-coalition-secures-supermajority>

³⁸ Dieguez, J. (2023, April 11). Suspensión de Venezuela en el MERCOSUR. MERCOSUR. <https://www.mercosur.int/suspension-de-venezuela-en-el-mercosur/>

³⁹ Cascione, S. (6th August 2017). Mercosur suspends Venezuela, urges immediate transition. Reuters. <https://www.reuters.com/article/idUSKBN1ALOIB/>

⁴⁰ Casey N. and Torres P. (2017, April, 1). Venezuelan Court Revises Ruling That Nullified Legislature. New York Times <https://www.nytimes.com/2017/04/01/world/americas/venezuela-court-national-assembly.html>

protests that were also associated with violence and many deaths. These shootings were attributed to pro-government militant grassroots groups⁴¹. The political violence and instability made Maduro push for the creation of a Constituent Assembly to rewrite the constitution. This could help the government consolidate power as according to Maduro, the opposition attempted to overthrow him. For the government, it would be an opportunity to continue ruling without being disturbed by political opponents. However, the opposition boycotted the elections and criticized the assembly as illegitimate⁴². In August 2017, Venezuela's new Constituent Assembly took over, leaving aside the opposition-controlled National Assembly. The international community condemned the Constituent Assembly's actions which were described as illegal. The U.S. State Department also criticized the assembly's power grab as undermining democratic institutions. Also, the situation made many top government executives leave the country after receiving threats for their lives⁴³. In 2018, Venezuela experienced one of the most controversial elections in the recent history of the country. Some of the main characteristics of these elections were the low participation (these were the elections with the lowest voter turnout since 1958 when Venezuela became a democratic state) and the fact that many of the opposition parties were banned from participating in the process. Nicolás Maduro managed to win the elections by dominating his opponents. PSUV received 67,85% of the total votes, which could indicate a strong preference for political stability when it comes to internal affairs if the polarization was not at such extreme levels⁴⁴. The election outcomes were disputed by many of the opposition parties but also by a big part of the international community. The main criticism about the election had to do with the lack of transparency and the opposition boycotts. The U.S. state of department stated that the election as neither free nor fair. They criticized the Venezuelan government for denying its citizens the right to participate in a democratic process⁴⁵. As the political tension increased, in January 2019, Juan Guaidó declared himself interim president, invoking the constitution and arguing that Maduro's 2018 re-election was illegitimate. The United States and many of its allies quickly recognized Guaidó as the legitimate president of Venezuela who tried to bring aid to Venezuela from the neighbouring countries⁴⁶. Despite Guaidó's support from the Western bloc, Maduro managed to regain control over the key government and military institutions in the country⁴⁷. During the next years, Guaidó's

⁴¹ BBC News. (2017b, April 20). Venezuela crisis: Three killed at anti-government protests. <https://www.bbc.com/news/world-latin-america-39645809>

⁴² BBC News. (2017c, May 2). Venezuela's President Maduro calls for new constituent body. <https://www.bbc.com/news/world-latin-america-39775092>

⁴³ Welle, D. (2017, August 19). Venezuelan constituent assembly seizes power from congress. dw.com. <https://www.dw.com/en/venezuelas-pro-government-assembly-seizes-congress-powers/a-40154532>

⁴⁴ Neuman W. & Casey N. (2018, May, 20). Venezuela Election Won by Maduro Amid Widespread Disillusionment. New York Times. <https://www.nytimes.com/2018/05/20/world/americas/venezuela-election.html>

⁴⁵ U.S. Department of State. (2019, March). Venezuela 2018 human rights report. <https://www.state.gov/wp-content/uploads/2019/03/VENEZUELA-2018.pdf>

⁴⁶ Montevideo, U. E. (2019, February 4). Several European countries recognize Juan Guaidó as Venezuela's Interim President - U.S. Embassy in Uruguay. U.S. Embassy in Uruguay. <https://uy.usembassy.gov/several-european-countries-recognize-juan-guaido-as-venezuelas-interim-president/>

⁴⁷ Buschschlüter, B. V. (2024, January 31). Venezuela crisis in brief. <https://www.bbc.com/news/world-latin-america-48121148>

influence fell as the political stalemate continued. The U.S. and other supporters of Guaidó continued to apply diplomatic and economic pressure on Maduro's regime, including sanctions, but these measures did not lead to a transfer of power⁴⁸. Guaidó is still active in Venezuela's politics but cannot be as influential as before as the overall support to his face has declined.

1.2.4 Hyperinflation in Venezuela

Despite the political crisis, the economic crisis was another big factor that affected Venezuela. Hyperinflation in Venezuela has persisted for many years because of factors such as oil prices, the "resource curse", and geopolitical risk, (Su et al., 2020).

Venezuela relies heavily on oil revenues. The biggest part of the national income comes from oil resources. The past governments did not develop any specific program to diversify the national economy into different categories. As a result, periods of high oil prices lead to better economic performance, whereas periods of low oil prices lead to bad economic activity and cause hyperinflation. Furthermore, the overall geopolitical risk and the political instability cause unrest. Events like the disputed election outcomes of 2018 and the fact that Guaidó declared himself the country's interim president factors that make Venezuela a country nobody can trust. Mariotti & Marzano (2021) argue about the importance of high-quality institutions and business confidence to attract foreign direct investments. Venezuela was a country that could not focus on creating a stable and competitive market from 2014 to 2022 due to political factors that increased the uncertainty for the majority of the population but also for foreign investments to flourish.

In Venezuela, the inflation rate has been very high since 2013. This reflects the political and consequently the major financial crisis of that period. In 2013 for example, after Chávez died, polarization increased even when Maduro won the national elections. Maduro's policies focused on controlling the economy and spending more on social programs. This polarized the country into two segments: the government and the opposition. In 2013 and 2014 the political situation led to massive anti-government protests that caused political and social unrest within the country. Following the bad economic activity of the previous years, the inflation rate reached 40.6% and 62.2% according to the World Bank. In 2015, the inflation following the concern regarding the National Assembly elections and the fact that the opposition Democratic Unity Body (MUD) won, climbed up to 121.7%. In 2016 things got worse, as Venezuela was excluded from MERCOSUR, and the international image of the country was damaged. During this year, inflation was approximately 255% according to the World Bank's database. As mentioned before, in 2017, Venezuela's newly established Constituent Assembly took over legislative duties, pushing aside the opposition-led National Assembly. This created a big governance concern which skyrocketed the inflation rate to

⁴⁸ Council of the European Union. (2017, November, 13). Venezuela: EU adopts conclusions and targeted sanctions. <https://www.consilium.europa.eu/en/press/press-releases/2020/11/12/council-extends-sanctions-on-venezuela-until-14-november-2021/>

438%. The events following the 2018 national elections created an atmosphere that made the inflation take off in the next years. The disputed win of Maduro in 2018 and the reaction by the United States that was followed by sanctions that were posed by many other Western countries led the inflation to sky-high levels that are difficult to find in other countries' history. This year, the inflation rate approached 66,000%. In 2019, 2020, and 2021, the political crisis that was a result of the presidential crisis kept the inflation rate again at significantly high levels for Venezuela (19,906%, 2,355%, and 1,588% respectively). Finally, the inflation went back to more normal, but was still at bad levels at the end of 2022, when it was close to 186% on an annual basis.

2. Literature Review

Trade blocs play a significant role in shaping the economic and political landscape of the member countries. The decision to join a trade bloc seriously affects a nation's economic growth, political stability, and governance structure. According to the past literature, joining a trade bloc can play an important role in resolving conflicts between countries. Countries that join Preferential Trading Arrangements (PTAs) like trade blocs, have lower possibilities of conflict with other members (Mansfield & Pevehouse, 2000). This can happen due to the specific institutional framework like conflict mitigation mechanisms that the PTAs require and the shared interests and goals of the member states. Another crucial factor for this relationship is economic interdependence, as such blocs contribute to better economic cooperation between countries and this reduces the likelihood of conflict. This paper studies the economic and political effects of Venezuela's joining MERCOSUR. Overall, South America is a region with a lot of sensitivities when it comes to the political and financial background, as many changes have occurred in most countries in the last decades. This explains why there is no significant bibliographic work on this area, and more specifically on the effects of the MERCOSUR membership. On the other hand, other blocs like the European Union, NAFTA, ASEAN, and APEC give a more comprehensive view of the topic. This is how this paper will add to the existing literature. By focusing on a very complex region and more specifically, one of the most unique countries that faced many severe economic and social changes in the last decades. I will try to look into all the factors that Venezuela's governments took into account before joining MERCOSUR and try to analyze how these factors differ when Venezuela was a member of the organization for four years (2012-2016).

2.1 Theoretical Literature

Theoretical literature can help the reader understand the political dynamics of the participation in a trade bloc in a broader perspective. Tuan (1994) argues that countries on the threshold of being a member of a trade bloc often demonstrate improvements in the political stability indices by examining the case of Vietnam's inclusion in ASEAN. This comes along ASEAN's governance approach which is based on not interfering in the members' domestic affairs, including issues related to democracy and human rights. The members will

adjust their internal policies and align with the organization's guidelines to the shared interests of the bloc's members. Similarly, Jan Zielonka (2007) also researches a similar topic to Tuan's paper, but he mostly focuses on the aftermath of a country's inclusion to a trade union. All in all, the case of the European Union provides a very interesting example. In his paper "The quality of democracy after joining the European Union", Jan Zielonka supports the idea that "joining the Union has some obvious negative implications for democracy in the new member states", and he bases these results on the lower representation of the local community due to a more centralized political system in the EU. To join the EU, members need to acquire some democratic standards that are set by the EU summits. These standards ensure stable institutions and require well-protected human rights, focusing on the rule of law. These factors can create a safe environment in which democracy can develop. However, to achieve such goals and to set these standards, the European Union needs to adopt more centralized systems of governance. As a result, many countries may oppose to such systems as they give less power to local politics and empower the central decisions and institutions at the top of the hierarchy.

In contrast to what Zielonka argues, Kaltenhaler & Mora (2002) in their paper "Explaining Latin American economic integration: the case of Mercosur" highlight the complexities of MERCOSUR and the entire region and they suggest that MERCOSUR is completely different from other blocs such as the European Union. One reason for this has to do with the fact that member states of MERCOSUR need a bigger political autonomy compared to the European countries. This makes MERCOSUR a hostile environment for the development of centralized governance. For this reason, the literature of the past had serious concerns about the success of MERCOSUR as a trade bloc due to the complexities of the area and the low levels of integration of the countries with the guidelines that the trade bloc sets. Despite the growth in trade between the members and the significant growth that technology experienced (Bustos, 2011), MERCOSUR is not seen as successful in other areas of development due to political, structural, institutional, and judicial constraints (Mecham, 2003). Campos's (2016) findings, validate Mecham's conclusion. In her paper "From success to failure: under what conditions did MERCOSUR integrate?" she shows that state-led integration and not economic interdependence, drove MERCOSUR's success. Brazil played a key role in Mercosur's early growth, motivated by its financial and democratic goals in the 1990s. However, as Brazil's economy improved and it turned its attention to global markets, its leadership in MERCOSUR declined, causing regional integration to slow down. On the other hand, Manzetti (1993) supported that MERCOSUR witnessed political and economic success in the early years. Also, the bloc was able to address global economic changes and internal crises with success.

2.2. Empirical Literature

Trade blocs are essential in making the relationships between the countries of a region better. Countries in preferential trade agreements like trade blocs have reduced chances of conflict with other members due to institutional frameworks and economic interdependence. The empirical analysis of Mansfield and Pevehouse (2000) proves that economic cooperation and

shared interests among member states mitigate conflicts. They use a logit model for their analysis. As for the corruption perceptions index, Alfano et al. (2021) use a panel regression specification to show that “entry into the EU increases corruption”, which is surprising but could explain the situation between Venezuela and MERCOSUR. There are two opposing mechanisms according to the authors. The first mechanism decreases corruption because the EU initiatives target it. However, the increase in bureaucracy can have the opposite impact on corruption. This makes the effect of joining a bloc on corruption not completely easy to measure or estimate.

When it comes to financial outcomes, studying the countries of the European Union, Campos et al. (2014) use a synthetic counterfactual method to demonstrate that countries that joined the European Union in 1973, 1980, 1995, and 2004 experienced a 12 percent income per capita increase compared to their non-entering counterfactual. Similarly, Ismail, Smith, and Kugler (2009) employ a gravity model to highlight that ASEAN membership increases foreign direct investment attractiveness. More specifically, the European countries invest more in ASEAN countries compared to all the other regions. When we look into the specific example of Turkey by applying an extended gravity model, we can see that the gains coming from being a part of a customs union are important (Ketenci, 2017). By liberalizing trade with the European Union, Turkey managed to improve their trade balance dramatically. In our specific example, this could mean that Venezuela’s inclusion in MERCOSUR might lead to a better financial performance during 2012-2016.

A country’s population might also be vital in promoting the integration process. Anderson and Reichert (1995) use an OLS regression and argue in their paper that individuals of countries that are considered as advantaged in the European Union are more likely to support integration policies. Also, in the after-war concept of the European Union, economic and political integration is more than important for the member states (Badinger, 2005). The integration effects might be temporary but their magnitude is very high, as GDP per capita in the European Union would be lower by one fifth if there was no integration process. This paper could serve as a useful guide for Venezuela as the South American market faced a similar situation in the 20th century. Since the two integration procedures in South America and the EU have some similar political characteristics, someone should expect simila

Despite the rich literature on trade bloc effects, only a few studies focus on the case of Venezuela or other South American countries. Valdes (1995) analyzes the potential effects of Chile joining a Regional Trade Agreement like NAFTA or MERCOSUR. He mostly focuses on the consequences that such an inclusion would have on the agricultural sector of the country and he concludes that joining such RTAs can increase competition from abroad and this will require the Chilean government to find a way to increase the competitiveness of the export sector. For this reason, Casella (1996) discusses the 1990s need for enlarging trade blocs, by using an OLS regression and argues that increased membership drives better integration and economic outcomes. However, they note it is difficult to achieve high levels of integration in

MERCOSUR due to the complexity of the bloc and the members. So I expect it to be difficult to find financial improvements in Venezuela's four-year period in MERCOSUR.

An overview of the papers used for this thesis and the main sources can be found on the Appendix and more specifically in Table 1.

3. Methodology

To understand how Venezuela's political and economic indicators differed in the period before and after their inclusion in MERCOSUR, compared to when they were a member of the trade bloc, an event study will be used. This way, the study will capture the impact of Venezuela's membership on the economic and political indices. The economic indices will be explained by factors that are sufficient to capture the overall economic performance of a country and to measure the level of transactions. The political dependent variables will be captured by indices that are determined by international organizations that set specific standards and give overall scores based on a country's performance in applying social policies. The regression specification is then the following:

$$Y_{it} = \beta_0 + \beta_1 * PreEvent_t + \beta_2 * Event_t + \beta_3 * PostEvent_t + \beta_4 * (Treatment_i * PreEvent_t) + \beta_5 * (Treatment_i * Event_t) + \beta_6 * (Treatment_i * PostEvent_t) + X_{it} + \varepsilon_{it}$$

This study wants to compare both the periods before (2005-2011) Venezuela entered MERCOSUR and after (2017-2022) Venezuela was suspended from MERCOSUR with the years that Venezuela served as a member of the trade bloc (2012-2016). The period between 2012 and 2016 is the reference period for this analysis. To do this, we need to compare two different components in three different periods. Venezuela and the rest members of MERCOSUR (Argentina, Brazil, Paraguay, and Uruguay) will be examined through this model. The associate members of MERCOSUR (Bolivia, Chile, Colombia, Ecuador, and Suriname) will not be included in the analysis because they are not participating in the voting process, nor are they considered official members of the bloc. Associate members are eligible for preferential trade agreements and also participate in meetings with other countries⁴⁹. However, their absence from decision-making processes and their inability to affect MERCOSUR's future will leave them out of the analysis.

For the purposes of this paper, I will use an event study methodology. The event study strategy is used to assess the impact of a specific event on a variable over time. In this study, the event study strategy is crucial for analyzing how Venezuela's membership in MERCOSUR influenced various economic and political indicators. By examining the periods before (2005-2011), during (2012-2016), and after (2017-2022) Venezuela's participation in MERCOSUR,

⁴⁹ Vectores. (2019b, August 22). MERCOSUR Countries - MERCOSUR. MERCOSUR. <https://www.mercosur.int/en/about-mercosur/mercosur-countries/>

the event study allows for a detailed assessment of the changes in economic performance and political stability associated with the membership. This approach helps isolate the impact of MERCOSUR membership from other external factors, providing a clearer understanding of the direct effects on Venezuela and other member countries.

In the next part, I will present the variables of the analysis their purpose.

Y_{it} is the outcome variable of interest. This variable will represent the economic and political outcome. The economic outcome is captured by foreign direct investment (FDI), GDP per capita growth, current account balance, and GDP per capita for the period 2005-2022. The foreign direct investment inflows are significant for the topic. This variable can explain the attractiveness of Venezuela and the other countries of the South America's trade bloc as a place that supports investments. Having in mind that entering a trade bloc increases the attractiveness of FDI (Bruno et al., 2021), we expect the membership in MERCOSUR to be positively correlated with the event variable and the same relationship to be negative for the pre-event and post-event period. GDP per capita growth is a widely used measure of economic activity and it will allow me to assess the economic performance adjusted to the number of citizens. This variable can capture the average financial growth in a country. Thus, I expect the GDP per capita growth to be lower in the post-event period, as Venezuela's economic activity in nominal terms deteriorated after exiting MERCOSUR. Furthermore, the current account balance reflects the country's trade competitiveness alongside net primary and net secondary income. By examining changes in the current account balance, the study can assess the impact of the MERCOSUR membership on a country's trade position, economic relationships and external financial flows. In other words, this variable measures the overall financial health of a country. I expect a positive coefficient for the pre-event period, as the financial activity was increased rapidly during the period 2005-2011. GDP per capita is another way to assess the economic activity of a country by also considering the population. Similarly to the current account balance, I expect the GDP per capita coefficient in the pre-event period for Venezuela to be positive and negative in the post-event period, as Venezuela's economy deteriorated to extremely low levels over the years. The pattern will most likely be the opposite for MERCOSUR as a whole, as the exclusion of Venezuela should lead to positive results for the other members. The difference between GDP per capita growth and GDP per capita is that the former provides the change over the years in percentages and the latter the absolute numbers of the variable. GDP per capita growth shows the change over time whereas GDP per capita is the amount at specific points in time.

The Political Stability Index, Corruption Perceptions Index and government effectiveness will serve as my political indicators. The political stability index is a good way to measure the changes in the political spectrum that occurred in Venezuela as a member of MERCOSUR. It gives insights into Venezuela's political dynamics and environment. The index reflects the likelihood of political instability or politically motivated violence, including terrorism, in a country. This index is part of the broader World Governance Indicators (WGI) project, which is compiled by the World Bank. The index is based on perceptions of the probability of

destabilization or overthrow of the government by unconstitutional or violent means, including domestic violence and terrorism. The Government Effectiveness Index measures the quality of public services, and the credibility of the government's commitment to applying policies. High scores indicate more effective governance, which typically reflects more effective policy-making, and stronger institutional frameworks. This is an important dependent variable, as it can show if the institutional framework was more or less advanced. I expect the government effectiveness coefficient to have a negative sign after Venezuela's exit. Finally, the corruption perceptions index variable measures the perceived level of corruption in the public sector. It is important to study this factor, as corruption in the public sector could potentially undermine economic efficiency and break down the trust in institutions. This can be a useful guide to what brought the political crisis in the country after the election results of the 2018 presidential elections and after Maduro undermined the governmental decision-making institutions. As a result I expect it to be negative in the post-event years.

To perform the event study strategy, I have added the event variable that indicates the event of Venezuela's inclusion into South America's trade bloc for the period 2012-2016 (reference period). This means that the pre-event period reflects the years before the aforementioned inclusion (2005-2011) and the post-event period the years after Venezuela's suspension (2017-2022). The countries will split into two different groups. In this scenario, Argentina, Brazil, Paraguay, and Uruguay will belong to the control group as they have been members since the establishment of the trade bloc in 1991, whereas Venezuela will be the treatment group in this specific analysis. The dummy variable Treatment, a dummy that takes the value of one when the country is Venezuela and zero otherwise, will be multiplied with the pre-event, event and post-event dummies. By including the interaction between Venezuela and the (pre/post) event dummies we can specifically capture the result of Venezuela's joining in MERCOSUR on the country's dependent variables. By just looking at the (pre/post) event dummies we see the overall impact for all the members of MERCOSUR, which helps us understand the more general effect on the members of the bloc.

The coefficient β_1 shows the effect of Venezuela's inclusion in MERCOSUR for the control group by comparing the dependent variables in the first two periods (2005-2011 and 2012-2016) for the control group. In other words, it captures the difference in the dependent variable between the pre-event and the event period for all MERCOSUR countries except for Venezuela. Similarly, β_3 shows the difference in the dependent variable between the post-event and the event period for the other countries after for the last two periods (2012-2016 and 2017-2022). Coefficients β_4 and β_6 capture the same effects as coefficients β_1 and β_3 , but for Venezuela instead of the rest MERCOSUR members. Coefficients β_2 and β_4 are getting omitted by Stata because they interact with the reference period. However, it is important to keep these coefficients in the main equation as they indicate the main events for the analysis. They serve as the reference periods.

To capture all the factors that can influence the results, I have added some control variables which I will explain below. The unemployment rate was chosen because it is a key indicator of labor market conditions. Changes in unemployment can affect government welfare programs and government revenues. South American countries face high unemployment rates, which can explain the fluctuations in their economy. The inflation rate is an important control variable that reflects the general price level. Inflation can affect investment decisions and business confidence but also simpler aspects of the everyday life such as poverty levels. By controlling for variations in the inflation rate, the analysis can account only for its potential effects on economic variables. The oil prices are included as a control variable because they are a crucial determinant of government revenues in Venezuela. Changes in oil prices can affect fiscal policy, external balances, and macroeconomic stability. It is important to control for variations in oil prices, as the analysis can assess the independent effects of Venezuela's MERCOSUR membership on economic outcomes by taking into account oil price fluctuations. The military expenditure is included because it reflects government priorities and spending patterns. High levels of military expenditure can reduce public investment in infrastructure, education, and healthcare, affecting long-term economic growth and development. The Rule of Law Index is included as a control variable because it reflects the quality of institutions and governance in a country. Strong rule-of-law institutions are essential for promoting economic growth, protecting property rights, and ensuring transparency and accountability. By controlling for variations in the Rule of Law Index, the analysis can assess the independent effects of Venezuela's MERCOSUR membership on economic and political outcomes while accounting for differences in institutional quality. The incorporation of external debt as a control variable represents a nation's obligations to foreign lenders. High levels of external debt present potential threats to the overall stability of a country's economy, its fiscal autarky, and its credibility in the global financial markets. This way, the analysis seeks to evaluate the specific impacts of Venezuela's MERCOSUR membership on economic outcomes, while also controlling for debt levels and the associated demands for debt repayment.

The inclusion of country fixed effects is essential to the analysis as they help control for unobserved heterogeneity and country-specific factors that may influence the dependent variables. Country fixed effects capture time-invariant characteristics of individual countries that may affect the outcomes of interest, such as institutional differences, cultural norms, and historical legacies. By incorporating fixed effects into the model, the analysis can better isolate the effects of Venezuela's MERCOSUR membership and reduce the risk of omitted variable bias, thereby enhancing the validity and reliability of the estimated effects.

4. Data

The empirical analysis conducted in this thesis relies on data collected from various reputable international organizations, academic databases, and research institutions. These sources provide comprehensive and reliable data on economic, political, and institutional indicators,

enabling a detailed examination of the impact of Venezuela's membership in MERCOSUR on various outcomes. The dataset is not missing any values which is important for my analysis. For all variables, I have included data covering a big period before, during, and after Venezuela's suspension from MERCOSUR. The dataset starts in 2005, 7 years before Venezuela entered the South American trade bloc, and continues until 2022, 6 years after MERCOSUR members decided to suspend the country from the organization. To construct this dataset, I mainly used data from the World Bank. I also exploited other sources like the IMF's database and databases regarding indices constructed by international organizations like Transparency International. All this data together makes up a panel dataset consisting of multiple different countries for different years (from 2005 to 2022).

The Foreign Direct Investment (FDI) variable represents the investments made by a country's residents in enterprises located in another country, where the investor has control or significant influence. FDI includes equity capital, reinvestment of earnings, and other capital, for which the ownership exceeds the threshold of 10 percent or more of ordinary shares. FDI data are reported in current U.S. dollars. For this specific variable, the data is taken straight from the World Bank's database. The annual percentage growth rate of GDP per capita is measured in constant local currency and shows the yearly change in average economic output per person. GDP per capita is calculated by dividing the gross domestic product (GDP) by the midyear population. GDP per capita growth is calculated by dividing the Gross Domestic Product per capita in year $t+1$ by the amount of GDP per capita in year t and subtract 1 from this value. The current account balance is the total net income from exports of goods and services and the income generated from primary and secondary activities. It is measured in billions of US dollars. All of the data regarding these variables is coming from the International Monetary Fund's Database.

The political indices are taken from two different sources. The Political Stability Index (absence of violence/terrorism) is directly taken from the World Bank's database⁵⁰ and describes the perceptions of the possibility of political instability or politically motivated violence like terrorism. Countries with a score close to 0 represent countries with a high possibility of political instability, whereas the closer to 100 the index gets, the less possible it is for a country to experience political violence or terrorism incidents. In our example, Venezuela has a low Political Stability Index, whereas Uruguay has a very high one. The index is based on, sources like the possibility of armed conflict, violent demonstrations and social unrest, the intensity of internal conflicts, government stability, protests and riots. The data are taken from the World Bank through expert assessments or surveys conducted among experts, businesses, and other organizations. The Corruption Perceptions Index is generated by Transparency International and quantifies the perceptions of corruption in the public sector. The index uses 13 different data sources such as surveys, assessments, and expert

⁵⁰ World Bank Group. (2024). Home | Worldwide Governance Indicators. In World Bank. <https://www.worldbank.org/en/publication/worldwide-governance-indicators>

opinions from 12 different institutions. The data is then aggregated to create the CPI rankings and CPI scores. In 2012, Transparency International changed the methodology used to calculate this index. Before 2012, the index was based on assessments and surveys of businesses. In 2012, more data sources were added such as assessments of international organizations and surveys of the general public. This means that the overall scores were also affected. Before 2012, the score for each country was given on a 0-10 scale whereas after 2012 the score was on a 0-100 basis. For this reason, for all years before 2012, I have multiplied the CPI score by 100.

In this paragraph I will present the data sources for the control variables used in the analysis with the political dependent variables. Data regarding unemployment rates are directly taken from the World Bank's database. It captures the percentage of the labor force that is available to work, but is still unemployed. This variable can describe economic downturns or improvements that are attributed to the workforce. Rule of Law reflects the degree to which individuals trust the norms and regulations of the society. This includes the quality of contract and law enforcement, protection of property rights, functionality of the judicial system, and response to crime and violence. In other words, the index takes into consideration factors such as order and security and other fundamental rights. Surveys and expert's assessments are employed to create the overall scores for the index. The World Bank was also the main source for the data concerning this variable. Similarly, data regarding military expenditure (as a percentage of GDP) is also taken from the World Bank's database. The index shows the share of economic resources dedicated to defense and security-related activities relative to the overall size of the economy. Government effectiveness is one of the six dimensions of governance measured by the World Bank's Worldwide Governance Indicators (WGI). It assesses the quality of public services and civil service, and the independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The index ranges from approximately -2.5 (weak effectiveness) to +2.5 (strong effectiveness). Higher scores indicate better government effectiveness. This is an important variable, as it helps us control for differences across countries in governance quality.

The first control variable for the economic outcome is unemployment exactly like the first part of the analysis. Furthermore, I have added the oil prices, as fluctuations in oil prices might have significant effect on the economy of Venezuela. I obtained the data regarding the oil prices from the U.S. Energy Information Administration, and more specifically, I used the Brent – Europe price for the analysis. I have used annual data for this variable. An important control variable is the inflation. Venezuela's economy experienced hyperinflation in 2018 reaching 65,374% according to the financial data, with one of the main determinants being the drop in oil prices⁵¹. The analysis accounts for this change as well. The data regarding

⁵¹ Graham-Harrison, E., Torres, P., & Daniels, J. P. (2019, March 15). Barter and dollars the new reality as Venezuela battles hyperinflation. *The Guardian*. <https://www.theguardian.com/world/2019/mar/13/venezuela-hyperinflation-bolivar-banknotes-dollars>

inflation were taken from World Bank. The last control variable included in the research is population growth. Venezuela's population experienced a decline or stagnation after 2012 due to the financial crisis, political instability, security concerns, the healthcare crisis, and the economic and social opportunities abroad. I included the yearly population growth in the dataset to account for this factor. Once again the data was taken from World Bank's database.

To make it easier for the reader, the tables 2 and 3 on the Appendix present the descriptive statistics table and the way each variable is measured in the analysis.

5. Results

In this section the results of the empirical part analysis of this thesis will be presented. The first two paragraphs will discuss the results regarding the economic and political indices respectively. Then, the third paragraph aims to explain these outcomes, taking into account the events that shaped Venezuela's and other MERCOSUR members' political landscapes during the period that is studied in this thesis.

5.1 Financial Results

The results of the regressions that take economic indices as dependent variables will be presented in the Table 1. After regressing the foreign direct investments, the GDP per capita growth, the current account balance, and the GDP per capita, we obtain important results that can help us interpret the effect of Venezuela's inclusion in MERCOSUR, and that align with our expectations about the financial situation in Venezuela.

First, foreign direct investments cannot give us a clear image of the effect of Venezuela's exit from MERCOSUR and its consequences on the aggregate economy. The coefficients for the pre-event and post-event variables are statistically insignificant, which does not let us make any safe predictions. The negative sign of both variables suggests that the inclusion of Venezuela in the trade bloc positively impacted MERCOSUR's FDI. Also, comparing the pre-event with the post-event variables, we could conclude that MERCOSUR's foreign direct investments were affected more negatively after Venezuela exited MERCOSUR and less negatively before Venezuela joined. However, the statistically insignificant coefficients cannot let us predict with confidence the effect on FDI. The coefficient regarding the pre-event and treatment variables' interaction refers specifically to Venezuela's case. Once again, the coefficients are statistically insignificant. Despite the fact that the coefficients show that Venezuela's FDI was relatively better before the 4 years of the country as a member of MERCOSUR (positive coefficient) and became worse after the country's exclusion from MERCOSUR, (negative coefficient), the high p-values do not let us jump to this conclusion easily and confidently.

In the second column of Table 1, we find more significant results than previously. One of the first things that the results in this column show, is that the countries of MERCOSUR

experienced higher GDP per capita growth when Venezuela was not in the organization. More specifically, the pre-event GDP per capita growth coefficient is equal to 0.253. This coefficient is statistically significant at the 1% level. This means that GDP per capita growth was on average 0.253 percentage points higher in the pre-event period compared to the reference period, holding all other variables in the model constant. In other words, the coefficient suggests a higher GDP per capita growth in the pre-event period to the event one. Furthermore, the coefficient for the post-event period is 0.246. This coefficient is statistically significant at the 5% level, which shows that GDP per capita growth is higher in the post-event period compared to the reference period. The coefficient shows that we expect a 0.246 percentage point higher GDP per capita growth for the MERCOSUR members in the post-event relative to the reference period (2012-2016). What is more, we see a surprising result regarding Venezuela. In the second column of the regression table, the interaction term “post_event * treatment” is highly positive and at the same time statistically significant at the 1% level. More precisely, the coefficient is equal to 0.543, and indicates that the GDP growth rate in the post-event period is 0.543 percentage points higher than in the event period. This contradicts my initial assumption about the GDP per capita growth coefficient for Venezuela for the period 2017-2022, as I would expect it to be lower for the post-event period due to the financial crisis and the hyperinflation of those years. However, I could attribute this specific coefficient to rebound effects. For example, the results might be affected by big recoveries after economic downturns. This particular indicator judges mostly short-term trends and does not focus on the long-run results, which could potentially explain the high and positive coefficient. Also, in this column, we can notice some significant coefficients for the control variables. A one percentage point increase in population growth is associated with a 0.204 percentage point increase in GDP per capita growth rate. The coefficient is significant at the 1% level. We can assume that the increased population growth can expand the labor force and increase consumption within the economy. This result also aligns with past research regarding GDP growth and population growth (Kuznets, 1967). Also, there is a significant and positive relationship between the inflation rate and the GDP per capita growth rate, which suggests that a 1% increase in inflation increases the GDP per capita growth by 4.45 percentage points. This does not validate the existing literature which supports that higher inflation slows down real GDP growth (Motley, 1994; Ayyoub et al., 2011). This could be explained by consumer expectations. People might have expected even higher inflation in the long term which increased the demand for goods in the short term. However, it is important to mention that changes in GDP are not adjusted to inflation and as a result the increase in GDP might be due to the increase in consumer prices and not because of the developed economy or the increased economic activity.

The current account balance variable shows statistically significant results only for Venezuela’s pre-event period. This interaction term produces a coefficient of 16.11, which means that Venezuela had a higher current account balance (16 billion) in the pre-event period relative to the reference period. This underlines the catastrophic events that occurred in Venezuela after joining MERCOSUR but this gap in the current account balance could be

created by the fact that Venezuela is a country that depends mainly on oil prices. As a result, the coefficient might be affected by a year with high oil prices like 2005. The rest of the independent variables are statistically insignificant, and as a result, their null hypotheses cannot be rejected. However, the coefficient for the pre-event variable indicates that the current account balance for the MERCOSUR countries was higher in the period before Venezuela's inclusion and lower for the period after Venezuela was suspended compared to the reference period. However, the results cannot be interpreted, as we cannot reject the null hypothesis.

Finally, the coefficients of GDP per capita can be helpful for the analysis. The pre-event coefficient is -4.018 for the MERCOSUR countries. This means that Argentina, Brazil, Paraguay, and Uruguay saw their economic performance improve on average after Venezuela joined the bloc. More specifically, GDP per capita was about 4,018 dollars lower in the pre-event period compared to the event period. The coefficient is also statistically significant at the 5% level. This could mean that letting Venezuela into MERCOSUR increased the GDP per capita of the other members. When it comes to Venezuela, the country experienced a period of high economic activity in the pre-event period (2005-2012) relative to the 2012-2016 period. During the pre-event period, the GDP per capita was 5,420 US dollars higher than the respective event level. After 2016, Venezuela experienced a period of lower economic activity (post-event period), which also reduced its GDP per capita, but this coefficient is statistically insignificant with a p-value of 0.125, so it cannot be further analyzed or interpreted. The results are similar to what I expected before performing the analysis, as Venezuela was hit by a big recession after 2016 and saw economic activity developing before joining MERCOSUR.

Table 1: regression results for the economic indicators

VARIABLES	(1) fdi	(2) GDP per capita growth	(3) current account balance	(4) GDP per capita
pre_event	-13.31 (15.83)	0.253*** (0.0529)	4.166 (8.159)	-4,018** (1,000)
post_event	-17 (17.51)	0.246** (0.0689)	-2.128 (13.28)	1,606 (1,921)
pre_event*treatment	0.9364 (2.454)	0.0605 (0.0517)	16.11** (3.687)	5,420* (2,043)
post_event *treatment	-8.752 (11.02)	0.543*** (0.0882)	13.56 (17.87)	-4,885 (2,719)
unemployment	-0.1244 (1.699)	-0.00600 (0.00984)	3.468 (2.805)	-857.8 (409.7)
oilprice	0.3312 (0.2641)	0.000311 (0.000942)	0.0806 (0.185)	-0.0210 (28.63)
inflation	-0.0004 (0.0004)	4.45e-06** (1.04e-06)	0.000747 (0.000477)	0.000130 (0.0190)
populationgrowth	-11.04 (10.08)	0.204*** (0.0273)	15.09 (14.02)	114.7 (621.6)
ruleoflaw	26.03 (20.48)	-0.0777 (0.0784)	-43.80 (32.04)	1,544 (2,378)
Constant	26.79 (22.01)	-0.245 (0.119)	-77.49 (38.65)	16,793** (3,792)
Observations	90	90	90	90
R-squared	0.396	0.809	0.453	0.808
Number of country_id	5	5	5	5

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

5.2 Political Results

The results of the political indices are presented in Table 2. The format of the table is similar to the one of the economic indicators. The main indicators to be discussed in this section are the political stability index, government effectiveness index, and corruption perceptions index (also denoted as CPI). The results can be useful in explaining what drove the changes in the political landscape in Venezuela and the whole of MERCOSUR. Overall, the indices show some interesting results that could be important for policy implications.

The first measure that will be analyzed is the political stability index. The coefficients in Table 2 reveal that MERCOSUR countries experienced higher political instability after Venezuela exited MERCOSUR in 2016. The coefficient for the post-event variable is -2.077 and is also statistically significant at the 10% level. This means that the political situation got worse in South America after the prime ministers of Argentina, Brazil, Paraguay, and Uruguay decided to kick Venezuela out of the organization. The political stability index for MERCOSUR countries was on average 2.077 points lower in the post-event period compared to the event period. This could be explained by various reasons. One of them, and the most relevant one, is that the suspension of Venezuela created issues regarding the reputation of the organization. Venezuela got suspended just four years after joining. This decision might create international concerns about the organization and its future and at the same time reduce the level of trustworthiness of the countries in the global community and cause low levels of political stability and social unrest. Other events that could influence the results and create social dissatisfaction and concern might be the pandemic, which challenged many countries of the region, the economic crisis in Argentina in 2018, or the tension that was caused in Brazil in the elections of 2022. The other variables can show an overall trend but cannot help us make safe estimations due to their statistical insignificance. The pre-event coefficient shows once again that the 2012-2016 period was a period of higher levels of political stability compared to the pre-event levels (2005-2012). Finally, the interaction terms for Venezuela show a similar pattern as the other MERCOSUR countries but do not give us statistically significant results.

On the other hand, the government effectiveness variable reveals two statistically significant coefficients at the 10% level regarding Venezuela. The results concerning the MERCOSUR countries are statistically insignificant and thus we cannot reject the null hypothesis. The -0.188 coefficient of pre-event interaction term suggests that Venezuela's government effectiveness was less effective by 0.188 index points in the pre-event period, relative to the event period in 2012-2016. Similarly, the coefficient of the post-event interaction is -0.412. This coefficient is higher in absolute numbers than the previous one and shows that the government effectiveness was 0.41 index points lower in the post-event period relative to the reference period. This could be explained because Venezuela was in a big political crisis during this period due to multiple factors that have to do with the big presidential crisis and the depreciation of the national institutions and the institutional bodies. Also, government effectiveness is positively correlated with the rule of law index. This is easy to predict as

countries with a high rule of law index can implement rules and regulations due to the high standards and quality of their institutions.

The last index to be analyzed is the Corruption Perceptions Index. This index measures how corrupt the public sector is. The results show that the countries in the control group were affected by the inclusion of Venezuela into South America's trade bloc. More specifically, the pre-event coefficient for the Corruption Perceptions Index is -0.321. This means that the MERCOSUR members experienced a corruption perceptions index that was 0.321 index points lower in the pre-event period relative to the reference period. On the other hand, the respective coefficient for the post-event period of -0.06 shows a similar pattern, but this coefficient is statistically insignificant with a high p-value (0.65). The coefficient of the pre-event interaction term, which captures the difference in Venezuela's corruption perceptions index before joining MERCOSUR compared to being in MERCOSUR, is positive, and the post-event interaction is negative. Both of them are not statistically significant which does not allow us to make confident predictions about the differences in Venezuela's CPI index before and after the 4 years after joining MERCOSUR in 2012 compared to the period in which Venezuela was a member of the trade bloc.

Table 2: regression results for the political indicators

VARIABLES	(1) politicalstability	(2) goveffectiveness	(3) cpi
pre_event	-5.108 (7.472)	0.104 (0.108)	-0.321** (0.105)
post_event	-2.077* (0.837)	-0.0561 (0.193)	-0.0609 (0.122)
pre_event * treatment	-11.98 (7.097)	-0.188* (0.0841)	0.109 (0.111)
post_event * treatment	-0.108 (5.939)	-0.412* (0.183)	-0.297 (0.207)
unemployment	-1.990 (1.465)	-0.0275 (0.0201)	-0.114*** (0.00587)
ruleoflaw	24.96 (13.80)	0.431** (0.129)	1.198** (0.327)
militaryexpenditure	3.237 (4.310)	0.116 (0.116)	-0.0514 (0.0948)
currentaccountbalance	0.0604 (0.0557)	-0.00114 (0.00141)	0.00280 (0.00221)
populationgrowth	1.693 (1.664)	0.0401 (0.0316)	-0.0481 (0.0827)
Constant	72.74** (17.43)	-0.0357 (0.261)	5.556*** (0.266)
Observations	90	90	90
R-squared	0.525	0.700	0.734
Number of country_id	5	5	5

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

5.3 Interpretation of results

In this section, I will provide an explanation for the results based on the political events that took place in Venezuela and its relative position in South America. In general, Venezuela after the 1980s was a country with many upsets in the political landscape. It is almost impossible to find a decade without a big political event that created unrest and dissatisfaction among citizens. The country's big oil resources were one of the main reasons for the big political and

economic changes. Crude oil is extremely volatile and the price of oil has had many fluctuations over the years. Figure 2 is taken from the U.S. Energy Information Administration (EIA) and is extremely helpful to better understand the topic. Starting from 2008, we can see that the global prices reached a period-high and just one year after they fell dramatically to almost \$55/barrel. This can explain how vulnerable the global economy is to the oil sector, but more importantly, how vulnerable a country that bases the biggest part of its GDP on oil production is. The oil sector is the most important sector when we measure its contribution to the GDP of the country. When looking at the oil rents as a percentage of GDP (data from the World Bank) in Figure 3, we see that Venezuela's oil production accounts for more than 20% for most years. The oil sector contributed massively to the Venezuelan economy all the previous decades. The oil rents are a big income-generating factor for the national economy either by taxes that the big multinational companies have to pay to Venezuela's government or more directly through profits that some national companies make by extracting oil. For example, *Petróleos de Venezuela, S.A. (PDVSA)* is a state-owned company responsible for Venezuela's oil exploration, production, refining, and distribution activities. PDVSA plays a crucial role in Venezuela's economy as one of the largest oil companies globally in terms of reserves and production capacity. Overall, there are many ups and downs both in the global oil prices and in domestic oil production that can affect this index. As a result, the uncertainty generated each year in the country's revenues is extremely high.

Keeping this in mind, we need to consider that South America is a vivid region with many political ups and downs. Revolutions, coups, and protests are way more common than in many other places in the world. There is high political uncertainty that is difficult to tackle. In Venezuela, even though Chávez was a leader who was criticized a lot by the United States and many of their allies, he was a stabilizing factor for the country and the region. During his leadership, the political tension was lower and Venezuela was less criticized for its economic and social policies. Even in periods of lower economic activity, Chávez could inspire a large proportion of the Venezuelan population and protect social cohesion in the terms that his actions and policies would not provoke big demonstrations and unrest within the country when compared to Maduro's actions. This is why we see most of the economic and social indices decline more in the post-event period relative to the pre-event one, or we even see some positive coefficients for the pre-event period for variables that produce a negative coefficient in the post-event period. After Maduro became president of the country, many protests started, and social unrest was expressed in various ways resulting in deaths and injuries of citizens because of the interference of authorities. It is possible that the MERCOSUR members accepted Venezuela in the trade bloc because they only focused on the good image of the country while neglecting other factors that create political and financial instability. For example, negotiations about Venezuela joining MERCOSUR started in 2006. This was a relatively good period for Venezuela if we compare the economic activity in the country with the subsequent years or the late 1990s. In other words, it might be the case that MERCOSUR did not protect itself from potential risks regarding Venezuela's unstable environment and did not consider other factors such as the quality of the institutions or the exposure to

different activities to generate income in the country. This led to a rushed and poorly thought-out decision. By making Venezuela an official member, Venezuela could gain a lot through the signing of preferential trade agreements but the organization would be exposed to the complex environment of the country and the reputation of the trade bloc would face a great risk. After examining the results, it can be concluded that this decision did not generate the expected results.

Figure 2: world crude oil prices

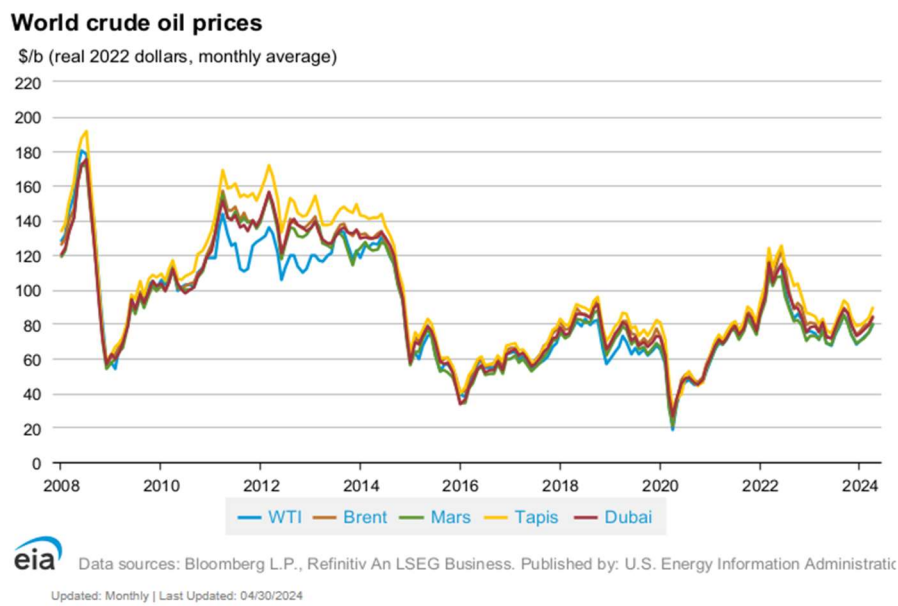
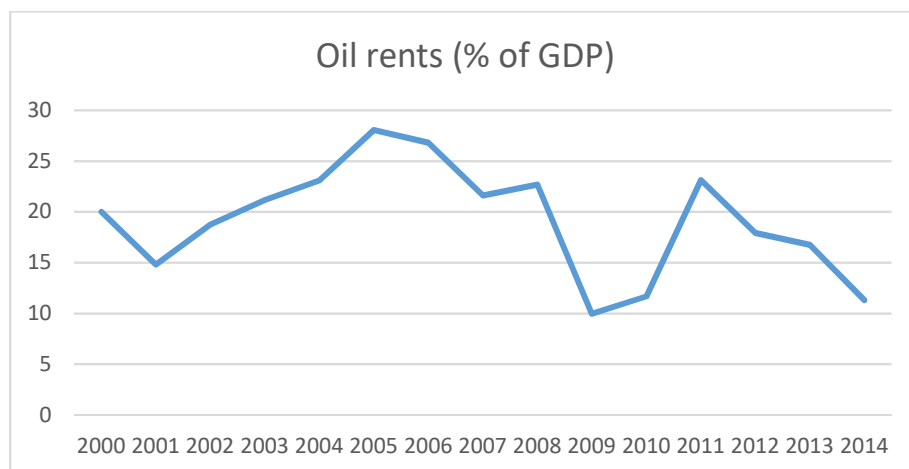


Figure 3: Venezuela’s oil rents as a percentage of GDP



Data Sources: World Bank

6. Conclusion

This paper analyzes the political and economic indicators of the countries of MERCOSUR (Argentina, Brazil, Paraguay, and Uruguay) and Venezuela to assess how the relative position of these countries changed over the years from 2005 to 2022. An event study strategy was exploited to perform the analysis. This way, I was able to capture the differences between the periods when Venezuela was and was not a member of MERCOSUR. The period 2012-2016, was the period in which Venezuela was included in MERCOSUR and serves as my main event (reference) period.

6.1 Economic Implications

The economic analysis was important to understand how the financial environment was influenced during the almost 20 years that make up the analysis. This period was affected by economic crises and political ups and downs that affected most of the member countries. What is more interesting is that South American countries tend to be heavily affected by what happens in the economies of the neighboring countries. For example, we mentioned that the financial crisis of Argentina in 2001 had some significant spillover effects on Uruguay's economy. The trade and debt dependency in the region is very high and the economies are interconnected. As for the main dependent variables, the pre-event period (2005-2012) exhibited higher GDP per capita growth among MERCOSUR countries, indicating a positive association with Venezuela's membership. The inclusion of one country might make a country's or region's economy more open. The post-event period (2017-2022) yielded unexpected results, particularly for Venezuela, where GDP per capita growth showed a surprising positive coefficient despite the country's economic challenges. This unexpected trend may be attributed to rebound effects or short-term fluctuations rather than long-term financial stability. Additionally, the current account balance showed a significant decrease for Venezuela after its inclusion in MERCOSUR, highlighting the country's vulnerability to external economic factors, particularly oil prices.

6.2 Political implications

The analysis of political indices shed light on the changing political landscape within MERCOSUR, particularly following Venezuela's suspension from the organization. The political stability index indicated a deterioration in political stability across MERCOSUR countries after Venezuela's suspension, possibly influenced by international perceptions of the organization's credibility. MERCOSUR has been criticized a lot over the years, as the organization has not seen a big financial boost like other trade blocs, such as the European Union. Furthermore, the findings suggest that the reference period of our sample (2012-2016) was the period with higher government effectiveness compared to the pre-event and post-event periods. A potential explanation could be Maduro's attempts to quickly and effectively impose laws due to the big protests in the country after Chávez died. Especially for 2017-2022, the continuous and consecutive internal political crises could lead to institutional weaknesses within Venezuela's governance structures. At the same time, the Corruption

Perceptions Index (CPI) showed mixed results due to some statistically insignificant coefficients. However, when analyzing such complex regions, we need to be very careful because different factors affect the overall dynamics of the area and the countries themselves.

6.3. Policy and future research implications

The analysis is important as it assesses the results of policymaking decisions made by MERCOSUR. When we are looking into political and economic integration within a bloc, it is important to have in mind how the blocs and the members reacted to a quickly changing environment. By looking at the case of Venezuela, this paper could be useful for future MERCOSUR decisions, in order to avoid the economic and social downturns that occurred during 2012-2022. In the next years, Bolivia will join MERCOSUR after getting accepted by the other members⁵². Future research could explore additional factors influencing economic and political outcomes within MERCOSUR, such as trade policies, regional conflicts, and external geopolitical dynamics. Moreover, comparable studies with other regional trade blocs could offer a better analysis of the broader implications of economic integration on development and governance across different contexts. In conclusion, this thesis contributes to the ongoing discussion on the impact of Venezuela's membership in MERCOSUR, providing valuable empirical evidence and analytical frameworks to understand the complex dynamics of regional integration in South America.

6.4 Research Limitations

While the study presented in this research provides information about the economic and political implications of Venezuela's membership in MERCOSUR, it is important to acknowledge several limitations that may affect the interpretation and generalizability of the findings. Even though the data used in the empirical analysis of this thesis comes from very credible sources such as the World Bank and IMF, many other issues might affect our findings. For instance, Venezuela is a unique economy. The big economic instability of the past and the hyperinflation led people to turn to alternative methods of payment like the black market. The black market is emerging at extremely high levels in the country and acts as a safe place for consumers in periods of economic crisis⁵³. Many Venezuelans use black market currencies to exchange bolivars for a more stable foreign currency. These transactions are not recorded in the national product and our data might therefore be slightly inaccurate. But the black market is not only a matter of currency. In Venezuela, most goods can be found in the black market. Essential products like food, medicine, and basic supplies for the household are scarce due to government price controls and supply chain issues. Consequently, a big black market has emerged, where these products can be found at extremely high prices. Many

⁵² Vectores. (2019, August 22). MERCOSUR Countries - MERCOSUR. MERCOSUR. <https://www.mercosur.int/en/about-mercosur/mercosur-countries/>

⁵³ Jazeera, A. (2019, July 18). Venezuela's black market comeback hints at looming devaluation. Al Jazeera. <https://www.aljazeera.com/economy/2019/7/18/venezuelas-black-market-comeback-hints-at-looming-devaluation>

other countries in South America face significant problems with the black market. For example, the Argentinian peso can also be found in the official and the black market. Many Argentinians turn to the solution of the black market as it gives a better exchange rate⁵⁴. This means that the black market in this particular area can be a significant factor that can influence the quality of the data. The impact of informal economic activities and remittances, which are significant in many South American countries, is not captured in traditional economic data.

Furthermore, the study focuses on specific economic and political variables but also needs other factors that could affect the outcomes. For example, the economic and political dynamics in MERCOSUR countries are influenced by global commodity prices, international trade policies, and geopolitical events, which are not fully accounted for in the analysis. In the analysis, I only use data regarding the oil prices, but there could also be other products that can affect the results.

⁵⁴ Otaola, G. (2024, January, 17). Argentine black market peso hits record low as gap to official FX tops 50%. Reuters. <https://www.reuters.com/markets/currencies/argentine-black-market-peso-hits-record-low-gap-official-rate-climbs-above-50-2024-01-17/>

Appendix

Appendix Table 1: list of all used literature

Author(s)	Year	Title	Journal
Alfano, V., Capasso, S., & Goel, R. K.	2021	EU accession: A boon or bane for corruption?	Journal of Economics and Finance
Anderson, C. J., & Reichert, M. S.	1995	Economic benefits and support for membership in the EU: A cross-national analysis	Journal of Public Policy
Ayyoub, M., Chaudhry, I. S., & Farooq, F.	2011	Does inflation affect economic growth? The case of Pakistan	Pakistan Journal of social sciences
Bruno, R. L., Campos, N. F., & Estrin, S.	2021	The effect on foreign direct investment of membership in the European Union	JCMS: Journal of Common Market Studies
Bustos, P.	2011	Trade liberalization, exports, and technology upgrading: Evidence on the impact of MERCOSUR on Argentinian firms	American economic review
Campos, G. L.	2016	From success to failure: under what conditions did Mercosur integrate?	Journal of Economic Integration
Campos, N. F., Coricelli, F., & Moretti, L.	2014	Economic growth and political integration: estimating the benefits from membership in the European Union using the synthetic counterfactuals method.	Journal of Economic Growth
Casella, A.	1996	Large countries, small countries and the enlargement of trade blocs	European Economic Review
De la Plaza, L., & Sirtaine, S.	2005	An Anlalysis of the 2002 Uruguayan Banking Crisis	World Bank Policy Research Working Paper
Ismail, N. W., Smith, P., & Kugler, M.	2009	The effect of ASEAN economic integration on foreign direct investment	Journal of economic integration

Kaltenthaler, K., & Mora, F. O.	2002	Explaining Latin American economic integration: the case of Mercosur	Review of International Political Economy
Ketenci, N.	2017	The effect of the European Union Customs Union on the balance of trade in Turkey	Foreign Trade Review
Kuznets, S.	1967	Population and economic growth	Proceedings of the American philosophical Society
Mansfield, E. D., & Pevehouse, J. C.	2000	Trade blocs, trade flows, and international conflict	Cambridge University Press
Manzetti, L.	1993	The political economy of MERCOSUR	Journal of Interamerican Studies and World Affairs
Mariotti, S., & Marzano, R.	2021	The effects of competition policy, regulatory quality and trust on inward FDI in host countries	International Business Review
Mecham, M.	2003	Mercosur: a failing development project?	International Affairs
Motley, B.	1994	Growth and inflation: a cross-country study (Vol. 395)	Center for Economic Policy Research, Stanford University
Su, C. W., Khan, K., Tao, R., & Umar, M.	2020	A review of resource curse burden on inflation in Venezuela	Energy
Tuan, H. A.	1994	Vietnam's membership in ASEAN: economic, political and security implications	Contemporary Southeast Asia
Valdes, A.	1995	Joining an existing regional trade agreement from the perspective of a small open economy: Chile's accession to NAFTA and MERCOSUR	American Journal of Agricultural Economics
Zielonka, J.	2007	The quality of democracy after joining the European Union	East European Politics and Societies

Appendix Table 2: descriptive statistics

VARIABLES	Obs.	Mean	St. dev.	Min	Max
Treatment	90	0.200	0.402	0	1
Pre-event	90	0.389	0.490	0	1
Event	90	0.611	0.490	0	1
Post-event	90	0.333	0.474	0	1
FDI	90	15.1	26.3	-1.28	102
GDP per capita	90	9253.629	4640.818	1566.602	19737.340
GDP per capita growth	90	0.069	0.185	-0.424	0.637
Current account balance	90	-9.367	26.450	-110.493	31.297
Political stability index	90	42.006	23.268	8.491	88.571
Corruption perceptions index	90	3.710	1.819	1.400	7.400
Unemployment rate	90	7.769	2.176	4.090	13.700
Rule of law index	90	-0.549	0.853	-2.333	0.788
Military expenditure	90	1.240	0.488	0.151	2.233
Inflation	90	1014.633	7178.132	1.800	65374.100
Oil price	90	75.576	22.972	41.960	111.630
Population growth	90	0.739	0.769	-2.905	1.671
Government effectiveness	90	-0.390	0.662	-1.889	0.850

Notes: All values have been rounded to three decimal places

Appendix Table 3: measurements for all variables

VARIABLES	Measurement	Source
FDI	Current US dollars (Billion)	World Bank
GDP per capita	Constant local currency	IMF
GDP per capita growth	Percentages of constant local currency	IMF
Current account balance	Billions of US dollars	IMF
Political stability index	Index from 0 to 100	World Bank
Corruption perceptions index	Index from 0 to 100	Transparency International
Unemployment rate	Percentages	World Bank
Rule of law index	Index from -2.5 to 2.5	World Bank
Military expenditure	Percentage of GDP	World Bank
Inflation	Inflation rate (Average consumer prices)	World Bank
Oil price	Brent - Europe	U.S. Energy Information Administration
Population growth	Percentages	World Bank
Government effectiveness	Index from -2.5 to 2.5	World Bank

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