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ECONOMIC INTEGRATION: A LEGAL PERSPECTIVE ON THE CREATION OF REGIONAL TRADING BLOCS

By

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ABSTRACT

The focus of this thesis is on the economic integration of regional trading blocs from a legal perspective. The hypothesis of the thesis is that the level of desired economic integration by the participating member states has a direct relationship or bearing on the type of institutional structure created. If the desired level of economic integration is lower, like a free trade area, the likelihood is that the institutional structure will be facilitative and intergovernmental with a dispute settlement mechanism created in order to resolve disputes. If, however, the desired level of economic integration has moved beyond the free trade area to the desire to create either a customs union or a common market, the institutions are more likely to be productive and possess supranational characteristics. In addition, it is increasingly likely that a legal system, with both legislative and judicial functions, will be created to resolve the disputes and differences between the participating member states of a proposed customs union or common market.

The thesis will commence with a theoretical look at economic integration from both a political science and economic perspective, which will be used as a basis for postulating a legal theory of the economic integration of regional trading blocs. The experiences of the European Community, the European Economic Area, the North American Free Trade Area and the Common Market of the South (MERCOSUR) will be examined in the following chapters. The final chapter of the thesis attempts to draw together the experiences of the four regional trading blocs and then will put forward for discussion a preferred institutional structure for future regional trading blocs.

ACKNOWLEDGEMENT

This thesis is dedicated to my family and friends, without whose help and support this thesis would never have been completed. Great appreciation also goes to the staff and faculty at the Faculty of Law at Queen's University, with special thanks going to my thesis supervisor, Professor Alex Easson.

TABLE OF CONTENTS

PREFACE

I have had a fascination with international affairs and politics for as long as I can remember. Anything to do with international politics and history would pique my interest and raise me to question why it was so. In my first undergraduate degree in International Relations I became aware of the worldwide movement toward globalization and the increasing willingness of international states not only to lower or eliminate tariffs on goods but also to move beyond that toward the creation of free trade areas and even customs unions. It is the aim of this thesis to observe and comment on economic integration initiatives of states on a multilateral basis from a legal perspective. By this, I mean the movement towards free trade areas, customs unions and even common markets on a systemic level and how this phenomenon can be explained from a legal perspective. The examples that I will be looking at are the European Union, the European Economic Area, the North American Free Trade Area and the Mercado Commun del Sur or as it is known in English, the Common Market of the South (MERCOSUR).

The thesis is not meant to be a conclusive answer to the questions that I postulate, rather it is meant as a starting point for discussion. The thesis is interdisciplinary in nature and will utilize both political science and economic models as basis for discussion. Economic integration is the main focus as I increasingly believe that one of the main considerations in international politics is the ultimate economic viability of a state vis a vis others in the international arena. When states integrate their economies even if only to the extent of lowering external barriers to trade in both goods and services, disputes will invariably

arise. Good economic practice, however, requires stability and predictability in order for people and businesses to feel comfortable about their economic investments. As part of the thesis, I will therefore attempt to postulate on what type of legal mechanism will be adequate in addressing the disputes that will invariably arise with increasing economic cooperation and integration. In other words, will a dispute settlement mechanism, common to most international agreements, be sufficient or will a more developed mechanism akin to a domestic legal system be required?

The European Union will be the main point of focus, especially in the first chapter and throughout the body of the thesis itself, as I will compare the other regional economic integration initiatives to the European Union experience. The European Union will be central to the thesis, because it is the most far reaching and integrated of all of the economic integration initiatives. It is also the first regional trading bloc to have developed a legal system central to the international economic integration initiative.

The thesis deliberately focuses on regional trading blocs and therefore does not address global trading rules, such as those of the World Trade Organization, nor does the thesis discuss internal trading rules such as Canada's Agreement on Internal Trade. Instead, the thesis has selected four regional trading blocs for comparison.

CHAPTER ONE

THE THEORIES OF ECONOMIC INTEGRATION

INTRODUCTION

The main hypothesis of this thesis is triangular in its structure as each piece of the structure influences the next one until the first one is influenced by the third. The political will of the member states that decide to embark on the initiative of greater economic integration and co-operation determines to a large extent how great the objectives of the initiative will be. In other words, the political determination will influence whether the desired objective is merely a free trade area or whether it is more ambitious in nature and results in the desire to create a customs union or even a common market. Consequently, the desired level of economic integration determines in part the degree to which the individual member states agree to either relinquish or restrict their national sovereignties in return for expected welfare gains from economic integration. The desired level of economic integration in turn influences the choice of whether to establish a dispute resolution mechanism to simply address disputes that arise in a legal and rule based manner or to go further and lay the foundations for the creation of a central legal system. The choice of systemic format or structure in turn will impact invariably on the political will or desire of the states participating in the economic integration initiative to continue with the deepening and evolution of the integration.

The main difference between my thesis and the other scholarly articles that have been written on either economic or political integration initiatives with regard to regional trading agreements or trading blocs is that my thesis looks not only at the political parliamentary aspects, but at the legal systems, the legislative (which includes parliament) but also the judicial. This union of the two in a legal system, the legislative and the judicial, has not been addressed by political scientists in the context of regional trading blocs, as the political scientists have tended to look at the systems with a particular focus on the parliamentary or executive units. Economists have focused almost exclusively on the economic decisions. I will be looking at the economic integration of regional trading blocs from a legal perspective with a regard to both political science and economic theory to give the legal theory a framework in which to conduct the analysis.

ECONOMIC INTEGRATION AND CREATION OF A LEGAL SYSTEM

One of the objectives of this thesis is to discuss and analyse when and if a functioning legal system becomes necessary within the development of an effective regional trading bloc or whether it is sufficient simply to create a working dispute resolution mechanism. The thesis will also examine how the political objectives of the trading agreement or treaty impact on the determination of the level of desired economic integration and the resulting characterisation of the central institutions of the regional trading bloc as supranational[1] or intergovernmental[2]. In

[1]Supranational is defined in *The Compact Oxford English Dictionary*(Oxford: Claredon Press, 1991), 272 as "Having power, authority or influence that overrides or transcends national boundaries, governments of institutions". In other words, a supranational authority will have the power to overrule the policies of sovereign international states.

other words, the interpretation of a treaty's objectives often has a major impact on whether the central institutions created by the treaty have the capacity to make decisions binding on the regional trading bloc member states or whether they do not have the power to do so. However, before discussing the institutional requirements of regional trading blocs as manifestations of economic integration, it is vital to understand what is meant by economic integration.

What is economic integration?

Economic integration has been defined as "the elimination of economic frontiers between two or more economies."[3] An economic frontier, in turn, is defined as "any demarcation over which mobility of goods, services and factors of production are relatively low".[4] Consequently, an economic frontier does not necessarily have to be the same as the political frontier between two independent, sovereign states[5]. Indeed, more than one economic frontier could exist within a sovereign state or an economic frontier could include within it two or even more sovereign

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[2]*The Compact Oxford Dictionary* in furthering the explanation of supranational gives a good contrast between the definition of what is supranational and what is intergovernmental. The organizations "were more 'intergovernmental' rather than 'supranational' - that is to say based on negotiations between sovereign Governments, not on the principle that the institution itself operating as a unit, could overrule member governments." Most international treaties or agreements presuppose that the institutional arrangements will be intergovernmental in structure, as a traditional international treaty would not require a relinquishment of sovereignty but merely the restriction of that sovereignty in limited areas. The relinquishment of sovereignty would entail the pooling of that sovereignty within a central institution with authority to override national constitutional arrangements. Restriction of sovereignty is analogous to a contract between two individuals who agree to abide or act in a certain manner toward each other. The power remains with them to act, as once the contract is terminated the restriction is no longer in place

[3]Jacques Pelkmans "The Institutional Economics of European Integration" in *Integration Through Law: Europe and the American Federal Experience, Vol I. Methods, Tools and Institutions Book 1 A Political, Legal and Economic Overview* (Berlin: Walter de Gruyter, 1986). 318.

[4]*Ibid.*

[5]The word "state" is being used as being synonymous to country.

states[6]. This thesis will focus solely on the process of economic integration between international sovereign states and how far they will go in integrating their economies.[7]

The study of economic integration has been undertaken by economists and political scientists who have postulated hypothetical models in attempts to explain why sovereign states agree to integrate parts or all of their economies within one regional economic frontier. The models have had varying degrees of success in explaining the process of economic integration of international states and the expected outcomes of such integration. This thesis will utilise and consolidate the political science and economic models into a discussion that seeks to define the interaction and relationship between economic integration and either the establishment of a functioning central legal system or the creation merely of a dispute resolution mechanism. In this context a legal system could be viewed as a "producing" system that establishes and enforces rules of conduct for the member states, while the dispute resolution mechanism is more of a "facilitative" system designed merely to ensure harmony through the resolution of disputes between the member states in an orderly and rule-based manner.[8] I will discuss what I consider to be the main differences between a legal system and a dispute resolution mechanism and how they relate to the economic integration of regional trading blocs a little later in this chapter. But before I do, I

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[6]An example of economic frontiers within one sovereign state is the Canadian provinces, which have more restrictive trade arrangements, especially in certain areas, between themselves than exist between Canada and the United States under the auspices of the North American Free Trade Agreement. The converse situation is the European Community (renamed in 1992 from the European Economic Community) that includes several nation states within one economic frontier. Arguably there is no "perfect" economy that does not have any restrictions on the mobility of economic factors.

[7]Jacques Pelkmans refers to "economic integration" as referring to both market integration and economic policy integration. *European Integration: Methods and Economic Analysis* (London: Addison Wesley Longman Limited, 1997), 6.

will examine three of the major political science models that have tried to explain the process of integration among independent nation states.[9]

POLITICAL THEORIES

Three of the major political science theories or models used to explain the formation of the European Communities have been the federalist, the neo-functionalist and the pluralist models. The first two models were most prominent in the decades immediately following the formation of the European Economic Community, as political scientists not only attempted to explain why the Member States would agree to enter into such an agreement but what the ultimate result would be. The pluralist model is the oldest and is most international in its focus.[10]

Federalist theory

The federalist approach emphasises the role of intergovernmental constitutional bargaining in the integration process.[11] Federalist theory was in direct response to the devastation of the Second World War, as even the League of Nations, which had respected the sovereignty and independence of nation states, had not been able to prevent another world war less than twenty

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[8]Contrast Frank Garcia's producing and facilitative institutions. Frank Garcia, "New Frontiers in International Trade: Decisionmaking and Dispute Resolution in the Free Trade Area of the Americas: An Essay in Trade Governance, (1997) 18 *Mich. J. Int'l L.* 357.

[9]Most of the academic writings on the integration of states have focused on the European Communities.

[10]Charles Pentland wrote his book, *International Theory and European Integration*, (London: Faber and Faber Ltd., 1973) in the early nineteen seventies to criticize and reformulate the theoretical literature on European integration. His analysis of the different schools of thought is very thorough and it is impossible for me to add anything to it in the scope of this thesis. However, his analysis is very useful and I will rely on it throughout my thesis.

[11]David Mutimer " Theories of Political Integration" in Hans J. Michelmann and Panayotis Soldatos, eds. *European Integration: Theories and Approaches*, (New York: University Press of America, 1994), 14.

years after the first.[12] The federalists believed that the cause of the Second World War had been the nation state and blamed the desires of the nation state to maintain its sovereignty as the main reason for the war. As Charles Pentland pointed out, the essence of this federalist approach to integration was the belief that the solution to peace was through the eventual formation of a common supranational state from previously independent and sovereign international states[13]. The federalists looked to the United States of America as an example of a working federation and envisioned a similar system in Europe where power was divided between two different levels of government. Indeed, Winston Churchill called for the creation of a "United States of Europe" in a speech he gave in 1946 in Zurich.[14]

The federalist approach emphasises the role of intergovernmental constitutional bargaining in the integration process. It envisions the creation of two levels of government. A constitutional arrangement would distribute the power between the two independent levels of government[15]. As a result of some type of constitutional conference, supranational institutions would be created that would have powers relinquished to them by the consensus of the participating member states. Economic integration would be but one aspect of the creation of a supranational state.

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[12] *Ibid.*

13 Pentland, *International Theory and European Integration*, 147-160, 170.

[14] *Ibid.* 15.

[15] This approach to integration of international states through the convening of a constitutional conference has yet to happen. In some ways the conference leading to the Single European Act and the Amsterdam Treaties at the European Communities level can be viewed as constitutional negotiations as they led to major changes to the Treaties of Rome. The Treaties, and especially the European Economic Community Treaty, could by the late 1980s be viewed as almost the constitution of the European Communities.

The Neofunctionalist theory

The neo-functionalist approach focuses on the creation of supranational institutions that arise out of the convergence of member state interests. The neo-functionalist approach is believed to have as its main concept the notion that "the progression from a common market to an economic union and finally to a political union among states is automatic".[16] Even though the decision to create supranational institutions is started by the national governments of the integrating member states, the process has been seen by some to be self-propelling in the move from economic to eventual political integration. In other words, some have suggested that the neo-functionalist theory sees the progression from the economic sphere of co-operation to the political as a continuum with the final result being a real "political community"[17] or political union. However, this is not necessarily the case, as for the true neo-functionalist the process is more important than the outcome.

The neo-functionalist theory began as a critique of the functionalist school of thought that was proposed in 1943 by David Mitrany as an alternative method for international integration as proposed by the federalists[18]. Ernst Haas was the main proponent of the neo-functionalist theory. Unlike Mitrany he did not believe that a clear separation could be made between political and functional institutions. Haas wrote, "[t]he history of the European Union movement suggests

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[16]Alicia Puyana de Palacios, *Economic Integration Among Unequal Partners: The Case of the Andean Group* (New York: Pergamon Press, 1982), xxi.

[17]Daniel J Elazar & Ilan Greilsammer "Federal Democracy: The USA & Europe Compared A Political Science Perspective", in *Integration Through Law: Europe and the American Federal Experience, Vol1. Methods, Tools and Institutions Book 1 A Political, Legal and Economic Overview* (Berlin: Walter de Gruyter, 1986) 82.

18 Pentland, *International Theory and European Integration*,

that the relationship between politics and economics remains somewhat elusive".[19] The neo-functionalist tries to define this elusive relationship by thinking of it in terms of the "spillover " effect. Spillover assumes that the political economies of states are connected in such a manner that once the supranational institution has responded to a problem in one area this will either create problems elsewhere or require that the institution resolve them in others. As such, it can lead to the erroneous, but quite logical conclusion, that economic integration automatically leads to an eventual political union. Arguably they are on a continuum, but as Mutimer points out; the precise outcome or form of the supranational authority is not always defined.[20]

An important idea put forward by the neo-functionalists is that of supranationality. According to this idea, supranationality is the pooling of, as opposed to the transfer of, sovereignty within a central institution by states involved in integration.[21] Spillover would occur as the supranational institution resolved problems which invariably lead to new ones, more and more of the member states' sovereignty would be pooled as the supranational institution becomes involved in more and varied areas of the economy. The end result of sufficient spillovers could be an arrangement very similar to the one proposed by the federalists but by a more indirect route.

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[19]E.B. Haas," The Uniting of Europe and the Uniting of Latin America", *Journal of Common Market Studies*, Vol. 5. No. 4 (1967), p.315.
In his later work, "The Obsolescence of Regional Integration", Haas put forward the idea that the original theories of integration, including the one he had proposed, were not adequate to explain the activities in the European Communities in the 1970s. See also Richard McAllister, *From EC to EU: An Historical & Political Survey* (London/New York: Routledge, 1997), 96.
I am putting forward the integration theories for the basis of a structure to begin debate.

[20]Mutimer, "Theories of Political Integration", 31.

[21]*Ibid.*

The Pluralist theory

The pluralist school of thought is the most traditional of the three international political science theories of interaction and co-operation of international states. Interaction is essentially the formation of a "community of states". Charles Pentland has described it as a self-sustaining level of diplomatic, economic, social and cultural exchanges between the cooperating member states. The focus has often been a "security community" whereby the states resolve their disputes and difficulties without resorting to armed conflict. The state is an autonomous unit with a high degree of decision-making ability or capacity.[22] The pluralist viewpoint is shared by the "realist" school of international political theorists, as they see any international cooperation that goes beyond pluralistic integration as unnecessary[23].

The pluralists envision the emergence of an international community through the improvement of the ways that the states regulate the relationship between themselves. Even a "political union" between states is viewed by pluralists to be largely enhanced co-operation between the member states on matters of national security and foreign policy. Economic integration of the participating or interacting states does not play as vital a role in the pluralist point of view as in the neo-functionalist school of thought.[24]

The pluralist school of thought appears to be a "transactionalist" type of model, as it looks at the transactional relationships between the states. The more the transactions between the

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[22] Pentland, *International Theory and European Integration*, 34.
[23] *Ibid.* 36.
[24] *Ibid*, 42.

participating states are seen to be beneficial, the greater the trust and co-operation between the states. This in turn encourages more communication and increased relations between the states.[25] Charles Pentland points out that some scholars have wondered whether "a high level of trade between two countries can be seen as a factor favouring further integration, or as evidence that some integration has already occurred."[26]

Consequently, for the pluralist, for states to be truly integrated they would form a "community" with a sense of obligation to each other enhanced by the greater number of transactions and increased trust.[27] However, it must be remembered that the pluralist considers that any resulting international organisation has no real will of its own and is dependent on the level of co-operation of the participating states. Thus unlike the federalists and neo-functionalists, the organisations created by the participating states remain international and intergovernmental with no transfer or pooling of sovereignty in them by the participating states. Integration thus means a different level of commitment and transfer of sovereignty depending on which model is employed.

I will now turn to the economic models of economic integration and examine how they describe and postulate the relationship between the participating member states.

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[25] *Ibid.*, 42.

[26] *Ibid.*, 44. Charles Pentland points out that if the high level of trade between two countries is both a factor favouring further integration as well as an indication of some level of integration, then the theory is circular and would need further work.

[27] *Ibid.*, 38,39.

ECONOMIC THEORIES

Classical Economic Trade Theory

The classical theory of economics believes that states will enjoy welfare gains through the reduction or elimination of barriers to trade. The classical theory focused on tariffs, but gradually economists realised that non-tariff barriers could also impede trade. Free trade between two states increases the welfare of the two countries through trade creation as barriers to the free flow of trade are eliminated. Overall economic welfare is increased when free trade allows the more competitive state to supply the less competitive or efficient state. Economic welfare increases especially if the more efficient "foreign" industry had been rendered uncompetitive in the other state due to the presence of a national tariff which made the good more expensive than the less efficient domestic counterpart.

However, free trade agreements can also have negative overall effects through trade diversion as trade is diverted from a more efficient third country whose goods are suddenly made uncompetitive because the tariff that is still applied toward the third country's goods makes the goods produced there more expensive than the ones that are produced tariff free within the free trade zone. Even with the threat of possible trade diversion the General Agreement on Tariffs and Trade allows for the creation of regional trading arrangements or blocs, in the belief that it will facilitate and quicken the reduction of world wide barriers to trade[28]. However, the classic model of economics needs to be expanded in order to describe the different levels of economic

[28]Chapter XXIV of the GATT allows for the creation of regional trading arrangements.

integration. The model developed by Bela Balassa is one of the most useful models in explaining the possible range of economic integration.

Balassa's Model of Economic Integration

One of the most important and also one of the most understandable economic models of economic integration is the one developed by Bela Balassa in 1961.[29]

The first phase of Balassa's model is the free trade area (FTA) which foresees the elimination of tariffs and quotas on imports from the FTA member states. However, each of the member states of the FTA maintains its own national tariffs and quotas against states that are not members of the FTA. Consequently, the member states do not have a harmonised policy on how to deal with imports from non-member states. The second stage of the model is the customs union (CU) in which the member states establish a common external tariff against non-member states while maintaining an internal FTA. The third phase of the model is a common market among the member states. What this means is that factors of production, such as labour and capital are allowed to move freely within the common market. From the common market, one moves to the fourth stage, which is the economic union. During this phase there is a movement toward a common economic policy as an attempt to eliminate the remaining economic disparity caused by different national economic policies. The fifth and final stage is complete or total economic integration. This stage presupposes the consolidation of fiscal, monetary, social and counter-

[29]Bela Balassa, *The Theory of Economic Integration* (Homewood, Illinois: Irwin, 1961)

cyclical policies. As such, it would probably entail the adoption of a common currency by the member states.[30]

Table 1 The Balassa stages of economic integration

Stage	Definition	Characteristics/comments
1.Free trade area(FTA)	-tariffs and quotas abolished for imports from area members -area members retain national tariffs(and quotas) against third countries	-essence of GATT definition; no positive integration
2.Customs Union(CU)	-suppressing discrimination for CU members in product markets -equalisation of tariffs (and no or common quotas) in trade with non-members	-essence of GATT definition; no positive integration
3.Common market(CM) *	-a CU which also abolishes restrictions on factor movements	-is "beyond" GATT; definition should also include services; no positive integration
4.Economic union	-a CM with "some degree of harmonisation of national economic policies in order to remove discrim-ination...due to disparities in these policies	-positive integration is introduced; extremely vague
5. Total economic integration	-unification of monetary, fiscal social and counter cyclical policies -setting up of a supranational authority where decisions are binding for the Member States.	-centralist; vision of unitary state; -supranationality only introduced here

Source: Pelkamans, 1997[31]

Pelkmans' Model of Economic Integration

Jacques Pelkmans established his own stages of economic integration, particularly taking into account the properties and characteristics of mixed economies. The 8 stages of Pelkmans Market-Integration-from-above start off from the Pure Tariff-Union and end with the Pure

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[30]Larry Neal and Daniel Barbezat, *The Economics of the European Union and the Economies of Europe* (New York: Oxford University Press, 1998), 48.

[31]Jacques Pelkmans, European Integration: *Methods and Economic Analysis* (London: Addison Wesley Longman Limited, 1997), p.7. The table on Bela Balassa's theory was taken from Jacques Pelkmans' book.

Common market. As the stages progress, there is an increasing restriction on each of the member states' ability to act in a sovereign fashion, as both the increasing negative and positive integration places greater restrictions and obligations on the member state, while at the same time allocating more power to a central authority.[32]

Pelkmans does not even include the free trade area in his model of the stages of economic integration as it only entails the elimination of tariffs among the member states. The sequence of economic integration is based on some basic assumptions. Firstly, it is politically easier for the politicians of the member states to integrate product markets than factor markets. Secondly, tariffs are more easily eliminated than non-tariff barriers. Thirdly, distortions in factor markets are more easily eliminated between member state economies than restrictions on capital and financial assets[33].

The eight stages of Pelkmans' model of economic integration are the following: (1) The tariff-union which is defined in article 24(8) of the GATT as a "customs union". At this stage the member states have adopted a common external tariff schedule and customs code. (2) Tariff-union-plus which starts to limit recourse by the member states to safeguard clauses and envisions the implementation of a common surveillance system. (3) Pseudo customs union takes the "free physical market access" in step two and eliminate the non-fiscal cross border restrictions such as national health and safety standards and technical requirements that can greatly hamper the free movement of goods across the "customs union". (4) The Pure Customs Union further liberates

32 Pelkmans, "The Institutional Economics of European Integration",. 322-333, 336-342.
33 *Ibid.*, p335-336.

trade between the member states and entails the harmonisation of an indirect tax system while virtually eliminating all exchange restrictions. (5) Undistorted product market integration entails the adoption of a "customs union" public policy on the free movement of goods and services. Regulations and policies are directed from a common central authority. (6) A Customs-union-plus assumes the incorporation of unhampered intra-union direct investments. (7) A Pseudo common market assumes the " free movement of all non-financial factors of production. (8) Pure common market entails the total integration of all factors of production, including monetary instruments and the existence of a common banking system.

Table 2. Pelkmans' Model of Economic Integration[34]

Stage of integration	negative integration	positive integration
1. Pure Tariff-Union	-abolition of tariffs, quotas on intra-union trade	-common external tariff schedule
2. Tariff Union-Plus	-abolition of autonomous custom rules -limitation of safeguard and abolition of escape clauses for intra-union trade	-common customs code -common surveillance
3. Pseduo Customs Union	-abolition of national non-tariff trade to third countries -abolition of transport discrimination -limitation or abolition of non-fiscal border interventions	-harmonization of technical obstacles -union norms -harmonization on insurance
4. Pure Customs Union	-abolition of exchange controls	-harmonization of indirect tax systems -common surveillance
5. Undistorted Product Market	-abolition of autonomous sector regulations -limitation of autonomous regional policy -abolition of discrimination in public	-common policies for regulated sectors -harmonization of regional policy instruments

34 Table based loosely on Pelkmans' Table 1: Stages of Market-Integration-from-Above, Pelkmans, "The Institutional Economics of European Integration"332

	procurement	-common competition policy toward firms
6. Customs Union-Plus	-abolition of restrictions on intra-union direct investment	
7. Pseudo Common Market	-abolition on labor mobility -free professions -right of establishment	-harmonization of merger laws, bankruptcy
8. Pure Common Market	-abolition of discrimination in banking laws -abolition of discrimination in law on security markets	-harmonization of banking laws -common surveillance over security markets

Pelkmans', however, points out that though preferable, not all attempts at economic integration directly move from one stage to the other. In practice the integrating economies may tackle a "higher" stage of integration before fulfilling all the requirements for the preceeding stage[35].

NEGATIVE AND POSITIVE INTEGRATION

One of the major differences between Balassa's and Pelkmans' models of economic integration is the stage at which each of the models introduces positive integration. Balassa's model does not envision the adoption of positive integration until the creation of an economic union and even then extremely vaguely. Pelkmans, who critiques Balassa's model, believes that in mixed economies, positive integration is a prerequisite for negative integration.[36] Only in the classical economic theory where there was little government intervention in the economy might negative integration precede positive integration. Pelkmans also warns that negative integration alone draws greater attention to the restriction on the manoeuvrability of the national governments and agencies and as a result makes it harder for further negative or positive integration to be

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[35] *Ibid.*, p.336-341.

adopted[37]. Pelkmans presupposes the mutual appearance of both negative and positive integration at the first stage of his model of economic integration, the tariff union.

To better understand this debate, it is vital to define what is meant by the terms negative and positive integration. Negative integration is defined by Pelkmans as "the removal of discrimination in economic rules and policies under joint surveillance"[38]while positive integration refers to the transfer of some sovereignty or policy-making power to a common institution by member states.[39]

Negative integration is usually viewed by politicians in member states as an easier and less restrictive political decision than positive integration. It is viewed as requiring the member states to relinquish less sovereignty and independent decision making powers to a central or even supranational authority. An example of negative integration is where the member states of either a FTA or a CU agree that they will not impose new tariffs or quotas on the imports from other member states. For example, under ex Article 12 of the European Economic Community Treaty, the member states agreed to "refrain from introducing between themselves any new customs duties on import or exports or any charges having equivalent effect, and from increasing those which they already apply in their trade with each other".[40] The wording of the Article 25 (ex

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[36]*Ibid.*, p. 321.

[37] *Ibid.*, 327.

[38]Pelkmans, *European Integration: Methods and Economic Analysis*, .6. Pelkmans claims that the distinction between positive and negative integration was originated by Tinbergen in 1954 , Pelkmans refers to negative integration as "the removal of obstacles to free exchange between the states".

[39]*Ibid.*

[40]Case 26/62 *Van Gend en Loos v. Nederlandse Administratie der Belastingen* [1963], E.C.R.1. Note, however, that the actual wording of Article 12 seems, at least at first glance to be a instance of positive integration as it seems

Article 12) has been changed by the adoption of the Amsterdam Treaty and now reads as follows: "Customs duties on imports and exports and charges having equivalent effect shall be prohibited between Member States. This prohibition shall also apply to customs duties of a fiscal nature"[41]. Further examples of negative integration are Article 28 (Ex. Article 30) that prohibits all quantitative restriction on imports and measures having equivalent effect between member states and Article 39 (Ex. Article48) that disallows discrimination against workers based on their nationality.

Positive integration would entail the adoption by the member states of a common policy or the transfer of policy-making capacity to a central authority. For example at the level of a customs union, it is necessary for the member states to adopt a common, unified tariff classification and to harmonise customs rules and jointly determine how customs revenues are to be distributed.[42] At the minimum, without any positive integration, the customs union would be merely a tariff union between the member states. In the case of a tariff union, the member states would simply adopt a common external tariff schedule and customs code through negotiations among themselves, but would not establish a central authority or surveillance body to monitor or come up with joint policies.[43]

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to impose a positive obligation on the member states. Rather it was an example of negative integration, as it disallowed the creation of new import or export duties on goods originating in the European Economic Community.

[41]The Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts: *Official Journal* 97/C 340/01, the Luxembourg Official Publications, ISSN 0378-68986, dated 10 November, 1997.

[42]Pelkmans, *European Integration: Methods and Economic Analysis*,.7-8.

[43]Jacques Pelkmans, "The Institutional Economics of European Integration", 335-336. In this particular chapter, Pelkmans proposed a reformulation of Balassa's model and established 8 stages of economic integration. Pelkmans commences his analysis with the tariff union and does not even mention the free trade area. By 1997, Pelkmans in *European Integration: Methods and Economic Analysis*, appears to have changed his analytical framework and discussion of Balassa's stages of economic integration. For instance, Pelkmans now even refers to sectoral

A few examples of positive integration are the following. The European Economic Community mandates Common Customs Tariff duties pursuant to Article 26(Ex. Article 28). Article 42 (Ex. Article 51) states that "[T]he Council shall ... adopt such measures in the field of social security as are necessary to provide freedom of movement for workers". Article 93 (Ex. Article 99) requires the adoption of common provisions for "the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market".

Another critique of Balassa's stages of economic integration is also made by Pelkmans. According to Pelkmans defining the last stage of integration as total integration is not only unnecessary but also unwarranted. Pelkmans points out that it is possible to have "partial 'unions' beyond the economic union. such as a tax union a social union, a monetary union and a political union".[44]

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integration, such as the 1965 US/Canada automotive agreement, which is considerably less integrative than a free trade area, p.7. Pelkmans' eight-stage economic integration analysis is very similar to the Balassa's model that he critiques, but is more precise and brings positive integration into his analysis before Balassa does. Pelkmans' model institutes at least a minimum amount of positive integration at the pure tariff-union stage. His final stage is the pure common market and is roughly analogous to the total economic integration stage of Balassa.

[44] *Ibid.*

INTERPLAY OR INTERSECTION OF POLITICAL AND ECONOMIC THEORIES

Many similarities seem to exist between the political and economic theories and how they deal with the integration of independent international states. The most obvious is that both Balassa's and Pelkmans' theories inevitably seem to lead to a final stage of economic integration that requires quite sophisticated political co-operation or almost a union in the same manner as a lot of neo-functionalist arguments suggest that the progression from free trade areas to even greater economic union are steps on a continuum starting from closer economic co-operation and eventually ending up as a political union. Unlike the political neo-functionalist approach, Balassa's theory indicates that a supranational authority or institution is only necessary at the last "total economic integration" stage. Pelkmans' model, however, brings in supranational institutional requirements much earlier.

Legal Systems versus Dispute Resolution Mechanisms

As the founding members of a regional trade bloc try to decide what level of economic integration they wish to establish, they have to be cognisant of the fact that as the level of economic integration increases, the need for an adequate and unbiased way of resolving disputes between the member state becomes increasingly important. The question then arises whether a dispute resolution mechanism will be sufficient or will it become necessary to create a central legal system for the trading bloc.

I deliberately use and contrast the term "legal system" which encompasses both legislative and judicial aspects with the term "dispute resolution mechanisms". Throughout my readings I have come across the usage of "dispute resolution mechanism or system" more frequently than "legal system" when the topic has been economic integration of states. This of course is because most international agreements have always been based more on co-operation rather than integration and as a result have not required supranational central institutions. The use of the term "dispute resolution" mechanisms implies a method that is ad hoc and not permanent. It carries with it the connotation that the decisions of this "ad hoc" tribunal or judicial body will have no direct legal effect in any of the member states. This is in contrast to a legal system which has a developed permanent court or judicial structure and secondly some type of central legislation. But the distinction between a dispute resolution mechanism and a legal system can go even deeper than that. The European Court of Justice has moved beyond being a dispute settlement body, even though it still retains a dispute resolution function through Article 227(ex Article 170)[45]. Article 227 stipulates that a Member State can, if it considers that another Member State has failed to fulfil a Treaty obligation, bring an action before the Court of Justice[46]. This provision would be very similar to one involving any two disputing states in an economic integration initiative. However, the European Community has moved beyond this phase and very rarely are actions taken under the before mentioned article.[47]

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[45]Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts.

[46]Ibid.

[47]According to the statistics that I have been able to discover, this Article has been used twice since its inception. *General Report on the activities of the European Commission* (Brussels: The Commission, 1990), 449.

A legal system can be said to comprise three elements: a legislative body to provide on-going rules, a common court to interpret and apply those rules, and access to the process by individuals. An inter-state dispute resolution mechanism in contrast is a "static" set of rules that can only be altered by a new treaty, ad hoc arbitral tribunals, and provides no direct access by individuals except through the intervention of their member state. In many ways the legal system will almost be part of a constitutional like structure while the treaty establishing a dispute resolution mechanism is almost akin to a domestic contract whose terms can only be changed with a the conclusion of a new contract or agreement.

Table 3 Contrasting the Differences and Similarities Between a Legal System and a Dispute Resolution Mechanism

LEGAL SYSTEM	DISPUTE RESOLUTION MECHANISM
-Usually permanent	-Usually ad hoc
-Evolving legislation	-Rules are static
-Direct access by individuals	-Direct access by states only (usually no direct access by individuals)
-Participating state can be held liable by individuals before their domestic courts	-Participating state can be held liable only on an international level
-Some type of enforcement	-Lack of formal enforcement (participating states allowed to retaliate)
-Direct effect	-No direct effect
-Supranational	-International or intergovernmental
-Superiority or primacy over domestic legal structure	-Domestic legislation has primacy

From the above chart, it becomes obvious that my definition of what constitutes a legal system has both a judicial and legislative function. A legal system also, I would argue, allows access to it by private individuals and companies. Instead of requiring private individuals to rely on the government of their member state to present their case or to raise their concerns on their behalf, individuals can hold even their own state accountable before the domestic court system for any

violation or infraction of the treaty establishing the economic integration. In effect when a legal system has been created, the treaty that was signed and adopted by the participating states has become directly effective and supranational, in the sense that the central treaty overrides the domestic legal structure of the individual participating states.[48] One of the best enunciations of this concept is by Brian F. Havel in his piece "The Constitution in an Era of Supranational Adjudication" when he states the following:

> Under true supranational governance, however, all domestic jurisdiction is ousted. As usually understood, supranationalism requires that a quantum of judicial power is, in effect transferred out of the nation-state to the supranational agency. The judicial power later re-enters the state in the form of absolute decrees to which the nation-state, including the judiciary must give plenary and unconditional effect. The acts of supranational institutions-- whether they wield legislative, executive or judicial powers, or a blend of all three- receive direct and immediate application without formal re-incorporation, in the domestic constitutional order.[49]

Also, some type of central enforcement mechanism of the rules is established.

A dispute resolution mechanism on the other hand usually has an ad-hoc arbitration tribunal to help facilitate the resolution of disputes between the participating states. The rules are static or only capable of being changed by further international co-operation or negotiations. The dispute resolution system is a facilitative system, very much like the pluralist concept of integration. Bringing in Pelkmans' views again, a dispute resolution mechanism is very like his idea of a system of "co-operation" where there are minimal subjections to international rules and no

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[48]This is leading to the European Court of Justice's decision in Case 26/62 as *Van Gend en Loos* v.*Nederlandse Administratie der Belastingen* E.C.R.1. Even though it was the court itself that determined that a new legal order had been created, it was arguably, the creation of a permanent court, which allowed the court to issue such a ruling that was also complied with by the participating states.

[49]Brian F. Havel, "The Constitution in an Era of Supranational Adjudication" (2000) 78 N.C.L. Rev., 257.

automatic domestic application of those rules[50]. In other words, the provisions of the treaty are not directly applicable nor have immediate direct effect in the domestic legal systems of the participating states. It provides for reliance on continuous negotiation and conflict management between the participating states, with no direct access for individuals to the process, unless their concerns are taken up by the government of their state. The system has no effective means of enforcement, except by the direct retaliation against one state by the other.

This difference between a dispute resolution mechanism and a legal system is vital. In an inter-state dispute resolution systems, private individuals and corporations must rely on their governments to address infringements of the agreement by another member state government. However, it is not always in the interest of the individual's national government to pursue the individual's grievance or claim against the offending government. Because states are encouraged to seek a "diplomatic solution" in an inter-state dispute resolution mechanism, the resolution of the matter between the states may fail to redress the wrong done to the individual complainant. Sometimes, however, the individuals' grievance is against their own government for the violation of the treaty and therefore under an inter-state dispute resolution mechanism the individual would have no opportunity for redress

By contrast, in a true legal system in which individuals have direct access to a court and can pursue actions against their own governments for violations of the provisions of the treaty, the individual's grievance will be addressed and resolved in compliance with the regional trading bloc treaty and secondary legislation.

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50 Pelkmans, "The Institutional Economics of European Integration",322.

WHAT TYPE OF SYSTEM IS SUFFICIENT?

The establishment of either a central legal system or a central rule based dispute resolution mechanism should at minimum reflect the depth of the economic integration desired by the member states in order to be effective. It has been generally accepted that divergence between the laws of states involved in economic integration is an obstacle to the free movement of products of production[51]. If divergences between the application of common customs union rules by the participating states were allowed, it would result in economic distortion, diminish regional trade and generally hamper the goal of greater economic integration. (i.e. free trade and the rules of origin that require that a certain percentage be manufactured in the participating states in order to enter the other member state tariff free.)

When applying the theory to the practical examples in the following chapters I postulate the following interplay will be observed. The more pluralist and limited in scope the final trade agreement is, the more likely the institutions will be intergovernmental and facilitative, with greater emphasis on negative integration and the more likely they will adopt simply a dispute resolution mechanism. If, on the other hand, the trade bloc is more federalist or neo-functionalist in tone with aims of moving beyond the customs union, then there is greater likelihood the institutions that are created will be supranational and producing in character and the possibility of the creation of a legal system increases.

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51 Nobou Kiriyama, "Instituional Evolution in Economic Integration: A Contribution to Comparative Institutional Analysis for International Economic Organization", 19 *U. Pa. J. Int'l Econ. L.*, 53, 66.

In the following chapters, I will discuss the European Community, the European Free Trade Area, the European Economic Area, the North American Free Trade Area and MERCOSUR, the Common Market of the South.

CHAPTER TWO

THE EUROPEAN COMMUNITY

INTRODUCTION

The European Community is the most economically integrated of all regional trading blocs in the world. It is governed by central institutions that are largely supranational in nature. Indeed, its treaty, the European Community Treaty has almost gained a constitution like status largely as a result of the activism by its central court, the European Court of Justice. However, the European Community, know at its inception as the European Economic Community, is only a part of what is called the European Union.

The European Union, which is not yet a legal entity, consists of three pillars. The first pillar consists of the three European Communities, which are the European Community[1], the European Coal and Steel Community (ECSC) and European Atomic Energy Community (Euratom). The second pillar is the common foreign and security policy, while the third pillar is the judicial and home affairs.[2]. While all three pillars share common institutions, the relationship between the institutions and the Member States is not identical. The cooperation in the last two pillars has

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[1] After the Treaty on European Union also known as the Treaty of Maastricht, the European Economic Community is now officially called the European Community. The Treaty Establishing the European Economic Community was amended to read Treaty Establishing the European Community. Inger Osterdahl in his article "Bananas and Treaty Making Powers: Current Issues in the External Trade Law of the European Union" [1997] *Minn. J. Global Trade*, commented that the three communities will probably merge into one on the expiration of the ECSC Treaty in the year 2002 and that this is further indicated by the name change of the European Economic Community to the European Community.

2This pillar has been renamed by the Treaty of Amsterdam and is now called Police and Judicial Cooperation in Criminal Matters. Andrew Duff ed. *The Treaty of Amsterdam: Text and Commentary,* xxxiv.

been characterized as intergovernmental as opposed to the supranational character that predominates in the three Communities.[3]

In order to understand the relationship of the central institutions with the Member States, it is vital to comprehend the history of the European Union and the Communities.

HISTORY

Throughout history there have been numerous attempts to unite Europe. The Roman Empire seemed to have fulfilled the goal of an integrated Europe with full economic integration, as during Roman rule most of Western Europe had a common currency, free trade, a common defence, a common foreign policy and a common legal system. However, the arrangement disintegrated as the Roman Empire crumbled. Napoleon also tried to unite Europe under his rule, but to no avail[4]. The idea of a united Europe was raised again by intellectuals between the two world wars. One of the better known of these intellectuals was Count Richard Coudenhove Kalergi who in 1923 advocated a uniting of Europe as a means of guaranteeing peace and prosperity on the European Continent[5].

3IOsterdahl " Bananas and Treaty Making Powers", 475.

4 Tore Totdal, "An Introduction to the European Community and to European Community Law" (1999) *75 N.D.L. Rev.* 59, 59 and footnote 2.

Western European Integration Post World War II

In 1945, the continental nation states of Europe lay in ruins, their economies, and political structures virtually destroyed. Never before had the world seen destruction on such a grand a scale as was caused by the Second World War. This time, unlike the pre-war period, the proponents of a more integrated and united Europe involved high level European politicians such as Winston Churchill, Konrad Adenauer, and Jean Monnet. The aim of the movement toward integrating Europe was to prevent the nation states of Europe from ever again waging war against each other.[6] These proponents of a united Europe believed that the nation state had played a central place in causing the two world wars.[7] It was their aim to prevent a third one.

However, there was not always a consensus on how the uniting of a peaceful and prosperous Europe could be accomplished. The attitudes and objectives of the Western European states after the war can be classified as falling under two main political science models, the federalists and the functionalists (or possibly the neo-functionalists). The British and the Scandinavians clearly wanted cooperation among the European states, but did not wish to relinquish their sovereignty to any supranational institution. The French, however, wished to have central institutions with sufficient powers to make decisions and to unite Western Europe. If not openly

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5 Derek W. Urwin, *The Community of Europe: A History of European Integration Since 1945* (London: Longman, 1991), 5.
6*Ibid.*,.5, 28; Stanley Henig, *The Uniting of Europe: From discord to concord* (London/New York: Routledge, 1997),.13.21-23.
7Hans J. Michelmann & Panayotis Soldatos, eds., *European Integration: Theories and Approaches*, (Maryland: University Press of America, 1994), 13.

federalist, the French wanted institutions capable of limiting German power and one way to do that was to consolidate Germany into a united Europe.[8]

Western Europe was dependent on the United States for military and economic aid, while it faced a threat of Soviet expansion from the East. Unification, it was felt, would strengthen the Western European states and enhance their ability to resist the pressures of both superpowers.

Treaty Of Paris

The Western European Powers under French leadership proposed the Schumann Plan, which was authored by Jean Monnet. The solution to the German problem was to consolidate Germany in a common Western European market of coal and steel, with common institutions[9].

By signing the European Coal and Steel Community Treaty in 1951, the proponents and negotiators for the Western European states had forgone and left behind the openly federalist ideas held by some immediately after the war. There was no constitutional convention founding a united Western Europe, rather there was the agreement to create a supranational treaty whereby the production of coal and steel would be governed by a joint community. The production of French and German coal and steel would be governed by joint institutions that would create a common market for coal and steel.[10] Article 7 of the European Coal and Steel Community Treaty

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8 The so-called "German problem" seemed to demand that either Germany be contained or consolidated. There was a very close link between the German problem and the idea of a united Europe. See Henig, *The Uniting of Europe*, 5 or Tore Totdal "An Introduction to the European Community and to European Law" (1999), *75 N.D.L.Rev.* 59, 59.

9With the consolidation of the control of the production of the means of war, coal and steel, under the joint control of both Germany and France, future wars would be impossible.

10 Henig, *The Uniting of Europe,* 24.

established four institutions, a High Authority, a Common Assembly, a Council of Ministers and a Court of Justice, with quite substantial supranational powers. The aim was to move away from an intergovernmental approach to management of coal and steel production.[11]

The supranational institutions created for the Coal and Steel Community were allowed to regulate issues such as production, prices, trade, consumption and development.[12] For the six countries that signed the treaty, the goal was more than just economic,

> [T]hey resolved to substitute for age-old rivalries the merging of their essential interests; to create by establishing an economic community, the basis for a broader and deeper community among peoples long divided by bloody conflicts; and to lay the foundations for institutions which will give direction to a destiny henceforth shared.[13]

Treaties Of Rome

The Treaties of Rome[14], were signed by the six European nations who had been parties to the ECSC Treaty. In 1957 they agreed to establish the European Economic Community (EEC) and European Atomic Energy Community (Euratom).[15] The six Member States agreed with the Spaak Report that the size of the market would be a determinant of economic success.[16] According to the Spaak Report, a large market would facilitate mass production without monopoly but a common market would be inconceivable without the adoption of common rules,

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11McAllister, *From EC to EU*, 13.

12Henig, *The Uniting of Europe*, 24.

13Treaty Establishing the European Coal and Steel Community, April 18, 1951, 261 U.N.T.S. 140.

14 The Treaty Establishing the European Economic Community, Mar 35, 1957, 298 U.N.T.S. 11 and the Treaty Establishing the European Atomic Energy Community, Mar 25, 1957, 298 U.N.T.S. 140 are referred to together as the Treaties of Rome.

15McAllister, *From EC to EU*, 19.

16The Spaak Report was the report of an inter-governmental committee chaired by the Belgian Foreign Minister Paul-Henri Spaak was constituted after the 1955 Messina Conference of Foreign Ministers of the six members of the ECSC in Sicily. The Spaak Report was to work out proposals for a common market and a joint atomic energy policy. McAllister, *From EC to EU.*, 15.

joint action and common institutions to supervise and monitor this process.[17]The Treaties of Rome established four institutions modeled on the four institutions of the Coal and Steel Community. Thus the EEC from its very outset had four institutions, the Council, the European Parliament, the European Court of Justice and the Commission[18]

However, those individuals who drew up the European Economic Community Treaty did not think of it merely as an agreement on economic integration, but thought of it as an initial stage in the process toward political union[19]. The preamble of the Treaty Establishing the European Economic Community [20]stated that the high contracting parties were determined to "lay the foundations of an ever-closer union among the peoples of Europe"[21], and they were resolved to eliminate the barriers which divide Europe. They also stated their intentions to strengthen the

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17McAllister, *From EC to EU*,15.

18The Commission was deliberately not called the High Authority even though it mirrored the function of the High Authority in the European Coal and Steel Community. *Ibid.*

19 Hening, *The Uniting of Europe*, 76.

20The Treaty Establishing the European Economic Community, Mar 35, 1957, 298 U.N.T.S. 11
The HIGH CONTRACTING PARTIES
DETERMINED to lay the foundations of an ever-closer union among the peoples of Europe,
RESOLVED to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe,
AFFIRMING as their essential objective of their efforts the constant improvement of the living and working conditions of their peoples,
RECOGNIZING that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition.
ANXIOUS to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less-favoured regions,
DESIRING to contribute, by means of a common commercial policy, to the progressive abolition of restrictions on international trade,
INTENDING to confirm the solidarity which binds Europe and the overseas countries and desiring to ensure the development of their prosperity, in accordance with the principles of the Charter of the United Nations,
RESOLVED by thus pooling their resources to preserve and strengthen peace and liberty, and calling upon the other peoples of Europe who share their ideal to join in their efforts,
DETERMINED to promote the development of the highest possible level of knowledge for their peoples through a wide access to education and its continuous updating,
HAVE DECIDED to create a EUROPEAN COMMUNITY ....
Note: The official versions of the Treaty were the ones which were drawn up, signed and ratified in the four languages of the founders of the European Economic Community: Dutch, French, German and Italian.

unity of their economies and to do this by means of a common commercial policy, to the progressive abolition of restrictions on international trade in a manner consistent with the Charter of the United Nations. Further, they resolved to preserve and strengthen peace and liberty by pooling their resources. Through the creation of a common market, the founders saw a means to ensure a lasting stability and peace in Europe.[22]

WIDENING AND DEEPENING THE INTEGRATION PROCESS

In many ways widening, the expansion of the membership of the Communities, and deepening, the increase of the depth of integration, could be viewed as polar opposites in the integration process. However, in some ways the process of both widening and deepening actually propel European integration even further and faster than would otherwise be the case. As the number of Community members grows, the need for stronger institutions increases in order to enable the Community to integrate the new members. With more members, Community decision making becomes more difficult, especially when unanimity is required.

New Members - Widening the Community

In 1973, the first countries to join the six original members of the European Communities were the United Kingdom, Denmark and Ireland. It had been hoped that Norway would join, but the accession into the Community received a negative vote by the citizenship of Norway in a national referendum[23]. The United Kingdom first asked for admittance in 1962, but largely due to the opposition of the French President De Gaulle, the United Kingdom and the other

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21 The Treaty Establishing the European Economic Community, Mar 35, 1957, 298 U.N.T.S. 11

22 *Ibid.*

applicants did not receive membership until 1973.[24]At the Hague Conference in 1969 when the Community accepted the application for membership of the applicants, the six Member States reaffirmed their "will to press forward with the further developments needed to promote the Community's 'development into an economic union'".[25]

In 1981 Greece became a member, followed in 1986 by Portugal and Spain. The Community membership reached fifteen when Austria, Finland and Sweden became members in 1995. However, a much more ambitious increase in Community membership was contemplated with the collapse of the Berlin Wall in 1989 and the dissolution of the Soviet Union in 1991. Suddenly it became possible to contemplate a united and unified Europe from the Atlantic to the Urals, something that had been impossible during the Cold War. So starting in 1991 Association Agreements were signed by the European Community and countries such as Hungary, Poland, the Czech Republic and Slovenia. These Association Agreements were meant to aid the former Communist countries in reforming their economies and moving toward future membership in the European Community. The Agenda 2000 report of the European Parliament took stock in 1996 of the progress of the former Communist and Soviet Countries. The Agenda 2000 required that these countries be able, on admittance to the Community, to accept all of the Community *acquis*

23At the 1969 Hague Summit it had been hoped that the UK, Denmark, Ireland and Norway would join. McAllister, *From EC to EU*, 51.
24*Ibid.*, p27.
25This reaffirmation of moving toward an economic union was found in paragraph 8 of Hague Conference's joint communique. *Ibid.*, 51.

and be democratic. In 1997 The Agenda 2000 report proposed that full membership negotiations be opened with six countries, Hungary, Poland, Czech Republic, Estonia, Slovenia and Cyprus.[26]

The Agenda 2000 also recognized that, to be able to accept the new members, the Community needed to deepen its institutional structure in order to remain governable and it contained plans for greater unification.

Deepening of the European Community

The European Economic Community's institutional structure remained largely as it was first agreed to in the 1957 European Economic Community Treaty until the 1986 adoption of the Single European Act[27], which contemplated the creation of a single market by the end of 1992[28]. While the Parliament in its 1974 Resolution stated that the Community was "constantly moving towards a closer union between the European peoples, while respecting their traditions", [29]the integration process instead had seemed to become paralyzed in the 1970's. Even though the Common Market was reached in 1968, a year ahead of target, there were still many impediments to trade within the Community in the 1980s. Many of those impediments were non-tariff barriers and were related to scientific and technological controls.

26The Treaty of Amsterdam has mandated that another IGC meeting must occur one year before the Community membership becomes at least 20. With the admittance of the proposed six states, the membership of the Community would become 21.

27The 1965 Merger Treaty merged the separate institutions of the ECSC, Euratom and the EEC so that they would all share in common the four institutions, the Commission, the Council, the Parliament and the Court of Justice. However, each of the institutions seemed to maintain a similar type of role in each of the three Communities that its predecessors had.

28The Single Market was declared to be in effect on January 1, 1993.

29 McAllister, *EC to EU*, 115.

The 1986 Single European Act (SEA) is seen by such academics as Stanley Henig as having laid the constitutional groundwork for both the 1992 Treaty on European Union (Maastricht) and the 1996 Treaty of Amsterdam. The main objective of the SEA was the creation or establishment of a unified single market, in which the four freedoms of the EEC Treaty would be fully realized by the end of 1992.[30] The four freedoms of the EEC Treaty are the free movement of goods, persons, services and capital. Also the SEA extended the competence of the Community in economic and social matters to promote the social cohesion of the Community.[31] Provisions were also made for the European Political Co-operation (EPC)[32], which can be seen as the precursor for the establishment of the second pillar of the European Union under the Maastricht Treaty.

The Treaty on European Union, or the Maastricht Treaty as it is better known, so named after the town of Maastricht where it was signed, had four main objectives. The first was the attainment of economic and social progress through economic and monetary union. The second was the establishment of a common foreign policy and security policy. The third was co-operation in justice and home affairs between the Member States. The fourth was the establishment of a European citizenship[33].

Perhaps the most well known and publicized aspect of the Maastricht Treaty was the provision established for the monetary and fiscal criteria for membership of the proposed common

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30 Henig, *The Uniting of Europe*, 84-85.
31 *Ibid.*
32 *Ibid.*
33 *Ibid.*, 86.

currency. It established very strict guidelines for membership, by incorporating into the Treaty a three-stage progression towards economic and monetary union.[34] The first stage was from June 1, 1990 to December 31, 1993 during which the Member States had to conform to the European Monetary System and its Exchange Rate Mechanism. The second stage started on January 1, 1994 and ended on December 31, 1998 during which the European Monetary Institute would monitor the Member States co-ordination of their economic and monetary policies. In order to be able to join EMU, the Member States had to meet a strict convergence requirement.[35]The Common Currency was adopted by 11 of the fifteen members on January 1, 1999 [36] that were joined by Greece on January 1, 2000.[37]

The Treaty of Amsterdam while it continued on with the constitutional changes envisioned in the Maastricht Treaty made no substantive changes to the four main institutions of the Communities. The European Central Bank, which was created under the Maastricht Treaty, continued to be the main institution to oversee the implementation of the common currency the Euro.[38] Instead it seemed to merely consolidate the progress made by SEA and Maastricht Treaty, as it consolidated and renumbered the changes made to the original Treaty of Rome, the European Economic Community Treaty.

34Terrence Fokas, "Economic and Monetary Union in Europe: The Legal Framework and Implications for Contractual Obligations", (1999) 36-FALL *Tex. J. Bus. L.* 2.)

35Ibid., It is beyond the scope of this thesis to go more into the convergence requirements but additional information can be found in the cited article.

36Denmark, the United Kingdom and Sweden decided not to join EMU while Greece did not initially meet the convergence criteria.

37Hilfe Country Report "Greece: Outlook", 7/10/00 *Hilfe Country Rep.* at http://web2.westlaw.com/shared/tex...WLW@.09&VR-2.0&n+16&action=Search

[38] Articles 105-109 of the Maastricht Treaty and Articles 105-111 of the Amsterdam Treaty. The European Central Bank is allowed to issue bank notes within the Community (Article 106) and shall have legal personality (Article 107).

INSTITUTIONS OF THE EUROPEAN COMMUNITIES

The four institutions created by the Treaty of Rome were the Parliament, the Council of Ministers, the Commission and the European Court of Justice. There is a fifth European Union institution called the European Council, which was first established in 1974 but did not gain Treaty recognition until the Treaty of Maastricht in 1986. The European Council meets at least twice a year and brings together the Heads of States and Government of the member states as well as the President of the European Commission. The European Council is arguably the only strictly European Union institution, as it serves the three pillars of the European Union, the Communities, the common foreign and security policy and police and judicial cooperation in criminal matters. The four institutions created by the original treaties are institutions of the Communities only. The four institutions have served the three Communities jointly since the 1965 Merger Treaty.[39]

The European Parliament

The European Parliament has always been viewed as the weakest of the institutions. However, since 1971 the European Parliament has had a say in the budgetary process of the European Communities. The Parliament has maintained since 1971 that it has the "right" to reject a budget *in toto*.[40] The European Parliament was given even more and increased powers under the Single European Act when it was given the right to propose legislative amendments, although the final word still rests with the Council, the main legislative body of the Communities.[41] Following the

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39McAllister, *From EC to EU*, 30, 31, 35.
40 McAllister, *From EC to EU*, 76-77.
41Henig, *Uniting of Europe*, 86.

Treaty of Amsterdam, the European Parliament's powers have been further increased as it now has co-decision rights with the Council of Ministers on a number of important matters. On these matters, the Parliament is allowed to negotiate on draft legislation as a full partner with the Council of Ministers.[42]

The Council of Ministers

The Council of Ministers, or as it is now called the Council of the European Union, as an intergovernmental institution was designed to function primarily as the European Community's decision maker. It is composed of ministerial representatives from the fifteen member states and it carries out its work by means of a standing committee.[43] The Council of Ministers is the main legislative institution of the Communities, and it is allowed to conclude international treaties on behalf of the Communities pursuant to Article 300.[44]. The Committee of the Permanent Representation of the Member States (COREPER) acts as a liaison between the Council and the Commission.[45] The original European Economic Treaty prescribed a system of voting that required unanimity on some measures but a qualified majority for others. However, in 1966 the French under General Charles De Gaulle were able to insist on unanimity on matters of extreme national importance. This compromise became known as the Luxembourg Compromise. Until 1986,the Council continued to Act on the basis of unanimity even though it was not legally required to do so. The Single European Act set out once again a system of qualified majority

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42 Andres Duff, ed. *Treaty of Amsterdam: Text and Commentary*, (London: Federal Trust, 1997) 143-145. Co-decision rights include citizens' rights (Article 8A(2)), social security for migrant workers (Article 51), rights of self-employed workers (Article 57) and cultural measures (Article 128(5)).

43John Fitzpatrick, "The Future of the North American Free Trade Agreement: A Comparative Analysis of the Role of Regional Economic Institutions and the Harmonization of Law in North America and Western Europe" (1996) 19 *Hous. J. Int'L L.* 1, 26.

voting under Ex. Article 145 (now Article 205) of the current European Community Treaty. However, under the Treaty of Amsterdam, qualified majority voting was once again counterbalanced by the right of the fifteen member states to request unanimity "for important and stated reasons of national policy"[46].

The Commission

The Commission is the only truly supranational institution of the Communities. It is required to act in the best interest of the Community and it serves in both an executive and administrative function. In its executive capacity the EU commission initiates specific proposals for community norms, while in its administrative capacity the primary responsibility of the EU Commission is to monitor the application and implementation of Community law by the member states.[47]John Fitzpatrick has noted that the advent of the European Council has increased the power of the Council of Ministers relative to the Commission as the Council can set the agenda and the basic framework for all policies. If that is true then the theory that Commission "proposes" and the Council of Ministers "decides" is no longer quite accurate.[48]

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44 Under Article 300 the Commission conducts the international negotiations and the Council concludes them.
45Fitzpatrick "The Future of the North American Free Trade Agreement", 25.
46 Youri Devuyst "The Community Method after Amsterdam", *Journal of Common Market Studies*, Vol. 37 No,1 109, 114.
47Fitzpatrick, "The Future of the North American Free Trade Agreement", 26
48*Ibid.*, 28.

The European Court of Justice

The mandate of the European Court of Justice is laid out in Article 220 (Ex. Article 164) and is to "ensure that in the interpretation of this Treaty the law is observed."[49] The Court now consists of fifteen judges and sits in plenary session when requested to do so by a Member State or a Community institution that is party to the proceedings pursuant to Article 221. The Court of Justice, however, usually sits in Chambers of either 3 or 5 judges. Nine Advocates-General assist the justices in their deliberations. The Court of Justice, under Article 230(Ex Article 173), has the power to review the legality of acts adopted by Community institutions, such as the European Parliament, the Council and the Commission. The Court of Justice also has the power under Article 231(Ex. Article 174) to declare Community acts to be void[50]. Arguably one of the provisions which has enabled the Court to most effectively play a role in the harmonization and enforcement of Community standards is Article 234 (Ex. Article 177) which states the following:

> The Court of Justice shall have jurisdiction to give preliminary rulings concerning:
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> (a) the interpretation of this Treaty;
> (b) the validity and interpretation of acts of the institutions of the Community and of the ECB;
> (c) the interpretation of the statutes of bodies established by an act of the Council, where those statutes so provide[51]

Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decision there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court of Justice.[52]

49.Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts, *Official Journal* 97/C 340/01, the Luxembourg Official Publications, ISSN 0378-6968, dated November, 1997.

50 *Ibid.*

51 Ibid.

The European Court of Justice can be said to have three main functions. The first is to determine whether the member states have been in compliance with their obligations under the Treaty and the Community secondary legislation. Secondly, it rules on the validity of the actions of the Community institutions. And thirdly, it has the duty of interpreting the provisions of the Treaty and the secondary legislation.

The European Court of Justice has decided some of the most important Community constitutional questions when delivering preliminary rulings on the referral of the Community law issue by national courts[53]. Even though in theory the preliminary judgments are only binding on the parties involved and on the referring court in so far as the judgment concerns Community law issues, the European Court of Justice's earlier decisions have legal effect on issues previously decided.[54] A European Court of First Instance was set up by the Council in 1989 in order to strengthen the availability of access by individuals to the Communities' justice system. The Court of First Instance was created to allow the Court of Justice to concentrate on the uniform interpretation of the laws of the Community.[55]

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52 *Ibid.*, at 79.
53 Note that most of the cases discussed later in this paper were preliminary rulings by the European Court of Justice under Article 234 (Ex. Article 177).
54 Fitzpatrick, "The Future of the North American Trade Agreement", 78.
55Official Journal No, C340, 10/11/1997, 0173.

LEGAL STAUTS OF THE EUROPEAN ECONOMIC COMMUNITY TREATY AND OF THE SECONDARY LEGISLATION

Status of the European Economic Community Treaty

Arguably the rulings of the European Court of Justice in the early 1960s, such as *Van Gend en Loos Nederlandse Administratie der Belastingen* [56]enunciating the doctrine of Direct Effect, have enabled the Treaty to attain an almost constitutional-like status.

There is nothing precisely stated in the European Economic Community Treaty that decrees how the Treaty should have effect in the Member States. The European Court of Justice decided in *Van Gend en Loos* that at least some of the Treaty provisions would be directly effective in all Member States[57]. Instead of adopting a literal approach and holding that the Treaty was only binding on state actors because it was addressed only to Member States, the European Court of Justice decided to go with a principled approach[58]. The European Court of Justice decided that the EEC Treaty had created a new international legal order and that something more than the international law concepts of comity and reciprocity were required to ensure that Members States did not circumvent Community objectives[59].

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56 Case 26/62 *Van Gend en Loos* v.*Nederlandse Administratie der Belastingen* E.C.R.1
57 Walter Van Gerven, "The Genesis of EEA Law and the Principles of Primacy and Direct Effect" (1999) 16 *Fordham Int'l L.J.*, 980.
58 Alex Easson "Integration Through Law: The Court of Justice and the Achievement of the Single Market" in *European Integration: Theories and Approaches* (Maryland: University Press of America, Inc., 1994), 314-316.
59 Eric F. Hinton, "Strengthening the Effectiveness of Community Law: Direct Effect, Article 5 EC, and the European Court of Justice", (1999) 31 *N.Y.U.J. Int'l L. & Pol* 307, 314-315.

The facts of the *Van Gend en Loos* case were not very complicated. The Dutch government had allegedly increased the tariff rate on ureaformaldehyde, which if true would have contravened the EEC Treaty. Under then Article 12[60], the EEC Treaty did not permit any increase in tariffs between Community Members after the inception of the Treaty. Van Gend en Loos was a Dutch importing company of ureaformaldehyde from Germany. It claimed that the Netherlands had unlawfully raised the inter-community tariff rate on ureaformaldehyde from the rate of 3% in 1958 at the signing of the EEC Treaty to 8% in 1960[61]. The action was launched by Van Gend en Loos in a Dutch national court against the Dutch government for contravening the provisions of the EEC Treaty. The Dutch national court then referred the question to the to the European Court of Justice under Article 177 of the Treaty in order to allow the European Court of Justice to determine whether the then Article 12 had direct application in the individual Community Member States.

The European Court of Justice held that because the prohibition in Article 12 of the EEC Treaty against increasing existing customs duties was sufficiently "clear" and "unconditional", it did not require further action by the Member States and was thus directly effective in all Member States[62]. Therefore an EEC Treaty provision, independent of Member State legislation, was held to impose obligations and to confer rights directly on individuals in the Member States. The Court based its decision on the following four principles. Firstly, the preamble of the EEC Treaty referred not only to the governments of Member States but also to the people. Secondly,

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60Article 12 now Article 25 states the following: Customs duties on imports and exports and charges having equivalent effect shall be prohibited between Member States. This prohibition shall also apply to customs duties of a fiscal nature.

61 Case 26/62 Van Gend en Loos v.Nederlandse Administratie der Belastingen E.C.R.1

the establishment of such institutions with sovereign rights also affected the people and citizens of the Member States. Thirdly, the citizens of the Member States were able to cooperate in the functioning of the Community indirectly through the European Parliament and the Economic and Social Committee. And the final point was that through the preliminary ruling procedure, Member States had conceded that their citizens could invoke the authority of Community law before the national Courts of the Member States[63].

The Van Gend en Loos opinion has played a very important role in the harmonization of Community law and objectives and therefore also the drive toward economic integration. The Dutch government attempted to put forward an argument, with the support of the German and Belgian governments, that a state should, until the breach of its Community obligation was rectified, be able to rely on its offending state legislation against its own citizen. This would have been in line with the regular international law practice of holding a nation state liable for a breach of an international treaty obligation while allowing the state to continue to enforce the offending legislation against its nationals. If the European Court of Justice had decided to adopt the Dutch government's argument, it would have taken years for individuals like Van Gend en Loos to receive their compensation[64].

Under direct effect *Van Gend en Loos* was able to obtain a quick remedy. Consequently, because private individuals and companies could get immediate relief, it created an incentive for them to launch actions in national courts against the their Member States for failing to

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62 Hinton, "Strengthening the Effectiveness of Community Law", (1999,314-316.
63 Walter van Gerven, "The Genesis of EEA Law and the Principle of Primacy and Direct Effect", 981.

implement Community Treaty obligations in a timely and effective manner. The development of the doctrine of direct effect, by The European Court of Justice, further propelled the harmonization of Community law.

The Court of Justice went further in the *Defrenne* cases[65] and held that provisions of the Treaty could also be "horizontally" effective[66] against private individuals and companies of the Member States. Thus, the Court of Justice held that Article 119 of the European Economic Treaty, the article mandating non-discrimination of individuals on the basis of their sex, could allow any employee to sue his/her employer for sexual discrimination if he/she was being treated unequally in terms of pay[67]. As a result, certain Treaty provisions could be either vertically or horizontally effective.

Status of Secondary Legislation

There are three main types of secondary legislation as set out by Article 249 -- regulations, directives and decisions. Regulations are the only truly supranational secondary legislation of the European Community, as they are directly effective and applicable in the Member States. The Member States do not have to enact any domestic legislation to implement a European Community regulation. On the other hand with a directive, the member states have to enact domestic legislation, but must do so in a manner that meets the goals and objectives of the

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64 Easson, "Integration Through Law", 80.
65 Case 43/75 *Defrenne* [1976] ECR 455 and Case 80/70 *Defrenne* [1971] ECR 445.
66 "Vertical" direct effect is the ability of the individual to rely directly on a Community Directive in an action against a State actor. While "horizontal" direct effect would allow an individual to rely on a Community Directive in an action against another individual. Please see Josephine Steiner, "From direct effects to *Francovich*: shifting means of enforcement of Community Law" (1993) 18 *E.L. Rev.* 3, 5.
67 Jeremy Richardson ed., *European Union: Power and Policy-Making* (New York: Routledge, 1996), 177-178.

Community directive. Decisions are binding in their entirety upon those to whom they are addressed[68].

While it appears from the Treaty that the Member States have a lot of discretion on how to implement Directives, the ability has been limited by decisions of the European Court of Justice. In decisions such as *Van Duyn*[69] and *Ratti*[70] the European Court of Justice went further by allowing Community directives to be directly effective in Member States. The Court of Justice reasoned that because regulations were directly applicable and directives were binding on Member States as to the result to be achieved, directives should be directly effective in Member States, as Community law had supremacy over the domestic laws of the Member States[71].

However, the European Court of Justice refused to extend "horizontal" direct effect to the directives. In *Marshall v. Southampton A.H.A.*[72] the Court of Justice held that because directives are not directly effective in the Member States in the manner that regulations and certain provisions of the Treaty are, private individuals should not be able to rely on the provisions of a directive against another private individual. The obligation of implementing directives was directed at the Member States and not at individuals.

Despite the fact that a state could be held liable for the failure to implement a Community Directive, Member States were increasingly failing to implement them in the late 1980s. This

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68Article 249, Treaty Establishing the European Community.
69 Case 148/78 *Van Duyn* [1979] ECR 1629
70 Case 148/78 *Ratti* [1979] ECR 1629.
71 Hinton, "Strengthening the Effectiveness of Community Law",317.

was of particular concern to the European Court of Justice, as the drive toward completion of a true internal market by December 31, 1992 was under way. The completion of the internal market was to be achieved largely through the harmonization by directive.[73] The European Court of Justice then emerged with another major constitutional principle in the case *Francovich v. Italian State* and *Bonifaci v. Belgian State*, which was decided concurrently with the *Francovich* case[74].

The *Francovich* case arose out of the Italian government's failure to implement Directive 80/987 that outlined Member State liability in the event of insolvency. The Directive was to have been adopted and implemented by the Member States by October 23, 1983, but the Italian government had failed to implement it by the time the case came to trial in 1991[75]. The European Court of Justice first inquired on whether or not Directive 80/987 was directly effective. However, it was found not to be sufficiently precise in its obligation on Member States to have direct effect. Rather than allow the Italian State to have no liability, the Court of Justice held that "it is a principle of Community law that the Member States are obliged to make good loss and damage caused to individuals by breaches of Community law for which they are held responsible".[76]

The Court went on stating "[t]he full effectiveness of Community rules would be impaired and the protection of the rights which they grant would be weakened if individuals were unable to obtain their redress when their rights are infringed by a breach of Community law for which a

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72 Case 152/84 *Marshall*, [1986] ECR 723.
73Josephine Steiner, "From direct effects to *Francovich*", 6.
74 *Ibid.* 7-9.
75 *Ibid.*

Member State can be held responsible"[77]. Combined with the requirement under Article 10(Ex. Article 5) that "Member States shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty" and that they "refrain from any measure which could jeopardize the attainment of the objectives of the Treaty", the Court of Justice held that a State could be held liable for failing to implement a Community Directive[78].

The European Court of Justice held that the State liability to indemnify an individual for damages suffered by the individual as a result of the Member State's failure to implement a Community Directive arose where three conditions were fulfilled. The three conditions are:

> 1. The result required by the Directive must include the conferring of rights for the benefit of the individuals.
> 2. The content of these rights must be determinable by reference to the provisions of the Directive; and
> 3. There must be a causal link between the breach of the obligation of the state and the damage suffered by the person affected."[79]

The *Francovich* ruling was of great importance to the development and harmonization process of European Community law because Member States could be held liable for the damages caused by their failure to implement a Community Directive. Consequently, States could be held liable regardless of whether the Directive had any direct effect. Thus an individual could claim compensation from their State authorities for damages caused by the Member State's failure to implement a Community Directive. As a result of the European Court of Justice's ruling another

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76 Hinton, "Strengthening the Effectiveness of Community Law", 328.
77 *Ibid.*
78 *Ibid.*
79 Josephine Steiner, "From direct effect to Francovich"3, 9
.80 E.E.C.Commission, *Second General Report on the Activities of the Communities*, 1968, (Brussels-Luxembourg, 1969) p.23

legal loophole, by which Member State's could have ignored Community Directive, was eliminated.

CONCLUSION

The importance of the establishment of a legal system within the Communities cannot be overstated. Without the establishment of the European Court of Justice and the legislative ability of the Community institutions, in my opinion, the European Community would not have been able to make as much progress as it has in its integration initiatives. From the very outset, as mentioned earlier, many proponents of a unified Europe envisioned a type of economic or political union for the Members States of Europe. The European Communities progress to an economic union has been a process that envelops approximately 50 years. During that time period the European Communities have moved from an initial free trade area, to a customs union commencing in 1968 to a common market from 1992 and are now moving toward an economic union with the introduction of a common currency and a central European Bank in Frankfurt, Germany.

The institutions of the European Communities were given considerable supranational powers. Initially, the 6 original Member States relied upon negative integration mainly as the tool to power of Member States began to realize that more than just negative integration was required in order to address many of the differences in legislation that remained between the Member States. Even though, negative integration initiatives remained more pervasive and successful, at least the Member States acknowledged a need for positive integration in order to begin to eliminate the non-tariff barriers that remained.

In the second general report by the European Commission to the European Parliament in 1968 the Commission wrote the following:

> Now that intra-Community duties have been abolished, uniform interpretation of the common customs tariff, that is the levying of one and the same duty on a given item, no matter which Member State has imported it assumes greater importance ... The total elimination of customs barriers has revealed the considerable extent to which obstacles to intra-Community trade are due to differences between one country and another in domestic legislation of industry.[80]

The institutional structure of the European Communities has arguably been more producing than facilitative, encompassing more of a neo-functionalist or even partly federalist tone than a pluralist one. Even though the Council and the European Council are in some ways intergovernmental, they have had a measure of supranationality by the fact that their legislation has been held to be both directly applicable and directly effective in the Member States. The Council is even more supranational and less international or intergovernmental in its flavouring when it only requires a qualified majority within the Council to pass the legislation proposed by the Commission than when there is a requirement for unanimity. The need to have unanimous support from all the member states not only delays the adoption of necessary measures, but also makes the agreement process more intergovernmental as all of the Member States governments must agree. Therefore, unanimity is more in line with a diplomatic international type of system.

I wish to draw special emphasis to the role of the European Court of Justice in the interpretation of the European Economic Community Treaty. No where in the Treaty was there specific reference to the fact that the Treaty was to have a supranational characteristic and that it should be directly applicable and effective in the judicial and legislative systems of the Member States.

Arguably it has been the European Court of Justice that has played a large part in the economic integration of the European Community. The main emphasis of the Court of Justice was on the wording of the Treaty and the enunciated objectives of the founders of the Communities to create an eventual common market and a unified Europe. Based on these interpretations, the Court of Justice ruled in *Van Gend en Loos* that a new legal order had been created and that private individuals, people and companies of the Member States, could hold their domestic governments accountable for violations of certain Treaty provisions.

The following quote by the Court of Justice in *Costa v. ENEL*[81] illustrates well the nature of the legal system in the Communities.

> By creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of powers from the States to the Community, the Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds their nationals and themselves.

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81 Case 6/64 *Costa v. ENEL* [1964] ECR 585.

CHAPTER THREE

THE EUROPEAN ECONOMIC AREA

INTRODUCTION

While in the previous chapter, I discussed the evolution of the European Community, in this chapter I will focus on the emergence of the European Free Trade Area (EFTA) and the creation of the free trade area, the European Economic Area (EEA). The EFTA developed as a response to the European Economic Community by five European countries. These five countries had no wish to join the European Community at that time. But over time, as will be discussed later on in this chapter, EFTA member states realized a need for further cooperation and liberalization of trade with the European Community and the European Economic Area was formed between the European Community and the EFTA members.

The European Economic Area is a very interesting economic integration initiative. The European Economic Area (EEA) is the creation of a free trade area between two regional trading blocs: the European Union and the Member States of the European Free Trade Area. The European Economic Area Agreement was signed in 1992 by the Commission of the European Communities and the representatives of the European Community Member States as well as by representatives of the individual governments of the Member States of the European Free Trade Area (EFTA). The aim of the EEA

Agreement was the strengthening of the economic and trade relations between the EC and EFTA Member States in order to create a "homogeneous European Economic Area"[1]

HISTORY

The European Economic Area Agreement was the culmination of close to twenty years of relationship between the EEC and EFTA. The European Free Trade Area was the personification of the post-war movement by certain European states for greater economic cooperation and free movement of goods without the creation of supranational institutions. It was the rival organization to the European Economic Community as it opted for the intergovernmental rather than supranational approach.[2] The United Kingdom was at the forefront of this approach. In 1956 the British proposed the creation of a European free trade area covering the whole of the OEEC[3]. It proposed the promotion of free trade in industrial products between the member states, but unlike the European Economic Community the proposals did not envision the establishment of a common market. The emphasis was on economics as there was no long-term political aspirations to the British proposal.[4] The British in many ways believed that the Community initiatives to create a common market would fail. The British further

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1 Sven Norberg, "The Agreement of a European Area", *CML Rev.* 1992, 1171, 1171 & 1177. The agreement at its signing had 21 Contracting Parties, the European Economic Community (EEC), the European Coal and Steel Community (ECSC), the twelve EC Member States and the seven EFTA States.
2 Tsoukalis, *The New European Economy: The Politics and Economics of Integration*, (New York: Oxford University Press, 1991) 279.
3 The OEEC stands for the Organisation for European Economic Co-operation and was established in 1948. It encompassed all of Western Europe except for Finland, Germany and Spain. The OEEC was created in order to organise and regulate U.S. aid to war torn Europe. See Henig, *The Uniting of Europe*, 19-20.
4 Henig, *The Uniting of Europe*, 48.

believed that in the unlikely event that the European Economic Community was created, Britain would not be frozen out of the arrangement. However, the British were mistaken and the European Economic Community was founded without British involvement.

The European Free Trade Area was created in 1960 in an effort to create a counterbalance to the European Economic Community. The EFTA consisted of the following five countries, the United Kingdom, Norway, Portugal, Sweden, and Switzerland. These states wanted to be able to reap the benefits of free trade without having to relinquish any national sovereignty to a supranational organization[5]. Their approach was "overwhelmingly economic and functional"[6]. However, there was never any strong trade relationship between the EFTA member states. At the same time the EFTA States were trading increasingly with the EEC Member States. Because the European Economic Community refused to participate in any multilateral negotiations with EFTA[7] many of the EFTA States signed bilateral free trade agreements with the European Economic Community.

However by 1986 the EEC was ready to begin multilateral talks with the EFTA States for the creation of a European Economic Area.[8]Congruently, the European Economic Community was proceeding with the Single European Act that envisioned the creation of

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5 Carl Baudenbacher, "Between Homogeneity and Independence: The Legal Position of the EFTA Court in the European Economic Area", (1997) 3 *Colum. J. Eur. L.* 169, 172.
6 Tsoukalis, *The New European Economy*, 20.
7 Henig, *The Uniting of Europe*, 49.
8According to the French "espace". It then became known as "area" partly through the influence of the British Prime Minister Margaret Thatcher. John Forman "The EEA Agreement Five Years On: Dynamic Homogeneity in Practice and its Implementation by the Two EEA Courts", *CML Rev.* 1999, 751,757.

a truly "free" internal market in the EEC by December 31, 1992. The EFTA States, in an effort not to be denied access to the EEC market, concluded the European Economic Area Agreement with the EEC the same year that the common market was created in the EEC. By that time, only Austria, Finland, Iceland, Norway, Sweden and Switzerland remained as members of the European Free Trade Area as the United Kingdom, Denmark and Portugal had joined the European Economic Community.[9] The European Free Trade Area states wished to ensure that they would not be frozen out of the European Community. The European Economic Area Agreement seemed able to guarantee access to the European Economic Community market better than the bilateral free trade agreements in place between the European Community and individual European Free Trade Area states[10].

The EEA Agreement's objective was the creation of an EEA that encompassed the four freedoms of the European Union within a free trade area.[11]. In other words, it was an agreement to establish the first stage of Bela Balassa's model of integration with no goal of moving to a higher level of economic integration such as a common market. The EFTA States in particular did not desire to compromise their own sovereignty or political autonomy as they had no tradition of working with supranational institutions similar to the ones in the European Community.[12] The objective was to increase trade by the

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9 Baudenbacher "Between Homogeneity and Independence", 173-174.
10van Gerven, "Articles the Genesis of EEA Law and the Principles of Primacy and Direct Effect", 955.
11The four freedoms of the European Community are: the free movement of goods, the free movement of persons, the free movement of services and the free movement of capital. Norberg, "The Agreement of the European Economic Area" ,1171.
12Marise Cremona " The 'Dynamic and Homogeneous' EEA: Byzantine Structures and Variable Geometry", (1994) 19 *Eur. L. Rev.* 508, 510.

creation of a rather advanced free trade area without establishing a tariff union, political union or monetary union.[13]

INSTITUTIONAL STRUCTURE OF THE EUROPEAN ECONOMIC AREA

PRINCIPLE OF HOMOGENITY

When the European Economic Area Agreement was signed the European Free Trade Area states adopted all of the relevant European Community regulations, directives and European Court of Justice case law. In so far as the provisions adopted were identical to the corresponding EC rules their implementation and application were to be interpreted in conformity with the rulings of the European Court of Justice.[14] This provision did not prejudice future law, as the EFTA States did not want to be ruled by a court that they would not be able to control. The joint institutions of the EEA do not have any supranational authority for arguably two major reasons. Firstly, the EFTA States did not like the idea of pooling any degree of their sovereignty in any supranational institution[15]. And secondly, the European Court of Justice had held that the Community could not delegate or give up power to a non-Community institution.[16]

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13 One year after the coming into existence of the European Economic Area Agreement Austria, Finland and Sweden joined the European Economic Community. That consequently only left Norway and Iceland as the remaining EFTA members of the EEA as Switzerland had decided to opt out of the EEA. The number of EFTA Pillar States was raised to 3 when Lichtenstein joined on May 1, 1995.

14Sven Norberg "The Agreement of the European Economic Area" , 1179

15 Cremona "The 'Dynamic and Homogeneous' EEA: Byzantine Structures and Variable Geometry", 508, 510.

16Opinion 1/76, *Draft Agreement establishing a European laying-up fund for inland waterway vessels* [1977] E.C.R. 741, Cremona "The 'Dynamic and Homogeneous' EEA: Byzantine Structures and Variable Geometry", 508, 510.

The European Court of Justice reiterated that point of view in its 1991 decision on the draft agreement of the European Economic Area by holding that a joint supranational institution overseeing the EEA would violate the European Community legal order[17]. The European Court of Justice continued by opposing the creation of a joint EEA Court that was initially envisioned to judicially supervise the implementation and functioning of the EEA Agreement. The European Court of Justice saw the creation of a joint EEA Court as a threat to its own autonomy within the European Community's legal order and as being contrary to Article 220 (Ex Article 164), which conferred on it exclusive jurisdiction on legal issues arising within the European Community.[18] Consequently, the first draft of the EEA Agreement was rejected. The second draft that was subsequently signed and accepted was more political in its approach to dispute resolutions. Consequently, the final EEA Agreement did not contain within it the provisions for a overall EEA Court. Rather, it created a "two pillar" system of both dispute resolution and decision making with the European Communities and its Member States constituting one of the pillars and the European Free Trade States making up the second pillar.

INSTITUTIONS

EEA Institutions

The European Economic Area Agreement established four joint institutions: The EEA Council (Article 89), the EEA Joint Committee (Article 92), the EEA Joint Parliamentary

17 European Court of Justice Opinion 1/91 [1991] E.C.R. I-6084.
18 European Court of Justice Opinion 1/91 [1991] E.C.R. I-6084.Willy Alexander, "Exhaustion of Trade Mark Rights in the European Economic Area", (1999) 24 Eur, L. Rev., 56,64.

Committee (Article 95) and the EEA Consultative Committee (Article 96)[19]. These four institutions are in addition to the separate institutional structure within the two pillars. In other words, the EEA created joint institutions that run parallel to the European Community institutions and the EFTA State institutions which were created by two agreements signed simultaneously to the EEA Agreement. The Agreement of the Establishment of a Surveillance Authority and The ESA-EFTA Court Agreement together established the European Free Trade Area Surveillance Authority (ESA) and an EFTA Court[20] and were agreements among the EFTA States to monitor the EFTA State compliance of the EEA Agreement. The European Community adherence to the EEA Agreement would be monitored in the same manner by the Community institutions as are the Community Treaties and legislation.

The EEA Council is more political than the EEA Joint Committee, as its role is to make political decisions on the future of the EEA Agreement.[21] The European Economic Area Joint Committee, on the other hand, is the forum for the two pillars to get together and to extend and move along the integration process of the EEA.[22] The Joint Committee as just stated is in charge of integrating into the EEA relevant European community acts through fostering consensus between the European Community and the EFTA States[23]. Even though EEA homogeneity is the principal objective of the EEA Agreement, the

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19Norberg, "The Agreement of the European Economic Area", 1180; Forman, "The EEA Agreement Five Years On", 751,759.
20van Gerven, "The Genesis of EEA Law and the Principles of Primacy and Direct Effect", (1999) 16 *Fordham Int'l L.J.*, 957.
21Norberg, "The Agreement of the European Economic Area", 1181.
22JForman, "The EEA Agreement Five Year On", 756.
23Norberg, "Guest Editorial", (1994), *CML Rev.* 1994, 1147, 1152.

EEA Joint Committee has no real independent power and operates by the goodwill of the two EEA pillars[24]. It is in this way very much an intergovernmental institution with an overall international rather than supranational quality of the EEA Agreement. However, unlike a truly public international law provision, Article 7 of the EEA Agreement is similar to the Ex Article 189 (Now Article 249) of the EEC. Article 7 of the EEA Agreement decrees that the acts in or referred to in the Annexes to the Agreement itself or in the decisions of the EEA Joint Committee shall have binding force upon the Community and the EFTA States. These decisions will become part of their internal order as follows:

> (a) an act corresponding to a EEC Regulation shall as such be made part of the internal legal order of the Contracting Parties;
> (b) an act corresponding to an EEC Directive shall leave to the authorities of the Contracting Parties the choice of form and method of implementation.[25]

According to Norberg such provisions were necessary, as otherwise EEA acts corresponding to EEC Directives would have been less binding than European Community law in the EC Member States.[26] However, when looking at the provisions, they are virtually identical to the effect of the European Community legislation in the Community Member States. Thus one could argue as Sven Norberg does that in practice a common European legal system exists between the EC and EFTA.[27] However, that is not quite the case as the EEA Agreement and practice has to take into account the decision-making autonomy of the European Community.

24As an aside, the European Communities seem to prefer creating legal institutional structures that are composed of pillars. The EEA has two and the new European "Union" has technically three pillars as mentioned in the proceeding chapter.
25Norberg, "The Agreement of a European Area", 1180.
26*Ibid.*,1180.

Article 97 of the EEA Agreement allows each of the Contracting Parties to amend their legislation as long as it does not adversely affect the functioning of the EEA Agreement.[28] However, the main emphasis is on the amendments to the legislation of the dominant partner or pillar of the EEA - the European Community. Article 99 of the EEA Agreement provides a mechanism whereby the European Community when drafting new legislation, which impacts directly on areas governed by the EEA, will consult with the EFTA States[29]. This provision is necessary because the EEA Agreement stipulates that in order to guarantee "the legal security and homogeneity of the EEA"[30] the relevant *acquis* be adopted by the EFTA States as soon as possible.[31] It would not be fair to the EFTA States if they did not have a say in the formulation of the European Community legislation when the homogeneity of the EEA requires that they implement similar measures.

The Joint Committee is also the main body that helps settle disputes between the European Community and the European Free Trade Area States. The mechanism is political but it is meant to try to create homogeneity between the case law of the European Court of Justice and the European Free Trade Area Court in their interpretations of the EEA Agreement provisions which are identical in their substance to

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27*Ibid.*, 1172
28*Ibid.*, 1183.
29*Ibid.*, 1184.
30*Ibid.*, 758.
31*Ibid.*, 758.

the European Community rules.[32] Under Article 111 of the EEA Agreement, a dispute on the interpretation or application of the Agreement itself may be brought before the EEA Joint Committee by an EFTA State or the European Community. The EEA establishes measures that a Contracting Party can take if the Joint Committee has not reached an agreement on a solution within six months of the dispute being logged or one of the Contracting Parties of the EEA Agreement has not asked the European Court of Justice for a ruling.[33]

However, if there is no consensus at the EEA Joint Committee level, then there will be a difference in the case law of the two EEA pillars. As Willy Alexander writes, "In spite of what the Contracting Parties may have thought at the time of drafting the Agreement, there appears to be no real interest in having a single exhaustion regime all over the EEA...."[34]. Alexander suggests that the in cases of difference in the case law of the EFTA Court and the European Court of Justice that the system of dispute or conflict resolution should not be applied.[35] The European Court of Justice has agreed with Alexander's interpretation from the beginning as it views the divergence in the aims and objectives of the EEA Agreement and the European Communities Treaties and laws to be

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32Leif Sevon and Martin Johansson, "The protection of the rights of individuals under the EEA Agreement" (1999) 23 *Eur .L. Rev.*,373, 376. There is a right of the EFTA States and the EFTA Surveillance Authority (ESA) to intervene and submit observations in cases before the European Court of Justice and there exist corresponding rights for the Member States of the European Communities before the EFTA Court.

33Alexander, "Exhaustion of Trade Mark Rights in the European Economic Area",64.

34Ibid, 56.

35Ibid, 56.

obstacles to the achievement of homogeneity in interpretation and application of the law in the EEA.[36]

The EFTA Institutions

EFTA Court

Since I have discussed the composition and the jurisdiction of European Court of Justice in the proceeding chapter, I will now turn to the discussion of the EFTA Court, the court of the second pillar of the EEA. The EFTA Court is permanently in session and has three Judges sitting in plenary session in Luxembourg.[37] There are ad hoc Judges who sit whenever one of the permanent Judges cannot do so. This is necessary because of the limited number of Judges available.[38] Also, the EFTA Court has limited resources compared to its counterpart the European Court of Justice. In that way, the rulings of the EFTA Court cannot be as detailed and worked out due to its weaker structure and resources[39]. As a result, the EFTA Court cannot play as important a part in the economic integration process of the EEA as the European Court of Justice has played in the integration of the European Communities. Compared with the number of cases

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36Ibid, 65.
37Per Christiansen, "The EFTA Court", (1997) 22 E.L. Rev. Dec., 539, 540. The number of Judges reflects the number of EFTA States in the EEA. There are currently four EFTA States, but Switzerland is not a member of the EEA. See Norberg, "The Agreement of a European Area" *CML Rev*, 1149. Also see L.N. Brown & J. Kennedy, *The Court of Justice of the European Communities* (London: Sweet & Maxwell, 2000), 251 The seat of the EFTA Court was moved from Geneva to Luxembourg in September 1996 thus strengthening its connection with the European Court of Justice.
38Per Christiansen, "The EFTA Court",541.

before the European Court of Justice, the number of cases that have appeared in front of the EFTA Court have been quite modest.[40]

The jurisdiction or competence of the EFTA Court is remarkably similar to the European Court of Justice. The EFTA Court deals with direct actions against an EFTA States by another state or by the EFTA Surveillance Authority in a similar manner to the way that actions can be launched under the European Communities law. Article 31 of the EEA reproduces the wording of Article 226(Ex 169)[41] while Article 32 of the EEA fulfils the same function as Article 227 (Ex 170) of the EC Treaty.[42] However, unlike the EC Treaty, there is no requirement that the EFTA States bring the dispute to the attention of the surveillance prior to taking action. Thus unlike the European Community States who have to bring the matter to the attention of the Commission before launching an action before the European Court of Justice, the EFTA States do not have to bring the matter before the ESA. The EFTA Court also gives advisory opinion on the interpretation of the EEA Agreement and against the ESA for it actions of for its failure to act.

39The EFTA Court does not have Advocate General like the European Court of Justice to aid it. Thus the EFTA Court is not "in a position to consider the various aspects of any given case to the same depth as the European Court of Justice..." Forman, "The EEA Agreement", 772.

40Forman, "EEA Agreement" 767. In 1994 there were 9 cases, 7 in 1996, the highest number of 10 in 1997, 6 in 1998 and no new cases were registered in the first five months of 1999.

[42]Up until at least 1999, no case had yet been heard on one EFTA/EEA State filing a case agiainst the other for infrigment of the EEA Agreement or for the ESA for failing to act. Forman "EEA Agreement" 768. Per Christiansen, 541; Helmut Tichy and Lucien Dedichen, :Securing a Smooth Shift Between the Two EEA Pillars: Prolonged Competence of EFTA Institutions with Respect to Former EFTA State After Their Accession to the European Union" CML Rev. 1995, 131,151;

The EFTA Court's opinion is very similar to the European Court of Justice's preliminary ruling procedure, except the opinions of the EFTA Court are not binding on the requesting member state's national courts. The EFTA Court's opinions are always advisory in nature; therefore, the state's can refrain from requesting an opinion and can even choose to ignore one even once it has been given[43].

That the EFTA States adopted the relevant legal structure and case law of the European Community through the adoption of the EEA Agreement, it was seen as possible that the EFTA/EEA contained the issue of primacy of EEA Treaty. However, this is not the case. Because primacy was considered not to flow directly from the nature of the EEA Agreement, Protocol 35 was added. Protocol 35 stated that the issue of sovereignty or primacy was to remain in the hands of the individual EFTA States. While the EEA rules would take precedence when coming into conflict with national law, it only applied to the EEA rules that had been directly introduced by the EFTA States into their national legal orders. In other words, the EEA rules would take primacy over other conflicting national provisions when the rules themselves had been directly adopted into the national legal order.[44]

In its opinion the European Court of Justice held that "the EEA...merely creates rights and obligations as between the Contracting Parties and provides no transfer of sovereign rights to the intergovernmental institutions which it set up."[45] On the other hand, Leif

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43 Per Christiansen, "The EFTA Court", 542
44Forman, "EEA Agreement", 775
45 European Court of Justice Opinion 1/91 [1991] E.C.R. I-6084.

Sevon and Martin Johanson point out that had the EEA Agreement been merely another international public law agreement, the European Court of Justice would not have been worried about the legal integrity of the European Communities. Because the EEA adopted provisions almost identical to the EEC Treaty, it can be argued that even though the EEA Agreement is less far-reaching than the EC Treaty, the scope of the EEA Agreement is greater than any other international public law treaty.[46]

CONCLUSION

The European Economic Area Agreement is an international agreement and intergovernmental in nature. It is very much in step with my predictions at the end of the first chapter as the central institutions are facilitative in nature and are found in an agreement with limited goals for the depth of integration, as the EEA aims only for the creation of a free trade area. As a result, the institutions were designed in a manner that would limit the encroachment of supranational institutions on the sovereignty of both the European Union of the EFTA Contracting states. Neither the EU nor the EFTA states did not want to pool their sovereignty in a central supranational institution.

Despite the weak central institutional structure, there seems to be a remarkable homogeneity in the EEA. This, however, seems to be the case because the EFTA states adopted all the relevant European Community legislation and principles at the inception of the EEA Agreement. In addition, the EFTA states are too weak to go against the

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46Leif Sevon and Martin Johansson, 381

wishes of the EU particularly when the objectives of the EFTA states was to ensure market access to the EU without restrictions.

CHAPTER FOUR

THE NORTH AMERICAN FREE TRADE AGREEMENT

INTORDUCTION

The North American Free Trade Agreement (NAFTA) is in many ways a hodgepodge of international and supranational features. Its aims seem quite limited at the beginning - the simple creation of a free trade area, but in many ways it is much more. The NAFTA is a complicated and far-reaching free trade agreement, which, within its scope, encompasses all trade between the United States, Mexico and Canada. NAFTA's core objective is the elimination and phasing out over a fifteen-year period of all tariff and non-tariff barriers between the three nations and includes two side agreements dealing with minimum labour and environmental standards.[1] However, these side agreements are quite limited and are not part of the overall agreement.

The main purpose of the NAFTA is the facilitation of trade and investment in North America. Canadian and Mexican negotiators especially wished to ensure guaranteed access to the United States markets and to maintain or increase American investments in their respective economies. At the same time, another major goal of the Canadian negotiators continued to be the objective of creating an effective system that would regulate anti-dumping duties and countervailing duties between Canada and the United States.

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[1]David Lopez, "Dispute Resolution Under MERCOSUR From 1991 to 1996: Implications for the Formation of a Free Trade Area of the Americas", 3 *SPG NAFTA: L & Bus Rev Am* 3, 18.

HISTORY

The 1992 North American Free Trade Agreement is an echo of the earlier Canada-United States Free Trade Agreement (CUSFTA). CUSFTA was signed by Canada and the United States in 1988 after a long election campaign on the issue of free trade with the United States was won by its proponents in Canada. The Canadian government had been the main instigator of talks with the Americans on liberalising trade between the two countries. The Americans agreed to go along with the negotiations because Canada had been one of only three countries to support the United States position on Libyan terrorism and had helped out with the 1980 Iranian hostage crisis.[2] It seems that the Americans were willing to engage in trade negotiations with Canada in return for Canada's support in other foreign affairs issues.

Prior to the signing of the CUSFTA, the idea of trade reciprocity between Canada and the United States had been around for nearly a century. Most of the prior agreements had not come to fruition because of the perceived political risk to Canadian sovereignty of becoming partners with a much bigger and more powerful nation, like the United States. However, by the mid-1980s, the Macdonald Report commissioned by the government of Canada, suggested that Canada was not powerful enough to break into world markets by itself and should consider a

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[2]John Whalley and Colleen Hamilton "The Intellectual Underpinnings of North American Economic Integration", (1995) 4 *Minn. J. Global Trade* 43, 60.

closer trading relationship with the United States.[3] Also, it was felt by some that multilateral trade arrangements under the GATT were too slow and ineffective for Canada to be able to increase its international trade.[4]

Another impetus to the Canadian initiative to pursue a trade agreement with the United States was the fear that Canadian exports would be caught by the protectionist sentiments of the Americans, as a response to a worldwide recession. Canadian trade experts feared that Canadian exports to the United States would face increased tariffs and countervailing and anti-dumping duties. In 1984, almost $6 billion of Canadian exports to the United States were being exposed to American protectionist measures such as anti-dumping, countervailing duties and surcharges.[5] This was of particular concern to the Canadian negotiators, as the Canadian economy was so highly dependent on the United States market for its economic viability and vitality. In 1988 Canada exported 72.82 percent of its total exports to the United States and imported over 65 per cent of its total imports from the United States.[6] Canada was therefore highly reliant on the United States. The Canadian negotiators aimed to negotiate comprehensive controls on United States actions on subsidies and countervailing and anti-dumping measures.

Canada was not very happy when the prospect of the North American Free Trade Agreement

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[3]*Ibid.* 57-58.

[4]The Tokyo Round of the GATT ended in 1979 without any major breakthroughs in facilitating international trade.
[5]Whalley and Hamilton, "The Intellectual Underpinnings of North American Economic Integration, 59 The Canadian government was giving subsidies to Canadian firms for regional or social policy purposes and as a result many of Canada's exports to the United States were being subject to American protectionist policies. *Ibid.*
6. Joyce Hoebing, Sidney Weintraub, and M. Delal Baer eds, *NAFTA and Sovereignty: Trade-offs for Canada, Mexico and the United States* (Washington: The Center For Strategic & International Studies) 58-61.

first emerged. The United States government, after the adoption of the CUSFTA, began to use regional and bilateral trading agreements as a method of enhancing and carrying on trade policy on a global level. Rather than wait for the limited progress of the multilateral approach, the United States was forging ahead with the creation of regional agreements. In 1990 the Bush administration promoted the idea of the Enterprise for the Americas Initiative (EAI) which had the "stated objective of forming a free trade zone from Anchorage to Tierra del Fuego"[7] Therefore, the Americans were quite receptive to the Mexican proposal for a regional free trade agreement. Canada went along with the negotiations in an effort to avoid a "hub-and-spoke arrangement"[8]. A "hub-and-spoke arrangement" would have allowed the United States to obtain preferential treatment in both Canada and Mexico, while both Canada and Mexico would have only enjoyed benefits in the United States.

The Mexican negotiators were happy to have Canada participate, in part to limit the American ability to totally dominate the discussions if the negotiations were simply between the United States and Mexico. Mexico wanted to be able to join the world economy and saw NAFTA as a means to do so. Mexico needed foreign capital and access to both Canadian and United States markets in order to progress from a developing to a developed nation. In 1990, then Mexican President Salinas stated " What we want is closer commercial ties with Canada and the United States, especially in a world in which big markets are being created. We don't want to be left out

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7Whalley and Hamilton, "The Intellectual Underpinnings of North American Economic Integration", 61.
8Frank Garcia "NAFTA & the Creation of the FTAA" 35 *Va. J. Intl L.* 558

of any of those regional markets, especially not out of Canadian and American markets"[9]

INSTITUTIONAL STRUCTURES

As it has been postulated, institutional structures and the creation of either legal systems or dispute resolution mechanisms are determined at least in part by the political objectives of members of the regional trading blocs. There is a consensus among academics that the main underpinning or impetus of NAFTA was economic. Unlike Europe, the North American countries did not have to rebuild war-shattered economies or ensure that there would be no future wars on the continent. Consequently, the emphasis was on the facilitation of free trade between the three countries. As a result, the negotiators of the agreements had no desire to create any over-arching or supranational institutions. While the United States had always been very protective of its sovereignty, Canada and Mexico both were equally concerned in maintaining control over such wide-ranging issues as social benefits, policies and health care and cultural issues. There were special concerns expressed in both Canada and Mexico that a comprehensive agreement with a much larger power could, if not checked, overwhelm their ability to act independently.

Consequently there was no contemplation that the organisational structure of NAFTA would be an evolving one[10], one that could grow toward integrated, supranational structures similar to the European Union and its supranational institutions. Indeed, the negotiators seemed to wish to avoid the creation of institutions or mechanisms similar to the European Communities. The

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9Whalley and Hamilton, "The Intellectual Underpinnings of North American Integration", (1995), 63-64.

negotiators never even really considered the European Communities' experience as a potential model for the creation of a North American trade bloc. It probably never fully entered their discussions that they were creating a regional economic integration system, which could, at least on an economic theory and even political theory hypothesis, be the first step on the continuum where a common market is the fourth (as discussed in the first chapter dealing with the theory behind economic integration). NAFTA is an example of the first stage of Balassa's theory of economic integration, whereas the European Union has undergone the first four stages in its process of development and is striving to achieve the completion of the fifth stage.[11] It can be argued that the European Union has or will reach the fifth stage once the Euro is released in currency form in 2002.

Instead of relying on the European Communities for examples, the negotiators of CUSFTA and NAFTA seemed to draw their inspiration from the GATT. The current WTO dispute settlement system under the Uruguay Round on negotiations had not yet been finalised and as a result both the CUSFTA and NAFTA were modelled on the old GATT system of trade dispute settlement. The objective of NAFTA was basically only to facilitate the movement of goods and services in lowering the barriers to trade, objectives very much in step with the objectives of GATT and the WTO. The end objective of NAFTA was the increase in the economic welfare of the three Member States, while the objective of the European Communities was the overall welfare and stability of the Member States, and economic welfare was but one part of that goal.

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[10]Lopez "Dispute Resolution Under MERCOSUR from 1991 to 1996" 13.
[11]Frank C. Garcia "NAFTA & the Creation of the FTAA: A Critique of Piecemeal Accession" (1995) *35 Va. J. Int'l*

The NAFTA institutions are limited, and operate largely as a forum for consultation and consensus-based co-operation as neither of the two main institutions, the Free Trade Commission nor the Secretariat, has decision-making powers capable of making binding decisions.[12] Nor does the NAFTA create a common external policy. Dispute settlement is largely an intergovernmental process, and with narrow exceptions the actual implementation of panel recommendations is a matter to be agreed upon by political decision-makers. The United States Congress and Canada do not allow selfexecuting effect for the NAFTA, while Mexico is the only member to directly incorporate NAFTA into its national law.[13]

INSTITUTIONS

Free Trade Commission (FTC).

There is no overarching NAFTA institution to oversee all aspects of the agreement. The only institution that comes close is the Free Trade Commission created under Chapter 20. The Free Trade Commission has the ultimate institutional authority over matters within the Agreement, but has no power over the governance or interpretation of either the Environmental or Labour side agreements of their respective commissions.[14] There are no provisions that allow the Free Trade Commission to overturn or trump the decisions of the Environment or Labour Commissions. None of the NAFTA institutions has the authority to negotiate and sign

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L. 539, footnote 6.
[12]Andreas R. Ziegler, " International Institutions and Economic Integration: Are International Institutions Doing Their Job?" (1996) 90 Am. Soc'y Int'l L. Proc. 508, 509.
[13]*Ibid.* 509.
14 Lopez, "Dispute Resolution Under MERCOSUR", 13

international agreements with non-NAFTA countries and groups in a way that the Commission and the Council of Ministers are allowed in the European Communities.

The Free Trade Commission does not have general powers to issue legislative rules binding on the member states of NAFTA[15] in a manner that the Commission in the European Communities is allowed to pass binding primary and secondary legislation enforceable against the member states of the European Communities. The FTC is considered to have a hybrid nature by some trade law academics and practitioners.[16] The hybrid nature stems from the observation that the FTC is run by ministerial level representatives of the Parties to the NAFTA giving the institution a political nature as well as an administrative character given the fact that the FTC has the primary role of administering the NAFTA agreement.[17] At the same time, the FTC has a dispute settlement capability under Article 2001 of NAFTA.[18] If a dispute arises out of the interpretation of the agreement the Parties have to bring the dispute first to the FTC and if the dispute is not resolved at that point an arbitration panel is established.

The FTC is, however, authorised to "supervise the implementation of the agreement and to oversee the work of the committees and working groups established under the agreement."[19]The

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15Andreas R Ziegler " International Institutions and Economic Integration" (1996)
16Vilaysoun Loungnarath and Celine Sthely, "The General Dispute Settlement Mechanism in the North American Free Trade Agreement and the World Trade Organization System: Is North American Regionalism Really Preferable to Multilateralism?" (2000) Journal of World Trade 34(1), 39, 44.
17*Ibid.*, 44.
18*Ibid.*, 44.
19Cherie O'Neal Taylor, "Institutions for International Economic Integration: Dispute Resolution as a Catalyst for Economic Integration and an Agent for Deepening Integration: NAFTA and MERCOSUR?", (1996) 17 J. INTL. L. BUS. 850, 855-856.

FTC decisions are taken by consensus of the three Member States of NAFTA[20]. Consequently, the FTC is more of an international or intergovernmental body than a supranational institution. The FTC therefore does not have the same type of mandate as the European Commission to act in the best interest of the Community as a whole. Rather the decisions of the FTC would be determined more by the power politics between the Member States in the process of international type negotiations.

NAFTA Secretariat

Decentralised National Section offices of the NAFTA Secretariat were also created under Chapter 20 of the Agreement. Each of the three Member States is responsible for funding each of the National Section offices[21] and are assigned the task of administrating the Agreement in their respective Member States. This makes for a decentralised administrative process.

DISPUTE SETTLEMENT PROVISIONS

The Canada-United States Free Trade Agreement established two separate dispute settlement mechanisms under Chapters 18 and 19. The North American Free Trade Agreement has incorporated these dispute settlement mechanisms and also expanded on them by including a separate chapter on investments under Chapter 11 of NAFTA. While Chapter 11 deals with investment issues, Chapter 19 deals with anti-dumping and countervailing duties and Chapter 20 with institutional and treaty wide issues. (Chapter 19 of NAFTA is modelled on Chapter 19 of

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20Sidney Picker, Jr., Symposium: "NAFTA and the Expansion of Free Trade: Current Issues and Future Prospects: Article: NAFTA Chapter Twenty -- Reflections on Party-to-Party Dispute Resolution", (1997) 14 *Ariz. J. Int'l & Comp. Law* 465, 467.

CUSFTA while Chapter 20 is modelled on the CUSFTA Chapter 18).

Each of the dispute settlement chapters is different in its approach to the adjudication of disputes. The main characteristic that they share, however, is the emphasis on negotiations as the first and often primary tool in resolving disputes. The United States was wary about giving up too much sovereignty to non-national adjudication panels. Even though Canada originally proposed to have more powerful adjudicative central CUSFTA bodies, Canada had to moderate its stance in the negotiations.[22] Canada had hoped to use more permanent dispute resolution mechanisms to counter the protectionist attitude of the United States and to make the process more neutral and less likely to be influenced by the political might of the United States. Even thus, many academics have seen the resulting institutional structures as violating the constitution of the United States and giving adjudicative powers to international institutions which they view as being the right of United States domestic courts.

In fact, the three main dispute settlement mechanisms of NAFTA remain more international than supranational. The three mechanisms are more in step with the WTO dispute resolution mechanisms (especially the new WTO dispute resolution mechanism created after the signing of CUSFTA) than with the European Court of Justice. Indeed, for at least Chapter 18 of the CUSFTA, the General Agreement of Tariffs and Trade (GATT) 1947 dispute resolution mechanism served as a model. Therefore, the influence of the GATT and the Uruguay Round,

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21Lopez "Dispute Resolution Under MERCOSUR", 13.

22 Loungnarath and Sthely, "The General Dispute Settlement Mechanism in the North American Free Trade

which led to the creation of the World Trade Organisation (WTO) dispute resolution mechanisms, is evident in Chapter 20 provisions of NAFTA.[23] Only the three Member States can bring a dispute for resolution under NAFTA Chapter 20 provisions[24] that are based on the original CUSFTA Chapter 18 provisions.

Chapter 20

Like any of the other NAFTA dispute resolution mechanisms, Chapter 20's main emphasis is on negotiated settlements rather than adjudicated settlements. The United States in particular wanted to avoid a supranational institution[25]capable of making decisions that are effective and binding on Member States. As a result, Chapter 20 arbitral panel decisions are not directly effective on the domestic laws or agencies of the Member States.[26] Whenever a dispute arises under NAFTA provisions that the GATT rules also apply to, the disputing party has the option to either commence the action under NAFTA provisions or to do so under GATT rules.[27]

The Chapter 20 dispute resolution mechanisms apply in cases where one of the Parties accuses another Member State of acting or in planning to act in a manner inconsistent with the NAFTA Agreement.[28] In this way the Chapter 20 provisions seem similar to the provision of Article 227

Agreement and the World Trade Organization System", 41.
23*Ibid.*, 39, 41.
24Picker, Jr., "NAFTA and the Expansion of Free Trade:", 466.
25 Loungnarath and Stehly, "The General Dispute Settlement Mechanism in the North American Free Trade Agreement and the World Trade Organization System" 39,43.
26*Ibid.*, 39,43.
27B. Appelton, B. *Navigating NAFTA: a concise user's guide to the North American Free Trade Agreement*, (Scarborough: Carswell, 1994), 145.
28 Article 2004 of NAFTA: Except for the matters covered in Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters) and as otherwise provided in this Agreement, the dispute settlement provisions of this Chapter shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement or wherever a Party considers that an actual or

of the Treaty of Amsterdam (former Article 170) that allows a Member State to raise a complaint to the European Communities' Commission that another Member State is violating one of its Treaty obligations and acting in a manner inconsistent with the Treaty.[29] Like the European Article 227, Chapter 20 has been used in infrequently. Between the inception of the NAFTA agreement in 1992 and February 1999 around 12 conflicts had arisen under Chapter 20, but only three of those disputes had actually reached the arbitral panel stage[30] while only five cases had arisen under the corresponding Chapter 18 of CUSFTA[31].

A Member State may have access to dispute settlement provisions under Chapter 20 if it "considers that any benefit it could reasonably have expected to accrue to it under any provision of" the automotive and energy sectors of the Agreement as well as and benefits accruing from the technical barriers to trade, services and intellectual property sectors of the Agreement have been impaired.[32] However, before accessing the dispute panel, the Parties have to engage in a process of negotiations. If the negotiations under the auspices of the Free Trade Commission fail to resolve the dispute, the complaining Party may request the Commission to establish a non-binding dispute panel.[33]

The five panelists are chosen from a roster of national nominees by a process of reverse

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proposed measure of another Party is or would be inconsistent with the obligations of this Agreement or cause nullification or impairment in the sense of Annex 2004.

29The European Treaty of Amsterdam Article 227 has been used very infrequently and so too have the provisions of Chapter Twenty of the NAFTA, at least in comparison to the provisions under Chapter Nineteen of NAFTA.

30Isidoro, Morales, I. (1999) NAFTA: The Governance of Economic Openness", 44.

31Picker, Jr., "NAFTA and the Expansion of Free Trade", 466.

32Annex 2004: Nullification and Impairment, North American Free Trade Agreement

nomination. Reverse nomination requires each of the two disputing Parties to choose two panelists who are nationals of the opposing Party. If the dispute involves the three Member States then the defending Party chooses a panelist from each of the complaining parties.[34] The Panelists do not have to be judges or of equal stature, but must be experts in law, international trade law, areas of law covered by the NAFTA Agreement or be experts in the resolution of international disputes.[35]

Even if not a party to the dispute, a third Party can make and receive submissions from the dispute panel, however, they do not receive a copy of the initial report released by the panel.[36]The initial report is not made public in the manner that the final report is. If the Parties do not agree with the initial report, they can make further submissions to the dispute panel. In a sense, the final report can be thought of as an appeal process. If the Parties agree with the initial ruling, then usually most of the recommendations are finalised in the final report.[37] The final report is non-appealable. The disputing parties have to give the dispute panel report to the Free Trade Commission and each Party may give its opinion on the ruling with the submission of the report.[38] If the two Parties agree to the Final Report, then the defending Party must implement the recommendations of the Report. If the defending Party does not implement the ruling of the Report, the complaining Party may retaliate against the offending Party by withdrawing NAFTA benefits equivalent to the harm to the complaining Party.[39]

33Picker, Jr., "NAFTA and the Expansion of Free Trade", 468.
34Appelton, *Navigating NAFTA*, 148.
35*Ibid.*, 148.
36 Picker, Jr., "NAFTA and the Expansion of Free Trade":, 468.
37*Ibid.*, 474.
38*Ibid.*, 474.
39These retaliatory actions can only be reviewed by another dispute panel if the actions are considered excessive.

The Final Reports are non-definitive in nature. The Final Report of the dispute panel may not be the definitive stage of the dispute settlement process under Chapter 20, as the Final Report can be renegotiated between the Parties.[40] If the Parties reach a negotiated settlement different from the Final Reports determination then the Parties may ignore the Final Ruling and implement the terms of their negotiated settlement. Consequently, the Parties can effectively ignore the arbitration process and effectively go outside the law. Thus power politics and the imbalance in power between the disputing Parties can play a big part in the final resolution of the dispute and leave the Chapter 20 institutional provisions quite meaningless. In the end, it is quite the old system of might winning over legality.

This is perhaps the most crucial difference between a dispute settlement procedure and a legal system. Within a dispute settlement mechanism, the parties are able to reach an agreement that may be contrary to the Treaty – we will let you violate this provision if you let us commit some other violation. In a legal system, such as the European Community, that is not possible.

Chapter 19

The Chapter 19 provisions of NAFTA are based on the earlier Chapter 19 provisions of the Canada- United States Free Trade Agreement. The chapter deals with anti-dumping and countervailing duty reviews. Unlike Chapter 20, this chapter is not the initial procedure but

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Appelton, *Navigating NAFTA*, 148.
40*Ibid.*, 149.

rather a review of decisions made by domestic tribunals. The chapter does nothing to harmonise the anti-dumping and countervailing duty laws of the three Member States of NAFTA. Thus Canada, the United States and Mexico retain their own laws and different standards of judicial review of the national trade tribunals. This makes for a lot of complications, especially when the review is of Mexican tribunal decisions, as Mexico is the only civil law rather than common law country[41]. Under the former CUSFTA, the standards of review of Canada and the United States were quite similar and provided little difficulty to the CUSFTA panels to apply the correct standard of review. Also, the Mexican procedures are not as well articulated or worked out and have been implemented only recently. What the provisions of Chapter 19 do is take away the judicial review process from the domestic courts of the Member States. Thus individual enterprises have no rights to appeal Chapter 19 decisions to domestic courts.

The United States rejected, in the earlier CUSFTA negotiation, Canada's proposal of harmonising their anti-dumping and countervailing duty laws. Chapter 19 of the CUSFTA was in response to the many trade-related disputes between Canada and the United States in the 1980s.[42] The main disputes had been about the definition of what constituted a state subsidy to businesses. As mentioned earlier, the Canadian federal government often used a policy of subsidies as part of their equalisation program to help less prosperous regions of the country. Neither Canada nor the United States could accept the other's definition of what constituted a subsidy, so they agreed to have a special bi-national panel review of national countervailing and

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[41]Kenneth Pippin, "An Examination of the Developments in Chapter 19 Antidumping Decisions Under the North American Free Trade Agreement (NAFTA): The Implications and Suggestions for Reform for the Next Century Based on the Experience of NAFTA After the First Five Years", (1999) *21 Mich. J. Int'l L.* 101, 103.
42Appelton, *Navigating NAFTA*, 135; Avi Gesser, "Why NAFTA violates the Canadian Constitution", (1998) 27

antidumping duty determinations. The Panels would apply the domestic law of the tribunal's decision being challenged but would do so in strict accordance with a timetable.[43] These CUSFTA measures were supposed to be temporary as a final and more comprehensive agreement was to be worked out later. This, however, never happened.

Thus these temporary provisions were carried forward and incorporated with minor modifications in Chapter 19 of the NAFTA. The NAFTA does not require the harmonisation of the domestic subsidies and antidumping laws of the Member States. The Member States are, subject to minimum standards, allowed to impose their own laws and procedures. The only provisions for even some central control over domestic laws is the provisions under Article 1902(2)(b) which requires the Member State to notify the other members of the NAFTA before making any changes to their domestic trade laws.[44]

Chapter 19, however, has had more cases brought before the panel review procedures than Chapter 20[45]. Indeed, the Chapter 19 review process is the most utilised of the dispute resolution sections of the NAFTA.[46] One of the reasons for the greater usage of the Chapter 19 process is

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Denv. Int'l L & Pol. 121.

43Appelton, Navigating NAFTA, 135.

44There is a more general notification obligation under Chapter 18. *Ib*, 136.

45There were a total of 42 antidumping binational panels initiated under Chapter 19 of NAFTA and 20 decisions issued from the inception of the Agreement until September 1, 1999. Kenneth Pippin, "An Examination of the Developments in Chapter 19 Antidumping Decisions Under the North American Free Trade Agreement (NAFTA): The Implications and Suggestions for Reform for the Next Century Based on the Experience of NAFTA After the First Five Years", (1999) 21 Mich. J. Int'l L. 101, 102.

46From NAFTA's inception in 1992 until September 1, 1999, 42 disputes had tested the provisions under Chapter 19, nine of which had been eventually terminated by the Parties while thirteen cases remained active. See Pippin, "An Examination of the Developments in Chapter 19." (1999), 111. For slightly different statistics see William D.

the fact that an individual or private party can instigate the Panel review even though a private party does not have direct access to the process. Article 1904(5) specifies that Member States must request a review if one of their nationals so desires,[47] thus, enabling a private party to initiate the review process and allowing a private party to at least indirectly rely on the NAFTA treaty provision.

The panel is composed of five members who are chosen from an established roster that has been submitted by the Member States. There is no requirement that the panel members be domestic judges, rather the NAFTA requires that the panelists be of "good character, have sound judgement and be familiar with international trade law".[48] Each Party chooses two of the panelists and the fifth panelist is chosen by consensus. Once all of the panelists have been chosen, the chair is chosen by the panel, with the only requirement that the chair be a lawyer.[49]

The Panel reviews the importing country's domestic agency's or tribunal's decisions as if the Panel was an appellate court of that country. The Panel thus decides whether the domestic agency made the final determination in accordance with the antidumping laws of the importing Party.[50] Consequently the standard of review is different depending on which of the Parties to the NAFTA was the importing country whose agency's decision is under scrutiny. Also, each of the three countries retains its own definition of what "dumping" means. In Canada, "dumping" is

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Merritt, "A Practical Guide to Dispute Resolution Under the North American Free Trade Agreement" (1999) 5 *NAFTA: L. & Bus. Rev. Am.* 169, 173

47Noemi Gal-Or, "Private Party Direct Access: A Comparison of the NAFTA and EU Disciplines" (1998) 21 B.C. Int'l & Comp. L. Rev. 1, 31.

48Appelton, *Navigating NAFTA*, 137; NAFTA annex 1901.2(1).

49*Ibid.*, 137; NAFTA annex 1901.2(1).

50. Pippin, "An Examination of the Developments in Chapter 19", 105

defined as exporting goods to Canada at less than the value of the goods in the exporting country.[51] In the U.S., "dumping" is said to have occurred when the imported goods are sold at less than the fair market value. Mexico has now adopted the GATT antidumping code, as its own dumping laws were very unclear and underdeveloped.[52]The lack of a common definition of what constitutes dumping makes it harder for the NAFTA panel to acquire a consistent body of decisions or precedents when the definitions as well as the standards of review are different depending on which of the three countries is the importing Party.

Canada's standard of review is found in subsection 18.14 of the Canadian Federal Court Act. The section sets out the grounds for review of the Canadian International Trade Tribunal (CITT) to be followed if the CITT failed to observe a principle of natural justice, erred in law when making its decision or based its decision on an erroneous finding of fact.[53] The American standard of review is determined by whether of not the domestic agency's determination was "unsupported by substantial evidence on the record, or otherwise not in accordance with law".[54] The Mexican standard of review is found in Article 238 of the Código Fiscal de la Federación or

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51 *Ibid.*, 105

52 *Ibid.*, 109.

53 Appelton, *Navigating NAFTA*, 138. ;A more detailed standard of review is the following: The agency's determination can be reviewed if it:

" a) acted without jurisdiction, acted beyond its jurisdiction or refused to exercise its jurisdiction;
b) failed to observe a principle of natural justice, procedural fairness or other procedure that it was required by law to observe;
c) erred in law in making a decision or an order, whether or not the error appears on the face of the record;
d) based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it;
e) acted, or failed to act, by reason of fraud or perjured evidence; or
f) acted in any other way that was contrary to law

Pippin, "An Examination of the Developments in Chapter 19", 108.

54 Pippin, "An Examination of the Developments in Chapter 19", , 109.

any successor statutes.[55]

Even though de jure there is no binding precedential value of the previous Chapter 19 antidumping panel decisions, there is an unofficial one that is gradually developing. Panels often cite previous decisions and attempt to distinguish agree with or "emphasise their total disregard of previous panel decisions very much like a common law court".[56]The NAFTA states that the antidumping panel decisions are only to be binding on the parties that are involved in the dispute under review. Most of the panels try to follow the reasoning of previous panels in determining what standard of review to apply. For instance in *Corrosion Resistant Steel*[57], the panel relied on three previous decisions to come to a final decision.[58]

The panel's decision can be overturned when the determination has put the integrity of the panel into question under the Extraordinary Challenge Committee (ECC), however, it is not meant to be an appeal process.[59] The determination can be reviewed by the Extraordinary Challenge Committee only if:

55Appelton, *Navigating NAFTA*, 138.; Article 238 of the Código Fiscal de la Federación states that: "An administrative determination shall be declared illegal when one of the following grounds is established:
I. Lack of jurisdiction or authority of the agency or official issuing the challenged determination or ordering, initiating or carrying out the proceeding in which the challenged determination was issued.
II. An omission of formal legal requirements by the agency or official issuing the challenged determination which affects the person's right of proper defense .... or a failure of the agency or official to provide a reasoned determination based upon the record.
III. A violation or defect of procedure by the agency or official issuing the challenged determination, which affects the person's right of proper defense as well as the scope or meaning of the challenged determination.
IV. I f the facts which underlie the challenged determination do not exist, are different from the facts cited by an agency, or were considered by the agency in an erroneous way; if the challenged determination was issued by the agency in violation of the applicable laws or rules or if the correct laws or rules were not applied by the agency.
V. Whenever a discretionary determination by an agency falls outside the lawful scope of the discretion.
See Kenneth J. Pippin, "An Examination of the Developments in Chapter 19...."101, 110.

56Pippin, "An Examination of the Developments in Chapter 19.", 117.

57*Certain Corrosion-Resistant Steel Sheet Products, Originating in or Exported from the United States of America*, CDA-9401904-04, at 8 (June 23, 1995)

58 Pippin, "An Examination of the Developments in Chapter 19.", 118.

59This is similar to the Chapter 19 provisions of the Canada - United States Free Trade Agreement which also

a)there is an allegation of gross misconduct by the panel;
b)the panel seriously departed from a fundamental rule of procedure;or
c)the panel manifestly exceeded its powers, authority or jurisdiction such as failing to apply the appropriate standard of review.[60]

Consequently the Extraordinary Challenge process can only be used when the panel's determination is materially affected by improper action. Individuals cannot request the review, only Member States as Parties can seek the challenge. The Extraordinary Challenge Committee can dismiss the challenge, vacate the original panel proceeding and/or constitute a new panel.[61]

Chapter 11

The main function of Chapter 11, NAFTA's investment chapter, is to establish common rules for the treatment of investments in NAFTA Member States by other NAFTA investors. It also liberalises the investment laws that existed at the time of the Agreement and provides for the creation of a mechanism to resolve investment disputes.[62] Chapter 11 is the only one of the NAFTA dispute resolution mechanisms that allows for direct private party access. Under Chapter 11 provisions an individual investor can directly request arbitration against the government of another NAFTA country. Only investors from the three Member States can request relief under this chapter[63].

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provided for a review of the panel's decision if the integrity of the process came into question.
60Appelton, *Navigating NAFTA*, 140.
61*Ibid.*, 140.
62*Ibid.*., 79.
63In order for a company to be considered a national of one of the three NAFTA countries, it must be incorporated in one of them and must be controlled by NAFTA investors and carry on substantial business activity in the member country of incorporation. See Horacio A. Grigera Naon, "Sovereignty & Regionalism" (1996) 27 *Law & Pol'y Int'l*

Before an investor can submit a claim for arbitration, the disputing party must first attempt to settle the issue through negotiation or consultation.[64] The need for consultation and negotiation is a common thread running throughout the NAFTA. The emphasis of the Agreement is clearly negotiations versus adjudication. Indeed, the drafters of NAFTA deliberately refrained from including formal adjudication as a dispute resolution mechanism.[65] It seems as if the negotiators deliberately created a system of state-to-state obligations, with only Chapter 11 giving direct access to private or individual investors to arbitration.

Section B of Chapter 11 sets out the causes of action between a Party and an investor of another Party. A cause of action against a Party will arise when the host government fails "to accord an investor national treatment with respect to the establishment, expansion, management, conduct, operation, and sale or other disposition of investments"[66]. Also, a cause of action will further arise where the host government fails to accord an investor most-favoured-nation treatment or to give the investor the better of national treatment or most-favoured-nation treatment.[67]

While Chapter 11 seems to create a new dispute resolution mechanism, it merely provides that a dispute arising out of trade-related investment measures and issues arising out of Articles 1502 and 1503, concerning state monopolies and government-owned enterprises, must be regulated by

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Bus. 1073, 1155.

64Article 1118: Settlement of a Claim through Consultation and Negotiation, North American Free Trade Agreement Between the Government of Canada, The Government of the United Mexican States and the Government of the United States of America, 1992, 211.

65Noemi Gal-Or, "Private Party Direct Access: A Comparison of the NAFTA and the EU Disciplines", (1998) 21 *B.C. Int'l & Comp. L. Rev.* 1,19.

66*Ibid.*, 1,27.

67*Ibid.*, 1,27. Other causes of action are failure by the host government to accord a foreign investor a minimum standard of treatment under international law; imposition by the host government of specific performance requirements or requiring that senior management be of a particular nationality or of noncomplying expropriation

arbitrage.[68] The dispute will be either regulated under the rules of the World Bank's International Center for the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law Arbitration Rules (UNCITRAL).[69] Under these rules there are potentially three ways that an investor could get before the ad hoc binding arbitration panel.

Firstly, if the investor's country and the host country are both parties to the ICSID Convention, then the ICSID rule will be applied. Secondly if only one of the country's is a signatory to the ICSID Convention, then the ISCID Additional Rules can be applied or thirdly the UNCITRAL rules will be utilised if neither country is a member of the ICSID convention.[70] However, the United States is the only signatory of the ISCID Convention and therefore ISCID rules cannot be applied under the present circumstances. While a dispute involving the United States government allows for the choice between ISCID Additional Rules or UNCITRAL rules, there is no choice when the dispute is between Canada and Mexico. In a dispute between Canada and Mexico only UNCITRAL rule may be applied.

LIMITED ACCESS BY INDIVIDUALS

One of the main features of the NAFTA Agreement that does not bode well for the evolution of the dispute resolution structure is the fact that an individual has such limited access to it. Only in

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of investments by host government.
68Morales, "NAFTA: The Governance of Economic Openess"47-49.
69*Ibid.*
[70]Noemi Gal-Or, "Private Party Direct Access", 1, 30.

Chapter 11 does an individual investor of one of the Member States have direct access to the dispute settlement mechanisms. Even then, the individual investor has access to an arbitration panel that is conducted within International trade rules. There is no real precedential value to the decisions. Under Chapter 20, individuals of the Member States have to lobby their respective governments to support their dispute.[71] Because individual access is usually quite indirect or limited, the number of cases being brought forward will be considerably lower than if individuals could rely directly on the Treaty before national courts or even before a NAFTA created court or permanent arbitration panel. As the European experience has demonstrated, an institution such as the European Court of Justice gains greater supranational power when individuals are able to rely on the Treaty and the subordinate legislation directly before national courts and the ECJ.

CONCLUSION

The North American Free Trade Area Agreement is an international treaty that establishes a free trade area that goes beyond the Bela Balassa model of a free trade area. Though it is not a customs union, it does address the elimination of non-tariff barriers to trade and also attempts to eliminate discrimination in the area of investments. It thus does not attempt to establish a legal system, similar to the one in the European Communities, but instead merely creates a dispute settlement mechanism.

Because the Treaty merely creates a dispute resolution mechanism, the member states can

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71Gal-Or, "Private Party Direct Access: A Comparison of the NAFTA and the EU Disciplines", 33

contract and conclude agreements on the side that contravene not only the spirit of the Treaty but the Treaty provisions. This is one of the main differences from a legal system, as under a legal system, the member states or the contracting parties would not be able to contract out of the minimum Treaty requirements. As it is more like any other international treaty and has not taken on any constitutional like status, the provisions of the Treaty do not have supremacy over the national laws of the member states nor are most of the provisions directly effective[72].

72 Though one could consider the Chapter 11 arbitration provisions to be directly effective in at least a limited sense as the investors of the member states can hold the host government liable for discriminatory legislation.

CHAPTER FIVE

LATIN AMERICAN ECONOMIC INTEGRATION AND MERCOSUR

INTRODUCTION

MERCOSUR, or the Common Market of the South, is arguably the most successful of the Latin American attempts at economic integration. Trade among the member states has increased quite dramatically since the inception of the Treaty of Asuncion in 1991, which called for the creation of a free-trade zone and the eventual creation of a common market similar to the European Community.[1] In order to understand the relative success of MERCOSUR, it is important to comprehend the history of integrationist attempts in Latin America as a whole.

HISTORY OF LATIN AMERICAN INTEGRATION

The history of Latin American integration has been a very tumultuous and difficult process, even more so than the European experience. One of the first attempts at integrating Latin America on a political basis occurred in the early nineteenth century under Simon Bolivar as part of an attempt by the Spanish colonies to gain independence.[2] The attempt by Bolivar to establish a confederation of Spanish American states never succeeded, but it did leave a lasting impression in the minds of Latin American leaders. It wasn't until after the end of the Second World War,

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[1]Mark B. Baker, "Integration of the Americas: A Latin Renaissance or a Prescription for Disaster?" (1997) 11 *Temp. Int'l & Comp. L.J.* 309, 319.

[2]*Ibid.*, 313.

that the Latin American states again considered integration[3]. This time, however, the emphasis was on economic rather than political integration.

Post World War II

The Latin American movement toward economic integration post-World War II, began virtually at the same time that the Europeans were developing the European Communities under the auspices of the Treaties of Rome. The Latin American Free Trade Association (LAFTA) was created in 1960 by the Treaty of Montevideo to which Argentina,, Brazil, Chile, Paraguay, Peru, Uruguay and Mexico were signatories.[4] The Latin Americans were clearly inspired by the founders of the EEC in their attempt to promote economic development after the Second World War.[5] Other sub-regional trade agreements were also created virtually at the same time, such as the Central American Common Market (CACM) in 1960, the Andean Pact in 1969 and the Caribbean Community (CARICOM) in 1973.[6]

While the Latin Americans were following the European lead in creating regional trading blocs, the ideals behind the Latin American arrangements were quite different from the underlying goals of the EEC. The Latin American arrangements were based on the policy of import substitution on a regional basis. "They asserted that larger regional markets would engender economies of scale and provide industries with a training ground to gain the competitiveness

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[3] *Ibid.* 315-316..

[4] *Ibid.*), 11 Temp. Int'l & Comp. L.J. 309, 316; Kenneth W. Abbott & Gregory W. Bowman, "Economic Integration in the Americas: 'A Work in Progress'", (1994), 14 *Nw. J. Int'l L. & Bus* 493, 497.

[5] Abbott & Bowman, "Economic Integration in the Americas": 497.

needed for later success in world markets".[7] However, these attempts were not successful. In part these early attempts by the Latin Americans were not successful because of their protectionist nature. The policy of import substitution caused trade diversion, which in turn reduced the benefits of creating regional trading arrangements. Also, the diversity and varying levels of economic development and competing political goals of the different Latin American states, which often had very unstable governments, lead to very weak regional trading blocs.[8] The weakness of the movement toward integration was further heightened by the rise of totalitarian regimes in the South American countries.

More Recent Attempts At Economic Integration

LAFTA was never really successful in encouraging and developing the necessary environment for the creation of institutional bodies capable of fostering economic integration in Latin America. In 1980, the Latin American Integration Association, called ALADI[9] according to the Spanish acronym, was signed by the eleven members of LAFTA as a replacement for LAFTA[10]. ALADI is the "umbrella" association for Latin American economic integration.[11] Unlike LAFTA, ALADI does not try to establish a short time line for economic integration; rather it simply enunciates the long-term goal of "the gradual and progressive formation of a Latin

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[6]Baker, "Integration of the Americas", p. 317; Jason R. Wolff, "Putting the Cart Before the Horse: Assessing Opportunities for Regional Integration in Latin American and the Caribbean" (1996), *20-SPG Fletcher F. World Aff.* 103, 106.

[7]Wolff, "Putting the Cart Before the Horse", p.106.

[8]*Ibid.*", 107.

[9]ALADI is also referred to in certain literature as LAIA according to its English acronym.

[10]The original 7 members were later joined by Columbia, Ecuador, Venezuela and Bolivia. Frank J. Garcia "'Americas Agreements'--An Interim Stage in Building the Free Trade Area of the Americas", (1997) *35 Colum. J. Transnat'l L.* 63, 81; Abbott & Bowman, "Economic Integration in the Americas", 497.

[11]Garcia, "Americas Agreements", 81

American common market".[12]ALADI is not itself a regional trading bloc, but rather an arrangement or system under which the current trading blocs such as MERCOSUR and the Andean Group have been negotiated. Sub-regional arrangements such as MERCOSUR are allowed just as long as the membership in the sub-regional agreement is open to all ALADI members and the sub-regional trading bloc stimulates further convergence and negotiation for creating new common markets.[13]

Since the early nineties, there has been a renewed interest in economic integration by the Latin American states. This time, however, the emphasis is on export-oriented policies in contrast to the import substitution regimes favoured by the area in the 1960s and 1970s.[14] There has also been a decrease in government control in the economy through deregulation and privatisation as well as the loosening of foreign currency and exchange restrictions. Currently, there is one free trade area[15] the Group of 3 (G-3) which is composed of Mexico, Colombia and Venezuela.[16] The members of the G-3 envision their agreement to potentially serve as a basis for integration with NAFTA. The rest of the sub-regional blocs either aim at creating customs unions or common markets. The agreements are the following: MERCOSUR, the Andean Common

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[12] Abbott & Bowman, "Economic Integration in the Americas", p. 497; Lia Valls Pereira, "Toward the Common Market of the South: MERCOSUR's Origins, Evolution, and Challenges" in R. Roett, ed *MERCOSUR: Regional Integration, World Markets*, (London: Lynne Rienner, 1999) 8. LAFTA was created in 1960 with the view of forming a free trade area within 12 years.

[13] Abbott & Bowman, "Economic Integration in the Americas", .498.

[14] Wolff, "Putting the Cart Before the Horse", 113.

[15] This does not include the numerous free trade arrangements between individual countries and trading blocs on bilateral levels.

[16] Garcia, "'Americas Agreements'--An Interim Stage in Building the Free Trade Area of the Americas", 74.

Market (ANCOM), the Central American Common Market (CACM) and the Caribbean Common Market (CARICOM)[17].

MERCOSUR

The four members of MERCOSUR, Argentina, Brazil, Paraguay and Uruguay were, as Brazilian Ambassador to Argentina, Marcos Castrioto de Azambuja, pointed out, able to take advantage of four important and fundamental coinciding conditions to create MERCOSUR in 1991. The four countries had achieved these conditions virtually at the same time. Firstly, each of the countries had established "profound and stable democratic regimes". Secondly, there was a growing recognition that the original trade policies of import substitution were no longer applicable or workable. Thirdly, broad and rational macroeconomic policies had been adopted by the four Member States. And lastly, there was an increasing realisation that in order to prosper in the new global environment the economies had to become more open and competitive.[18]

Creation of Mercosur

Mercado Commun del Sur (MERCOSUR) or the Common Market of the South was created by the Treaty of Asuncion that was signed by the representatives of Argentina, Brazil, Uruguay and Paraguay in March 1991. The Treaty of Asuncion expanded on the earlier 1988 Treaty on

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[17]The members of MERCOSUR are Argentina, Brazil, Paraguay and Uruguay. The members of ANCOM are Columbia, Bolivia, Venezuela and Ecuador - Chile and Peru, who were originally members in 1969 are no longer members. The original members of CACM were El Salvador, Guatemala, Costa Rica, Nicaragua (which withdrew) and Honduras. There has been talk that the new CACM might merge with the G-3 FTA. The members of CARICOM are the 13 English speaking nations of the Caribbean basin. See Garcia "'Americas Agreements", 74-79.

Integration, Co-operation and Development that was negotiated and signed between Brazil and Argentina,[19]which had been negotiated under the ALADI framework. The idea at that time had been to create a common market between the two countries. The Presidents of the two countries in December of 1990 signed the ALADI Economic Complementation Accord No. 14 and agreed to form a common market called MERCOSUR.[20] Paraguay and Uruguay did not wish to be left out of the common market and joined the proceedings.[21] The Treaty of Asuncion was signed on March 24, 1991[22] adding Paraguay and Uruguay. The Treaty called for the creation of a customs union by 1995[23]

During the Asuncion Treaty negotiations, it became clear that a transition phase from 1991-1995 was needed in order to allow for the completion of an internal free trade area before the inception of a customs union in 1995. Each of the four countries had long lists of goods that would initially be excluded from the free trade list. For instance Brazil had insisted upon excluding more than 300 products and Argentina close to 400.[24] The Treaty, however, did call for the "coordinated, progressive automatic reductions of customs tariffs, the elimination of non-tariff barriers and other restrictions to trade"[25]. Each list of excluded items was to be reduced by ten per cent the first year and by twenty percent annually every year after that until the end of the

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[18]Andreas R. Ziegler, " International Institutions and Economic Integration", (1996) 90 *Am. Soc'y Int'l L. Proc.* 508, 514.

[19] Pereira, "Toward the Common Market of the South" 9.

20 Tate, "Sweeping Protectionism Under The Rug", 389.

21 *Ibid.*

22 *Ibid.*

[23]Pereira, "Toward the Common Market of the South", 9.

[24]*The Economist* ,August 24, 1991 World politics and current affairs section, U.K. Edition Pg. 45, International pg. 37 "The business of the American hemisphere" Uruguay had a super-inclusive list of 940 items. Tate, "Sweeping Protectionism Under the Rug", 396.

transition period to a common market. For the most part, most of these reduction schedules were followed so that by the time the Common External Tariff became operational on January 1, 1995, many of the intra-regional tariffs were eliminated.[26]

COMMON MARKET

The end of the transition period was marked by the Protocol of Ouro Preto, dated December 17, 1994. This heralded the implementation of the results of the negotiations between the four member states during the transition period.[27]The customs union that came into effect on January 1, 1995, was not a complete customs union as each of the countries had numerous goods they wished to have exempted from the common external tariff. The exceptions were in acknowledgement of "different productive structures of the member countries".[28]Even though each of the member countries were allowed to have numerous exceptions, close to 88 percent of goods on which tariffs were charged were included under the common external tariff at its inception.

INSTITUTIONS OF MERCOSUR

The institutions that were created by the Treaty of Asuncion and the subsequent protocols, of Brasilia and Ouro Preto, are not supranational in structure. The four institutions are the Council

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[25] Tate, "Sweeping Protectionism Under the Rug", 394.

[26]Ibid, 14. The full customs union is scheduled to come into effect in 2006. Also, there will not be full intra-regional free trade until 2001. Lia Valls Pereira "Toward the Common Market of the South", 12.

[27]Lia Valls Pereira, "Toward the Common Market of the South", 11.

of the Common Market, the Common Market Group, MERCOSUR Trade Commission and the Joint Parliamentary Commission.

The Council of the Common Market is the highest organ of MERCOSUR. It is composed of the Ministers of Foreign Affairs or the Minister of the Economy of each MERCOSUR member state. Its duty is to supervise the implementation of the Treaty of Asuncion and its protocols and associated agreements. The Decisions by the Council of the Common Market are supposed to be binding on the member states. The Common Market Group (CMG) is composed of the representatives of the Ministries of Foreign Affairs, the Economy and the Central Banks. The CMG drafts MERCOSUR decisions and then proposes them to the Council of the Common Market that then issues the decisions. This system seems to be very similar in nature to the European Community system where the Commission proposes and the Council decides. In a similar fashion the Common Market Group is allowed to negotiate on trade related issues with third countries or groups of countries within the limits set by the Council of the Common Market. The decisions of the Common Market Group, called resolutions, are also supposed to be binding on the member states of MERCOSUR.[29]

The MERCOSUR Trade Commission with the Common Market Group monitors the application of common trade policy by the Member States and it oversees complaints referred to it by the

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[28] Pereira. "Toward the Common Market of the South". 11.

[29] Cherie O'Neal Taylor, " Institutions for International economic Integration: Dispute Resolutions as a Catalyst for Economic Integration and an Agent for Deepening Integration: NAFTA and MERCOSUR? (1996/1997) *17 J. INTL. L. BUS.* 850, 869.

National Sections of the Commission that originate with the Member States or individuals.[30]By nature, the directives issued by the MERCOSUR Trade Commission are binding. The fourth institution, the Joint Parliamentary Commission, is established to co-ordinate the relationship between the other MERCOSUR institutions and the member state governments in an effort to "assist with the harmonisation of legislation, as required to advance the integration process."[31]

DISPUTE RESOLUTION

Method of Dispute Resolution

Disputes within MERCOSUR are to be settled according to an international arbitration process, preceded by consultation and mediation by the Common Market Group.[32] The dispute resolution has several stages that have to be gone through before the complainant's lawsuit reaches arbitration. The affected party may bring the action before its national section of the Common Market Group (GMG) that, with the help of a technical committee, must look at the merits of the dispute before passing it on to the arbitration tribunal. The arbitration tribunal is composed of three panel members. Two of the panel members are representatives from the two disputing countries while the third, is chosen from a third country not involved in the dispute. The tribunal's decision is final and does not allow for appeal, but "it cannot be enforced," said former Uruguayan Foreign Minister Sergio Abreu.[33]

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[30] *Ibid.*

[31] *Ibid.*

[32] Frank Garcia, "New Frontiers in International Trade: Decision making and Dispute Resolution if the Free Trade Area of the Americas: An Essay in Trade Governance" (1997) 18 Mich. J. Int'l L. 357, 380.

[33] LATIN AMERICA: INTEGRATION BODY FACING A CAUSTIC TEST Inter Press Service, December 11, 1996 by Raul Ronzoni Load date December 12, 1996.

Most resolutions of disputes between the Member states are resolved on a diplomatic and political level, usually at Presidential conferences. Even though the dispute resolution mechanism is in place, most of the Latin American countries prefer diplomatic solutions to adjudicated ones. However, as the Uruguayan Foreign Minister once said, the MERCOSUR arbitration system "is not the best instrument for giving government legal security." He explained, "[W]hat we need is a legal structure with jurisdiction above and beyond the will of individual governments, in order to ensure the rule of communalist law over national legislation."[34] However, there must be political will from the MERCOSUR members to acquiesce in the creation of a community legal system.

USE OF THE ARBITRAL PANEL

The use of the arbitration panel system by the MERCOSUR member states has been rare and until recently the arbtitral decisions were kept private. Negotiations are still the preferred method of resolving disputes. However, one of the few times that the dispute resolution mechanism was used was in 1998 by Argentina against Brazil. The Argentines launched the case in reaction to the Brazilian government's adoption of non-tariff barriers to trade. The measures that were adopted by Brazil appeared on their face to be neutral but in practice they delayed trade and discouraged imports by making them more expensive. The Brazilian measures imposed strict sanitary and phytosanitary controls for agricultural, chemical and pharmaceutical products. The vice-president and director of the Chamber of Argentine Exporters (CERA), Elvio

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[34] *Ibid.*.

Baldinelli, stated "We believe that the import licences and sanitary restrictions are not legal"[35]. The new licence was even stricter than the original licence requirements, which Brazil had promised to eliminate as soon as the Siscomex, the new computerised export system, was established[36]. The reason for the Brazilian behaviour was its attempt to reduce imports while raising exports in an attempt to better its financial position. The Brazilian current account deficit in 1998 amounted to 4.37 per cent of the GDP and the official prediction was that it would increase to 7.2 per cent by the end of the year[37]. The Brazilians unofficially commented that they agreed that it was time to begin to utilise MERCOSUR's arbitration court. A Brazilian diplomat is reported to have said, "After judging the first case, several others will be filled in. This is essential for the consolidation of MERCOSUR".[38]

STATUS OF MERCOSUR LEGISLATION

As mentioned during the discussion of the institutions, the decisions of the MERCOSUR institutions are supposed to be binding on the member states and when necessary are required to be incorporated into the national legislation of the member states.[39] The legislation or decisions by the MERCOSUR organs cannot be considered supranational in structure as the Protocol of

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[35]BBC Summary of World Broadcasts "Argentines resort to MERCOSUR controversy-solving mechanism against Brazil" Source Gazetta Mercantil, Rio De Janiero, in Portuguese 11 Nov 1998. Load date November 16, 1998. However, even though the Argentineans were willing to have the dispute resolved by the MERCOSUR Arbitration Court, they would have preferred to solve the dispute through bilateral negotiations.
Note: even though the BBC refers to it as the MERCOSUR Arbitration Court, it is really the arbitral panel that is being referred to.

[36]*Ibid.*.

[37]*Ibid.*.

[38]*Ibid.*

[39] O'Neal Taylor, "Institutions." 869.

Ouro Preto does not dictate how quickly the member states must incorporate them into their domestic legal systems. The Status of the Treaty of Asuncion and the Protocol of Ouro Preto are not constitutional like in any sense, as the member states have retained the ability to determine what the future structure of MERCOSUR will be.[40]

DISCUSSION

As pointed out by Roberto Bouzas, MERCOSUR has to expand and work on its institutional structure in order to progress smoothly in the future and be able to deal successfully with the expanding agenda between the MERCOSUR members. Bouzas comments that even though supranationality "is no substitute for weak political commitments and feeble interdependence" inter-governmental negotiations alone are not sufficient to deal with the ever increasing areas of potential dispute between the member states of MERCOSUR[41].

Although discussions have been held among and within the member states about the pros and cons of institutionalising intergovernmental bargaining and intra-regional interactions, no major initiative has been adopted in order to give MERCOSUR a permanent institutional framework. Rather, loose regulations and shallow institutions have been maintained at a relatively low

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[40]Cherie O'Neal Taylor points to Professor Joel Trachtman's definition that a "constitutional-like" treaty exists when it "provides for further legislation and adjudication" and does "more than simply create substantive rules for application, but creates a method, beyond mere intergovernmentalism, for creating substantive rules, either through legislation or adjudication". 870

[41]Robert Bouzas " MERCOSUR and Preferential Trade Liberalization in South America: Record, Issues and Prospects" in Richard G. Lipsey and Particio Meller eds. *Western Hemisphere Trade Integration: A Canadian-Latin American Dialogue*, (London: Macmillan Press Ltd., 1997), 89.

political cost.[42] While trade between the member states of MERCOSUR has increased, the current institutional structure is too weak to support the desired common market.

Then President of Uruguay, Mr. Sanguetti, echoed the sentiment of the Brazilians when he stated the following: "The issue of supranationality is not a subject I'd say could help build MERCOSUR because, otherwise, it would hinder this process. We are gradually reaching an institutionalization through negotiations, coordination and by seeking consensus." He continued by stating "We are trying to develop an institutionalisation that can solve conflicts promptly, which is why we feel that we need controversy-solving mechanisms. We have already witnessed some arbitration decisions on some important subjects. We all feel the need for heading towards a stronger institutionalization"[43]. At the same time there is a fear of over bureaucratisation and the institutions taking power away from the sovereignty of the member governments. It is felt that instead of helping with the integration of the member states, the talk of creating supranational institutions would be hurtful to the process because it would focus the debate on the loss of sovereignty by the member states in the area[44]

"MERCOSUR does not have the luxury to develop its architecture .... MERCOSUR has difficulty with setting up institutions with bureaucratic content. The political will does not seem to be there. The environment is contradictory to the 1950's institutionalise of Europe." So has said Marco Castrioto de Azambuja, the ambassador of Brazil to Argentina at one of the meetings

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[42] Riordan Roet editor, *MERCOSUR: Regional Integration, World Markets*, (London: Lynne Rienner Publishers, 1999), 40.

[43] BBC Summary of World Broadcasts December 10, 1999 Friday "Presidents end MERCOSUR summit in Montevideo with news conference" Load date December 9, 1999.

in 1996.-[45] Yet it has been Brazil that has often been the main antagonist to the idea of creating institutional bodies, such as a formal court. "While Argentina and Paraguay have already altered their constitution to allow the installation of such a tribunal, Brazil is continuing to obstruct the creation, since it is unwilling for a body to have power over the State," observed international law consultant Maristela Bassos.[46] These comments were made in 1996, just prior to the visit by Sepulvedoa Pertence, President of Brazil's Federal Supreme Court to the European Court of Justice in Luxembourg. Mr. Pertence stated that he believed that it was too soon to constitute a similar court in the MERCOSUR structure, as one should not rush to "transplant a sophisticated institutional model of the European community" which he said was the product of over forty years of integration47. What, he did not mention was, that the European Court of Justice and the other main institutional structures of the European Communities were created at the very start of the European integration process. There was no real economic integration to speak of between the European countries prior to the Treaties of Rome (and Paris). It was actually the creation of such supranational institutions, such as the ECJ, that deepened and probably even lead the integration of the Communities on both an economic and legal front. In many ways, the level of economic integration between the members of MERCOSUR was definitely much greater by 1996, as they were already utilising the Common External Tariff as part of their customs union, even though the area had not gained full free trade status between the members.

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[44] *Ibid.*,.

[45] The quotations came from presentations made by the indicated speakers at the ASIL Annual meeting on March 29, 1996, as loosely transcribed by the author - O'Neal Taylor "Institutions" 850.

[46] Gazeta Mercantil Online July 12, 1996 "MERCOSUR could have Justice Tribunal" Load date May 27, 1997.

[47] Gazeta Mercantil Online, "Brazilian Supreme Court head against MERCOSUR Court". Load date May 17, 1997.

CONCLUSION

MERCOSUR has attained the level of a customs union through the use of facilitative institutions and is attempting to reach the stage of a common market through the utilisation of those very same institutions. The MERCOSUR institutions at the moment remain facilitative and intergovernmental even though they have basically achieved the level of a customs union and wish to deepen the level of integration to a common market by the year 2006. However, most of the process is still driven by diplomacy and is conducted primarily at the presidential level. The arbitration process up until recently was private and the deliberations of the arbitral panels were not released. The arbitration process, though it seems very legalistic and rule oriented from reading the Brasilia and the Ouero Preto protocols, is not, nor does it allow the direct access to the process by the individual as the original reading seems to suggest. While the amount of trade has increased between the member states, there is an acknowledged need for greater institutional integration. Many of the participants have also noted that there eventually will be a need for a permanent court, however, little has been done to actually incorporate one.

CHAPTER SIX

CONCLUSION

This final chapter will draw together the experience of the four regional trading blocs discussed in the preceding chapters. The discussion of the lessons gleaned from the examples of the regional trading blocs and the institutional structures that have been adopted by each will be used as a basis for enunciating what type of institutional system I believe is necessary to ensure that the success of integration within a regional trading bloc.

The proposition has been made that there is an obvious and identifiable connection between the level of desired economic integration by the participating member states and the type of institutional structure that is created within the regional trading bloc. The level of desired economic integration determines whether negative integration is sufficient or whether positive integration is required. In other words, the founders of a regional trading bloc must determine whether to simply prohibit certain types of conduct, such as imposition of customs duties between member states (negative integration) or whether more detailed rules, such as commons customs codes (positive integration) are necessary. That, in turn, determines what type of institutional and judicial structure is required, in particular whether a simple dispute resolution mechanism will be sufficient or whether it will be necessary to create a supranational legal system, which includes both judicial and legislative functions. The hypothesis states that if the states involved in setting up a trading area desire a low level of integration, that is to say to create simply a free trade area, they usually set up an institutional arrangement where only an ad hoc dispute resolution mechanism is established to resolve disputes. In such a system, the other

central institutions are also merely facilitative and intergovernmental in nature with no supranational powers. Therefore, the decisions and actions of these institutions would not be directly applicable in the domestic legal systems of the member states. However, if the states desire to co-operate on an initiative for greater economic integration, that is to say moving toward a common market or even an economic union as defined by the Balassa and Pelkamans models, there was a greater possibility that a legal system would be created.

THE FOUR REGIONAL TRADING BLOCS

Overview

In the preceding four chapters the thesis examined and commented upon the formation of the following regional trading blocs: the European Community, the European Economic Area (EEA), the North American Free Trade Area (NAFTA) and the Common Market of the South (MERCOSUR). Two of these regional trading blocs, the EEA and NAFTA[1], are examples of free trade areas according to the Balassa model of economic integration. The enunciated initial goal of the founders of both the European Community and MERCOSUR was the formation of a common market. The European Community is now progressing toward the creation of an economic union, complete with a common currency and central bank. Thus the European Community experience is very much in line with the neo-functionalist school of thought, as the Community has progressed from initially a free trade area to a customs union, then to a common market and is now hoping to attain the level of an economic union.

Nexus between level of integration and the institutional structure[2]

The question now that must be asked, is whether the hypothesis proved to be correct in that there is a relationship between the level of desired economic integration and the type of central institutional structure of the regional trading bloc. As mentioned earlier, the EEA and NAFTA are both economic integration initiatives that only desire the creation of a free trade area. In line with the hypothesis, it would be expected that the member states of both free trade areas would have created merely facilitative and intergovernmental institutions, with a dispute resolution mechanism being the institutional structure established to resolve disputes between the member states. In fact, this is what the members of both the EEA and NAFTA have done.

The institutions, such as the EEA Joint Committee and the NAFTA Free Trade Commission are facilitative institutions, which have no authority to bind the member states. The negotiations are intergovernmental and diplomacy is still the main tool of the game. Neither the EEA nor NAFTA has a central court to resolve disputes[3]. While NAFTA has established separate system of arbitral panels for different areas of dispute, the EEA lacks even that. The common method of resolving the difference between the case law of EEA is the political discussions at the EEA Joint Committee, as each of the two pillars of the EEA, the European Community and the EFTA member states, are expected to ensure the compliance of their members to the EEA Agreement. Thus, the EEA and NAFTA examples are in step with the hypothesis that the members of a free

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[1] These two free trade areas have been acknowledged to be more integrative than the simple free trade area as both regional trading blocs attempt to eliminate not only tariff barriers to trade, but also attempt to eliminate non-tariff barriers.

[2] Please refer to Table Four on page 117 to see a chart of the comparison of the four regional trading blocs.

[3] As mentioned in Chapter 3, the EEA does not have a central court, but the EFTA Court was created at the time of the inception of the EEA Agreement in order to monitor the compliance of the EFTA States to the provisions in the EEA Agreement.

trade initiative are more likely to create a dispute resolution mechanism rather than a legal system.

Turning now to the two economic integration initiatives that wish to go beyond the creation of either a free trade area or even simply a customs union, the European Community and MERCOSUR, the question is whether their experience is in line with the hypothesis. Here, however, it is only the European Community that follows the hypothesis, as it has created a legal system, in which there is a central court and institutions with supranational characteristics. MERCOSUR does not have either a central court or supranational institutions, as it continues to rely on political negotiations at the presidential level in its move toward the creation of a common market. As well, the members of MERCOSUR prefer to resolve disputes through political negotiations rather than the use of the arbitration process that has been established.

PREFERRED INSTITUTIONAL STRUCTURE

The experiences of the four preceding chapters indicate, at least on the surface that a free trade area can exist and even appear to prosper with simply a rule based dispute resolution mechanism. It is, however, my contention, that even a free trade area would benefit from the creation of a central legal system, as it would ensure that the participating member states or parties to the trade agreement would not be able to circumvent the provisions of the treaty. As pointed out in the first chapter, in an inter-state dispute resolution system, the outcome is often a diplomatic one in which the disputing states reach a compromise. That compromise is not always in the best

interest of the individuals who are the "real parties" in the dispute. Nor is the compromise always consistent with the terms of the founding treaty.

The best example of this would be the ongoing debate and dispute over the issue of the trade of softwood lumber between Canada and the United States. Even though Chapter 19 ad hoc arbitration and extraordinary challenge panels[4] ruled that the Canadian policy of stumpage fees do not constitute unfair trading subsidies, the issue has once again re-emerged. The issue of softwood lumber has re-emerged because the most recent agreement between the United States and Canada just expired at the end of March of this year. In the agreement, Canada agreed to limit the amount of softwood lumber that it would allow its producers to export to the United States. And, with the U.S. economy facing a possible recession, it is increasingly likely that the American lumber industry will lobby the George W. Bush administration to institute a countervailing duty of 39.9% or even 77.9%[5] on Canadian softwood lumber imports.

The fact that the Americans and Canadian were able to reach an agreement whereby Canada had to place a quota system on its domestic producers in order to avoid excess U.S. countervailing duties, is an indication that the free trade regime is not fully operational. As I mentioned earlier in the thesis, a main difference between a regional trading agreement or bloc that institutes a dispute settlement mechanism rather than a legal system is that a dispute settlement mechanisms allows the participating member states to go outside the provisions of the regional trading bloc

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4 In the Matter of Certain Softwood Lumber Products from Canada, USA-9201904-01: Decision of the Panel in Remand, Dec. 17, 1993; In the Matter of Certain Softwood Lumber Products from Canada, ECC-94-10-4-01 USA, Memorandum Opinions and Orders, 3 Aug. 1994. For further discussion of the topic please see the article by Lawrence L. Herman "NAFTA: The Broad Strokes: A Canadian Lawyer's Perspective", (1997) 23 Can- U.S.L.J. 85.

5 Robert Russo, "U.S. raises stakes in softwood war: Canadian exports face punitive duty", Tuesday, April 03, 2001, The Canadian Press.

treaty and negotiate an agreement that contravenes its provisions. With a legal system, like the European Union, the softwood lumber agreement would not have been possible. The Court of Justice would have ruled that the softwood lumber agreement contravened the provisions of the treaty and would have, in the manner of a constitutional court, held that the agreement was therefore of no force and effect.

Another reason why I prefer the creation of a legal system over merely a dispute resolution mechanism is that it allows private parties, that is individuals and companies, to hold the governments of the member states accountable for violating provisions of the treaty. Because governments are more likely to attempt to negotiate outside agreements similar to the softwood lumber agreement, it is the private party who is more likely to proceed with litigation to ensure that the provisions of the treaty are complied with. The *Van Gend en Loos*[6] decision of the European Court of Justice is an excellent example. In that decision, the Court of Justice held that a new legal order had been created because the European Economic Treaty mentioned the people and not only the governments of the member states. Therefore, the Court of Justice held that private parties in the member states should be able to hold their governments directly accountable to the provisions of the treaty. In other words, the European Economic Community Treaty would be directly effective in all of the judicial systems of the member states.

The governments of Germany and the Netherlands attempted to argue that that was not the correct interpretation, and that the government of the Netherlands should only be liable to the other member states in a manner of international law. Therefore, they argued that their own

[6] Case 26/62 *Van Gend en Loos v. Nederlandse Administratie der Belastingen* [1963] ECR 1.

nationals should not be able to rely on the provisions of the Treaty but should only be able to rely on domestic law, even if the domestic law contravened the Treaty.

A legal system is also preferable because it tends to have a permanent court rather than only ad hoc tribunals. The main issue I have with ad hoc tribunals is that they are ad hoc and usually do not have an adequate support mechanism. Because of the ad hoc nature of the tribunals, none of the panelists really do not begin to develop a real expertise at rulings, nor do they have a full time staff at their disposal. In the NAFTA panels, the parties are qualified trade experts in their own fields, but because they usually are practitioners, they have to rely on either their articling students or some other personnel from their law firms for their support. Nor do they meet on a regular basis. They have talks, but rarely meet face to face, thus in my view, reducing the strength of their decisions. If they were able to do this full time or even to have a full time support, with clerks (similar to the judges clerks) to aid in the research of the law, even tribunals would have more effective roles to play.

In all of the regional trading blocs there is need for some type of efficient enforcement mechanism of the judicial decisions made by either a court or an arbitral panel. Most of the decisions of the free trade area courts or arbitration panels are not binding on its members. If the members are allowed to negotiate separate agreements outside the decisions of the panels, such as the softwood lumber agreement, arguably the role of the panel is diminished. While in the European Community, the decisions of the Court of Justice are binding; it is the domestic courts of each of the member states that actually ensure the compliance with the decision of the Court of Justice. Until the Treaty of Maastricht, the Court of Justice had no other means to ensure

compliance. Now under Article 228, the Court of Justice can apply a monetary penalty to a state that refuses to comply with the ruling.

And the final point of why I prefer a legal system to a dispute resolution mechanism is the ability of the central institutions to create legislation. Rather than requiring constant diplomatic negotiations and changes to the actually treaty itself, the ability of the central institutions to make binding legislation, which should in my opinion have direct effect, keeps the regional trading agreement or bloc more dynamic and homogeneous. That being said, the institution that creates these legislation could be like the European Council and the Council of Ministers in the sense that the players would be the political heads of the member governments or states of the participating member states. In other words, the legislators would be the heads of government or parliament of high ministerial level individuals of the member states. Particularly if certain measures were to require unanimity, then the vital interests of one of the member states could not be discounted. While, preferable, qualified majority would be ideal, especially if the economies and judicial and legislative systems of the member states were sufficiently similar. Regional trading agreements without sufficient commonality in purpose and background in my opinion are foolhardy and less likely to succeed.

The experience of the European Union demonstrates that a higher level of economic integration, such as a common market or economic union, cannot be achieved without a comprehensive supranational institutional structure. The central institutional structure requires an effective legal system in which individuals have enforceable rights. However, the European Union's institutional structure is not the only acceptable model. The main requirement, however, is that

the central institutions possess both adjudicative and legislative abilities that effective and enforceable.

Unless there is a willingness on the part of the member states of the regional trading bloc to surrender a degree of their national sovereignty to a supranational legislative and judicial structure, it is very unlikely that the economic integration initiative can progress successfully beyond a customs union, or perhaps even a free trade area.

At least there should be some type of effective domestic method of ensuring that provisions of the Treaty are enforced and enforceable by private individuals, in a manner similar to the European Economic Area where both pillars ensure compliance of its respective member states by the courts. (Though the EFTA Court is only advisory and has no real binding authority.) The homogeneity of the region is really maintained by the overwhelming power of the European Union vis a vis the individual EFTA states.

I hope that this thesis will serve as a minor contribution on the issue of what type of institutional structure is required in a regional trading agreement.

Table 4	EUROPEAN UNION	EUROPEAN ECONOMIC AREA	NORTH AMERICAN FREE TRADE AREA	MERCOSUR
Reasons for Creation	Avoidance of war Four Freedoms	Economic integration Market access	Free movement of goods Market access	Maintaining democracy Four freedoms
Initial Desired Level Of Integration	Common Market	Free Trade Area	Free Trade Area	Common Market
Institutional Structure	Supranational	International	International	International
Status of Judicial Institution	Court of Justice	EEA Joint Committee	Arbitration Panels	Arbitration Panel
Status of Treaty	Directly effective	Not directly effective	Not directly effective	Not directly effective
Status of Legislation	Largely supranational	Limited central legislation	No central legislation	Theoretically Binding.
Overall Emphasis	Legal system	Diplomacy	Diplomacy and some Rule based settlements	Diplomacy with goals for future creation of a legal system

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