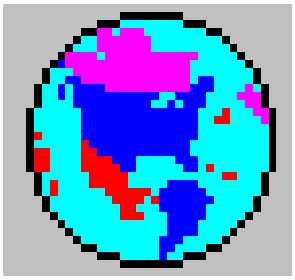
# THE LAW OF REGIONAL ECONOMIC INTEGRATION IN THE AMERICAN HEMISPHERE



**J.H.H. Weiler**
**University Professor, NYU**
**Joseph Straus Professor of Law and European Union Jean Monnet Chair,**
**NYU School of Law**

**AND**

**Sungjoon Cho**
**Assistant Professor of Law,**
**Chicago-Kent College of Law,**
**Illinois Institute of Technology**

## Unit I

## General Principles

# THE LAW OF REGIONAL ECONOMIC INTEGRATION IN THE AMERICAN HEMISPHERE

## Unit I: General Principles

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## GUIDING QUESTIONS

*Reflect on the following questions while/after reading the material:*

1. *Why is free trade often so unpopular in the domestic arena while it makes sense in the international dimension through the realization of collective welfare gain? (Think of the famed phrase: "All politics is local.")*

2. *Why is free trade often so unpopular even in the international arena, especially to a certain group of people? (Think of the Seattle debacle in December 1999; Is free trade itself really culpable for the collapse?)*

3. *What do you think is the proper domain or boundary of the WTO? Should labor or environment be part of it? If so, how? What kind of "linkage" would be desirable in terms of "trade and …"?*

4. *What interests do states generally pursue in negotiations on trade liberalization? Why?*

5. *Multilateralism v. Regionalism --- What are the merits and demerits of both perspectives from a legal, economic and political standpoint? To what extent and how can a regional economic arrangement (such as free trade area or customs union) be legal in the WTO context?*

6. *The NAFTA debate --- Who (US Government or Opposing NGOs) do you find more convincing and why? Please look carefully at the empirical evidence which both camps mobilized to legitimize their positions.*

7. *In general, what is the legal relationship between the GATT 1994 and the NAFTA? Which trumps which? Is the "later-in-time" rule applied? How about the dispute settlement process (where to go)? Please read carefully NAFTA Article 103 and 2005.*

8. *Tariffication case (In the Matter of Tariffs Applied by Canada to Certain US-Origin Agricultural Products) --- Please look carefully at the interrelationship among NAFTA, CUSFTA (US - Canada Free Trade Agreement) and WTO.*

9. *Institutional Arrangement --- NAFTA often invites the criticism due to its weak institutionalization. What is the role of the Free Trade Commission? Is it a supreme decision-making (or dispute- settling) organ in NAFTA? What is its status vis-à-vis other organs such as the Council(s) or the Secretariat(s)?*

# I. GENERAL FEATURES OF INTERNATIONAL TRADE

## 1-1. Philosophy

*1-1-1. Pro-Trade Perspective*

1-1-1-1. Comparative Advantage

From the WTO Web-site:
http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm

> "What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country, being always in proportion to the capital which employs it, will not thereby be diminished... but only left to find out the way in which it can be employed with the greatest advantage."
> (Adam Smith, The Wealth of Nations, Book IV:2, Modern Library edition)

Nobel laureate Paul Samuelson (1969) was once challenged by the mathematician Stanislaw Ulam to "name me one proposition in all of the social sciences which is both true and non-trivial." It was several years later than he thought of the correct response: **comparative advantage**. "That it is logically true need not be argued before a mathematician; that is is not trivial is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them." 1/

What did David Ricardo mean when he coined the term comparative advantage? According to the principle of comparative advantage, the gains from trade follow from allowing an economy to specialise. If a country is *relatively* better at making wine than wool, it makes sense to put more resources into wine, and to export some of the wine to pay for imports of wool. This is even true if that country is the world's best wool producer, since the country will have more of both wool and wine than it would have without trade. A country does not have to be best at anything to gain from trade. The gains follow from specializing in those activities which, at world prices, the country is *relatively* better at, even though it may not have an absolute advantage in them. Because it is relative advantage that matters, it is meaningless to say a country has a comparative advantage in nothing. The term is one of the most misunderdstood ideas in economics, and is often wrongly assumed to mean an absolute advantage compared with other countries.

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1/ P.A. Samuelson (1969), "The Way of an Economist," in P.A. Samuelson, ed., *International Economic Relations: Proceedings of the Third Congress of the International Economic Association*, Macmillan: London, pp. 1-11.

1-1-1-2. Paul R. Krugman, *What Do Undergrads Need To Know About Trade*?, 83 AM. ECON. REV. 23, 23-26 (1993)

Few of the undergraduates who take an introductory course in economics will go on to graduate study in the field, and indeed most will not even take any higher-level economics courses. So what they learn about economics will be what they get in that first course. It is now more important than ever before that their basic training include a solid grounding in the principles of international trade.

I could justify this assertion by pointing out that international trade is now more important to the U.S. economy than it used to be. But there is another reason, which I think is even more important: the increased *perception* among the general public that international trade is a vital subject. We live in a time in which Americans are obsessed with international competition, in which Lester Thurow's *Head to Head* is the non-fiction best-seller and Michael Crichton's *Rising Sun* tops the fiction list. The news media and the business literature are saturated with discussions of America's role in the world economy.

The problem is that most of what it student is likely to read or hear about international economics is *nonsense*. What I want to argue in this paper is that the most important thing to teach our undergrads about trade is how to detect that nonsense. That is, our primary mission should be to vaccinate the minds of our undergraduates against the misconceptions that are so predominant in what passes for educated discussion about international trade.

## I. The Rhetoric of Pop Internationalism

As a starting point, I would like to quote a typical statement about international economics. (Please ignore the numbers for a moment.) Here it is: "We need a new economic paradigm, because today America is part of a truly global economy (1). To maintain its standard of living, America now has to learn to compete in an ever tougher world marketplace (2). That's why high productivity and product quality have become essential. (3). We need to move tile American economy into the high-value sectors. (4) that will generate jobs (5) for the future. And the only way we can be competitive in the new global economy is if we forge a new partnership between government and business (6)."

OK, I confess: it’s not a real quotation. I made it up as a sort of compendium of popular misconceptions about international trade. But it certainly sounds like the sort of thing one reads or hears all the time- it is very close in content and style to the still-influential manifesto by Ira Magaziner and Robert Reich (1982), or for that matter to the presentation made by Apple Computer’s John Sculley at President-elect Clinton’s Economic Conference last December. People who say things like this believe themselves to be smart, sophisticated, and forward-looking. They do not know that they are repeating a set of misleading cliches that I will dub "pop internationalism."

It is fairly easy to understand why pop internationalism has so much popular appeal. In effect, it portrays America as being like a corporation that used to have a lot of monopoly power, and could therefore earn comfortable profits in spite of sloppy business practices, but is now facing an onslaught from new competitors. A lot of companies are in that position these days (though the new competitors are not necessarily foreign), and so the image rings true.

Unfortunately, it's a grossly misleading image, because a national economy bears very little resemblance to a corporation. And the ground-level view of businessmen is deeply uninformative about the inherently general-equilibrium issues of international economics.

So what do undergrads need to know about trade? They need to know that pop internationalism is nonsense- and they need to know *why* it is nonsense.

## II. Common Misconceptions

I inserted numbers into my imaginary quotation to mark six currently popular misconceptions that can and should be dispelled in an introductory economics course.

1. — "We need a new paradigm..." Pop internationalism proclaims that everything is different now that the United States is an open economy. Probably the most important single insight that an introductory course can convey about international economics is that it does not change the basics: trade is just another economic activity, subject to the same principles as anything else.

James Ingram's (1983) textbook on international trade contains a lovely parable. He imagines that an entrepreneur starts a new business that uses a secret technology to convert U.S. wheat, lumber, and so on into cheap high-quality consumer goods. The entrepreneur is hailed as an industrial hero; although some of his domestic competitors are hurt, everyone accepts that occasional dislocations are the price of a free-market economy. But then an investigative reporter discovers that what he is really doing is shipping the wheat and lumber to Asia and using the proceeds to buy manufactured goods-whereupon he is denounced as a fraud who is destroying American jobs. The point, of course, is that international trade is an economic activity like any other and can indeed usefully be thought of as a kind of production process that transforms exports into imports.

It might, incidentally, also be a good thing if undergrads got a more realistic quantitative sense than the pop internationalists seem to have of the limited extent to which the United States actually has become a part of a global economy. The fact is that imports and exports are still only about one-eight of output, and at least two-thirds of our value-added consists of non-tradable goods and services. Moreover, one should have some

historical perspective with which to counter the silly claims that our current situation is completely unprecedented: the United States is not now and may never be as open to trade as the United Kingdom has been since the reign of Queen Victoria.

2.-"Competing in the world marketplace": One of the most popular, enduring misconceptions of practical men is that countries are in competition with each other in the same way that companies in the same business are in competition. Ricardo already knew better in 1817. An introductory economics course should drive home to students the point that international trade is not about competition, it is about mutually beneficial exchange. Even more fundamentally, we should be able to teach students that imports, not exports, are the purpose of trade. That is, what a country gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves: the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment.

One of the distressing things about the tyranny of pop internationalism is that there has been a kind of Gresham's Law in which bad concepts drive out good. Lester Thurow is a trained economist, who understands comparative advantage. Yet his recent book has been a best-seller largely because it vigorously propounds concepts that unintentionally (one hopes) pander to the *cliches* of pop internationalism: "Niche competition is win-win. Everyone has a place where he or she can excel; no one is going to be driven out of business. Head-to-head competition is win-lose." (Thurow, 1992 p. 30). We should try to instill in undergrads a visceral negative reaction to statements like this.

3.-"Productivity": Students should learn that high productivity is beneficial, not because it helps a country to compete with other countries, but because it lets a country produce and therefore consume more. This would be true in a closed economy; it is no more and no less true in an open economy; but that is not what pop internationalists believe.

I have found it useful to offer students the following thought experiment. First, imagine a world in which productivity rises by 1 percent annually in all countries. What will be the trend in the U.S. standard of living? Students have no trouble agreeing that it will rise by 1 percent per year. Now, however, suppose that while the United States continues to raise its productivity by only 1 percent per year, the rest of the world manages to achieve 3-percent productivity growth. What is the trend in our living standard?

The correct answer is that the trend is still 1 percent, except possibly for some subtle effects via our terms of trade; and as an empirical matter changes in the U.S. terms of trade have had virtually no impact on the trend in our living standards over the past few decades. But very few students reach that conclusion-which is not surprising, since virtually everything they read or hear outside of class conveys the image of international trade as a competitive sport.

An anecdote: when I published an op-ed piece in the *New York Times* last year, I emphasized the importance of rising productivity. The editorial assistant I dealt with

insisted that I should "explain" that we need to be productive "to compete in the global economy." He was reluctant to publish the piece unless I added the phrase- he said it was necessary so that readers could understand why productivity is important. We need to try to turn out a generation of students who not only don't need that kind of explanation, but understand why it's wrong.

4.-"High-value sectors": Pop internationalists believe that international competition is a struggle over who gets the "high-value" sectors. “Our country's real income can rise only if (1) its labor and capital increasingly flow toward businesses that add greater value per employee and (2) we maintain a position in these businesses that is superior to that of our international competitors" (Magaziner and Reich, 1982 p. 4).

1 think it should be possible to teach students why this is a silly concept. Take, for example, a simple two-good Ricardian model in which one country is more productive in both industries than the other. (I have in mind the one used in Krugman and Maurice Obstfeld [1991 pp. 20- 1].) The more productive country will, of course, have a higher wage rate, and therefore whatever sector that country specializes in will be "high value," that is, will have higher value-added per worker. Does this mean that the country's high living standard is the result of being in the right sector, or that the poorer country would be richer if it tried to emulate the other's pattern of specialization? Of course not.

5.-"Jobs": One thing that both friends and foes of free trade seem to agree on is that the central issue is employment. George Bush declared the objective of his ill-starred trip to Japan to be "jobs, jobs, jobs"; both sides in the debate over the North American Free Trade Agreement try to make their case in terms of job creation. And an astonishing number of free-traders think that the reason protectionism is bad is that it causes depressions.

It should be possible to emphasize to students that the level of employment is a macroeconomic issue, depending in the short run on aggregate demand and depending in the long run on the natural rate of unemployment, with macroeconomic policies like tariffs having little net effect. Trade policy should be debated in terms of its impact on efficiency, not in terms of phony numbers about jobs created or lost.

6.-"A new partnership": The bottom line for many pop internationalists is that since U.S. firms are competing with foreigners instead of each other, the U.S. government should turn from its alleged adversarial position to one of supporting our firms against their foreign rivals. A more sophisticated pop internationalist like Robert Reich (1991) realizes that the interests of U.S. *firms* are not the same as those of U.S. *workers* (you may find it hard to believe that anyone needed to point this out, but among pop internationalists this was viewed as a deep and controversial insight), but still accepts the basic premise that the U.S. government should help our industries compete.

What we should be able to teach our students is that the main competition going on is one of U.S. industries against *each other,* over which sector is going to get the scarce resources of capital, skill, and, yes, labor. Government support of an industry may help that industry compete against foreigners, but it also draws resources away from other domestic industries. That is, the increased importance of international trade does not change the fact the government cannot favor one domestic industry except at the expense of others.

Now there are reasons, such as external economics, why a preference for some industries over others may be justified. But this would be true in a closed economy, too. Students need to understand that the growth of world trade provides no additional support for the proposition that our government should become an active friend to domestic industry.

## III. What We Should Teach

By now the thrust of my discussion should be clear. For the bulk of our economics students, our objective should be to equip them to respond intelligently to popular discussion of economic issues. A lot of that discussion will be about international trade, so international trade should be an important part of the curriculum.

What is crucial, however, is to understand that the level of public discussion is extremely primitive. Indeed, it has sunk so low that people who repeat silly cliches often imagine themselves to be sophisticated. That means that our courses need to drive home as clearly as possible the basics. Offer curves and Rybczinski effects are lovely things. What most students need to be prepared for, however, is a world in which TV "experts," best-selling authors, and $30,000-a-day consultants do not understand budget constraints, let alone comparative advantage.

The last 15 years have been a golden age of innovation in international economics. I must somewhat depressingly conclude, however, that this innovative stuff is not a priority for today's undergraduates. In the last decade of the 20th century, the essential things to teach students are still the insights of Hume and Ricardo. That is, we need to teach them that trade deficits are self-correcting and that the benefits of trade do not depend on a country having an absolute advantage over its rivals. If we can teach undergrads to wince when they hear someone talk about "competitiveness," we will have done our nation a great service.

* * *

*1-1-2. Anti-Trade Perspective*

1-1-2-1. Global Trade Watch

http://www.publiccitizen.org/trade/index.cfm

**Global Trade Watch** leads the way in educating the American public about the enormous impact of international trade and economic globalization on our jobs, the environment, public health and safety, and democratic accountability. We work in defense of consumer health and safety, the environment, good jobs and democratic decision-making, which are being threatened by corporate-led globalization that includes so-called "free-trade" agreements such as the WTO and NAFTA.

1-1-2-2. Fair Trade Watch

http://www.naftalawsuit.uswa.org/fairtradedef.html

The United Steelworkers of America

believe in "Fair Trade" that works for working families.

We believe in a global economy, but not the kind created by NAFTA and other trade agreements which serve only Wall Street, Bay Street and giant multinational corporations.

We want trade agreements that:

protect workers

create jobs

provide security and safety

protect the environment

The individual rights of citizens and their countries are rapidly being eroded in the name of trade. NAFTA and other agreements and treaties are creating a new environment putting capital firmly in control. The individual rights of countries to control their economies, protect their environment, and protect the health and safety of their citizens are being lost.

We as workers and consumers have the ultimate authority by choosing who we vote for and what products we buy.

We should demand companies reinvest profits for the future, allowing for secure jobs, instead of continuing to fuel the almost insatiable appetite of Wall Street, Bay Street and world financial markets.

We should demand that all workers, regardless of their geographic location, be allowed family supportive wages, reasonable healthcare, safe working conditions, a clean environment, and dignity.

We have built that kind of economy before.

Together with our children we can do it again.

1-1-2-3. Cases Against Free Trade (Objections to and Limitations of Free Trade)

**Free Trade as an Official Ideology?**

A very strong presumption exists that free trade is unquestionably "good" thing; it promotes the economic welfare of all members which participate in this enterprise. This truism largely originates from classical economic theories that had been developed by Adam Smith and David Ricardo, centering on the theory of specialization and comparative advantage.

This truism has been carrying a powerful force; according to Peter Jones (p 218, 1998) free trade is the "official ideology", which is also "consequentialist":

> (...) "free trade is valued for what it brings about and the goods that it brings about are collective and diffuse in character rather than targeted at the entitlements of specific individuals."

However, it could be the case that theoretical – economic – foundations of free trade are debatable or questionable. In fact, the doctrine of free trade has been under repetitive and sometimes painful scrutiny by many economists since the Smith-Ricardian era. Such debate over the economic merits of free trade has not yet ended: it is still on-going. (Douglas Irwin, p 230, 1996). Moreover, this official ideology may not be irrebuttable. In reality, one may imagine a variety of occasions in which free trade loses its status as an ideology or at least becomes unpersuasive. More simplistically, the fact that anti-free traders abound across the world today is a strong indication of such possibility.

Against this background, it would be a meaningful task to examine a variety of cases against free trade – objections and limitations – and extract some implications from such examinations. This task is expected to render a sobering "reality check" about free trade doctrine as well as some "prescriptive advice" that may be applied to design a future global trade order.

**Challenge against Free Trade from Economists' Standpoints**

*Adjustment Problem*

Assuming free trade, at its initial stage, maximizes the collective welfare of a nation, it still cannot be said that every citizen of the nation may be better off due to free trade with foreign nations. (Douglas Irwin, p 219, 1996). This is the problem of "ex-post adjustment" or "compensation" always accompanying the free trade debate. In other words, without due care for "losers" that free trade definitely creates the merit of free trade cannot but be undermined. More extremely, one might conceive a situation in which the social cost for such adjustment as a whole exceeds gains from trade.

This is not a mere economic concern; its social and political reverberation may be huge. For instance, Ross Perot found some of his audiences by his "giant sucking sound" argument and so did Pat Buchanan in a similar fashion. In most cases, pain to losers tend to materialize much easily and quickly than gains from trade.

*Terms of Trade Argument (Optimal Tariffs)*

Classical Ricardian model presumes that trading partners are "equal" in light of economic power and market influence, and hence a perfect competition. However, if one country is big enough to play its price-maker status by the "exploitative intervention" (Deardorff and Stern, 1987) at the expense of other states, the rest of the world loses more than the tariff-levying country.

*Necessary Protection (Government Intervention)*

A long-standing justification for the interventionist trade policy can be found in the so-called "infant industries protection" theory, widely endorsed by Mill, List and Hamilton. In the past, as we see in the US trade policy represented by a high tariff throughout the nineteenth century, this theory used to be dominant. More recently, this theory also served as a theoretical basis for the "special and different status" of developing countries within the framework of the GATT, thereby creating the so-called Enabling Clauses and GSPs. (Trebilcock and Howse, p 9, 1995)

A modern reincarnation of such infant industries protection is the "strategic trade theory". (Trebilcock and Howse, p 10, 1995) Based on a more relaxed economic assumption of imperfect competition and increasing return of scale, modern governments tried to nurture a national champion (e.g., Airbus) by using protective measures such as tariffs and subsidies. This highly-interventionist trade policy tends to precipitate a trade war between big countries producing similar products.

**Non-Economic Challenge against Free Trade**

*Realists' Attack (Realpolitik)*

Before discussing the merit or demerit of free trade, political scientist (realists) attack the philosophical foundations on which free traders base their dogma. Realists argue that the universal and cosmopolitan nature of free trade regime focusing on non-discrimination and global distributive justice needs a serious reality check. (Simon Carney, p 26, 1998)

Rejecting such cosmopolitanism as a mere utopian, realism contends that the "national interest" is the only practical as well as legitimate parameter on the basis of which every policies, including trade policy, should be determined. To the eyes of realists, the current trade regime (WTO) may be just an apology, rather than a genuine legal regime.

A variation of such realism is the so-called "hegemonic stability theory" argued by Charles Kindleberger. He maintains that because free trade is a public good, it has a political

prerequisite: the existence of a hegemonic power. (Joanne Gowa, p 4, 1994) From such perspective, free trade is more likely within than across political-military alliances.

*Free Trade as Unfair Trade*

"Unfair trade", in many forms, has been a dominant counterargument against free trade. In many cases, unfairness allegedly originates from stark difference in production costs (e.g., low wages) or other regulatory gap (labor or environmental standards). To the eyes of producers from developed countries whose production costs cannot but be higher due to a considerable amount of compliance cost for advanced social regulations vis-à-vis producers from developing countries, their putative competitive disadvantage may be unfair. They insist that this kind of discrepancy be corrected by trade policy, such as countervailing duties or import ban. They desire that their playing fields be leveled.

The similar arguments are rooted in different – regulatory – concerns. Many government officials as well as NGOs condemn free trade as a road to the "race to the bottom" because free trade, they argue, urge producers to pursue a cheaper production process that inevitably ignores important regulatory concerns. (William Greider, p 195, 1993) Some of them further argue that massive exports from developing countries well short of such regulatory standards should be regarded as the "social dumping" or as countervailable.

*Free Trade as Unfair Trade II (Development Issue)*

Different kind of unfairness argument comes from developing countries which argue that they have been marginalized from the center of global trade and that the benefits – gains from trade in a global level – have not been distributed fairly. One of the backgrounds of this assertion is related to the fact that developing countries began to participate in trade negotiations relatively in a later stage. (Hoekman and Kostecki, p 237, 1996) Developing countries used to receive various trade preferences (e.g., GSPs or waivers) instead of negotiating with developed countries on an equal footing. The flip side of this long-standing phenomenon is that developing countries have not been allowed to fully benefit from those sectors such as textiles or agriculture in which they traditionally enjoy large degree of comparative advantages vis-a-vis developed countries. Such sectors have been heavily protected in developed countries mainly by domestic political reasons.

Since an epochal compromise between developing and developed countries in the name of "single undertaking" at the end of Uruguay Round in 1994, developing countries have been dissatisfied with slow phase-out of trade restriction in such sectors as textile or agriculture for which they bargained services and intellectual property rights. Moreover, recent anti-dumping spree from the US in the steel sector fueled up such dissatisfaction and even arouses rage from developing countries. To them, free trade may be a rich man's game. Against this background, a strong voice for a more balanced approach in future trade rounds begins to reverberate in front of the Seattle Ministerial Meeting.

*Cultural Autonomy*

Some critics argue that cultural values are seen as threatened by the homogenizing effects of economic imperialism masquerading as free trade. (Trebilcock and Howse, p 13, 1995) This concern comes from not only developing countries but also developed countries. Traditionally, Canada and EU have been very sensitive and even defiant to the inflow of US entertainment and media sectors. As a remedy of this concern, exceptions (such as Article 2005 of the US-Canada Free Trade Agreement) or legislation (such as EU's "Television without Frontiers Directive") have been invented. Apart from the technical GATT-legality of such cultural provisions or legislation, many critics view such initiatives as legitimate. For instance, one European critic suggests that American "cultural dumping" can validly be opposed by appropriate government action. (Brian Barry, p 15, 1998)

Also from developing countries' perspective, such concern equally exists. Since the biggest and most powerful cultural enterprises come from the North, the already prevailing Western culture will be more prosperous, thereby eroding the cultural diversity of the Third World rapidly. (Martin Khor, p 104, 1993) Threats of "cultural genocide" may come from television, films and radio. (Braun and Parker, p190. 1993)

**Some Questions**

*4-1. Could regional integration among developing countries be an instrument for enhancing the leverage and bargaining power against the developed countries in future trade rounds? If so, could this be another justification for regionalism vis-a-vis multilateral free trade regime?*

*4-2. To what extent could free trade regime transform the internal politics as well as administrative structure of developing countries? Could such transformation prove to be positive (e.g., modernization) or negative (e.g., loss of political sovereignty)? Would the* ***size*** *of countries be a critical factor determining such transformative effect? If so, would trade diplomacy rather than trade legalism be more desirable to some developing countries?*

*4-3. In managing "trade and culture" interface, do we need more than free trade, i.e., "free trade plus" (integration or community-building) or less than free trade, i.e., "free trade minus" (cultural exemptions or waivers)?*

*4-4. Wouldn't it be the case that too much stress on cultural identity prevents a healthy multiculturalism or cross-cultural dialogue? Wouldn't it be incompatible with the canons of an* ***open*** *society, symbolized by freedom of expression? Would some government intervention (trade restriction) be effective in the face of advanced technology of telecommunication such as the Internet?*

*4-5. Could a trade restriction for the purpose of preserving the cultural identity be justified in terms of exercising a basic human right as enshrined in Article 1 (1) of the International Covenant on Civil and Political Rights?*

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## 1-2. Multilateralism v. Regionalism

### Renato Ruggiero, *Regional Initiatives and Global Impact: Cooperation and the Multilateral System*

*Attached is a speech given by Renato Ruggiero, Director-General of the World Trade Organization, to the 3rd Conference of the Transatlantic Business Dialogue (TABD) in Romey (7 November, 1997).*

http://www.wto.org/english/news_e/sprr_e/rome2_e.htm

Let me first say how pleased I am to address this gathering of transatlantic government and business leaders - a group which is among the most important constituents of the multilateral trading system. As we approach that system's 50th anniversary, it is important to remember how much we owe to the vision of a few people on both sides of the Atlantic who together laid the foundations of an international order which has secured for us a half century of unprecedented prosperity. In many ways, the Transatlantic Business Dialogue is a direct descendant of this remarkable period of transatlantic cooperation and creativity. Today we live in a world which is very different from the one which existed a half century before - a multipolar world of multiple interests bound together by trade, investment and technology as never before. But it is also a world whose security and equilibrium is no less dependent on a strong transatlantic partnership where not only interests but also values and visions are shared.

This is why this dialogue is so valuable. You are operating at the leading edge of economic integration, and the accelerating pace of globalization gives your work an importance which reaches well beyond your region. In this time of rapid transition, business and government must work together as never before to ensure that our national and international rules keep pace with our evolving economies; to ensure that they help, not hinder adjustment; and to ensure that they provide a common ground of stability in a period of breathtaking change.

The problem is not globalization, as some think; the problem is governance.

Tonight I want to talk about this challenge of governance in an integrated and interdependent world - and how the transatlantic community has a central role to play in bringing together the two main paradigms of this emerging international order - multilateralism and regionalism.

Fifty years ago the central challenge facing the postwar trading system was to prevent a return to protectionism - a path which had led directly to the Great Depression of the 1930 and ultimately to the descent into world war. The deep levels of economic integration we have achieved today are in many ways a testament to the success of that system. The new international competition is for wider markets, more investment, and

better technologies, not for building higher tariff walls. And yet for all our progress, it would be unrealistic to assume that deeper integration is inevitably leading to a period of universal cooperation and stability. The impulses for international rivalries, competition, and protection have not disappeared in our interconnected world - arguably deeper integration makes them stronger than ever. In many ways, these new challenges facing the international trading system are now being played out in the debate over the relationship between regionalism and multilateralism.

Most observers have concluded that regional agreements have made a generally positive contribution to the liberalization of world trade. In many cases, regional arrangements have provided stepping stones for integration into the global trading system - helping industries, sectors and countries adjust to the competitive winds of globalization. They have served as important crucibles for trade policy innovation, the results of which have frequently spilled over into the multilateral arena. Regionalism has also often been a source of creative tension in the global system as a whole, forcing the pace of other regional and multilateral initiatives. It is not coincidental that the Kennedy Round moved forward with the creation of the European Community, the Tokyo Round with the Community's first enlargement, and the Uruguay Round with the Single Market initiative and with NAFTA.

Perhaps most importantly, regional integration has offered countries a way to resolve issues that would be more difficult to resolve in the wider multilateral context. For the European Community - to take perhaps the best example - greater trade and economic integration was seen above all as a way of welding Europe's political future together and making another continental war unthinkable. The goals of NAFTA were explicitly economic rather than political. But here too the idea was that North America's degree of economic integration called for deeper and more comprehensive regime of rules than could be achieved in the larger multilateral system.

Now, however, we find ourselves in a new phase of regionalism - one which is qualitatively and quantitatively different from the kind of regionalism represented by the European Community or even NAFTA. The last decade has witnessed an unprecedented proliferation of regional arrangements. Since the entry into force of the GATT in 1947, 163 regional trade agreements were notified to the GATT or the WTO. In the period 1986-1991 only five agreements were notified to the GATT; the equivalent number for the period 1992-1996 is 77. Of these 163 agreements, around 60 per cent are currently in force. Thus over three quarters of the operational regional agreements in existence today have entered into force in the last four years.

And it is not just the pace of regionalism which is different today, but its breadth of ambition as well. The proposed Free Trade Agreement of the Americas (FTAA), to take one example, covers all but one of the 35 countries of North, Central and South America, boasting a combined market of well over half a billion people. And then there is the grandest regional project of them all - APEC. Spanning both sides of the Pacific Ocean and incorporating three of the world's four economic superpowers - the United States, Japan,

and increasingly China - APEC includes 40 per cent of the world's population, some 54 per cent of the world's GDP, and 42 per cent of its trade.

The central argument for regionalism has always been that smaller groups of countries may be able to move further and faster towards integration than in a much wider multilateral system. But does this logic still lie behind the vast regional arrangements we see unfolding around us today?

For one thing, it is very difficult to make the argument that liberalization is any easier in, say, APEC, the FTAA or between the EU and the Mediterranean countries, than in the WTO. Many of these new regional arrangements contain countries as different in outlook, economic size and level of development as any countries in the multilateral system. And the points of trade friction are no less vexing. For example, are negotiations between Japan and the United States really any easier in APEC than in the WTO? Can the Europe resolve the issue of agricultural liberalization any more swiftly transatlantically with Mercosur, or across the Mediterranean with the countries of the Middle East and North Africa?

A second point is that the globalization process itself underscores the logic of global rules for global firms operating in a global marketplace. As firms increasingly internationalize their production and distribution systems, and as economies become increasingly integrated, it is in no one's economic interests to have a fragmented system with fragmented rules and even perhaps a fragmented dispute settlement system. This is even more true in the world of borderless technologies we are now entering - world where economic activity in areas like telecommunications, financial services, and electronic commerce will more and more take place in a single, global economic space, one which is basically indifferent to distance, time and geography. In this borderless information economy, regional preference becomes an increasingly inadequate - even anomalous - instrument for managing the integration process.

This leads to a third important point - the new strength of the WTO system itself. This year alone we have reached path-breaking agreements in information technologies and telecommunications - the combined value of which equals world trade in autos, textiles and agriculture. I believe a successful financial services agreement is within our grasp. And we have made important progress in the 32 accession negotiations currently underway, one of which, China's, will have an economic effect roughly equivalent to the Tokyo Round. Hardly the signs of a system unable to keep up with the fast pace of globalization.

If the logic of regionalism often makes less economic sense in an era of globalization, why are we witnessing such a dramatic expansion of regional initiatives? Perhaps part of the answer could be that in some cases these initiatives are less about advancing regional economic efficiency or cooperation - as the TABD clearly and commendably is - and more about securing regional preferences, even regional spheres of influence, in a world marked by growing competition for markets, for investment and for technology. This, in my view, is potentially the most worrying feature of the new regionalism we see unfolding around the world today. Let's be clear that it is a feature

which stands in stark contrast to the unifying vision of the founding fathers of the multilateral system half a century ago.

What makes this competition more worrisome is that at its heart lies the world's two major economic players - the United States and the European Union. What we see when we look at the pattern of regional expansion in the world today is essentially two focal points with concentric circles of preferential trade arrangements radiating outwards - almost as if they were competing to see who can establish the greatest number of preferential areas the fastest.

If it is true that the strength of the multilateral system for fifty years rested on the strength of the transatlantic partnership, it is also partly true that the sudden proliferation of regional arrangements reflects a certain inability of the transatlantic community to coordinate its trade interests and vision.

One danger is that this transatlantic competition could encourage other regions to form more preferential groupings of their own. The other danger is that we could run a risk of re-opening the North-South divide - after all, the only countries presently excluded from the expanding web of regional arrangements are the least- developed countries. This, in my view, would be one of the most tragic outcomes of all since globalization's greatest promise is its potential to erase the barriers between previously separate worlds.

The fundamental point is that while regionalism can provide an important complement to the multilateral system, it cannot provide a substitute. The solution, in other words, is to globalize regionalism, not to regionalize globalization. I see two important dimensions to this task.

First, we must ensure that the foundation of the trading system remains non-discrimination as embodied in the two fundamental principles of National Treatment and Most-Favoured-Nation. Regional agreements which are preferential by nature represent an exception to the most favoured nation treatment. When the number and extension of these exceptions to the most favoured nation treatment reach a very significant level, the exception could become the rule and the multilateral system would be substantially changed. Surely our goal must be to make regionalism conform to multilateralism, not vice versa.

The second challenge is to ensure that regionalism and multilateralism converge in their goals and aspirations - which means that we must ensure that our multilateral goals remain as ambitious as our regional efforts. More and more the success of regional arrangements must be measured in terms of their ability to help design and build this new economic order - both in terms of their own interests, and in the interests of the global economy as a whole. Here initiatives like the Transatlantic business dialogue can play a critical rôle in channelling regional energies and initiatives into multilateral negotiations - as you helped to do so successfully in the case of the information technology agreement and the recent telecommunications deal.

I know that you are playing a similarly positive rôle in financial services - the key priority for the WTO in the coming weeks.

The objective of the financial services negotiations is to achieve real improvements in access to markets. Essentially, this means the right for foreign investors to operate on equal competitive terms with national companies in national markets. It also means the removal of unnecessary restrictions on the cross-border supply of financial services - restrictions which will, in any event, become increasingly anomalous in a world of borderless, electronic commerce. And it means protecting equity rights already achieved in these markets.

I believe that an agreement should now be close at hand. Ninety-five countries have already made provisional market access commitments on financial services in the two previous negotiations, and in the negotiations which are due to end on 12 December we shall see improvements or new commitments made by something like 40 countries. This is a highly significant harvest. The number and the quality of the commitments negotiated are essential for a positive outcome. But it is equally essential that we firmly anchor the financial services sector in general in the multilateral system of rules and procedures. We cannot afford continuing doubt about the commitment of the major powers to multilateralism in this fundamental services sector. We cannot afford to lose at the last moment what has taken so long as so much energy to attain.

Many ask about the possible effects of the recent turbulence in financial markets in Asia on the WTO negotiations to liberalize financial services. Partly these reports spring from confusion about the distinction between liberalization of market access - which is our aim - and capital account liberalization - which is not. They are quite different, and the Services Agreement explicitly recognizes not only the right of all governments to regulate financial markets but their responsibility to take whatever prudential measures that are necessary to safeguard the integrity of those markets and their liberalization. I am greatly encouraged by the affirmation of all participants in the negotiations that recent events in the markets have not shaken either their belief in liberalization or the commitment to this negotiation.

The transatlantic community's unique contribution to the global system has always been as a bridge - across the Atlantic, across languages and cultures, across interests. It is a community which already represents the most important economic link in world - some US$ 300 billion in two-way trade in 1996, $810 billion in investment, against a combined transatlantic output of over $16.5 trillion. Nor do these statistics capture the essential quality of the transatlantic relationship - the extent to which Europe and North America are at the epicentre of a growing web of transborder investment, technology and ideas - the new arteries of the global economy. In many ways the economic ties between your two continents represents a single transatlantic market.

In such an intense economic relationship disputes and differences are inevitable - and fortunately we now have in the WTO a new binding dispute settlement mechanism where most of these conflicts can be resolved expeditiously on the basis of mutually agreed

rules and disciplines. It is not only in the interests of all government to strengthen and build upon this system - it is there responsibility.

Yet, having said this, it would be difficult for me not to be concerned about certain recent signs of deterioration in the tone of the transatlantic relationship. And this is why an organization like the transatlantic business dialogue is so vitally important. It is not that closer transatlantic cooperation is an end in itself or an alternative to broader global cooperation; it is rather that a strong North Atlantic relationship is central to our ability to advance a broader and multipolar global community.

Let me conclude by summing up what I see as being at stake in this fundamental relationship. It comes down to the basic question of what sort of world we want; one of three or four major regional blocs - each of which discriminates against the other's members - or a truly global system of rules to deal with our globally integrating world.

Perhaps more than any other force, the principle of non-discrimination - as embodied in the rules-based multilateral trading system - has reduced power politics, and guaranteed all countries equal rights as well as equal responsibilities, irrespective of their size and power. This has proved a remarkably cohesive force over the years, providing a unique and invaluable foundation for international cooperation and consensus. Non-discrimination was the vision of the transatlantic community which arose out of the ruin of the two world wars and which has guided us to today. It is a vision which has helped us to expand trade and investment, to break down barriers between economies and peoples, and to build the multilateral institutions which have done so much to spread the benefits of modernization and growth around the world.

It must also provide a guiding vision for the challenges that lie ahead. I repeat, the challenge is not globalization, which is a growing reality, but our system of international governance, which is still clearly inadequate to our interconnected and interdependent world. The transatlantic community is again being called upon to help build a new vision for our globalized world - it must be one still rooted in the basic ideals of non-discrimination and the rule of law.

* * *

**1-3. Trade Adjustment**

From the U.S. Labor Department Website
http://www.doleta.gov/tradeact/2002act_index.cfm

## Trade Adjustment Assistance Reform Act of 2002

The President signed into law the Trade Adjustment Assistance Reform Act of 2002 (TAA Reform Act) on August 6, 2002. It reauthorizes the Trade Adjustment Assistance (TAA) program through fiscal year 2007, and amends and adds provisions to the TAA program, **many of which apply to TAA petitions received on or after November 4, 2002.**

The TAA Reform Act:

- Repeals NAFTA-TAA, consolidating that program into TAA (Workers certified for NAFTA-TAA under petitions received before November 4, 2002, however, will continue to receive NAFTA-TAA services for as long as their eligibility lasts.)

- Expands eligibility to more worker groups, increases existing benefits available and provides tax credits for health insurance coverage assistance

- Increases timeliness for benefit receipt, training and rapid response assistance

- Legislates specific waiver provisions

- Establishes other TAA programs

NEW! Beginning August 6, 2003, petitioners filing a Petition for Trade Adjustment Assistance may also request consideration for the **Alternative Trade Adjustment Assistance (ATAA) program for older workers**. ATAA is a new program that provides eligible individuals over the age of 50 who obtain new employment within 26 weeks of their separation with a wage subsidy to help bridge the salary gap between their old and new employment. The program was designed to provide assistance to workers for whom the retraining offered under the regular TAA program may not be appropriate. In order for any of the workers in the petitioning worker group to be eligible for ATAA, a request for ATAA consideration must be filed at the same time as the TAA petition is filed. If the worker group is certified as eligible to apply for TAA and ATAA, individuals will have the option of applying for benefits under the TAA program or the ATAA program. The link below provides a recommended form for requesting ATAA consideration.

(…)

## II. NAFTA PREAMBLE (DEBATE OVER NAFTA)

### 2-1. Relevant Provision (Preamble)

**North American Free Trade Agreement**

**PREAMBLE**

The Government of Canada, the Government of the United Mexican States and the Government of the United States of America, resolved to:

STRENGTHEN the special bonds of friendship and cooperation among their nations;

CONTRIBUTE to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation;

CREATE an expanded and secure market for the goods and services produced in their territories;

REDUCE distortions to trade;

ESTABLISH clear and mutually advantageous rules governing their trade;

ENSURE a predictable commercial framework for business planning and investment;

BUILD on their respective rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperation;

ENHANCE the competitiveness of their firms in global markets;

FOSTER creativity and innovation, and promote trade in goods and services that are the subject of intellectual property rights;

CREATE new employment opportunities and improve working conditions and living standards in their respective territories;

UNDERTAKE each of the preceding in a manner consistent with environmental protection and conservation;

PRESERVE their flexibility to safeguard the public welfare;

PROMOTE sustainable development;

STRENGTHEN the development and enforcement of environmental laws and regulations; and

PROTECT, enhance and enforce basic workers' rights;

HAVE AGREED as follows:

## 2-2. NAFTA at Ten (1994-2004)

*2-2-1. Success*

2-2-1-1. An Official Evaluation by Member Countries

From the USTR Website
http://www.ustr.gov/regions/whemisphere/nafta2003/brochure-english.pdf

# NAFTA:
# A DECADE OF STRENGTHENING A DYNAMIC RELATIONSHIP

The North American Free Trade Agreement (NAFTA), is an outstanding demonstration of the rewards to outward-looking countries that implement policies of trade liberalization as a way to increase wealth and improve competitiveness. The NAFTA is an example of the benefits that all countries could derive from moving forward with multilateral trade liberalization. Farmers, workers and manufacturers benefit from the reduction of arbitrary and discriminatory trade rules, while consumers enjoy lower prices and more choices.

STRENGTHENING A DYNAMIC RELATIONSHIP

January 1, 2004 marks an important milestone in the trade and economic relationship between Canada, the United States and Mexico. This date marks the tenth anniversary of the launching of the North American Free Trade Agreement (NAFTA). Ten years ago the three countries formed a free trade area with a total gross domestic product (GDP), at present, of US$11.4 trillion. This makes North America the world's largest free trade area, with about one-third of the world's total GDP, significantly larger than that of the European Union. Even with the addition of ten new members next year, the EU's GDP will increase to US$8.3 trillion, still well behind the NAFTA region.

Our three countries have enjoyed a thriving relationship derived from their decision to open doors and break down barriers. As we approach NAFTA's tenth anniversary, markets continue to open up for a freer flow of goods, services and investment, and our economies are integrating as never before. By expanding trade, investment and employment, the NAFTA is enhancing opportunities for the citizens of all three countries and has made our trilateral relationship more dynamic.

Looking forward, the Parties are committed to ensuring that the NAFTA strengthens this relationship. By maintaining the NAFTA rules-based framework for expanding the scope of North American business relationships, we are setting the conditions in which citizens of North America can excel.

## STRENGTHENING TRILATERAL TRADE AND INVESTMENT

By strengthening the rues an procedures governing trade and investment on this continent, the NAFTA has allowed trade and investment flows in North America to skyrocket. According to figures of the International Monetary Fund, total trade among the three NAFTA countries has more than doubled, passing from US$306 billion in 1993 to almost US$621 billion in 2002. That's US$1.2 million every minute. In this same period:

> Canada's exports to its NAFTA partners increased by 87 percent in value. Exports to the United States grew from US$113.6 billion to US$213.9 billion, while exports to Mexico reached US$1.6 billion.
>
> US exports to Canada and Mexico grew from US$147.7 billion (US$51.1 billion to Mexico and US$96.5 billion to Canada) to US$260.2 billion (US$107.2 and US$152.9 billion, respectively).
>
> Mexican exports to the US grew by an outstanding 234 percent, reaching US$136.1 billion. Exports to Canada also grew substantially from US$2.9 to US$8.8 billion, an increase of almost 203 percent.

The NAFTA has allowed both Canada and Mexico to increase their exports to the United States but , not at the expense of each other's share in the U.S. merchandise import market. That's because substantial new trade has been generated throughout North America. Canada has consistently accounted for approximately 18 percent U.S. imports, while Mexico has seen its share of the U.S. imports increase from 6.8 percent in 1993 to 11.6 percent in 2002.

The NAFTA has also boosted competitiveness at the global level. The Agreement has been instrumental in making North America one of the most active trading regions in the world. The NAFTA countries now account for almost 19 percent of global exports and 25 percent of imports.

NAFTA fosters an environment of confidence and stability required to make long-term investments and partnering commitments. With a strong, certain and transparent framework for investment, North America has attracted foreign direct investment (FDI) at record levels. In 2000, FDI by other NAFTA partners in the three countries reached US$299.2 billion, more than double the US$136.9 billion figure registered in 1993. NAFTA has also stimulated increased investment from countries outside of NAFTA. North America now accounts for 23.9 percent of global inward FDI and 25 percent of global outward FDI.

## STRENGTHENING PROSPERITY IN NORTH AMERICA

Liberalized trade provides advantages for businesses and consumers. Manufacturers in the NAFTA region benefit from a greater supply of inputs at lower prices. The result has been

a rise in productivity that strengthens their competitiveness in global markets. For consumers in all three countries, NAFTA has provided more choices at competitive prices. Lower tariffs mean that families pay less for the products that they buy and they have a greater selection of goods and services, which increases their standards of living. The NAFTA has provided benefits in other, sometimes unexpected, ways as well. The movement of goods and people is creating growing linkages that facilitate the exchange of ideas and methods of addressing common challenges. People of the three countries are visiting each other in increasing numbers and are forming families and friendships that span the continent, which, in turn, promotes a deeper understanding of their respective cultures.

## STRENGTHENING ENVIRONMENTAL PROTECTION

The NAFTA partners recognize the importance of protecting the environment for themselves and for future generations. The economic integration promoted by the NAFTA has spurred better environmental performance across the region by facilitating the transfer of green technologies and market-based solutions to environmental problems and, ultimately, by increasing national wealth. Through the North American Agreement on Environmental Cooperation (NAAEC), the partners are promoting effective enforcement of environmental laws in all three countries. The Commission for Environmental Cooperation (CEC), created by the NAAEC, has trilateral programs that facilitate the sharing of information, data, and best practices; promote transparency and public participation; and foster enhanced technical expertise and environmental policies among the three countries.

In 2003, the CEC Council adopted the Strategic Plan for North American Cooperation in the Conservation of Biodiversity. This is a landmark of cooperation among the NAFTA partners to protect our shared environment, and under this Plan the NAFTA Parties will identify potential collaborative opportunities for biodiversity conservation that arise from regional trade.

In 2002, the CEC Secretariat prepared a report on Environmental Challenges and Opportunities of the Evolving North American Electricity Market. In response, the Council established a North American Air Working Group to provide guidance and to facilitate future cooperative work on air related issues.

In 2002, the Parties agreed to a cooperative agenda to protect children from environmental risks, and in 2003 the CEC Council agreed to publish North America's first report on environment and health indicators for children.

Over the years, the CEC has prepared North American Regional Action Plans aimed at achieving sound management of chemicals. This program has resulted in the elimination of the production and use of chemicals such as DDT and chlordane within North America.

In 2003, the CEC organized its second North American symposium on assessing the environmental effects of trade, which focused on energy and agriculture.

In June 2003, the CEC Council agreed to work toward the development of a green purchasing action plan that is consistent with national and international obligations of the Parties.

## STRENGTHENING THE RESPECT FOR BASIC LABOUR STANDARDS

The North American Agreement on Labour Cooperation (NAALC) adds a social dimension to the NAFTA. Through NAFTA's labour supplemental agreement, the continental trading partners seek to improve working conditions and living standards, and commit themselves to promoting 11 labour principles to protect, enhance and enforce basic workers' rights. To accomplish these goals, the NAALC creates mechanisms for cooperative activities and intergovernmental consultations, as well as for independent evaluations and dispute settlement related to the enforcement of labour laws.

Enforcement of labor laws in the NAALC countries has been greatly enhanced through an active program of cooperative activities in key areas such as occupational safety and health, protection for migrant workers, workforce development. The tripartite participation of labor union representatives, employers and government officials in the continuing dialogue among the NAALC countries also lends important balance to the policy discussions and programs.

The Agreement establishes institutions and creates a formal process through which the public may raise concerns about labor law enforcement directly with governments. This process has led to 26 submissions having been filed and reviewed under the NAALC on issues such as freedom of association; the right to organize and bargain collectively, the right to strike; child labor; minimum employment standards; employment discrimination; occupational safety and health; and the protection of migrant workers.

Over 50 trilateral cooperative programs have been carried under the NAALC including conferences, seminars, and technical exchanges focusing on labor relations, occupational safety and health, workplace equity, and workforce development.
The three countries have established a Trilateral Working Group on Occupational Safety and Health. The purpose of the Working Group is to review issues raised in public submissions, formulate technical recommendations for consideration by the governments; develop and evaluate technical cooperation projects; and identify occupational safety and health issues appropriate for bilateral and trilateral cooperation.

## STRENGTHENING OUR COMMITMENT FOR FURTHER TRADE LIBERALIZATION

The success of the NAFTA in increasing prosperity in our countries through the creation of more and better paying jobs, has strengthened our interest in pursuing further regional and multilateral trade liberalization. The NAFTA Parties share the view that the multilateral trading system is a tremendous opportunity for all countries to strengthen their economies and societies. While the WTO's Cancun Ministerial meeting was a set-back, Canada, the United States and Mexico remain committed to the Doha Round of negotiations and will continue to work to achieve success.

At the regional level, the NAFTA Parties remain committed to the successful conclusion of the Free Trade Area of the Americas (FTAA) negotiations by January 2005. The FTAA will build on the existing free trade agreements and on the expanding links that the NAFTA countries have elsewhere in the hemisphere, allowing them take full advantage of emerging hemispheric markets.

In addition, at the bilateral level, each of our countries has built on the NAFTA experience to negotiate additional free trade agreements. Since 1994:

Canada has concluded free trade agreements with Chile, Costa Rica and Israel, and is negotiating with four countries in Central America (El Salvador, Guatemala, Honduras and Nicaragua), the European Free Trade Association, and Singapore. Canada has agreed to initiate discussions toward bilateral free trade agreements with the Caribbean Community and Common Market (CARICOM), the Dominican Republic (DR) and the Andean Community (Bolivia, Colombia, Peru, Ecuador and Venezuela).

The United States has concluded free trade agreements with Jordan, Chile and Singapore, and is currently negotiating with five countries of Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), Morocco, Australia, and the Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland). The United States has announced its intent to enter into negotiations with the Dominican Republic and Bahrain.

Mexico has concluded free trade agreements with Chile, the European Union, the European Free Trade Association, Israel, Bolivia, Colombia, Venezuela, Nicaragua, the Central America Northern Triangle (El Salvador, Guatemala, and Honduras), Costa Rica, and Uruguay. Mexico is currently negotiating a free trade agreement with Japan and Argentina.

For more information about NAFTA, please visit our websites:
Canada: http://www.dfait-maeci.gc.ca
United States: http://www.ustr.gov
Mexico: http://www.economia.gob.mx

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| PIERRE S. PETTIGREW | ROBERT B. ZOELLICK | FERNANDO CANALES |
| Minister for | United States Trade | Secretary of the |

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| International Trade,<br>Canada | Representative,<br>United States of America | Economy,<br>Mexico |

2-2-1-2. Daniel T. Griswold (Cato Institute)

From the Cato Institute Website
http://www.cato.org/dailys/01-08-04.html

January 8, 2004

## After 10 Years, NAFTA Continues to Pay Dividends

by Daniel T. Griswold

*Daniel T. Griswold is associate director of the Center for Trade Policy Studies at the Cato Institute.*

(…)

"Nevertheless, ill-informed domestic critics continue to assert that NAFTA has cost hundreds of thousands of American jobs and, further, is somehow responsible for the lingering recession in U.S. manufacturing. They use NAFTA as an argument against proposed trade agreements with Central American and other Latin American countries. But an objective look at the record shows that none of the dire warnings about the agreement have come true."

(...)

NAFTA has been a blessing for many U.S. manufacturers. Our domestic automobile industry, for example, now produces about the same number of cars and light trucks in the United States as it did before the agreement, but it assembles those vehicles more cost-effectively by spreading out its sourcing among the three NAFTA countries -- the United States, Mexico, and Canada. (…)

The recession in manufacturing sector that began in 2000 cannot be reasonably blamed on NAFTA. It began years after the agreement took effect, and for reasons unrelated to NAFTA, such as the East Asian financial crisis, the bursting of the dot com and telecom bubbles, a collapse of business investment and demand, corporate scandals and uncertainty caused by the war on terrorism. (…)

*2-2-2. Partial Success*

From the World Bank Website
http://wbln0018.worldbank.org/LAC/LACInfoClient.nsf/1daa461032291238852568310005ce0eb/717aaa5b2cbdd9c885256cf00062fa44/$FILE/NAFTA-US%20v2Final.pdf

**Lessons from NAFTA for Latin American and Caribbean (LAC) Countries: A Summary of Research Findings**

Daniel Lederman, William F. Maloney, and Luis Serven[1]
Office of the Chief Economist for LAC
The World Bank
December 2003

## Introduction

The Free Trade Area of the Americas (FTAA) is closer to becoming a reality, with potentially major effects on the flows of goods and capital across the Western Hemisphere and significant consequences for growth and development in the region. In Central America, the advent of the Central America – U.S. Free Trade Agreement (CAFTA) is imminent, and Chile already has an agreement with the U. S. This article is a summary of a broader report that aims to provide guidance to these countries on what they can expect from this type of trade agreement, and to identify policies -- both in terms of measures that countries can take unilaterally and those that could be negotiated with FTA partners – that can help them derive the maximum benefits from trade integration in the Americas.

Mexico's performance under NAFTA provides the most directly relevant experiment from which other LAC countries can learn about the likely contents and economic effects of a trade agreement with the U.S. For this reason, the report draws extensively from the NAFTA experience. However, attempting to draw lessons from NAFTA for the FTAA poses several difficulties. First, only a short time has elapsed since implementation of the agreement, and Mexico's post-NAFTA years started with the dramatic setback of the Tequila crisis in 1995, making it hard to disentangle the effects of the treaty on the Mexican economy. Second, an FTAA or CAFTA might differ from NAFTA, and thus their results could also be different in important dimensions. Third, there is considerable diversity in the initial conditions of LAC countries hoping to join the FTAA, and hence the key priorities, necessary preparatory measures and likely effects of accession also differ considerably across countries.

In these respects, the report summarized in this article is selective rather than exhaustive. While it devotes attention to a few key issues regarding possible content changes between NAFTA and the FTAA, and considers how specific characteristics of FTAA prospective members may shape its impact, it does not attempt to cover the full range of alternatives of FTAA design and/or member countries' initial conditions. Nor does it intend to identify the particular set of policies best suited for each individual country in Latin America and the Caribbean; instead, it underscores those reform areas where the experience of NAFTA suggests that policy action in preparation of, or

conjunction with, the FTAA will have the biggest payoff in terms of growth and development. A companion report on "Deepening NAFTA" draws policy lessons for Mexico.

The report's main conclusion regarding NAFTA is that the treaty has helped Mexico get closer to the levels of development of its NAFTA partners. The research suggests, for example, that Mexico's global exports would have been about 25% lower without NAFTA, and foreign direct investment (FDI) would have been about 40% less without NAFTA. Also, the amount of time required for Mexican manufacturers to adopt U. S. technological innovations was cut in half. Trade can probably take some credit for moderate declines in poverty, and has likely had positive impacts on the number and quality of jobs. However, NAFTA is not enough to ensure economic convergence among North American countries and regions. This reflects both limitations of NAFTA's design and, more importantly, pending domestic reforms.

An FTAA designed along the lines of NAFTA will offer new opportunities for growth and development in LAC, particularly if improvement is achieved on some aspects of NAFTA – such as the distorting rules of origin and the anti-dumping and countervailing duties. However, significant policy and institutional reforms will be necessary in most countries to seize those opportunities. In particular, the reforms will need to focus on reducing macroeconomic instability, improving the investment climate and the institutional framework, and putting in place an education and innovation system capable of fostering technological advancement and productivity growth. In addition, regional trade integration will have to be accompanied by unilateral, bilateral and multilateral actions on other trade fronts to maximize the gains from trade liberalization and reduce the possible costs from trade diversion caused by the FTAA.

These conclusions follow from careful analysis of a comprehensive, although not exhaustive, set of issues associated with the implementation of NAFTA and the upcoming FTAA. To identify the effects of NAFTA on Mexico and other countries – especially the neighboring countries of Central America and the Caribbean -- the analytical work reviewed policies and trends prior to and after NAFTA implementation, using in many cases a broader international perspective and drawing lessons from the experience of other FTAs, notably the EEC / EU.

The report consists of seven chapters. Chapter 1 examines the evidence concerning economic convergence in North America by assessing how NAFTA has affected Mexico's per capita income relative to the U.S. Chapter 2 studies the evolution of macroeconomic synchronization across NAFTA member countries, sectors and regions, and draws the relevant implications for macroeconomic policy design. Chapter 3 provides a critical evaluation of NAFTA's remaining trade barriers by focusing on the impact of rules of origin on trade in manufactures, especially textiles and apparel, agricultural policies, and anti-dumping and countervailing duties. Chapter 4 focuses on the integration of factor markets, namely capital and labor. Chapter 5 provides a comprehensive diagnosis of Mexico's innovation system. Chapter 6 examines the consequences of NAFTA for the trade flows of third countries, and Chapter 7 does the same with FDI flows to countries excluded from

NAFTA. Both chapters pay particular attention to NAFTA's neighbors in Central America and the Caribbean. This summary discusses the report's main findings and policy recommendations.

(…)

*2-2-3. Failure*

From the **Public Citizen** (Global Trade Watch) Website
http://www.publiccitizen.org/publications/release.cfm?ID=7295

Before NAFTA, trade agreements dealt with traditional matters such as cutting tariffs and lifting quotas that had set the terms of trade in goods between countries. NAFTA shattered the boundaries of trade agreements; its central focus and most powerful rules concerned investment, and it contained 900 pages of one-size-fits-all "non-trade" rules with significant implications for food safety, drug patents and access to medicines, not to mention jobs, wages and economic security. It also constrained the ability of local government to zone against sprawl or toxic industries. NAFTA was a radical experiment – never before had a merger of three nations with such different levels of development been attempted.

When NAFTA was being debated, proponents and opponents alike predicted its consequences. Now the data are in. What are NAFTA's lessons in Canada, the United States and Mexico? The Free Trade Area of the Americas (FTAA) and Central American Free Trade Agreement (CAFTA) are both proposals to expand NAFTA, but NAFTA's record is playing a significant role in both the hesitance of some FTAA target countries to adopt the NAFTA model and the concerns of U.S. lawmakers to approve CAFTA.

(…)

**U.S. WORKERS' JOBS, WAGES AND ECONOMIC SECURITY**
http://www.citizen.org/documents/NAFTA_10_jobs.pdf

NAFTA was a radical experiment — never before had a merger of three nations with such different levels of development been attempted. Plus, until NAFTA, "trade" agreements only dealt with cutting tariffs and lifting quotas setting terms of trade in goods between countries. But NAFTA contained 900 pages of one-size-fits-all rules to which each nation was required to conform all of its domestic laws — regardless of whether voters and their democratically-elected representatives had previously rejected the very same policies in Congress, state legislatures or city councils. NAFTA required limits on the safety and inspection of meat sold in grocery stores; new patent rules that raised medicine prices; constraints on local government's ability to zone against sprawl or toxic industries; and elimination of preferences for spending your tax dollars on U.S.-made products or locally-grown food. Calling NAFTA a "trade" agreement is misleading, NAFTA is really an investment agreement. Its core provisions grant foreign investors a remarkable set of new rights and privileges that promote relocation abroad of factories and jobs and the privatization and deregulation of essential services, such as water, energy and health care.
(…)

Ten years of NAFTA has resulted in over 1.5 million Mexican farm livelihoods destroyed as cheap U.S. corn was dumped in Mexico, dropping prices paid to Mexican farmers by 70%. Displaced rural workers have migrated to Mexico's overcrowded cities where underemployment and unemployment have kept wages for scarce jobs low or made the perilous journey to the U.S. to seek work, with such migration more than doubling under NAFTA as Mexico's economy failed to create nearly enough jobs for its workers.1 Despite this, NAFTA defenders often point to Mexico's increased exports to the U.S. and inflow of foreign investment as evidence of success. Yet, NAFTA rules forbade Mexico from adopting the policies that could have harnessed these inflows to create permanent gains for the Mexico's economy. And while exports increased, the average wage paid Mexico's manufacturing workers declined from $5 per day (which was not a living wage) to only $4.
(…)

**UNDERMINING SOVEREIGNTY AND DEMOCRACY**
http://www.citizen.org/documents/NAFTA_10_democracy.pdf

Think of NAFTA as a Trojan Horse attack on sovereignty and democracy: hidden beneath the "free trade" cover was an entire anti-democratic governance system under which policies affecting our daily lives in innumerable ways are decided out of our sight or control. When NAFTA was debated in 1993, few realized that this "trade agreement" included hundreds of pages of non-trade policies to which every signatory country was required to conform its domestic laws — even if Congress or state legislatures had opposed the very policies NAFTA's terms required. NAFTA set limits on domestic meat and produce safety and inspection, environmental protections, service sector regulation, investment and development policy, and
banned many Buy-America and other procurement preferences. Plus, NAFTA established dozens of closed-door committees empowered to set new standards outside the domestic regulatory process — which requires openness and public participation.
(…)
NAFTA's "investor-to-state" dispute resolution, which applies to NAFTA's investment rules empowers private investors and corporations to sue NAFTA-signatory governments in special closed-door trade tribunals for cash compensation. NAFTA supporters claimed that extensive investor protections and their private enforcement were necessary to protect investors from state seizure of private property (i.e. expropriation, nationalization).Yet the majority of NAFTA investor-to-state cases have had little to do with property seizure. Instead, the cases have challenged the basic functions of government — environmental and health laws, zoning and permit policies, procurement practices and even Canada's public mail delivery system.
(…)

## III. NAFTA CHAPTER I

*** Summary (NAFTA Chapter 1)**

*From the SICE of the OAS Web-site*

http://www.sice.oas.org/summary/nafta/nafta1.asp

**OAS Overview of the North American Free Trade Agreement**

**Chapter One: Objectives and Scope**

This chapter declares the establishment of a free-trade area between Canada, the United States and Mexico, describes the overall objectives of the North American Free Trade Agreement (the NAFTA or Agreement), sets out the relationship of the NAFTA to other international agreements, and confirms the extent of the obligations undertaken by Canada, the United States and Mexico (the Parties) in entering into the NAFTA. In effect, it provides the guiding principles for the interpretation of the Agreement as a whole. These principles non-discrimination, transparency, cooperation and due process then worked out in detail in the chapters that follow. Article 101 sets out that the NAFTA is established pursuant to and consistent with Article XXIV of the General Agreement on Tariffs and Trade (the GATT), the Article that provides the framework and criteria for free-trade agreements involving GATT members.

Article 102 sets out the objectives of the three countries in entering into the NAFTA. The Article contains: a statement that the Agreement is based on the fundamental principles of national treatment, most-favoured-nation (MFN) treatment, and transparency; a commitment to facilitate the cross-border movement of goods and services; a commitment to provide adequate and effective protection and enforcement of intellectual property rights; a statement calling for effective domestic procedures for the implementation and application of the Agreement; and a rule of interpretation requiring the Parties to apply the Agreement in the light of its objectives and in accordance with international law.

Paragraph 2 of Article 102 affirms a basic provision of customary international law regarding the interpretation of international agreements as set out in the Vienna Convention on the Law of Treaties. The Parties shall interpret and apply the provisions of the Agreement in the light of its objectives and in accordance with applicable rules of international law. For example, the "Notes" to the Agreement that follow the main body of the text set out agreed interpretations on various provisions of the Agreement, and thus are essential to an accurate understanding of the text. Also, under the Vienna Convention, the subsequent practice of the Parties is an important guide to their intentions. Thus, where subsidiary rules agreed by the Parties (such as the uniform regulations provided for in chapter five, the marking rules called for in annex 311, or exchanges of letters on specific

subjects) more fully elaborate various provisions of the Agreement, the Agreement should be read in the light of such rules.

***Relationship to Other International Agreements***

Article 103 defines the relationship of the NAFTA to other international agreements to which the NAFTA countries are parties. It affirms existing rights and obligations under both bilateral and multilateral agreements, including the GATT, and provides that the **NAFTA prevails in the event of any inconsistency between it and such other international agreements, except as otherwise provided.** *(emphasis added)*

Canada and the US have agreed to suspend the operation of the Canada-US Free Trade Agreement, so long as both countries are parties to the NAFTA, and intend to enter into an agreement to establish transitional arrangements for certain aspects of the FTA, including for chapter nineteen (judicial review and dispute settlement in antidumping and countervailing duty matters), and to carry forward certain other provisions of the FTA not otherwise dealt with in the NAFTA.

Article 104 reverses the general rule of Article 103 in regard to certain international environmental agreements. It provides that, so long as a government taking trade action under a specified international environmental agreement chooses the least trade restrictive measure available, that measure will take priority over its NAFTA obligations. Accordingly, in the event of any inconsistency between the NAFTA and the specific trade obligations of the Convention on International Trade in Endangered Species (CITES), the Montreal Protocol on Substances that Deplete the Ozone Layer, the Basel Convention on the Control of Trans-boundary Movements of Hazardous Wastes and Their Disposal (when it comes into force), or the Canada-United States and the United States-Mexico bilateral agreements on the transport of hazardous wastes (listed in annex 104.1), the latter will prevail.

Article 104 is limited in application to those international agreements that have been specifically included in its coverage. It does not provide cover for trade restrictions against exports unless the relevant convention so provides, and the importing country has chosen the least trade restrictive measure available .

Article 105 commits each Party to respect its NAFTA international treaty obligations throughout its territory, including by state and provincial governments. The Article builds on Article XXIV:12 of the GATT. It provides that the three federal governments shall ensure that all necessary measures are taken to give effect to the Agreement, including its observance by state and provincial governments, subject to the exceptions set out elsewhere in the text. The manner in which the obligations under the Agreement are implemented is strictly a matter for decision within each Party.

Not all provisions of the NAFTA apply to provincial, state or local governments. For example, the government procurement disciplines of the Agreement do not cover any sub-federal or local government entities. NAFTA chapters eleven (investment), twelve

(cross-border trade in services) and fourteen (financial services) exempt all existing local government measures and provide a means for "grandfathering" sub-federal measures. Other NAFTA provisions (e.g., chapter nine on standards-related measures) carry a lower level of obligation for state, sub-federal or local governments than that imposed on federal governments.

## 3-1. Relevant Provisions (Chapter 1)

### Chapter One: Objectives (NAFTA)



### Article 101: Establishment of the Free Trade Area

The Parties to this Agreement, consistent with Article XXIV of the General Agreement on Tariffs and Trade, hereby establish a free trade area.

### Article 102: Objectives

1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:

a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;

b) promote conditions of fair competition in the free trade area;

c) increase substantially investment opportunities in the territories of the Parties;

d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;

e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and

f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

2. The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

**Article 103: Relation to Other Agreements**

1. The Parties affirm their existing rights and obligations with respect to each other under the Genera lAgreement on Tariffs and Trade and other agreements to which such Parties are party.

2. In the event of any inconsistency between this Agreement and such other agreements, this Agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement.

**Article 104: Relation to Environmental and Conservation Agreements**

1. In the event of any inconsistency between this Agreement and the specific trade obligations set out in:

a) the Convention on International Trade in Endangered Species of Wild Fauna and Flora, done at Washington, March 3, 1973, as amended June 22, 1979,

b) the Montreal Protocol on Substances that Deplete the Ozone Layer, done at Montreal, September 16, 1987, as amended June 29, 1990,

c) the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, done at Basel, March 22, 1989, on its entry into force for Canada, Mexico and the United States, or

d) the agreements set out in Annex 104.1,

such obligations shall prevail to the extent of the inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement.

2. The Parties may agree in writing to modify Annex 104.1 to include any amendment to an agreement referred to in paragraph 1, and any other environmental or conservation agreement.

**Article 105: Extent of Obligations**

The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments.

**Annex 104.1**

Bilateral and Other Environmental and Conservation Agreements

1. The Agreement Between the Government of Canada and the Government of the United States of America Concerning the Transboundary Movement of Hazardous Waste, signed at Ottawa, October 28, 1986.

2. The Agreement Between the United States of America and the United Mexican States on Cooperation for the Protection and Improvement of the Environment in the Border Area, signed at La Paz, Baja California Sur, August 14, 1983.

* Relevant Provisions (*Tariffication* Case)

**WTO Agreement on Agriculture**

**Article 4: Market Access**

1. Market access concessions contained in Schedules relate to bindings and reductions of tariffs, and to other market access commitments as specified therein.

2. Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties', except as otherwise provided for in Article 5 and Annex 5.

1.These measures include quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties, whether or not the measures are maintained under country-specific derogations from the provisions of

GATT 1947, but not measures maintained under balance-of-payments provisions or under other general, non-agriculture-specific provisions of GATT 1994 or of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement.

**The Canada-United States Free Trade Agreement (FTA)**

**Article 710**

Unless otherwise specifically provided in this Chapter, the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the General Agreement on Tariffs and Trade (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI.

**The North American Free Trade Agreement (NAFTA)**

**Article 701: Scope and Coverage**

1. This Section applies to measures adopted or maintained by a Party relating to agricultural trade.
2. In the event of any inconsistency between this Section and another provision of this Agreement, this Section shall prevail to the extent of the inconsistency.

**Article 702: International Obligations**

1. Annex 702.1 applies to the Parties specified in that Annex with respect to agricultural trade under certain agreements between them.

**Annex 702.1: Incorporation of Trade Provisions**

4. The Parties understand that Article 710 of the Canada - United States Free Trade Agreement incorporates the GATT rights and obligations of Canada and the United States with respect to agricultural, food, beverage and certain related goods, including exemptions by virtue of paragraph 1(b) of the Protocol of Provisional Application of the GATT and waivers granted under Article XXV of the GATT.

* * *

## 3-2. Tariffication Case (CDA-95-2008-01)

http://www.sice.oas.org/DISPUTE/nafta/english/ca95081a.asp

***Tariffs applied by Canada to certain U.S.-Origin Agricultural Products***

**Final Report of the Panel (Dec. 2, 1996)**

*** * ***

(…)

## IV. CENTRAL CONTENTIONS OF THE DISPUTING PARTIES

A. The United States

16. The central contention of the United States is that Canada is applying tariffs to over-quota imports of specified agricultural products of U.S.-origin contrary to its commitments under the NAFTA. In the submission of the United States, these over-quota tariff rates are "significantly in excess of the NAFTA bound rate of duty and significantly above the rate in existence on December 31, 1993".

17. The United States invokes NAFTA Article 302(1) and (2) which provide:

    1. Except as otherwise provided in this Agreement, no Party may increase any existing customs duty, or adopt any customs duty, on an originating good.
    2. Except as otherwise provided in this Agreement, each Party shall progressively eliminate its customs duties on originating goods in accordance with its Schedule to Annex 302.2.

(…)

B. Canada

19. Canada contends that, while it imposed tariffs on over-quota imports of specified U.S.-origin goods in question, the tariffs were imposed in consequence of an obligation to tariffy existing non-tariff barriers to trade in the goods in question pursuant to the WTO Agreement on Agriculture. This agreement entered into force as between Canada and the United States on January 1, 1995. (…)

20. Canada further contends that, under the NAFTA, the disputing Parties agreed that while in-quota trade in agricultural goods between them would continue to be governed by the regime established by the Canada-United States Free Trade Agreement ("FTA"),

over-quota trade would be governed by the arrangements that would emerge from the Uruguay Round of Multilateral Trade Negotiations ("Uruguay Round"). As the tariffs were imposed pursuant to the WTO Agreement on Agriculture obligation to convert existing non-tariff barriers into tariff equivalents, their application to the trade in agricultural goods between Canada and the United States is consistent with the Parties' commitments under the NAFTA.

21. Canada relies, inter alia, on FTA Article 710, incorporated into the NAFTA by NAFTA Annex 702.1, on NAFTA Article 309(1) and/or on NAFTA Note 5 as well as on the *travaux préparatoires* and other documents and on the subsequent practice of the disputing Parties.

(…)

## V. FACTUAL AND LEGAL BACKGROUND

*A. The Canada-United States Free Trade Agreement (FTA)*

26. FTA Article 710 provided:

> Unless otherwise specifically provided in this Chapter, the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the General Agreement on Tariffs and Trade (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI.

(…)

*B. The GATT Uruguay Round and the Conclusion of the North American Free Trade Agreement*

(…)

29. Various Contracting Parties, including Canada and the United States, submitted proposals suggesting approaches to the negotiations. On July 7, 1987 the United States presented its first proposal on agricultural reform calling for a complete phase-out over 10 years of all import barriers. This was followed by a further proposal by the United States on November 9, 1988 in which it was suggested that all non-tariff barriers to imports be converted into tariff equivalents. The tariffication proposal was developed further in a series of documents submitted by the United States - in particular, a *Discussion Paper on Tariffication* of July 10, 1989 ("the July 1989 U.S. Tariffication Paper") and a *Submission on Comprehensive Long-Term Agricultural Reform* of October 25, 1989.

(…)

*C. The WTO Agreement on Agriculture*

(…)

38. The Uruguay Round came to an end with the adoption and signature of the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations ("the Final Act") in Marrakesh on April 15, 1994. The WTO Agreement, including the WTO Agreement on Agriculture, was an integral part of the Final Act. In accordance with the terms of paragraph 4 of the Final Act, the WTO Agreement entered into force on January 1, 1995.

(…)

*D. Relevant NAFTA provisions*

(…)

42. NAFTA Article 302, in paragraphs (1) and (2), provides, inter alia, that, insofar as originating goods are concerned, and except as otherwise provided in the NAFTA, no Party may increase any existing customs duty, or adopt any customs duty and that each Party shall progressively eliminate its customs duties in accordance with its Schedule to NAFTA Annex 302.2.

(…)

44. NAFTA Article 701, addressing the scope and coverage of NAFTA Chapter Seven, "Section A -Agriculture", provides as follows:

**Article 701: Scope and Coverage**

> 1. This Section applies to measures adopted or maintained by a Party relating to agricultural trade.
> 2. In the event of any inconsistency between this Section and another provision of this Agreement, this Section shall prevail to the extent of the inconsistency.

47. The regime applicable to agricultural trade between Canada and the United States was addressed in NAFTA Article 702(1) and Annex 702.1 in the following terms:

**Article 702: International Obligations**

> 1. Annex 702.1 applies to the Parties specified in that Annex with respect to agricultural trade under certain agreements between them.

**Annex 702.1**
**Incorporation of Trade Provisions**

> 4. The Parties understand that Article 710 of the Canada - United States Free Trade Agreement incorporates the GATT rights and obligations of Canada and the United States with respect to agricultural, food, beverage and certain related goods, including exemptions by virtue of paragraph 1(b) of the Protocol of Provisional Application of the GATT and waivers granted under Article XXV of the GATT.

(…)

## VI. ARGUMENTS OF THE PARTIES

(…)

*D. The application of the tariffs resulting from tariffication to over-quota imports of U.S.-origin agricultural goods under the NAFTA*

(a) The Canadian case

63. Canada's argument in support of its contention that it is entitled under the NAFTA to apply the tariffs created by the process of tariffication to over-quota imports of U.S.-origin agricultural goods rests on its view of the interrelationship of the FTA, the NAFTA and the WTO Agreement on Agriculture. The central element of this argument is that, through NAFTA Annex 702.1, which incorporated FTA Article 710, Canada and the United States agreed that over-quota trade in agricultural goods would continue to be governed by multilateral arrangements. (…) With the entry into force of the WTO Agreement on Agriculture on January 1, 1995, and pursuant to the obligation therein to tariffy existing non-tariff barriers, over-quota trade in the goods in question could no longer be subject to non-tariff barriers but would be subject instead to the tariff equivalents that had been established in the context of tariffication.

(…)

74. It follows, in Canada's view, that the incorporation into the NAFTA of FTA Article 710 preserved the Parties' rights and obligations not only under the GATT as it was at the time the NAFTA was concluded but also under the emerging WTO Agreement on Agriculture, an agreement concluded "within the framework and under the aegis of" the GATT. By incorporating FTA Article 710, the NAFTA therefore also incorporated the tariffication regime on which the WTO Agreement on Agriculture was based.

(…)

77. By way of alternative to its central proposition, Canada contends that, in the event of a conflict between its obligations under the NAFTA and under the WTO Agreement on Agriculture, its obligations under the WTO Agreement on Agriculture must prevail as, in accordance with accepted principles of international law, the "WTO Agreement on Agriculture is a later-in-time agreement between the same parties regarding the same subject matter".

(…)

80. Finally, Canada contends that the approach advocated by the United States would lead to absurd and unreasonable results as (a) it would lead to conflict between the NAFTA and the WTO Agreement on Agriculture, a situation which the Parties did not intend, and (b) it would restore the status quo ante as between the Parties as, if FTA Article 710 does not incorporate the results of the Uruguay Round, the GATT Article XI regime as it existed when the FTA or the NAFTA entered into force would be retained as between Canada and the United States and would continue to govern the Parties' bilateral over-quota trade in the products in issue.

(b) The United States reply

81. The United States response to Canada's argument rests on a different appreciation of the interrelationship of the FTA, the NAFTA and the WTO Agreement on Agriculture in the context of the present dispute. Central to this approach is the proposition that tariffs and non-tariff barriers are two distinct trade instruments: "tariffs are not interchangeable with non-tariff barriers"; different rules apply to each. This dispute, in the United States contention, is about tariffs, not about non-tariff barriers. The critical issue is, therefore, in the United States view, whether there is some provision in the NAFTA which permits Canada to maintain the tariffs that it has imposed. (…)

83. (…) The WTO Agreement on Agriculture, the text of which was adopted on December 15, 1993, some 12 months after the NAFTA was signed and 17 days before it entered into force, required the elimination of all non-tariff barriers to imports of agricultural goods. By this time, Canada had, however, within the NAFTA, agreed to eliminate its tariffs on imports of U.S.-origin agricultural goods. It was thus faced with the obligation under the WTO Agreement on Agriculture to eliminate its non-tariff barriers and the prohibition under the NAFTA on increasing tariffs. As a result of its negotiating gamble, Canada was therefore faced with a requirement to remove its non-tariff barriers under one agreement and a prohibition on tariffying under another. The inability to resolve this conflict in negotiations with the United States, coupled with the imposition of tariffs on over-quota imports of U.S.-origin agricultural goods, led to the present dispute.

84. A third element of the United States reply is that, under GATT Article XXIV, the NAFTA is an exception to the GATT, not subject to it. (…)

85. (…) In the United States contention, it is an "absurd proposition" to suggest that WTO tariff bindings constitute an exception to the NAFTA tariff bindings. This argument would, in the United States view, "render meaningless all the NAFTA tariff bindings for agricultural, food, beverage and certain related goods".

86. The United States also relies on GATT Article XXIV to rebut the Canadian argument that, in the event of a conflict between Canada's obligations under the NAFTA and its obligations under the WTO Agreement on Agriculture, its obligations under the latter

agreement must prevail as the Agreement on Agriculture is an agreement later-in-time.
(…)

## VII. DECISION OF THE PANEL

(1) Analysis

A. Preliminary matters

(…)

(b) Approach to interpretation

118. The starting point in the interpretation of the NAFTA is NAFTA Article 102(2), which provides:

> The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

119. The applicable rules of international law include, the Parties agree, Articles 31 and 32 of the Vienna Convention on the Law of Treaties 1969 ("the Vienna Convention"), which are generally accepted as reflecting customary international law.

120. The basic proposition of Article 31 is as follows:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".

The Panel must therefore commence with the identification of the plain and ordinary meaning of the words used. In doing so, the Panel will take into consideration the meaning actually to be attributed to words and phrases looking at the text as a whole, examining the context in which the words appear and considering them in the light of the object and purpose of the treaty.

121. Subsequent agreement and subsequent practice are also factors which Article 31 of the Vienna Convention specifically directs should be taken into account together with the context. The Panel further notes the admissibility of recourse to supplementary means of interpretation, including preparatory work, pursuant to Vienna Convention Article 32 in order to confirm the meaning resulting from the application of the rule in Vienna Convention Article 31 or to determine the meaning when an interpretation in accordance with Vienna Convention Article 31 leaves the meaning ambiguous or obscure or leads to results which are manifestly absurd or unreasonable.

122. The Panel also attaches importance to the trade liberalization background against which the agreements under consideration here must be interpreted. Moreover, as a free trade agreement the NAFTA has the specific objective of eliminating barriers to trade among the three contracting Parties. The principles and rules through which the objectives of the NAFTA are elaborated are identified in NAFTA Article 102(1) as including national treatment, most-favoured-nation treatment and transparency. Any interpretation adopted by the Panel must, therefore, promote rather than inhibit the NAFTA's objectives. Exceptions to obligations of trade liberalization must perforce be viewed with caution.

(…)

B. The central issues in dispute

(…)

(a) The temporal application of FTA Article 710

132. Canada argues that the effect of FTA Article 710 is to make rights and obligations under the GATT, and under any agreement negotiated under the GATT, even subsequent to the entry into force of the NAFTA, part of the NAFTA. This has the effect, in Canada's view, of making obligations under the WTO Agreement on Agriculture part of the NAFTA. The WTO Agreement on Agriculture, Canada claims, is an "agreement negotiated under the GATT". The United States, on the other hand, argues that FTA Article 710 refers only to rights and obligations under the GATT or under agreements negotiated under the GATT existing at the time that the FTA entered into force or, at the most, existing at the time the NAFTA entered into force.

133. The Panel is therefore confronted with the question whether the rights and obligations retained under FTA Article 710, as subsequently incorporated into the NAFTA, are limited to those established under the GATT and its related agreements as at the time of the entry into force of the FTA or of the NAFTA, or whether they extend to later established rights and obligations. Given the incorporation of FTA Article 710 into the NAFTA, the critical date for the operation of FTA Article 710 is, in the Panel's view, the date of entry into force of the NAFTA. However, the most convenient way to approach the matter is to look initially at the meaning of FTA Article 710 in the context of the FTA and then determine whether that meaning was changed when FTA Article 710 was brought into the NAFTA.

(i) The meaning of Article 710 in the FTA

134. The United States argues that the use of the verb "retain" in FTA Article 710 is conclusive. That word, in its view, means "to continue to have, use, recognize, accept etc." and one cannot continue to have something that is not yet in existence. In the view of the Panel, the issue of the temporal application of FTA Article 710 112 is not resolved simply by reference to the terms of the article itself. The Panel does not accept that the meaning of the word "retain" is as restricted as the United States contends; one can "retain" rights that exist in the present, and one can also "retain" rights under a regime that evolves and

extends into the future. An obvious example of this is found in FTA Article 1608(2) under which, "[e]ach Party and investors of each Party retain their respective rights and obligations under customary international law ...." Clearly, this reference to "customary international law" is a reference to an evolving system. Yet the Parties found it quite appropriate to use the word "retain".

135. As the words of FTA Article 710 are on their face capable of bearing two meanings, either GATT rights and obligations in existence at the date of the incorporation of FTA Article 710 or both existing rights and obligations and those which come into existence through subsequently negotiated agreements, the Panel must look elsewhere for guidance regarding which of the two meanings more closely represents the intention of the Parties.

136. The Panel does so, in accordance with Article 31 of the Vienna Convention, by considering the words of FTA Article 710 in their context and in the light of the object and purpose of the agreement as a whole. It is apparent that in the FTA the Parties had other means available to them for limiting the operation of FTA Article 710 to existing rights and obligations if this is what they had intended to achieve. The word "existing", which according to FTA Article 201 means "in effect at the time of the entry into force of this Agreement", could have been introduced. (…) The use of the word "existing" would have made it clear that the "rights and obligations" referred to were only those in existence at the time that the agreement entered into force.

137. In other contexts the Parties were able to express their intention to preserve only existing GATT rights and obligations. Thus, FTA Article 501 provides that each Party is to accord national treatment to the goods of the other "in accordance with the existing provisions of Article III of the General Agreement on Tariffs and Trade (GATT) ...." (emphasis added). Paragraph 2 provides that national treatment is to be applied "in accordance with existing interpretations adopted by the Contracting Parties to the GATT" (emphasis added). (…)

138. This inference is strengthened by the use of similar wording elsewhere in the FTA where a prospective application must surely have been intended. FTA Article 1801(2) falls into this category. This article provides that disputes "arising under both this Agreement and the General Agreement on Tariffs and Trade, and agreements negotiated thereunder (GATT) may be settled in either forum, according to the rules of that forum ..." It seems unlikely that the Parties agreed in FTA Article 1801 that the option of choosing between GATT and FTA dispute settlement applied only to disputes arising under the GATT and negotiated agreements, or to the rules of either forum, only as they existed on January 1, 1989, and that no such right would have applied in respect of any developments under the GATT or to any agreements negotiated after that time. In other words, reference to the GATT and agreements negotiated under the GATT must have been a reference to the GATT not as a fixed body of law but as one that was capable of developing.

139. This, it seems to the Panel, is the essence of Canada's argument that the reference to the GATT in FTA Article 710 had to be understood as a reference to "an evolving system of law". The GATT is more than a static set of rights and obligations. Based on a set of

principles embodied in the General Agreement, the GATT has been developed, clarified and supplemented by subsequent legal instruments through successive negotiating rounds, into a complex of substantive and procedural rules. That process was continuing even as the Parties negotiated the FTA. They could hardly have been unaware of such considerations when they referred in their agreement to the GATT and to agreements negotiated under it.

(…)

145. The Panel concludes therefore that the terms of FTA Article 710, considered in their context and in light of the object and purpose of the FTA as required by the Vienna Convention, are forward-looking.

(ii) The effect of the incorporation of FTA Article 710 into the NAFTA

146. The Panel must now consider whether the forward-looking character of FTA Article 710 was changed when it was incorporated into the NAFTA. Neither Party has suggested that the use of the word "incorporate" in NAFTA Annex 702.1 alone affects the content of FTA Article 710 or changes its forward-looking character. However, the United States regards the wording of paragraph 4 of NAFTA Annex 702.1 to be particularly significant. Paragraph 4 provides as follows:

> The Parties understand that Article 710 of the Canada-United States Free Trade Agreement incorporates the GATT rights and obligations of Canada and the United States with respect to agricultural, food, beverage and certain related goods, including exemptions by virtue of paragraph (1)(b) of the Protocol of Provisional Application of the GATT and waivers granted under Article XXV of the GATT.

147. This paragraph, the United States points out, makes no reference to "agreements negotiated under the GATT". If the Parties had intended to include agreements negotiated under the Uruguay Round within the ambit of FTA Article 710, the United States argues, they would have made reference to these agreements in this understanding. The fact that they did not do so indicates that they did not intend to bring WTO agreements into the NAFTA.

148. The Panel does not find this argument persuasive. NAFTA Annex 702.1(4) can only be viewed as having been included to provide greater certainty. It clarifies FTA Article 710 by mentioning explicitly the GATT PPA exemptions and the GATT waivers that were not referred to in the text of FTA Article 710 itself, thereby overcoming any possible inference that FTA Article 710, which explicitly refers to GATT Article XI, might otherwise omit those exemptions and waivers. Moreover, the language of NAFTA Annex 702.1(4) appears to be inclusive not exclusive. Thus, the Panel would require more explicit evidence of the intention of the Parties to be convinced that NAFTA Annex 702.1(4) changed the meaning of FTA Article 710 or somehow narrowed its scope.

149. The Panel is also unable to find in the general circumstances of the conclusion of the NAFTA anything that would assist in the interpretation of FTA Article 710 as a NAFTA provision. Quite clearly, the Parties used different words in the NAFTA when referring to agreements negotiated under the Uruguay Round than were used in the FTA. In particular, the term "successor agreement" was used frequently as a drafting device in the NAFTA, although it was not so used in the FTA. In the United States view, failure to use such terminology, or to use the terminology of "tariffication" on the incorporation of FTA Article 710 into the NAFTA, when such terms were used elsewhere in NAFTA Chapter Seven, is indicative of the Parties' intention. Canada argues that the Parties intended simply to incorporate into the NAFTA what they had already agreed to under the FTA in respect of agriculture. Since, in the Canadian view, FTA Article 710 as drafted was already "forward-looking" there was no need for additional wording to be included in the NAFTA text.

150. The Panel does not regard the failure of the Parties, when incorporating FTA Article 710 into the NAFTA, to amend it to include words such as "successor agreements" or "tariffication", to be a compelling consideration. The absence of such terms is most striking when the relationship between FTA Article 710 and NAFTA Article 309 is considered. Both cover agricultural non-tariff barriers but NAFTA Article 309 refers 122 expressly to "successor agreements" while FTA Article 710 does not. It is unlikely, in the Panel's view, that the one provision (NAFTA Article 309) was intended to be prospective and the other (FTA Article 710) was intended to be static. But the fact that these provisions have been worded differently does not mean that they are different in effect. If the words of FTA Article 710 were not capable of applying to the future, then additional wording relating to successor agreements or tariffication would have been necessary, and their absence would have been revealing. However, as the Panel has already pointed out, the wording of FTA Article 710 is just as capable of being forward-looking as it is of referring only to existing rights and obligations. Although the Parties could have reworded FTA Article 710 to make it conform more closely to the terminology of the NAFTA, there was no need to do so. FTA Article 710 simply retained the prospective effect in the NAFTA that it had had in the FTA.

151. The Panel is also referred to practice of the Parties in the context of the Uruguay Round. In particular, Canada emphasizes the United States own adoption of tariffs on over-quota imports of agricultural products and their application to Canada - a position seemingly at variance with that being advanced by the United States under the NAFTA against Canadian over-quota tariffs applying to the United States.

(…)

153. The United States points out that Canada had made proposals to it for an agreement that would provide formally for tariffication under the WTO Agreement on Agriculture to be brought within the framework of the NAFTA and considers that the rejection of these proposals precludes the Panel from endorsing the Canadian interpretation of FTA Article 710. However, the Panel does not regard such actions by themselves as establishing the validity of the United States position. In the Qatar v. Bahrain case, the International Court

of Justice pointed out that the rejection in negotiations of a form of words corresponding to the position asserted by one party did not imply that the thesis of the other party had to be upheld. (…)

154. Accordingly, the Panel finds nothing in the circumstances of the incorporation of FTA Article 710 into the NAFTA to alter the conclusion that the intention of the Parties was that FTA Article 710 was not limited in its application to the GATT and agreements negotiated under the GATT as they existed at the time that the FTA or the NAFTA entered into force.

(…)

(b) The substantive application of FTA Article 710

168. Having determined that FTA Article 710 is prospective in nature, the Panel must now consider what particular "rights and obligations with respect to agricultural, food, beverage and certain related goods" arising from the Uruguay Round agreements were in fact brought into the NAFTA by FTA Article 710. Canada argues that it is required by virtue of the WTO Agreement on Agriculture to establish tariff equivalents in place of its agricultural quotas. This obligation, in Canada's view, is found implicitly in Article 4.2 of the WTO on Agriculture, "but even more explicitly in the Modalities document". In Canada's view, "the only way to make sense of the language of Article 4.2" is to treat tariffication as a "genuine requirement". FTA Article 710, Canada claims, makes this obligation to tariffy part of the NAFTA.

169. The United States denies that the WTO Agreement on Agriculture creates any such obligation or requirement. The establishment of tariff equivalents was an option available to states - it was a "facility" not a "requirement". The WTO Agreement on Agriculture created an obligation to eliminate non-tariff barriers. (…) The replacement of these non-tariff barriers with tariff equivalents was something states were free to do if they wished. But, the United States argues, Canada having chosen the option of establishing tariff equivalents, that was admittedly available to it in the multilateral arena, is now subject to its NAFTA obligation not to increase or to introduce new tariffs.

170. Although the Parties differ over whether the WTO Agreement on Agriculture is an "agreement negotiated under the GATT" for the purposes of FTA Article 710, in the Panel's view the position is clear. By the Punta del Este Declaration launching the Uruguay Round the CONTRACTING PARTIES decided to enter into multilateral trade negotiations "within the framework and under the aegis of the General Agreement on Tariffs and Trade". The Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994 ("Marrakesh Protocol"), agreed in the context of the adoption and signature of the Final Act concluding the Uruguay Round, described the negotiations as having been carried out "within the framework of GATT 1947". Clearly, the WTO Agreement on Agriculture and the other agreements resulting from the Uruguay Round are "agreements negotiated under the GATT".

(i) The concept of "tariffication" under the WTO Agreement on Agriculture

171. Much of the discussion before the Panel on the question of "tariffication" is concerned with the issue whether the WTO Agreement on Agriculture imposed an obligation to tariffy. Canada argues that it did; the United States denies this. The point of difficulty arises because of the language of Article 4.2 of the WTO Agreement on Agriculture: "Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5" (emphasis added). Did these words create an obligation to tariffy? In the Panel's view, taken by themselves, or even in conjunction with the rest of the WTO Agreement on Agriculture, they did not. Clearly, however, the words emphasized in the quotation above suggest that there did exist separately from Article 4.2 a provision containing an antecedent obligation to tariffy.

172. Since as a matter of general principle some meaning must be attributed to the words in Article 4.2 of the WTO Agreement on Agriculture, it becomes necessary to look beyond the text of the provision to its context, to any subsequent agreement or practice of the parties and, if necessary, to supplementary means of interpretation such as the travaux préparatoires of the WTO Agreement on Agriculture and the circumstances of its conclusion more generally. This approach is expressly contemplated by Vienna Convention Articles 31 and 32. The starting point of this analysis must be the negotiations constituting the Uruguay Round. The objective of the negotiations in relation to agricultural trade as set out in the Punta del Este Declaration was to: ... achieve greater liberalization of trade in agriculture ... by:

> (i) improving market access through, inter alia, the reduction of import barriers;

174. The mechanism for achieving this, as first proposed by the United States in 1988, was the conversion of non-tariff barriers to "tariff equivalents", a process known as "tariffication". The essence of tariffication was that states were required to eliminate their agricultural non-tariff barriers and were permitted to establish tariff-rate quotas in their place.

175. The United States tariffication proposal formed the basis of subsequent discussion in the Negotiating Group on Agriculture. (…)

180. What is evident from the record of the Uruguay Round negotiations on agriculture set out
above is:

> (a) the commitment of states to remove their non-tariff barriers to imports of agricultural products, (b) as the quid pro quo for the removal of the non-tariff barriers, the right of states to establish tariff equivalents (at rates not exceeding the level of protection provided by the non-tariff barriers they replaced), and (c) the expectation that such tariff equivalents would in fact be established. The certainty of this expectation, affirmed by the practice of WTO Members, is reflected, albeit

rather obscurely, in the language of Article 4.2 of the WTO Agreement on Agriculture.

181. In the light of the quid pro quo evident in the agreement to remove non-tariff barriers, the entitlement to establish and apply tariff equivalents was, in the minds of the participants, inextricably linked with the obligation to remove non-tariff barriers. While an entitlement to establish and apply tariff equivalents is not the same as an obligation to do so, there were nevertheless several elements of obligation involved in this entitlement. States wishing to replace their non-tariff barriers with another form of protection had an obligation to tariffy. No other form of protection would have been permissible. Furthermore, the level of that protection could not in principle exceed the level of protection afforded by the non-tariff barrier it replaced. (…)

182. In any event, whether or not tariffication is viewed as the discharge of an obligation (as appears to have been the principal ground on which Canada has based its comments before the Panel), in the Panel's view it is the exercise of a right arising from an agreement negotiated under the GATT.

183. In this connection, it is once again necessary to go back to the beginning of the Uruguay Round. Liberalization in agricultural trade, as the Punta del Este Declaration makes clear, required the reduction of import barriers. This was to be achieved by the elimination of non-tariff barriers. States, nevertheless, had the right to establish "tariff equivalents" in place of these non-tariff barriers. (…) This, indeed, is expressly acknowledged by the United States in its Statement of Administrative Action on the implementation of the Uruguay Round Agreements into United States law: This [tariffication] means that they [states] will replace their non-tariff barriers with tariffs set at rates that will provide trade protection equivalent to the protection provided during the base period by the non-tariff barriers. (Emphasis added)

184. The very words widely used to describe these measures of equivalent protection - "tariff equivalents" -clearly indicate their raison d'être.

185. Thus, in the Panel's view, an examination of the course of the negotiations on agriculture in the Uruguay Round as evidenced by the Dunkel Draft and the Modalities Document leads to the conclusion that the arrangement under which agricultural non-tariff barriers were eliminated rested on a simple bargain. States agreed to eliminate their non-tariff barriers as the quid pro quo for the right to replace them with "tariff equivalents". That is, they were replacing protection in the form of quotas or other non-tariff barriers with protection in the form of tariffs. This right to establish such tariffs was also subject to certain reduction and volume commitments, including a commitment to phase those tariffs down over time.

(…)

187. (…) As both Parties acknowledged in the course of these proceedings, the actual implementation of tariffication varied widely. (…) The basic obligation to remove

non-tariff barriers was, however, strictly adhered to. No such barriers were permitted to remain.

188. In practice, therefore, tariffication has to be understood as a "package" in which the goal of the elimination of non-tariff barriers was to be achieved by allowing states some leeway in the setting of the tariff regime that replaced their previously existing regimes of non-tariff barriers. The culmination of tariffication was the entry into force of the WTO Agreement on Agriculture and of the tariff schedules annexed to GATT 1994. (…) On the entry into force of the WTO Agreement in January 1, 1995 tariff schedules annexed to the Marrakesh Protocol became schedules to GATT 1994.

189. These instruments crystallised the arrangement for the elimination of non-tariff barriers, and they constitute the binding agreement of WTO members with respect to the items included and the tariffs resulting from tariffication. This was the package accepted by both Canada and the United States when they became parties to the WTO. There is, in the Panel's view, no basis for going behind this agreement and questioning the tariffs included in Canada's WTO tariff schedule. The preceding paragraphs demonstrate that in the context of the Uruguay Round states acquired a right to establish tariff equivalents in place of their non-tariff barriers, and that following the entry into force of the WTO Agreement more specific rights and obligations arising out of tariffication emerged. These were the obligation under the WTO Agreement on Agriculture not to "maintain, resort to, or revert to" agricultural non-tariff barriers, and the right to apply the tariffs resulting from tariffication to agricultural products on the terms set out in each state's tariff schedule. The extent to which these "rights and obligations" are brought into the NAFTA by FTA Article 710 will now be considered by the Panel.

(ii) The content of the "rights and obligations" incorporated by FTA Article 710

191. In light of this analysis of the rights and obligations of the Parties in respect of tariffication, the Panel must now consider the effect of FTA Article 710 as incorporated into the NAFTA. Canada argues that its effect is to incorporate into the NAFTA the "tariff equivalents that function as direct replacements for the non-tariff measures" that have now been eliminated.

192. The United States argues that even if FTA Article 710 is forward-looking, it does not incorporate tariffs into the NAFTA. The United States also contends that, in any event, WTO tariffs are not exceptions to NAFTA tariffs. It takes the view that, following Canada's reasoning, the entire NAFTA schedule for agricultural, food, beverage and certain related products would be replaced by the WTO tariff schedules. In the view of the United States, the distinction between tariff and non-tariff barriers has been reflected carefully in the NAFTA. NAFTA Article 302(1) focuses on tariffs. FTA Article 710 focuses on non-tariff barriers.

193. The Panel is not persuaded that FTA Article 710 is limited in application to non-tariff barriers. FTA Chapter Seven is not restricted exclusively to non-tariff barriers. FTA Article 702 permits a Party, subject to certain conditions, to impose a temporary duty on

fresh fruits and vegetables originating in the territory of the other Party. Nor is NAFTA Chapter Seven limited to non-tariff barriers. Section A of NAFTA Chapter Seven applies to "measures adopted or maintained by a Party relating to agricultural trade". A "measure", according to NAFTA Article 201(1), includes any "law, regulation, procedure, requirement or practice".

Clearly it is not limited to non-tariff barriers; it can extend to tariffs. Moreover, NAFTA Article 703, the title of which is "Market Access", contains provisions relating to tariffs. The concept of "market access" in NAFTA Chapter Seven covers both tariff and non-tariff barriers.

(…)

195. Thus, neither the FTA nor the NAFTA contains any prohibition against FTA Article 710 applying to both tariff and non-tariff measures. Whether FTA Article 710 applies to particular tariffs cannot be answered in the abstract. The question in the present circumstances is whether it applies to the tariffs established through tariffication under the WTO Agreement on Agriculture.

196. In determining the content of FTA Article 710, the Panel is conscious of the need to ensure that the article not be used as a basis for defeating the objectives of the NAFTA as a free trade agreement. The particular character of a free trade agreement is that it provides special rules applicable to trade between its parties that may differ from those applicable multilaterally. Thus, FTA Article 710 could not have been intended to provide for the wholesale incorporation of GATT rights and obligations relating to agricultural products. In this respect, the Panel accepts the United States argument that FTA Article 710 cannot be interpreted to provide for the simple substitution of the WTO tariff schedule for the NAFTA tariff schedule.

197. In the Panel's view, an important objective of FTA Article 710 both in the FTA and carried over into the NAFTA was to preserve for both Parties the agricultural protection permitted by the GATT, including GATT Article XI agricultural quotas, GATT PPA exemptions and GATT waivers. It is true that the primary purpose of GATT Article XI is to eliminate quantitative restrictions, but it is on the exceptions to such elimination that Canada and the United States appear to have focused in both the FTA and the NAFTA. This is made clear by the wording of FTA Article 710 itself which refers expressly to GATT Article XI and by the understanding of the Parties set out in NAFTA Annex 702.1(4) in which GATT PPA exemptions and GATT waivers are mentioned specifically as being included in FTA Article 710. By accepting the application of GATT rights and obligations, including those under agreements negotiated under the GATT, the Parties were also accepting any modifications that might be made to the regimes under the GATT that permitted agricultural protection.

198. The question, then, is what is the nature of the change made as a result of the Uruguay Round to the right to maintain agricultural non-tariff barriers? The United States argues that the change was the elimination of these barriers. The fact that they were turned into

tariffs is, in a sense, incidental. But, as the Panel has already pointed out, the right to tariffy was granted in exchange for the obligation to eliminate non-tariff barriers. This was all part of a "package" on agricultural trade. To bring into the NAFTA only the obligation to eliminate non-tariff barriers without the quid pro quo for their elimination would ignore the agreement that made the elimination of non-tariff barriers acceptable. Even more important, it would ignore the fact that WTO Members have the right to apply the tariffs on agricultural products set out in their tariff schedules annexed to the GATT 1994.

199. The Panel concludes, therefore, that FTA Article 710 brings into the NAFTA, as between Canada and the United States, the rights and obligations under the Uruguay Round agreements that replaced those rights and obligations under which agricultural quotas were maintained. These rights and obligations brought into the NAFTA include:

> (a) the obligation not to "maintain, resort to, or revert to" non-tariff barriers to agricultural trade of the kind that have been converted to tariffs, as required by Article 4.2 of the WTO Agreement on Agriculture and subject to the exceptions therein provided;
>
> (b) the right to apply the tariffs that resulted from tariffication, as set out in their respective tariff schedules, to over-quota imports of agricultural products; and
>
> (c) the obligation to reduce these tariffs and to ensure minimum volumes of imports as provided in the Parties' WTO Tariff Schedules.

200. The Panel notes that the incorporation into the NAFTA of the WTO tariffs that replaced the non-tariff barrier regime in respect of imports of agricultural products raises a question about market access obligations set out in FTA Articles 704, 705 and 706 which were obviously drafted with non-tariff barriers in mind. However, the Panel notes Canada's statement to the Panel that in establishing its over-quota tariffs it had taken account of those provisions, treating them as if they applied equally to such tariffs.

201. Thus, in the Panel's view, FTA Article 710 does not mandate the wholesale bringing into the NAFTA of GATT, and now of WTO, rights and obligations; it allows only for the incorporation of those tariffs that resulted from tariffication. In other words, in respect of products formerly subject to quotas, the result is that in-quota tariffs applying between the United States and Canada in respect of agricultural products are those established under the NAFTA, and tariffs on over-quota imports are those established in the WTO tariff schedules. WTO in-quota rates do not come into the NAFTA; they were not part of the tariffication quid pro quo. FTA Article 710, in the Panel's view, does not provide for the unlimited incorporation of GATT "rights and obligations" into the NAFTA.

(c) The relationship between NAFTA Chapters Three and Seven

202. The United States argues that NAFTA Article 302(1) poses a barrier to Canada's over-quota tariffs on imports of agricultural goods. It provides a clear prohibition on

increasing customs duties or adopting new duties. Although NAFTA Article 302(1) is subject to exceptions, these are, according to the United States, limited to those circumstances where exceptions are specifically provided for. No exception is provided in respect of FTA Article 710. 203. Canada argues that NAFTA Article 302(1) is on its face subject to other parts of the NAFTA. This is recognized in the opening words of the article, "[e]xcept as otherwise provided in this Agreement ...." Moreover, NAFTA Chapter Seven, which deals with the specific area of agriculture, provides at the outset in NAFTA Article 701(2) that "[i]n the event of any inconsistency between this Section and another provision of this Agreement, this Section shall prevail to the extent of the inconsistency". On this basis, Canada argues that "with respect to agricultural goods, Chapter Seven is paramount as between these two chapters".

204. The Panel accepts that the obligations set out in NAFTA Article 302(1) can be subject to exceptions. This is clear from the opening words of paragraph 1 of the article. It is also made clear in NAFTA Article 300 which deals with the "[s]cope and [c]overage" of that Chapter. NAFTA Article 300 provides:

> This Chapter applies to trade in goods of a Party, including:
>
> ... (c) goods covered by another Chapter in this Part, except as provided in such ... Chapter.

205. In addition, the assertion of the primacy of NAFTA Chapter Seven in the event of an inconsistency suggests that there will be circumstances where a conflict between NAFTA Chapters Seven and Three would be resolved in favour of NAFTA Chapter Seven.

206. The United States argument that NAFTA Article 302 is not subject to the provisions of FTA Article 710 is based on its view that NAFTA Article 302 applies to tariffs and FTA Article 710 to non-tariff barriers. The Panel has already rejected this distinction, and this undermines the force of the United States argument on this issue.

207. As already pointed out, the effect of FTA Article 710 is to incorporate into the NAFTA, inter alia, the obligation on the Parties to remove agricultural non-tariff barriers and the right to replace those non-tariff barriers with the over-quota tariffs set out in their tariff schedules. But NAFTA Article 302(1) provides a clear prohibition on increasing existing, or adopting new, customs duties. Thus, the creation of over-quota tariffs on the import of products at rates higher than the NAFTA rates for in-quota imports of such products results in an inconsistency between FTA Article 710 and the obligations under NAFTA Article 302(1). In these circumstances, the Panel concludes, NAFTA Article 701(2) applies. There is an "inconsistency between this Section [Section A of Chapter Seven] and another provision of this Agreement". In that event, according to NAFTA Article 701(2), "this Section shall prevail to the extent of the inconsistency". Thus, FTA Article 710 must prevail.

C. Conclusion

208. The Panel decides that FTA Article 710 has the effect of bringing into the NAFTA the replacement regime for agricultural non-tariff barriers that was established under the WTO. This consists of an obligation not to introduce or maintain such non-tariff barriers and the right to apply the tariffs that resulted from tariffication, as set out in their tariff schedules, to over-quota imports of agricultural products, together with the obligation to reduce those tariffs and ensure certain minimum volumes of imports. These rights are not diminished by NAFTA Article 302(1).

(2) Determination

209. In light of the above analysis and conclusions, the Panel determines that the application of customs duties by the Government of Canada to the U.S.-origin products specified in the enclosure to the July 10, 1995 letter of the United States Trade Representative, Michael Kantor, to the Canadian Minister for International Trade, Roy MacLaren, conforms with the provisions of the North American Free Trade Agreement.

(…)

## IV. INSTITUTIONAL ARRANGEMENT

http://www.sice.oas.org/trade/nafta/chap-201.asp#A2001

### Section A - Institutions

### Article 2001: The Free Trade Commission

1. The Parties hereby establish the Free Trade Commission, comprising cabinet-level representatives of the Parties or their designees.

2. The Commission shall:

(a) supervise the implementation of this Agreement;

(b) oversee its further elaboration;

(c) resolve disputes that may arise regarding its interpretation or application;

(d) supervise the work of all committees and working groups established under this Agreement, referred to in Annex 2001.2; and

(e) consider any other matter that may affect the operation of this Agreement.

3. The Commission may:

(a) establish, and delegate responsibilities to, ad hoc or standing committees, working groups or expert groups;

(b) seek the advice of non-governmental persons or groups; and

(c) take such other action in the exercise of its functions as the Parties may agree.

4. The Commission shall establish its rules and procedures. All decisions of the Commission shall be taken by consensus, except as the Commission may otherwise agree.

5. The Commission shall convene at least once a year in regular session. Regular sessions of the Commission shall be chaired successively by each Party.

### Article 2002: The Secretariat

1. The Commission shall establish and oversee a Secretariat comprising national Sections.

2. Each Party shall:

(a) establish a permanent office of its Section;

(b) be responsible for

(i) the operation and costs of its Section, and

(ii) the remuneration and payment of expenses of panelists and members of committees and scientific review boards established under this Agreement, as set out in Annex 2002.2;

(c) designate an individual to serve as Secretary for its Section, who shall be responsible for its administration and management; and

(d) notify the Commission of the location of its Section's office.

3. The Secretariat shall:

(a) provide assistance to the Commission;

(b) provide administrative assistance to

(i) panels and committees established under Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters), in accordance with the procedures established pursuant to Article 1908, and

(ii) panels established under this Chapter, in accordance with procedures established pursuant to Article 2012; and

(c) as the Commission may direct

(i) support the work of other committees and groups established under this Agreement, and

(ii) otherwise facilitate the operation of this Agreement.

* * *

## ADDITIONAL RESOURCES AND REFERENCES (OPTIONAL READING)

**- Frederick M. Abbott, Law and Policy of Regional Integration (1995)**

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**Excerpts from pp 1-4**

*INTRODUCTION AND OVERVIEW*

The North American Free Trade Agreement (NAFTA) is a phenomenon of great importance to the people of Canada, Mexico and the United States, and to the international community as a whole. The NAFTA is the second post-World War II regional integration effort among globally-important national economies, and the first such effort to be undertaken outside the shadow of violence. The NAFTA seeks to integrate the economies of the two most highly industrialized countries in the Western Hemisphere and the rapidly developing economy of a major Latin American political power. The NAFTA integration process will shape the structural evolution of the Western Hemisphere economy, affect the economic interests of countries outside the hemisphere, and inevitably have an important impact on political and social developments both within and outside of its territorial boundary.

The principal focus of the NAFTA is the removal of tariff and non-tariff barriers to trade in goods and services, and the provision of an open and secure environment for cross-border investment and the exchange of information and ideas. The commitments of the three NAFTA country parties (Parties) in these areas are extensive. Certainly in comparing regional integration effort at the formation stage, the economic liberalization commitments of the NAFTA Parties are as or more extensive than any set of commitments previously undertaken among a regional group. The economic liberalization commitments of the NAFTA Parties are worthy of close study because of the impact they will have in and outside the NAFTA territory. A central focus of this book therefore will be to describe and analyze the legal framework of the NAFTA economic liberalization program.

The NAFTA establishes an institutional structure that is quite different from the institutional structure of the European Union. The major NAFTA institutions are essentially a setting for consultation and cooperation among the Party governments. The framers of the NAFTA assiduously avoided granting to regional institutions the power to make decisions which would directly bind the Parties. These framers were operating in a historical and political environment far removed from that in which the framers of the European Economic Community operated in the 1950s, and these NAFTA framers doubtless perceived little enthusiasm in the body politic of any of the parties for a transfer of government authority to a regional center. The NAFTA's consultative-cooperative institutional structure is of course of great interest because it is the mechanism by which the NAFTA will operate. The NAFTA institutional structure also defines the way in which

the region will interact with multilateral institutions, including the World Trade Organization and European Union, as well as individual non-Party countries. The NAFTA again is quite different tan its European Union counterpart in that it does not provide for the coordination of the external commercial policy of its Parties. The NAFTA institutional structure will be an important focus of attention in this book,

The NAFTA was first conceived as a mechanism for trade liberalization and not as a social charter, The NAFTA's limited provisions for the free movement of labor reflect the necessities of doing business across national boundaries and not the intention of creating a homogenous social environment. Nevertheless, the intense demand of individuals and interest groups concerned with the social consequences of economic integration, including those concerned with its impact on the physical environment, lead to the incorporation of provisions in the basic NAFTA charter which address in a minimum way some of the non-economic issues that the Parties and their nationals face, and lead to the adoption of two Supplemental Agreements which more extensively address labor- and environment-related issues. While the social provisions of the NAFTA remain rather limited at present , these provisions deserve attention because they are the foundation for the future evolution of the NAFTA's social framework.

The year 1993 was pivotal to defining the medium term structure of the international trading system for three reasons. First, the NAFTA was approved in the United States in the face of resistance from a nascent managed trade movement in the Congress. The political and economic backdrop of the NAFTA's approval are central concerns of this book. Second, the Maastricht Treaty on European Union was ratified in 1993 after exhaustive political debate on the future of European integration. Although the Maastricht Treaty is an incremental step in the European integration process, its failure would have signalled a turning away from the European integration ideal and would have created considerable uncertainty for the future. Third, the Final Act of the GATT Uruguay Round negotiations was approved, paving the way for the metamorphosis of the GATT into the World Trade Organization (WTO) in 1995.

The creation of the WTO as an institution is largely a symbolic event. The WTO will be formally recognized as an international organization replacing the less formally constituted General Agreement on Tariffs and Trade (GATT), more importantly, the WTO Agreement and its incorporated multilateral trade agreements will extend international trade law discipline to the new areas of trade in services, trade-related investment measures (TRIMS) and trade-related aspects of intellectual property fights (TRIPS), and will make important improvements to the mechanisms intended to assure the enforcement of WTO rules, In addition, WTO rules will generally be applied to the broad spectrum of WTO membership, giving a universal character to a set of rules which was previously applied in a multi-tiered manner.

The WTO Agreement contemplates the co-existence of the WTO and regions integration arrangements (RIAS) such as the NAFTA. It provides in GATT Article XXIV rules intended to govern the formation of RIAs with respect to trade in goods and it provides new and separate rules for regional services liberalization regimes in General

Agreement on Trade in Services (GATS) Article V. In some important respects, however, such as in dealing with RIA changes to the rules of origin, GATT Article XXIV continues to provide inadequate guidance. The new GATS Article V attempts to establish an objective standard for evaluating RIA services liberalization agreements, but it is not clear that the approach it takes is well suited to the different subject matter it governs. The WTO Agreements establishes a Working Party Review process that is carried forward from GATT practice is hampered by a consensus decision-making procedure that is an obstacle to concrete action.

Despite the fact that the WTO Agreement foresees co-existence between the WTO and RIAs, including the NAFTA, the relationship between the WTO and RIAs is imprecisely defined, and conflicts between the WTO rule-system and the RIA rule-system ate inevitable. The WTO Agreement establishes the individual constituent countries of the RIA as responsible for compliance by the RIA with WTO rules, except in the special case of the European Union which shares direct responsibility with its Member States. The NAFTA Parties, however, agreed that their regional rules will take precedence over GATT rules as between themselves, and this rule of priority may extend to part or all of WTO rules. The NAFTA Parties in general may elect either WTO/GATT or NAFTA dispute settlement procedures to resolve conflicts arising under both agreements. In the case of environment-related disputes among the NAFTA Parties, the NAFTA dispute settlement process will ordinarily be used. NAFTA and WTO /GATT rules with respect to environment-related provisions are different in some important respects.

A principle objective of this book is to situate the NAFTA within the new framework of WTO rules, and to evaluate both the conformity of the NAFTA with these rules and the adequacy of the WTO rules themselves. The interplay between WTO/GATT and NAFTA rules and dispute settlement procedures is addressed. It is of paramount importance to the health of the multilateral trading system that the WTO and NAFTA be able to operate in relative harmony. While some modest level of tension between complementary rule systems is of course to be expected and may prove a useful stimulus to new ideas and approaches, there is a danger that conflict and tension between systems will eventually force the abandonment of one or the other. Though there is no such threat to the WTO or NAFTA on the immediate horizon, it will be well to consider the potential for conflict between the two systems.

The approval of the NAFTA contemporaneously with the approval of the WTO raises a host of interesting and difficult policy questions. From the end of the Second World War through the 1980s, the United States was the principal advocate of a multilateral approach to the governance of international trade. The WTO/GATT is the concrete embodiment of the multilateral trade ideal. Does the United States pursuit of the NAFTA represent a significant shift from multilateralism to regionalism in U.S. trade policy, or is the NAFTA perceived by U.S. trade policy-makers as a tool by which to accelerate the multilateral integration process? Are the European Union and NAFTA likely to become so strong as regional economic powers that the WTO will be marginalized? If the WTO is in fact marginalized, what will the consequences be for countries remaining largely outside formal regional frameworks, such as Japan, the

People's Republic of China and Taiwan? This book examines the potential impact of the NAFTA on the WTO framework, as well as on some specific countries and regions outside its territory.

The NAFTA has been portrayed by the United States government as the first step toward a Western Hemispheric free trade area extending from Anchorage to Tierra del Fuego. Plans for extending the NAFTA already are under discussion. There are a variety of legal mechanisms which could be used to undertake this extension, including direct accession of third countries to the NAFTA, the merger of the NAFTA with existing or newly formed Western Hemispheric RIAS, or a "hub and spoke" arrangement with the United States and/or Mexico acting as hubs to which other countries join in free trade agreements as spokes. This book examines some of these potential arrangements, as well as the potential economic impact of a Western Hemispheric free trade area on countries outside the hemisphere.

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**Excerpts from pp 23-28, 35-60**

*THE BASIC STRUCTURE OF THE NAFTA*

The NAFTA was not designed with the ultimate goal of political and social integration on the North American continent, but rather as a means of promoting economic growth in its constituent countries. If the NAFTA process some day results in a deeper integration of North America, it will not be because the NAFTA was initiated with that vision. The NAFTA institutions are designed to coordinate the activities of the Parties and not to make decisions on their behalf. This arrangement reflects the fundamental conceptual basis of the NAFTA as a means of promoting trade and investment.

*NAFTA and Other Agreements*

The NAFTA largely superseded the Canada-United States Free Trade Agreement (CUSFTA), but it did not expressly terminate or suspend the CUSFTA. The NAFTA provides at Article 103 that it prevails to the extent of inconsistencies with other agreements to which the Parties are party. There is an exception to this general rule in the case of certain specified agreement relating to the environment, such as the Basel Convention on the Transboundary Movement of Hazardous Waste. Since the NAFTA in general prevails over inconsistent agreements, to the extent that the NAFTA and CUSFTA concerned the same subject matter, the NAFTA would govern. Various provisions of the CUSFTA are incorporated by reference in the NAFTA. U.S. legislation implementing the NAFTA contemplated that the United States and Canada would agree to suspend the CUSFTA as a result of entry into force of the NAFTA.

The CUSFTA was suspended upon entry into force of the NAFTA pursuant to an Exchange of Notes between the Canadian and U.S. governments . The suspension will remain in effect for such time as the two countries remain Parties to the NAFTA. Pursuant to an Exchange of Letters between Canada and the United States regarding suspension of the CUSFTA, antidumping and countervailing duty (AD/CVD) final determinations published prior to entry into force of the NAFTA remain subject to dispute resolution proceedings under the relevant CUSFTA AD/CVD dispute settlement provisions. Pending disputes (and pending consultations that may result in dispute settlement proceedings) regarding interpretation and application of the CUSFTA, that would have been subject to general CUSFTA dispute settlement proceedings, will be subject to equivalent dispute settlement proceedings under the NAFTA. This will not affect the application of CUSFTA substantive rules in any such proceedings.

In Article 103 of the NAFTA, the Parties affirm their existing rights and obligations to each other under the GATT, but provide that the NAFTA prevails over the GATT to the extent of inconsistencies between the two agreements. As discussed in Chapter Four, the Parties expressly disavow at least one provision of the GATT relating to the adoption of measures necessary to protect human, animal and plant life and health (as it relates to sanitary and phytosanitary measures), in favor of different NAFTA rules on this subject matter.

The fact that the NAFTA took priority over the GATT was of course significant from the standpoint both of defining the general relationship between the NAFTA and the GATT and establishing applicable norms in the dispute settlement process. The GATT establishes "working parties" to review the compliance by regional integration arrangements (RIAS) with GATT rules governing their formation. A GATT Working Party reviewed the CUSFTA. A number of CUSFTA Working Party members were quite concerned with the potential implications of an equivalent hierarchy of norms established between the United States and Canada in the CUSFTA, both from the perspective of general policy and with respect to concern over the implications for dispute settlement. The NAFTA is a more detailed agreement than the GATT and has a wider scope of coverage (for example, in the area of investment measures). It is tempting to conclude that the drafters of the NAFTA chose to give it priority over the GATT because its rules would be more easily applied in concrete situations. Nevertheless, even if the GATT is viewed as a broader constitutional charter it would not have been extraordinary from judicial perspective have subjected the more narrow NAFTA rules to the GATT's overriding discipline. It therefore seem that the hierarchy of norms established by the NAFTA reflected a political bias favoring more direct regional concerns over more diffuse global concerns.

Article 103 expressly establishes the NAFTA's priority over existing agreements between the Parties, including the GATT. The question arises whether the NAFTA prevails over the new WTO Agreement, which agreement is the subject of the next Chapter. Establishing the legal priority of the substantive rules of the NAFTA and those of the new WTO is a matter of considerable complexity. A number of contextual factors are

involved in defining this relationship, and it may be some years before an authoritative definition of the relationship emerges, whether through action taken by the NAFTA Parties to expressly establish the relationship, or through an accumulation of dispute settlement panel opinions that may establish a common law of interpretation. A discussion of the contextual factors will be better understood after the structure and rules of the WTO and the NAFTA have been more thoroughly described, and so a more detailed consideration of this relationship is found in Chapter Six, Part II (regarding dispute settlement). However, the situation in general terms may be described as follows.

The basic charter of the GATT is the General Agreement on Tariffs and Trade. The General Agreement, as amended, along with its accumulated formal understandings and interpretations, will become an integral part of the new WTO. However, in order to facilitate the transition between the GATT and WTO, the General Agreement incorporated in the WTO will be referred to as the "GATT 1994," and the old General Agreement will be referred to as the "GATT 1947. The GATT 1994 is "legally distinct" from the GATT 1947. Some countries may choose to remain parties only to the GATT 1947, at least for an interim period, and become parties neither to the WTO or the GATT 1994. Canada, Mexico and the United States are all expected to become parties to the WTO (and GATT 1994).

The parties to the WTO Agreement have agreed to follow the prior customs and practices of the GATT 1947, and only parties to the GATT 1947 may become "original Members" of the WTO (i.e., they are not required to negotiate separate accession agreements). Neither the legal distinction between the GATT 1947 and the GATT 1994, nor the formation of the WTO, is intended to signal a break in the continuity of the GATT organization or its rules. Thus, from a contextual standpoint, the GATT 1994 is a continuous extension of the GATT 1947. The GATT 1994 is a successor agreement to the GATT 1947 that, in a narrow technical sense, may supersede the prior agreement. However, in light of the basis for the technical distinction between the agreements, that technical succession should probably not be understood to cause the GATT 1994 to be considered a new and different agreement than the GATT 1947 for NAFTA Article 103 purposes.

If the foregoing hypothesis is correct, there nevertheless remain important and difficult questions. Although the GATT 1994 and GATT 1947 are largely coextensive, the WTO as a whole contains agreements in addition to the GATT 1994. Some of these agreements take the place of existing GATT agreements negotiated in the Tokyo Round. The relationship between these new WTO agreements and the old Tokyo Round agreements may be evaluated on roughly the same basis as the GATT 1994 is evaluated in respect to the GATT 1947. Other new WTO agreements are more or less extensions of Tokyo Round agreements, or codifications of GATT practice, and are in somewhat more of a grey area than those that strictly take the place of the Tokyo Round agreements. Finally, some new WTO agreements concern subject matter areas (such as trade in services and protection of intellectual property) not previously regulated by the GATT. These agreements would be considered part of a GATT continuum only under a rather broad interpretative view of the GATT.

Therefore, as a preliminary conclusion it may be suggested that the rules of the NAFTA will continue to prevail over GATT 1994 rules, as well as WTO rules that take the place of Tokyo Round agreement rules. However, there are grey areas with respect to WTO rules tat are not continuous extensions of GATT 1994 and the Tokyo Round rules. These may not be subject to a general rule of priority, and evaluations may need to be on a case by case. It may be quite some time before questions of NAFTA-WTO/GATT priority may be answered definitively.

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*REGIONAL INTEGRATION ARRANGEMENTS IN THE WTO FRAMEWORK*

The World Trade Organization (WTO) succeeds the General Agreement on Tariffs and Trade (GATT) as the international organization principally responsible for the global regulation of trade. The WTO is the result of the Uruguay Round of GATT negotiations which began in 1986 and culminated with approval of a Final Act on December 15, 1993. (…)

The WTO Agreement formally constitutes the WTO as an international organization. The WTO Agreement includes among its integral parts applicable to all Members the General Agreement on Tariffs and Trade, and its related interpretative decisions and understandings (collectively referred to as the GATT 1994). The integral agreements applicable to all Members (referred to as the Multilateral Trade Agreements or MTAS) also include the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). The GATS and TRIPS Agreement incorporate important new areas of coverage into the framework of multilateral trade regulation. The WTO Agreement also incorporates an Understanding on Dispute Settlement which works significant changes to the GATT 1947 dispute settlement procedure. These changes are intended to enhance the binding character of WTO dispute settlement. The Uruguay Round negotiations and the new WTO are the subject of an extensive literature.

At the highest level of generality, the WTO establishes the basic framework of the liberal global trading system. It has as its overarching goal the progressive elimination of barriers to the trade of goods and services with a view to encouraging an optimal allocation of globe resources. It seeks to accomplish this goal by the establishment of certain fundamental rules, principally; the Most Favored Nation principle, which generally requires that each Member treat all other Members on an equivalent basis, and; the National Treatment principle, which generally prohibits domestic discrimination against imported products, and covered foreign services and service providers.

As the global trading system has become an increasingly complex affair, the necessity of refining general principles into specific rules has become apparent. The lengthy and highly contentious Uruguay Round negotiations testify to the difficulty in reducing general principles to specific norms. The complete package of WTO agreements provide a lengthy, complex and not always entirely clear set of rules for the conduct of global trade. In this Chapter an attempt is made to describe and analyze the regulation of RIAs within this new framework.

## *RIAs IN THE WTO - TRADE IN GOODS*

### ARTICLE XXIV

The GATT 1947 was tolerant of the formation of RIAS. The GATT 1994 retains that historical tolerance. While an Understanding on the Interpretation of Article XXIV of the GATT 1994 was adopted as a part of the Uruguay Round Final Act, this understanding by and large addresses technical issues that have surfaced in the application of Article XXIV and does not alter the fundamental approach of the GATT to customs unions and free trade areas.

Provided that the members of a prospective RIA notify WTO Members and agree to eliminate tariffs and other restrictive regulations of commerce on "substantially all the trade in products originating in their territories within a reasonable length of time, they are permitted under Article XXIV of GATT 1994 to ignore that agreement's Most Favored Nation treatment principle and to grant each other tariff preference which need not be extended to non-RIA members (as well as, in the case of a "customs union" (CU), to form a common tariff wall). The incidence of tariffs and other regulations of commerce affecting non-members of a CU shall not "on the whole" be higher or more restrictive than those which were applicable to them prior to the formation of the CU. Tariffs and other regulations of commerce affecting non-members of a free trade area (FTA) "shall be no higher or more restrictive" than those existing in the same constituent countries prior to its formation. One survey of Article XXIV working party reports found that constituent counties have contended that from fifty to ninety-five percent trade coverage meets the requirement for RIA elimination of tariffs on "substantially all the trade".

Article XXIV limits not only the raising of individual country (in the case of the FTA) or aggregate (in the case of the CU) tariffs in respect to nonmembers, but also limits the adoption of more restrictive "other regulations of commerce" in respect to non-members. The meaning of this limitation has become an important subject of debate in respect to changes in rules of origin in the NAFTA context and is discussed further in Chapter Four.

Article XXIV specifies only that tariffs must be substantially eliminated on "products originating in" the constituent territories of an RIA. There is no requirement that goods imported from outside the RIA will benefit from preferential tariff treatment once they have entered the territory of the RIA. The intra-RIA tariff treatment of such goods

will be defined by the RIA members. The Treaty on European Union accords to imported goods free circulation within the territory of the EU once the applicable tariff has been paid on goods first entering a Member State. However, the EU might have required that additional tariffs be paid upon third country goods in the subsequent crossing of Member State borders without violating the terms of Article XXIV. The NAFTA, as will be detailed in Chapter Four, does not accord free circulation to imported goods after tariffs have been paid upon entry into the first Party. The NAFTA establishes strict rules of origin intended to prevent imported third county goods from obtaining preferential tariff treatment within the NAFTA territory. However, the NAFTA attempts to relieve imported goods from the imposition of a tariff in excess of the maximum single tariff of any of the Parties in its duty drawback rules.

An "interim agreement" leading to the formation of a free trade area or customs union must include a plan for its formation within a "reasonable length of time." Since the parties forming customs unions or FTAs typically phase in their preferential tariff reductions over a transition period, the typical FTA will technically be considered an 'interim agreement" during this period. The WTO Understanding regarding Article XXIV provides aforementioned "reasonable length of time" should "exceed ten years only in exceptional cases"; and that "where Members believe that ten years insufficient they shall provide a full explanation to the Council for Goods of the need for a longer period." However, since Article XXIV requires only that constituent countries eliminate tariffs on "substantially all" the trade between them, it seems reasonable to conclude that an insubstantial portion of inter-constituent tariffs could be eliminated over a longer than ten year period without the provision of a special justification.

One of the principle objectives of the WTO Understanding with regard to Article XXIV is to resolve ambiguity concerning application of the requirement that a customs union's tariffs not "on the whole" be higher than "the general incidence of the duties and regulations of commerce" in the constituent territories prior to its formations. It was not clear from the text of Article XXIV what tariff rates would be used to calculate the general incidence of duties since countries bind their duties in GATT schedules but often apply duties which are lower than their bound duties. The Understanding specifies that "applied rates of duty" will be used in the calculation. In addition, Article XXIV does not specify a method for determining the relative weight to be given tariffs applicable to different products. How is it to be determined whether the CU's lowering of duties with respect to one constituent Member country's imports of oranges will adequately compensate for the raising of duties with respect to another constituent country's import of apples? The Understanding to Article XXIV establishes a mechanism for making such determinations. The Understanding also permits countries adversely affected by increases in tariff rates, and which have been unable to obtain adequate compensatory adjustments, to withdraw concessions in accordance with other applicable provisions of the GATT 1994.

*RIAs AND WTO RULES*

The working party review by no means represents the limit of WTO involvement with respect to the RIA. In the first instance, the individual members of the RIA remain as full Members of the WTO, unless they and the WTO might eventually decide to accept the RIA as a substitute Member. A complete substitution has not taken place to date, although the European Communities/Union will achieve a special concurrent form of membership with its Member States in the new WTO Agreement arrangement. Under the new arrangement with respect to the EU, the EU is party to the WTO Agreement (including the various Annexes) and may act on behalf of the Member States. The Member States are also parties to the WTO Agreement. If the EU votes, its vote will be counted as the number of votes equal to the number of Member State. The Member States may also vote individually, in which case the EU will not have a vote. The mechanism for deciding whether the EU or the Member States will vote is an internal EU matter. Outside the special EU context, RIAs are not themselves Members of the WTO and so must be regulated vicariously through their constituent Member States. The WTO Understanding on Interpretation of Article XXIV seeks to make clear that Members will undertake this responsibility by providing that each "shall take reasonable measures as may be available to it to ensure such observance [of the provisions of GATT 1994] by regional and local governments within its territory."

1. Most Favored Nation and National Treatment Derogations

a. *The MFN Principle*.

Article XXIV permits discriminatory preferences with respect to "duties and other regulations of commerce" maintained in each of the constituent territories of an RIA. Though Article XXIV is decidedly vague, this reference appears to be directed at permitting only derogations from the GATT 1994 MFN principle, specifically as it requires each WTO Member that grants a tariff benefit to any country to extend immediately and unconditionally the same benefit to all WTO Members. Under this narrow construction, preferential arrangements under Article XXIV are limited to the discriminatory reduction or elimination of intra-RIA tariffs and should not extend to the discriminatory reduction or elimination of non-tariff barriers such as internal sales taxes (e.g., the removal or reduction of taxes only in favor of regionally produced goods). The latter type of preferential treatment would involve derogation both from the GATT 1994 MFN principle (regarding equivalency of treatment for all WTO Members) and from the GATT 1994 National Treatment principle.

b. *The National Treatment Principle.*

The National Treatment principle is a fundamental tenet of the WTO/GATT. Each Member agrees to treat goods from each other Member on a level comparable to those produced in its own territory for the purposes of internal sale. Article XXIV does not expressly address deviations from the National Treatment principle and there is no good reason to conclude that the drafters of the GATT 1947 and GATT 1994 intended that RIAs be permitted to grant internal preferences to locally produced goods. However, on a purely

semantic level, a case for an interpretation of Article XXIV which permits derogation from the National Treatment principle can be
made, though such interpretation is by no means widely accepted. The EU has from time to time adopted and been challenged for adopting regional internal discriminations with respect to locally produced goods.

## *RIAs AND TRADE IN SERVICES*

The regulation of trade in services is a more complex matter than the regulation of trade in goods. Because services are routinely provided by persons "at the site," they are generally not subject to border measures such as tariffs (although there are border measures affecting services, such as employee visa requirements). External service providers are typically regulated (and discriminated against) both on a national and RIA level by internal regulations such as licensing requirements which establish, either expressly or through their operational effect, different standards of treatment for local (or "national") and foreign (or non-RIA member country) service providers. The trade regulation of "foreign" service providers, then, occurs not necessarily (or even generally) at an RIA's external border, but rather internally where rules and regulations may be either expressly or operationally discriminatory. A local service provider licensing requirement, in order to discriminate against a foreign service provider, need not expressly preclude the foreign service provider from operating locally if such licensing requirement provides, for example, that the provider must possess certain local academic credentials which cannot reasonably be obtained by a person seeking to enter the market (and which are not a reasonable requirement for the license). Insurance and banking enterprises might be discriminatorily impaired from providing services across borders as a result of disparate capital or reserve requirements which are arbitrary or unjustified. Thus, trade restrictions based on nationality may be disguised in the form of licensing or other regulatory requirements which do not expressly contain reference to nationality. To the extent that such regulatory requirements are arbitrary or unjustified, they are the equivalent, from a trade regulation standpoint, of denial of National Treatment.

A GATT Panel Report involving a claim by the EU against the United States, arising out of the discriminatory impact of section 337 of the Tariff Act of 1930, makes clear that compliance with the National Treatment principle is not to be confined by reference to the language of rules or regulations. An inquiry into the application (or potential application) of the rules or regulations is appropriate. An analysis of legal rules should not be confined to instances of their application, but should take into account their "potential impact" as well. This conclusion applies both to individual trading countries and RIAs.

Because of the disparate ways in which trade in goods and trade in services are regulated, the new WTO General Agreement on Trade in Services includes an important provision regarding RIA services liberalization measures which is significantly different than GATT 1994 Article XXIV and its treatment of RIA trade in goods.

## *THE GENERAL AGREEMENT ON TRADE IN SERVICES*

The new WTO General Agreement on Trade in Services (GATS) establishes a generally applicable set of rules with respect to Member services measures, and separate rules with respect to sectors in which Members have made market access commitments. The most important general commitment of each Member is to provide most favored nation treatment to other Members in regard to all services sectors, provided, however, that Members are permitted to maintain measures inconsistent with the MFN requirement if such measures are listed in a GATS annex. Other generally applicable rules include those relating to transparency (including notification), domestic regulation procedures, recognition and emergency safeguards. The general MFN provision establishes that each Member must treat the service providers of each other Member in an equivalent manner, but it does not require that each Member treat any (and all) other Member's service providers on the same basis as it treats its own. Members are entitled to maintain internal services regimes that discriminate against foreign service providers.

Non-discriminatory access to the internal services market of a Member is only provided by means of a specific market access commitment of the Member in a particular sector. Each Member maintains a schedule of market access commitments which sets out with respect to sectors in which commitments are made:

(a) terms, limitations and conditions on market access;
(b) conditions and qualifications of national treatment;
(c) undertakings relating to additional commitments
(d) where appropriate the time-frame for implementation of such commitments; and
(e) date of entry into force of such commitments.

Members agree to provide treatment no less favorable than that set out in their schedules, and with respect to each sector agree to eliminate a listed set of discriminatory restrictions. Members may elect to eliminate discrimination with respect to some forms of service supply and not others; although the financial services annex, for example, imposes specific requirements regarding modes of supply. Each Member commits to according national treatment to service suppliers of other Members in respect of covered sectors, but this is subject to conditions and qualifications set out in the granting Member's schedule of market access commitments. Thus with respect to each covered sector each Member commits both to providing the minimum standard of treatment set forth in its schedule and to providing treatment no less favorable than that accorded its own nationals, subject to specified qualifications.

## *THE INTERFACE OF RIA AND WTO REGULATORY SYSTEMS*

The rule system of the WTO is principally addressed to individual countries

generally referred to in the agreement as "Members". The GATT 1994 carries forward the existing text of the GATT General Agreement (GATT 1947) and accompany interpretative understandings and related decisions (as the GATT 1994). The GATT 1994 agreement is principally applicable to trade in goods. Tile fundamental rules of international trade embodied in the GATT 1994 are well known, including: (1) the most favored nation treatment principle; (2) the national treatment principle; (3) tariffs as the accepted means of trade protection; (4) prohibition of quotas; (5) reciprocity, and; (6) special and differential treatment for developing countries. Of course, there are also rules relating to dumping and subsidization, safeguard measures and dispute settlement. All of these general rules of the GATT 1994 are at least indirectly applicable to RIAs through the responsibility of their constituent member countries. This constituent member responsibility, as discussed above in section I.C of this chapter, is confirmed in the Understanding regarding Article XXIV.

Since its inception, the GATT has undergone a continual process of refining its rules. The principal set of refinements was adopted at the conclusion of the Tokyo Round in 1979 in the form principally of a series of codes applicable only to the parties which accepted them (primarily the OECD countries). These codes covered dumping and subsidies, government procurement, technical standards, customs valuation and a number of other areas. Among the major goals of the GATT Uruguay Round was to further refine these codes or agreements, as well as to extend their application to a far wider group of parties. In the latter regard the Uruguay Round succeeded beyond expectations by extending the coverage of almost all of these supplementary agreements to all Members of the WTO.

As with the GATT 1994, the obligation of RIAs to comply with the rules of the supplementary agreements (referred to as "Multilateral Trade Agreements')[hereinafter MTAS], is principally based on the obligations of the constituent Members of the RIA. However, the application of MTA rules to RIAs may become more direct as the RIA assumes control over constituent member regulatory activities. The regional bodies of the European Union, for example, have assumed significant control over regulatory structures within the Member States of the EU. Moreover, in the particular case of the EU, the RIA is a Member of the WTO and should be understood to have accepted direct responsibility for compliance with both GATT 1994 and MTA rules. The Member States of the EU will also be parties to the WTO, and so share responsibility with the RIA governmental bodies for compliance with the rules.

At present, the EU situation is unique within the WTO structure as the EU is the only RIA which as an international person is accorded membership in the WTO. The NAFTA does not have an international legal personality, at least insofar as such a personality might be expressly established by its charter. In addition, unlike the EU, the NAFTA does not have central regional institutions with authority to exercise regulatory control within its constituent country parties. To the extent that the NAFTA regional bodies may assume responsibility for regulatory matters, they will be obliged to observe the provisions of the WTO agreement by virtue of the responsibility of the constituent countries.

The mechanism for determining the hierarchy of norms between the RIA and the WTO is of great importance. The European Court of Justice has held that the EU is bound by the GATT, but it has never overturned a Union regulation on the ground that such regulation is incompatible with GATT rules.

In Article 103 of the NAFTA, the Parties affirm their existing GATT rights and obligations to each other, but provide that:

> In the event of any inconsistency between this Agreement and other such agreements [including the GATT], this Agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement.

As discussed in Chapters Two and Six, the extent to which the Article 103 rule of priority applies to the WTO and GATT 1994 remains to be authoritatively determined. The potential conflict between WTO and NAFTA rules is manifestly of concern with respect to the compatible and complementary operation of the two rule systems. These concerns are explored in Chapter Six, infra. In Chapter Four, the extent to which the regulatory rules of the NAFTA may be inconsistent with the rules of the WTO is examined.

## *THE INTERFACE OF RIA AND WTO DISPUTE RESOLUTION SYSTEMS*

Article XXIII of GATT 1947 established a mechanism for the settlement of disputes between Contracting Parties. This broad provision was supplemented by customary practice which eventually was codified in an Understanding with respect to Dispute Settlement. The WTO Agreement includes a new Understanding on Rules and Procedures Governing the Settlement of Disputes which substantially modifies prior GATT customs and rules with respect to the structure of the dispute settlement institution (principally by addition of a standing appellate body), the procedure by which the decisions of dispute settlement panels are adopted (moving from a consensual to quasi-automatic adoption procedure), and enhancing surveillance of implementation of decisions by WTO Members.

Of course, each WTO Member maintains its own judicial system that performs dispute settlement functions, and national courts may interpret and apply the WTO Agreement to the extent it is either considered directly applicable or is transformed into national law by legislative act. It is certainly possible that a national court might interpret the WTO Agreement differently than the WTO Dispute Settlement Body (DSB); though, in respect to the same dispute, the decision of the DSB should be considered to authoritatively interpret the WTO charter since it is the DSB which is empowered by the charter to interpret and apply the agreement. National courts also interpret and apply the

domestic trade law of the country in which they operate, and that trade law may or may not be consistent with WTO law.

RIAs may also establish their own mechanisms for resolving disputes concerning interpretation of their charter document or its application by the constituent countries. Both the European Union and the NAFTA establish dispute settlement bodies, although the European Court of Justice and NAFTA arbitration panels differ markedly in the scope of their powers of review and the enforceability of their decisions. In the course of performing their functions, regional dispute settlement institutions may interpret and apply the WTO Agreement. It is possible that the decision of a regional dispute settlement institution with respect to interpretation of the WTO Agreement would differ from the interpretation of the WTO Dispute Settlement Body; but, as is the case with respect to national courts, the DSB's interpretation should be considered authoritative.

The potential conflict between decisions of regional dispute settlement institutions and the WTO DSB with respect to interpretation of the WTO Agreement is perhaps of relatively minor consequence since it seems clear that the WTO ultimately is responsible for interpreting its own rules. The conflict which may arise when a regional dispute settlement institution applies RIA rules and the WTO DSB applies WTO rules with respect to the same dispute or subject matter may be more serious because both decisions will likely be most :authoritative within the sphere of competence of the respective dispute settlement institution. A national government may find itself asked or directed to comply with two different decisions arising out of the same subject matter.
This raises a number of concerns.

Both the WTO DSB and a regional dispute settlement body may find their authority eroded if a decision is ignored. The national government may be subject to sanction (e.g., withdrawal of trade concessions) by the organization whose rules it disobeys. Interest groups may find that one dispute settlement decision is more compatible with their position than the other, and seek to manipulate the national political process to support the favored position. This may give rise to political pressure to more generally disapply the rules of the non-favored organization, and ultimately undermine the vitality of one or the other system.

There is no solution to the potential conflict between WTO and RIA dispute settlement decisions on the immediate horizon. This problem deserves systematic attention by WTO Members and RIA constituent countries. The NAFTA dispute settlement mechanism and its interface with the WTO DSB is described and analyzed in Chapter Six.

## *CONCLUSION*

The place of RIAs in the WTO system is not very well defined. In light of the growing importance of RIAs within the world trading system it is necessary to begin to more carefully define the relationship between regional structures and the global structure.

A fundamental difficulty in this regard is that the structures and functions of RIAs are dissimilar. It may be that no single set of rules will act as an adequate interface between RIAs and the WTO. It may be that a solution will lie in establishing an RIA accession procedure to the WTO that will be designed at least in part to define the relationship between the RIA and the WTO. This might be much like the present procedure by which individual countries accede to the GATT with separate protocols of accession. To some extent this has already taken place with respect to the European Union which is now to be considered a formal member of the WTO. However, even with respect to the EU, the relationship remains an uneasy one because of lingering internal EU-Member States differences concerning external competences. The relationship of NAFTA to the WTO is problematic, and efforts must begin to better define this relationship.

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**- Paul R. Krugman, Free Trade: A Loss of (Theoretical) Nerve?: The Narrow and Broad Arguments for Free Trade, 83 AM.ECON.REV.362, 362-366 (1993)**

Economists have a notorious, only partly deserved reputation for disagreeing about everything. One thing that almost all economists have always agreed about, however, is the desirability of free trade.

Why are economists free-traders? It is hard not It) suspect that our professional commitment to free trade is a sociological phenomenon as well as all intellectual conviction, that is, that there is more to it than our altruistic desire to persuade society to avoid deadweight losses. After all, if social welfare were all that were at stake, we should as a profession be equally committed to, say, the use of the price mechanism to limit pollution and congestion. However, support for free trade is a badge of professional integrity in a way that support for other, equally worthy causes is not. By emphasizing the virtues of free trade, we also emphasize our intellectual superiority over the unenlightened who do not understand comparative advantage. In other words, the idea of free trade takes oil special meaning precisely because it is someplace where the ideas of' economists clash particularly strongly with popular perceptions.

On the other hand, the contrast between what economists know and everyone else believes about trade creates special incentives for economists to turn apostate. In 1986 John Culbertson was given prime space in *The New York Times,* not once but three times, to propound exactly the same confusion between comparative and absolute advantage that Ricardo had exploded 170 years earlier. (On the strength of that performance he was then invited to publish an article in the *Harvard Business Review).* Lester Thurow's (1992) latest book is a best-seller because it seems to agree with (lie popular view of international trade as a struggle over market shares, even if some appreciation of general equilibrium is hidden in the footnotes. And despite her considerable qualifications, does anyone think that Laura Tyson would have attracted the attention that has now made her the president's chief economic adviser if she had criticized conventional wisdom on health care or social security instead of trade policy'?

Let me be clear from the outset that economists are basically right and the general public basically wrong about international trade. Those who criticize the professional conventional wisdom rarely do so because they have a serious alternative. Usually what their objections amount to is simply a failure to understand the idea of opportunity cost. And it is certainly disturbing when rewards are lavished on economists or self-described political economists who seem to pander to popular misconceptions.

Yet there is still the question of what really is known about trade policy. Is the case for a free-trade policy really as overwhelming as the professional consensus might suggest? The answer, I will argue, is no: there is a case for free trade, but it is a more subtle and above all a more *political* case than we are used to making.

## I. What We Know about International Trade

Since the late 1970's there has been a fundamental rethinking of the theory of international trade. This rethinking his not thrown out the grand tradition of trade theory, but it has modified that tradition enough to create a new climate of doubt about what we actually know about trade and trade policy. What is the current state of play? . The first thing that seems pretty clear is that international specialization and trade cannot be explained simply by an appeal to comparative advantage, that is, speaking loosely, by countries trading in order to take advantage of their differences. While comparative advantage due to differences in resources and exogenous differences in technology is clearly important, so is specialization driven by economies of scale and external economies. The importance of non-comparative-advantage sources of specialization is not, or at any rate should not be, news: the importance of increasing returns has repeatedly been emphasized by acute observers of trade, including Bertil Ohlin himself. What has happened since the late 1970's, however, is that the role of increasing returns has been codified in nice models; since economists prefer to emphasize those aspects of the world they think they understand, this codification has made increasing-returns stories about trade and specialization much more compelling to our ears than they used to be.

Once one has abandoned the assumptions of constant returns and perfect competition, one has also abandoned the Arrow-Debreu world in which markets necessarily produce a Pareto optimum; so the "new trade theory" that legitimized imperfect competition in positive discussion of trade also opened the door to possible arguments for government intervention. Also, in the mid-1980's there was **i** flurry of excitement over the idea, first enunciated by James Brander and Barbara Spencer (1985), that governments could successfully engage in "strategic" trade policies that would help domestic firms snatch excess returns away from foreign rivals.

After several years of theoretical and empirical investigation, however, it has become clear that the strategic trade argument, while ingenious, is probably of minor real importance. Theoretical work has shown that the appropriate strategic policy is highly sensitive to details of market structure that governments are unlikely to get right, while efforts to quantify the gains from rent-snatching suggest small payoffs. (…) Free trade is not the optimal policy, these studies suggest, but clever interventionist policies will do only a little better.

These results apply, however, only to efforts to capture excess returns in oligopolistic industries. What about external economies? International economists have long known that external economies could provide an argument against free trade. Since we have little empirical evidence on the actual importance of external economics, however, it is difficult to know how important this arguments really is. My personal guess, based in part on looking at semi-plausible numerical examples, is that external economics will turn out to be a more important argument against free trade than excess returns, but that we will still be talking about relatively small stakes. I propose the following question:

suppose that the United States were to carry out a clever, completely antisocial attempt to corner the world market in high-externality industries, and that the rest of the world were to remain entirely passive as it did so. How much would this raise real income in the United States? I would guess less than 1 percent.

If this guess is right, then the widespread popular view that the economic future of the United States rests on its success in a "head-to-head" international competition over who gets the good industries is basically if not totally wrong. However, to say that trade is not a zero-sum game is not the same as saying that free trade is the best policy. I have just argued that the new trade theory, while it refutes the position that free trade is optimal, does not suggest that any alternative will achieve great results. Still, why should free trade be the null hypothesis? There are, I think, two arguments for free trade that survive the revolution in international trade theory: a narrow economic arguments and a more compelling argument that is as much political as economic.

## II. The Narrow Economic Argument for free Trade

It markets were perfect, their laissez-faire in general, and free trade in particular, would be Pareto optimal. 'This is the simplest case for free trade, but it has a problem: since markets are imperfect, it is clearly an untrue case in fact.

There is, however, a much more sophisticated economic case for free trade. It is that, while markets are without question imperfect, the appropriate fix for their imperfection rarely involves trade policy per se. What is wrong with markets is usually a *domestic* distortion, best fixed by a surgical policy aimed directly at the source of the market failure.

The theory of' domestic distortions was developed during the 1960's (see Jagdish Bhagwati(1971) for it classic exposition). The canonical example is a perfectly competitive economy distorted by an exogenous wage differential, say, between unionized and non-unionized industries. The first-best policy to deal with this distortion is a wage subsidy. A production subsidy is second-best. Trade policy, if it is the only tool, can raise welfare, but it is only a third-best policy.

In the imperfectly competitive world of the new trade theory, it is not so easy to produce strong policy rankings. Nonetheless, efforts to quantify strategic trade models suggest that the presumption against trade policy as a preferred tool remains.

In practice, the theory of domestic distortion is rarely used to prescribe actual policies. Instead, it is used as it debating point against interventionist trade policies. Suppose, for example, that someone argues for import restrictions to save jobs in some industry. The economist can then make an argument something like this: "Well, if it’s jobs that are the objective, then let's subsidize employment in that industry-the cost to the taxpayers will be about $xxx,000 per job saved. Oh, you're not willing to pay that price?

But you know an import quota is even more expensive when you consider its true costs. So you must really not want one."

However, while the theory of domestic distortions is an effective argument *against* particular protectionist proposals, it seems somewhat lacking as a positive argument *for* free trade. Is it possible to offer something stronger? Only if one goes beyond narrow economic justifications and discusses political economy.

## III. The Broad (Political-Economy)Argument for Free Trade

The broad argument for free trade, to which many economists implicitly subscribe, is essentially political; free trade is a pretty good if not perfect policy, while an effort to deviate from it in a sophisticated way will probably end up doing more harm than good.

Let me offer two examples of how this might work. First, imagine trade between two countries that both have considerable market power. It is a familiar point that even in a world of perfect markets, each country has an incentive to try to exploit its market power with an optimal tariff. Yet if both countries impulse unilaterally optimal tariffs, the resulting trade war will move them off contract curve and (if they are not too asymmetric) leave both countries worse off than if they had adopted free-trade policies. In this situation it would be in their mutual interest to commit themselves to free trade. They could, of course, commit to some other efficient set of policies. One may plausibly argue, however, that among the set of efficient policies free trade would be uniquely easy to define and monitor and would thus stand out as a focal point for negotiations.

Now suppose that a new trade theorist comes along and informs the countries that markets are imperfect, and free trade is not really an efficient policy after all. There is, however, no simple and easily denied policy that can take its place, and the gains from optimal deviations from free trade will be small. What should the countries do?

It seems quite reasonable to argue that the countries should stick with free trade rather than try something complicated that could easily lead to a breakdown in cooperation. The perfect may be the enemy of the good: free trade may be a reasonable, rule-of-thumb way of avoiding what could otherwise degenerate into a prisoner's dilemma, in which a seemingly more sophisticated strategy might fail.

This first example may be somewhat lacking in force, since countries do not often seem to set tariffs in order to realize market power in trade. Instead, they seem to protect in order to redistribute income to selected producer groups. Although there have been some attempts to model this political process, notably the clever recent effort by Gene Grossman and Helpman(1992), it is not yet possible to offer as neat a story as that of optimal tariff warfare. Nonetheless, it is not too hard to imagine that setting trade policy also amounts to a kind of prisoner's dilemma: in a country in which each interest group gets the protection it wants, the net effect may be to make even the interest groups themselves worse off than if there had been a prior commitment to free trade. (This is more likely to be true if one thinks

of policy as a Rawlsian process in which rules of the game are set before the players are sure whether or not their interest group will be one of the favored ones). As in the first example, free trade may not be optimal, in the sense that it is on the interest groups' contract curve, but it may be the best solution that is simple enough to be negotiable and enforceable.

These examples suggest how one call be both a new trade theorist and a free trader. That is, one can believe quite strongly that the international economy bears little resemblance to the perfectly competitive, constant-returns world of pre-1980 theory and yet at the same time continue to support free trade as the best policy we are likely to get. That is indeed the position that I personally hold.

## IV. The Political Economy of Trade Theory

I think that I have just offered a coherent story of how one call combine it new-fangled view of the world economy with a traditional view about trade policy. This then raises two questions.

First is whether new thinking about trade may not itself do harm. In both of my examples, one finds that it is a bad thing to try to be too clever. It follows that an economist who points out the weaknesses of the traditional argument for free trade may end up reducing everyone's welfare. Does this mean, then, that it would have been better not to think these thoughts-or at least that challenges to free trade should have been treated like recombinant DNA, handled carefully so as not to contaminate the real world? On the other hand, if after all the rethinking of' international trade all we end up with is a sadder but wiser endorsement of free trade, does the theory do anyone any good?

The answer to the first question is, one hopes, that trying to understand how the world works is a terribly difficult exercise, it will be in impossible one if the economist is burdened with the additional responsibility of trying to avoid saying anything that may be misused. One might also add that in the long run even the cause of free trade is probably best served by having as sophisticated a model of trade as possible. For example, a few years ago it was common for advocates for aggressive trade policy like Bruce Scott (1985) to dismiss economists on the grounds that their theories neglected : “dynamic” aspects. We can now answer, truthfully, that we have looked pretty thoroughly into those dynamic aspects and found their policy implications to be limited.

It is, to be honest, somewhat disappointing that a fundamental rethinking of theory can have such modest implications for policy; but this does not mean that nothing has been accomplished. Even if the ultimate aim of economic theory is better policy, one does not best serve that aim by trying to make every journal article into a policy proposal. The immediate policy implications of a new idea are in the end important than its intellectual contribution. There are plenty of people out there trying to change the world un various ways; the point of economic research is to understand it.

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**- Jagdish N. Bhagwati, *Challenges to the Doctrine of Free Trade*, 25 N. Y. U. J. INT'L & POL. 219 (1993)**

*In this article, the author explains the challenges of the doctrine of free trade in two ways: "old" and "new" challenges. The old challenges includes the NTBs (Non-Tariff Barriers), VERs (Voluntary Export Restraints) or other "administrative protection", which all dilutes or circumvents the doctrine of free trade embedded in theGATT system. On the other hand, more serious (or problematic) challenge lies in the so-called new challenges centering on the argument of "fair trade", "level-playing fields" or "trade and wages".*

**- Stephen Woolcock, <u>Regional Integration and the Multilateral Trading System, in Regional Trade Blocs, Multilateralism, and the GATT</u> 115-130 (1996)**

*"The problem is how to link regional and multilateral efforts and thus ensure that the kind of synergy discussed above is used to further the development of multilateral rules. Strict multilateral controls are likely to be, at best, ineffective. What may, however, be possible would be to require new regional initiatives to be notified to the WTO thereby allowing for greater transparency arid, possibly, providing the catalyst for multilateral negotiations on similar measures. This would be the link between regional and multilateral processes that is required if divergence is to be avoided in the years to come."*

**- Frank J. Garcia, NAFTA and the creation of the FTAA: A Critique of Piecemeal Accession, 35 Va. J. Int'l L. 539, 552-560 (1995).**

*In this article, the author depicted the impact of "regional trading arrangements" (RTAs), such as "free trade areas" (FTAs) and "customs unions" (CUs) to the multilateral (global) trade regime in two ways: "static" and "dynamic" effects. The author introduced the traditional welfare effect analysis focusing on the comparison between the "trade-creating" and "trade-diverting" effect, which was invented by Jacob Viner.*

*The author then highlighted that in terms of "static effects" even if it is true that trade diversion is an "inherent risk" in FTAs / CUs, this does not necessarily indicate that all FTAs and CUs may equally produce significant trade diversion. Rather, he argued, the eventual result would more depend upon the extent to which trade creation effects exceed the costs of trade diversion. He also emphasizes that a regional trade arrangement comprised of bilateral agreements may take the form of a "hub-and-spoke" trading system and that this specific type of RTA is generally inferior to multilateral free trade and trade on an FTA/CU model because it results from a serious risk of trade diversion.*

*Moreover, he tries to draw attention to the "dynamic effects" in an economic analysis of RTA vis-à-vis the multilateral trade system. The dynamic effects of regional free trade, which has not received as much scholarly attention as that of the traditional static effects, would have greater impact on the development of the world trading system. Dynamic analysis concerns the extent to which RTAs influences main growth factors such as the "development of new technology", "competition and investment", and the "creation of efficiencies".*

**- Sam Laird, *Fostering Regional Integration* http://www.itd.org/forums/forreg.htm**

*Revised 21 August 1995*
*Telephone: Geneva 739 5493*
*Fax: Geneva 739 5765*
*e-mail: SAM.LAIRD@WTO.ORG*

Abstract

There has been a recent resurgence of interest by developing countries in regional trading arrangements, despite their checkered history. The new arrangements seem to have a greater prospect of success because of extensive autonomous trade reforms and a greater outward orientation in recent years. This paper looks at briefly at experiences in Latin America, and goes on to look at stages of integration, discussing how economic integration processes may be deepened. Provided regional integration agreements maintain their outward orientation, they can be building blocks for the multilateral trading system. This paper was first published in **Regionalism and its Place in the Multilateral Trade System**, OECD, Paris, 1996. (…)

**- Baer & Weintraub, <u>The Politics of NAFTA: The NAFTA Debate</u> (1994)**

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**North American Economic Integration and Canadian Sovereignty**

*Alan M. Rugman*

(…)

*"In Canada, the phrase **cultural nationalism** is an excuse for being anti-American." (…) "This is the Canadian burden-to perform in an economically successful manner on a world stage where the actors are following nineteenth-century scripts."*

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**The U.S. Domestic Politics of the U.S.-Mexico Free Trade Agreement**

*Howard J. Wiarda*

(…)

*"The real "sleeper" issues in all this involve political variables: reelection possibilities, embarrassing the president, using NAFTA, and political bargaining over other issues that have little to do with NAFTA. These are so infinitely changeable, often depending on the sense in Congress of how strong or how vulnerable a president is depending on the way the political winds blow, that almost any outcome is possible."*

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**The Changing Face of Mexican Nationalism**

*Soledad Loaeza*

(…)

*"The evolution of the international environment in the last quarter of the twentieth century has made the United States the main political and cultural challenger to the Mexican nation. A strategy of closer cooperation between the two countries is inaugurating an original alternative to the problems posed by geography, the consequences of which are still difficult to predict."*

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**The Pressures for Political Reform in Mexico**

*M. Delal Baer and Sidney Weintraub*

(…)

*"As economic reform proceeds, Mexican authorities will no longer have the luxury of compartmentalizing politics and economics. At that point, these two strands of national life will rapidly become part of the same process."*

(…)