

REGIONAL INSTITUTIONS AND DISPUTE SETTLEMENT MECHANISMS

Over the last couple of decades, there has been a growing awareness in academic and policymaking circles regarding the importance of institutions for economic development. Institutions constitute the rules of the game in a society or, more precisely, the restrictions designed by members of a society to influence human interaction. Any transformation affecting these rules may clearly have a direct impact on behavioral patterns (North, 1990).

As new cross-country institutional databases have become available, a growing body of empirical work has been confirming the important role played by the quality of institutions in a wide variety of dimensions of economic performance, such as the depth of financial markets, success in attracting foreign direct investment (FDI) or keeping inflation under control, and, most importantly, the growth performance of nations.

While institutions have an impact on economic development, important economic reforms, such as the creation of a regional integration agreement, may in turn affect the development of national institutions. They do so by establishing new rules and expectations as to how various policy options should be selected and implemented; by opening up new opportunities as well as establishing restrictions in the design and application of economic and trade policy; by generating new stakeholders while disenfranchising previous ones; and by laying the groundwork for a new philosophy in development policy. Accordingly, Rodrik (1999, 2000) has pointed out that assessing the ultimate effectiveness of economic and trade policy reforms should be based not only on their immediate

impact on economic variables, but also in terms of their contribution to the development of a high-quality institutional environment in a given country.

The move toward trade liberalization in the countries of Latin America under the framework of the World Trade Organization (WTO), as well as the formation of regional trade agreements, has tested the adequacy of the prevailing institutions, both at the national and regional level, and in various instances led to their strengthening and reform.

Just as national institutions are key determinants of national economic performance, regional integration agreements also require their own well-functioning institutions in order to be effective. The effectiveness of regional integration agreements, in terms of their impact on trade and investment flows, is closely related to the capacity of the countries involved to enforce the obligations stipulated in such agreements. This chapter describes the key institutional factors involved in integration experiences in the region. In particular, it looks at the development of dispute settlement procedures, discusses the extent to which they have been used, and demonstrates the vital policy role that these mechanisms play in the process of economic integration.

INSTITUTIONAL ASPECTS OF THE REGIONAL INTEGRATION PROCESS

Observance of the rule of law plays a vital role in sustaining and increasing trade and investment flows

between countries participating in an integration scheme. To that end, private players consider an effective, transparent regulatory and legal framework, as well as the establishment of institutional mechanisms and structures to regulate the interaction between the different players involved, to be a necessary precondition for the integration process.

The structures of institutional organization that accompany the coordination and implementation of trade integration must be considered as part of this process. In other words, how will the necessary communication and decision-making links, as well as the mechanisms to settle disputes arising between countries, be established?

Examination of regional integration finds two model institutional structures regarding the vertical dimension: minimalist and maximalist (Mattli, 2001).¹ These models explain the extent to which decision-making and authority shift from the national levels to the regional or global ones (Box 4.1).

Intergovernmental Institutional Model

Under the intergovernmental or minimalist institutional model, the countries, protective of their national sovereignty, retain power and initiative for decision and action. The process is therefore based fundamentally on interaction between governments. Under this scheme, the institutions are agents to which the governments grant few powers. As a result, the institutions lack sufficient authority and cannot effectively move the integration process forward any more quickly than dictated by the wishes of the countries, according to their interests and priorities. Under this minimalist institutional model, the larger countries exercise de facto veto power over the rules of the process, which tend as a result to converge toward the lowest common denominator reflecting the interests of those countries. Some experts believe that this model also entails the problem of supervision and how to avoid noncompliance with agreements.

Supranational Institutional Model

At the other extreme is the supranational, or maximalist institutional model, under which the policy players are persuaded to transfer their activities and expecta-

tions to a new, broader central authority in which the institutions have some jurisdiction over the member countries. In contrast with the minimum institutional model, the governments give broad powers to the supranational institutions so that they are not merely specialized technical agents serving the countries, but play a strategic role in the integration process, with a clear mandate for its promotion. The capacity and autonomy of supranational institutions to play this strategic role depend, however, on the rules established and the discretion of the mandate that they are given.

Regional Experience

Based upon the objectives of the agreements involved, regional economic integration processes in the Western Hemisphere have been developed on the basis of both the intergovernmental institution model as well as on supranational institutional structures.

The North American Free Trade Agreement (NAFTA) is clearly the best example of a minimalist institutional integration model. From the beginning of the negotiations, the participating countries made two fundamental decisions on the architecture of the treaty: that it would be strictly a free trade agreement and that the governing mechanisms and institutions would be limited to a minimum. The deliberate decision to establish a minimalist institutional arrangement is explained by the hesitance of the U.S. executive branch and Congress to establish new institutions.² This preference was welcomed by the governments of Canada and Mexico, as the negotiators from all three countries shared two concerns about the institutional structure of the treaty—its repercussions on national sovereignty and its costs—and these concerns prevailed in the design and architecture of NAFTA.

The special concern of the United States, the largest partner, about sovereignty was also reflected in the dispute settlement mechanisms provided in the treaty. Washington's position, for example, was that

¹ According to Mattli, horizontal integration refers to the mechanisms of communication and integration between the public sector, the private sector, and civil society in general.

² Weintraub (1994, p. 28).

Box 4.1 Institutional Organization in Regional Integration Arrangements: Decision-making and Executive Bodies

Supranational or Maximalist Model

The supranational or maximalist model generally involves subregional organizations with international legal status and powers transcending those of the member countries. These organizations typically include certain permanent decision-making and executive bodies.

A *policy steering body* comprised of presidents or ministers of the member country governments and vested with legislative powers is generally the highest authority in the process. It exercises maximum political representation for the group, formulates policy on integration, and is responsible for making decisions to ensure that the objectives of the process are met.

The policy steering body is generally complemented by an *executive body* that ensures compliance with and execution of arrangements and programs adopted by the member countries, generally in direct coordination with the jurisdictional authority. These bodies typically have the capacity to make proposals to the competent legislative authorities.

In addition, there is generally a *jurisdictional body* that is responsible for enforcement and uniform interpretation of the agreement. It hears disputes in which member countries may be involved, and its decisions are binding. In most cases, the jurisdictional body also presides over disputes that involve subregional institutions, firms and individuals.

Many arrangements based on the maximalist model also include a *parliamentary body* as well as bodies representing other sectors of society. The parliamentary body, comprised of representatives from member country legislatures, generally plays a consultative and deliberative role and has few if any legislative pow-

ers. Other bodies generally include representatives from economic and social sectors, including the private sector.

Inter-Governmental or Minimalist Model

The minimalist model rests exclusively on inter-governmental decision-making and coordination authority and as such has no supranational institutions with independent legal status. The decision-making and executive bodies under this type of arrangement generally include an *administrative commission for the agreement* that is responsible for enforcement and proper application of obligations. Comprised of ministers of trade and integration, it serves as a consultative body, with responsibility for settling disputes between countries related to the application and interpretation of the agreement. The commission has limited powers to propose and agree on new regulatory texts.

Another component of this model is the *technical committees, working parties and expert groups*. These entities are responsible for technical monitoring of the implementation of specific obligations stipulated in the agreement, for proposing ad hoc recommendations to the administrative commission on various topics, and for conducting technical studies.

Finally, the *dispute settlement bodies* serve as mechanisms for resolving differences between the parties through settlement proceedings conducted by an impartial outside authority (panel), based on standards and principles previously approved and established in the agreement.

each country's national legislation should apply in the treatment of laws against unfair trade practices. In other words, the agreement substantially constitutes an instrument to ensure transparent application of national regulations. This is also the spirit of the parallel agreements on labor and environment. The situation is different, however, in the case of the mechanism for settling disputes between countries, which is analyzed below.

The NAFTA negotiation for all three countries involved a key foreign policy initiative. As a result, no complex institutional structures were required to hold the governments' interest in the process. Because of the importance that it represented to all three countries, NAFTA also helped improve the technical and decision-making capacity of the three signatory countries by introducing important institutional changes in all

three governments.³ Some authorities maintain, however, that, eight years on, it is becoming clear that NAFTA lacks the intrinsic institutional capacity to maintain the active interest of the governments to continue its implementation and to enhance and expand some areas of the integration process.⁴

Mercosur is another example of the minimalist institutional approach. It differs from NAFTA, however, in that the signatory countries initially decided to establish a customs union as the first step toward building a common market, and not simply a free trade agreement. The problems that have occurred in the process of implementing the customs union (partial application of the common external tariff, delays in formulating and implementing common trade policies, insufficient progress in eliminating nontariff barriers, unilateral noncompliance, etc.) have brought to light the weakness of the institutional mechanism under the agreement.⁵ One should bear in mind, however, that the economic differences between countries have widened rather than narrowed since 1995. It would also seem that the larger partners are not interested in yielding sovereignty in their trade and economic policy management to supranational institutions, which may limit their flexibility in making decisions. Clear examples of this reluctance were the establishment of a secretariat with purely administrative functions, and the recent introduction of a strictly intergovernmental dispute settlement mechanism.

In the cases of the Andean Community (AC) and the Central American Common Market (CACM), as is true for Mercosur, the countries set the establishment of a common market as the ultimate objective of the integration process. Unlike Mercosur, however, the partners decided to establish institutional schemes with some supranational discretion, inspired in both cases by the European model. The clearest example is perhaps the Andean Community, which is comprised of a set of supranational bodies and institutions with legal status. The Andean Integration System (AIS) includes the Andean Presidential Council, the maximum authority in the system; and the Council of Foreign Ministers and the Commission, which are the management and decision-making bodies. In addition, the Secretariat-General, the executive body, has the capacity to propose and enforce agreements, and the Andean Court of Justice, the jurisdictional body, is responsible for

overseeing the legality of the regulations and settling disputes.

A similar institutional structure was agreed upon by the Central American countries, which established the Meeting of Presidents and Councils of Ministers, the Central American Court of Justice, and a Secretariat of Economic Integration.⁶

Despite the existence, at least in theory, of a supranational institutional scheme, many problems related to effective implementation of a common external tariff and harmonization of policies and standards have until now delayed the initial objective of consolidating a customs union and common market among all signatory countries. In addition, some of the institutions established do not have sufficient legitimacy to override the interests of the countries and private players. The courts of justice responsible for settling disputes are often not perceived as flexible and specialized mechanisms to settle disputes.^{7,8}

These experiences demonstrate both the importance and the weakness of the institutional mechanisms established in the processes of trade integration in the region. The following section analyzes the specific case of dispute settlement systems. While they constitute key instruments for promoting the process of liberalization to the extent that they shield the opening process from attack by protectionist pressure groups, these systems may be weakened in practice by countries' overriding political interests.

³ Fernández de Castro (2001).

⁴ See Dymond (2001).

⁵ Bouzas (2001).

⁶ It is important to bear in mind that the Andean and Central American integration processes began during the 1970s and 1960s, respectively, in the context of an import-substitution economic model. Both, however, like the Caribbean Community (CARICOM), underwent institutional reform during the 1990s.

⁷ Only three of the five Central American countries ratified the statute of the Central American Court of Justice. Even the countries that signed the statute, thereby acknowledging the jurisdiction of the Court, have not resorted to that mechanism to solve their trade differences. At least 16 trade disputes have occurred between the member countries, and only one involved recourse to the Court for settlement.

⁸ Even the general public has this perception. See Cerdas (2002, p. 19).

DISPUTE SETTLEMENT SYSTEMS: OBJECTIVES, CHARACTERISTICS AND FUNCTIONS

For a number of decades, the specialized literature has addressed the issue of what should be the function of a dispute settlement mechanism within the context of a trade agreement. Effective legal mechanisms for settling disputes perform two essential functions.⁹

First, these mechanisms help provide the economic players with a sufficiently consistent and sound environment to engage in economic activities at the international level.¹⁰ Penetration of new markets through trade or investment is an intrinsically risky activity. Moreover, it requires the commitment of substantial resources to produce yields in the medium or long term. Hence there is a need for legal institutions to help reduce some of these risks by clearly establishing the rules of the game applicable to the economic players involved, and the mechanisms to maximize compliance with these rules.

Second, legal systems for trade dispute settlement also play a key political role. The use of an impartial outside entity to settle disputes helps prevent a trade problem from becoming politicized and from being affected by other non-trade considerations that may eventually exacerbate it. De-politicizing disputes increases the probability that the violating country will comply with the final decision. Further, an effective dispute settlement mechanism in the last instance provides an outlet to channel the tensions that the application of trade barriers can generate between countries.

Experience in subregional integration processes during the past decade in the Western Hemisphere, and particularly in most Latin American countries where these negotiations have supplemented profound processes of economic reform, demonstrates another important function of trade dispute settlement mechanisms: consolidating the economic liberalization process. Within this context, dispute settlement mechanisms provide government sectors promoting the reform with institutional protection against pressures from corporate interests attempting to impede or delay economic liberalization.

Dispute settlement mechanisms represent the instrument of last resort that can be used to guarantee compliance with the substantive obligations under trade agreements. Without effective dispute settlement

procedures, compliance with obligations would depend on the willingness of the national governments.¹¹

In addition, the willingness of national governments to observe standards and disciplines covered in trade agreements depends on the capacity available to these governments at a given time to address pressure groups defending the status quo and whose interests will be affected. This capacity is normally limited, particularly when confronting pressure groups has a high political cost for the prevailing administration.

An effective trade dispute settlement system goes a long way to avoiding such situations. The possibility of an adverse reaction at the international level for failing to meet an obligation under a trade agreement represents a shield for governments that are particularly vulnerable to domestic protectionist pressure. This applies especially to countries with insufficient institutional strength, and with legal systems that are insufficiently strong to withstand pressure from more powerful interest groups that as a result can easily influence government decisions. Even in countries with more developed institutions, however, the need to reach a solution through a dispute settlement mechanism represents a way for governments to avoid bearing the full political brunt of complying with an obligation opposed by powerful interest groups. This political cost will be shifted to the treaty itself, or to the international institution responsible for its application.

What features do trade dispute settlement mechanisms require to operate effectively? At least in the context of the Western Hemisphere, where developing countries are numerically predominant, these mechanisms should meet three fundamental require-

⁹ The use of the term "legal" to qualify these trade dispute settlement mechanisms is a deliberate reference to a mechanism through which a dispute between two or more parties to a trade agreement is settled in a proceeding conducted by an impartial outside entity on the basis of substantive standards and principles previously agreed to by those parties and stated in the treaty. This type of legal mechanism is differentiated from other types of dispute settlement mechanisms that are based on negotiations between the parties involved rather than being subject to an adjudication proceeding.

¹⁰ See Jackson (1997), Petersmann (1997), and Cameron and Campbell (1998).

¹¹ This assertion is proven by experiences in applying numerous trade agreements of partial scope negotiated between Latin American countries during the 1960s and 1970s.

ments: they must be expeditious, effective and inexpensive.

They must be expeditious in that they must have the capacity to determine quickly whether or not a given measure is compatible with the obligations under the trade treaty. If a given measure has been contested, it is likely that in practice the measure represents a substantial source of economic damage to a given economic sector. Hence the need for issuing a resolution on the legality of this measure as quickly as possible in order to avoid lengthy interruptions and distortions to free and normal trade flows. An expeditious settlement process becomes a particularly pressing objective when the controversy involves relatively small, highly vulnerable enterprises in the export markets, as is normally the case when one of the parties to the dispute is a small economy.¹²

Despite the vital importance for a dispute settlement mechanism to operate expeditiously, this goal is in fact often difficult to achieve in practice. First, the country affected by the contested practices will be required to dedicate some time to amicable consultations with the government that imposed the measures, in order to explore the possibility of reaching a settlement. Second, depending on the obligation in question and the contested measure, settlement of the conflict may require establishing numerous facts and complex scientific or technical records, inherently requiring the participation of experts in the process. This process tends to be time-consuming.¹³

It is also vitally important that dispute settlement mechanisms be effective. Such mechanisms should serve as the last resort to induce the party that violated an obligation to comply with the settlement. The effectiveness of the systems should also be such that the penalty or threat thereof must be sufficiently credible to serve as a clear deterrent against violating the obligations involved. The effectiveness of these mechanisms is vital to executing the intrinsic function of the system—what good is a settlement if it is not observed? Further, effectiveness is basic to the credibility of the system and the economic integration process as a whole. Despite the importance of effective mechanisms, however, there are many cases in the Western Hemisphere when resolutions are ignored by the party involved, seriously undermining the credibility of the integration process.

Another fundamental feature of dispute settlement mechanisms, particularly in the context of developing countries, is to be usable at a low cost. The cost of resorting to dispute settlement proceedings should be substantially lower than the cost of tolerating the disputed measure. Further, if another function of the legal dispute settlement system is to try to smooth the immense asymmetries derived from economic or political differences between the countries, then the weakest countries are those that most need such settlement mechanisms to defend their interests.

Countries having greater economic weight, in fact, are in a better position to defend their interests with alternative methods to legal settlement. The facts, however, indicate an ironic reality. In many regional integration arrangements in the Western Hemisphere, and at the multilateral level in the World Trade Organization, the relatively more developed countries are the ones that most frequently use dispute settlement mechanisms. This suggests not only the need to assess the incidence of the costs of such proceedings on their use by relatively less-developed countries, but also the need to strengthen the institutions by establishing technical teams in the competent agencies to enable countries to make effective use of the dispute settlement mechanisms theoretically available to defend their trade interests.

EVOLUTION AND USE OF DISPUTE SETTLEMENT MECHANISMS

Experience in the settlement of trade disputes at the regional and multilateral levels can be analyzed from

¹² For an enterprise whose total income is generated by foreign sales, being prevented from placing products on its traditional export market as a result of a problem under a trade agreement is tantamount to undergoing financial suffocation. This vulnerability increases in the case of small economies for which the exporting enterprises tend to have export markets highly concentrated in one or several countries. This underscores the need for dispute settlement mechanisms to include precautionary measures and remedies to avoid irreparable damage. In this connection, however, there is much scope for improvement in international legal doctrine and negotiating practices at the regional and multilateral levels.

¹³ In light of the WTO, there are also delays attributable to the requirement to conduct the proceeding in more than one language. One of the challenges of the WTO's dispute settlement mechanism has been the need to translate the lengthy reports from panels into the organization's three official languages.

two standpoints. First, it is important to observe the actual features of dispute settlement mechanisms under different integration arrangements in order to identify predominant patterns in the legal evolution of this type of regulation. The second standpoint focuses not on the evolution of dispute settlement procedures, but on their use in different subregional integration schemes as well as in the WTO.

Evolution: “Legalization” and Regulatory Migration

Although experience with regional integration in Latin America dates to the 1960s, the topic of negotiation and the use of dispute settlement processes conceived as adjudication instruments did not begin to take effect until almost 30 years later with the rise of what has been called the “new regionalism” of the 1990s.

Until the early 1990s, interpretation of or compliance with the obligations established under economic integration agreements tended to be viewed as problems that could or should be resolved by the parties themselves. As a result, settling trade disputes in these treaties was originally designed primarily as processes of political consultation between the interested parties rather than settlement processes. This can be seen in the many bilateral agreements of partial scope negotiated between the 1960s and 1980s in the framework of the Latin American Integration Association (LAIA).¹⁴ By contrast, in customs unions established during the 1960s and 1970s, the formal existence of supranational courts either proved ineffective or did not become effective until the 1990s.¹⁵

The negotiation of legally oriented dispute settlement mechanisms beginning in the 1990s reflects the events in the multilateral arena during that period. The “legalization” of the dispute settlement system was one of the main results of the Uruguay Round that culminated in the establishment of the new institutional structure of the multilateral trade system. With the entry into force of the Dispute Settlement Understanding (DSU) in 1995, the legal orientation of dispute settlement mechanisms of the multilateral trade system was consolidated with the development of two fundamental characteristics: the possibility that a resolution by a panel could be binding, even without the unsuccessful party’s consent; and the establishment of the Appellate

Body responsible exclusively for examining potential legal errors in resolutions by panels.

The fact that the resurgence of the regional economic integration process in the Western Hemisphere began during the early 1990s, when the Uruguay Round was still pending completion, largely explains the influence of the latter on the architecture of the integration schemes that began to be negotiated during that period.

This “regulatory migration” resulted in part from the interest of the United States in reflecting at the regional level the same trade agenda that was proposed in the multilateral arena. It is therefore no accident that NAFTA negotiations comprised practically the same content as the Uruguay Round, including what were known at the time as new issues, which until then had been excluded from regional trade agreements. Once NAFTA was negotiated, it became a model free trade agreement that was reproduced throughout Latin America—first by Mexico and later by Chile and the countries of Central America.

The influence of the WTO in determining the characteristics of the dispute settlement procedures included in the hemisphere’s subregional economic integration agreements has been an ongoing process. Lessons learned from the application of the WTO’s Dispute Settlement Understanding were reflected in the dispute settlement instruments negotiated recently among countries in the hemisphere. Moreover, preferential agreements negotiated in the region provided solutions to problems that arose in application of that understanding.¹⁶

¹⁴ Resolution 114 of the LAIA provides for consultation by the parties or intervention by the Committee of Representatives as mechanisms to settle disputes regarding obligations under the 1980 Montevideo Treaty.

¹⁵ See footnote 7 regarding the Central American Court of Justice. In the case of the Andean Community, the court was not established as a legal body until 1979. The Cochabamba Protocol, which has been in effect since 1999 and now governs the functioning and competence of that court, was not signed by the AC members until 1996.

¹⁶ For example, recently negotiated dispute settlement instruments such as the Mercosur Olivos Protocol, the CACM Dispute Settlement Treaty, and the chapter on dispute settlement in the free trade agreement between Canada and Costa Rica explicitly prohibited one of the parties in a dispute from determining unilaterally whether the other party had effectively complied with the recommendations of the panels, thereby eliminating any doubt in connection with the application of Article 21.5 of the Dispute Settlement Understanding disputed in the context of the WTO.

Trends in the Use of Dispute Settlement Mechanisms

Trade dispute settlement mechanisms during the past decade have been concentrated within a few regional integration agreements. Although there are approximately 30 reciprocal trade agreements on the Americas (in addition to partial scope agreements signed within the framework of ALADI), only three have regularly used dispute procedures: NAFTA, the Andean Community and Mercosur.¹⁷

There are three possible explanations for not using settlement mechanisms. First, this type of mechanism might not be available to the parties of the conflict, either because it does not exist or because it is not efficient or functional, and therefore not helpful to the parties in settling disputes. This forces the parties to use alternative mechanisms such as negotiation, mediation, or sheer economic or political force.

Second, the affected party takes a passive approach. Although the mechanisms exist, a party might be unable to use them for other reasons such as intimidation or insufficient resources.

A third and final explanation could be the absence of a sufficiently important conflict to justify the use of a settlement mechanism.

In the Western Hemisphere, limited activity in trade settlement proceedings can be explained by all three variables discussed. Many trade agreements, in fact, do not include settlement mechanisms to resolve trade conflicts. Other agreements include settlement mechanisms in theory, but have not accomplished their function in practice and have failed to meet the needs of the parties. This has been the case of the Central American Court of Justice, although that situation can be expected to change in the short term due to the signing by the five Central American countries of the Dispute Settlement Treaty.

Further, the passive approach by signatory countries of these agreements in using international settlement proceedings, despite the existence of mechanisms potentially capable of serving this purpose, may be attributed, at least in the Western Hemisphere, to two additional but fundamental reasons.

The first reason is political in nature and involves a government's fear of initiating an international settlement proceeding to solve a quarrel. This

fear may involve the latent risk that the accused country might retaliate by politicizing the trade conflict, thus posing problems to other components of a broader agenda that usually exists within the normal scope of international relations between countries. Whether or not a country resorts to an international settlement jurisdiction is, after all, a political decision, and as such it is the product of a balance of power within the government that makes such a decision. It is sometimes no easy matter to reach a consensus within the government to summon a trading partner before a regional or multilateral forum.

The passive approach to using dispute settlement mechanisms may also be attributable to institutional deficiencies such as a lack of technical and financial resources required for adequate preparation and defense of the country's trade interests. Not all governments in Latin America have technical and professional staff capable of preparing and defending a petition before an international trade court.¹⁸ Those that do not must also have the financial capacity to contract specialized external attorneys to that end.

As a rule, the countries that tend to use dispute settlement mechanisms most at the regional level also resort to such proceedings more frequently at the multilateral level. This suggests that such countries have the institutional capacity to more proactively defend their trade interests. The Western Hemisphere countries that have most frequently invoked WTO dispute settlement procedures represent the strongest economies in the region: the United States, Canada, Brazil, and Mexico. They are also members of subregional integration agreements that have registered trade settlement activities.

Another variable that plays a role in the use or failure to use dispute settlement mechanisms is insuffi-

¹⁷ There are three regional integration agreements in which only one trade dispute has been registered since their inception: the Central American Common Market, the agreement of partial scope between Chile and Bolivia in the framework of ALADI, and the free trade agreement between Mercosur and Chile.

¹⁸ For this reason, many governments have been forced to contract specialized attorneys abroad (particularly in the United States). The participation of private attorneys in dispute settlement processes has even been subject to debate in the WTO and, more specifically, in the wake of the banana conflict involving several Caribbean countries. To defend their positions, some of these countries were forced to contract foreign experts. See World Trade Organization (2002).

Table 4.1 Trade Share and Number of Disputes

	Average annual intra-regional trade share	Average annual intra-regional trade share growth rate (%)		Total number of disputes	
	1989-2000 (%)	1989-2000	1995-2000	1989-2000	1995-2000
NAFTA	42.11	2.07	1.87	105	17
Mercosur	17.93	5.65	1.34	18	9
AC (Tribunal)	9.10	6.75	-3.55	54	54
CACM	13.78	-0.96	-6.38	1	1
CARICOM	8.63	4.01	2.63	na	na
G-3	2.30	0.49	-9.36	0	0
Mercosur-Bolivia	1.10	-2.58	2.59	0	0
Mercosur-Chile	4.59	2.45	1.94	1	1
Mexico-Bolivia	0.04	-2.85	-4.90	0	0
Mexico-Costa Rica	0.26	-2.73	3.76	0	0
Mexico-Chile	0.65	3.75	-4.07	0	0
Mexico-Nicaragua	0.07	0.70	5.66	0	0
Chile-Bolivia	1.13	2.90	0.74	1	1
Canada-Chile	0.22	3.79	1.92	0	0

Source: IDB Integration and Regional Programs Department.

cient trade flows between many countries that signed free trade agreements during the 1990s. Table 4.1 shows that rather than regulating dense trade flows, most free trade agreements have been negotiated with a view to generating new trade and investment flows that were practically insignificant when the treaty was being negotiated. As they account for a small relative share of total imports in the destination market, potentially competing sectors for the new exports generated by free trade agreements do not perceive them to be a threat. As a result, there is no pressure on the government of the importing country to impose trade barriers. It follows that, while trade flows increase significantly in absolute terms, since they are limited in comparison with flows from nonmember countries, they transpire without any major problems. Trade barriers that might arise for whatever reason can be easily eliminated or resolved by informal consultation between the parties, in light of the significant discretion available to the administrative authorities to dismantle these barriers.

The importance of trade flows as an impetus for the use of dispute settlement mechanisms is confirmed by the fact that virtually all disputes in connection with the application of economic integration agreements in the Western Hemisphere have occurred

among countries that are geographically close—generally neighbors—and whose trade flows have some relative importance (namely, NAFTA, the Andean Community and Mercosur).

Table 4.2 shows that the Andean Community is the subregional integration scheme that registers the most frequent use of dispute settlement mechanisms. Over 1995-2001, 61 complaints involving controversies were filed with the Andean Court of Justice—more than three times the total number of requests for consultation in the context of NAFTA and Mercosur.

Decisive in explaining the active use of the Andean dispute settlement system is the preponderant role of the Secretariat of the Andean Community as the presiding body in the process. Countries and even representatives from productive sectors must go before the Secretariat of the Community in the first instance. When a complaint has been prepared, the Secretariat takes responsibility for conducting the investigation. If there are inconsistencies with the Andean regulations, the Secretariat must file a petition with the Andean Court of Justice against the country in question.

The active role of the supranational bureaucracy has a significant mediating effect on the political dynamics that normally characterize the use of trade

Table 4.2 Number of Trade Disputes between Western Hemisphere Countries

	1995	1996	1997	1998	1999	2000	2001
Referrals to the WTO	3	5	9	2	7	14	13
Subregional disputes: ¹	8	7	4	17	19	26	15
NAFTA	7	3	1	5	0	1	0
AC	1	3	3	10	14	23	7
Mercosur	0	1	0	1	5	2	8
CACM	0	0	0	1	0	0	0

¹ Conflicts formally submitted to dispute settlement mechanisms.

dispute settlement mechanisms. In such cases, the governments of the parties do not hold the monopoly on activating the dispute settlement mechanism, which multiplies the risk that petitions not sponsored by any government are filed, which could lead to problems in system compliance and effectiveness.

From a time standpoint, Table 4.2 shows a trend that merits discussion owing to its important implications. While in both the Andean Community and Mercosur, the number of disputes grew substantially beginning in 1998, in the case of NAFTA, the number of requests for consultation were concentrated during 1995-98, and began to decline substantially in 1999. In the Andean Community, the number of disputes submitted for consideration by the Andean Court of Justice tripled in 1998 compared with the preceding year—a trend that continued in 1999, intensified in 2000, and declined abruptly in 2001. In the case of Mercosur, the number of disputes brought before the dispute settlement mechanism began to increase in 1998, and increased further in 1999 and 2001.

In the cases of Mercosur and the Andean Community, the increased use of the dispute settlement mechanism would seem to be associated with pressures derived from financial and political crises that affected virtually all member countries during that period.¹⁹ This trend would also seem evident in the case of NAFTA. The highest number of requests for consultation were registered from 1995—which marked the beginning of the Mexican financial crisis and the devaluation of the peso—until 1998. Of the 16 dispute settlement cases filed during that period, more than

half were initiated by Mexico, and all were against the United States, suggesting Mexico's reaction to the restrictive trade measures implemented by its main trading partner.

The increased use of trade dispute settlement systems in times of crisis—at least in some trading blocs—suggests two concepts vital to understanding the context and function of these mechanisms. An initial conclusion seems to be that governments are more likely to apply protectionist measures in times of crisis (see Chapter 7). A second conclusion, perhaps less evident and more important than the first, is that increased use of dispute settlement mechanisms in times of crisis would appear to highlight the important function of these mechanisms as a protective shield for the gradual process of economic liberalization and as a counterweight against protectionist pressures that tend to gain negotiating power against governments whose political capital is eroded by the crisis.²⁰

Lessons from the WTO

The credibility of the WTO Dispute Settlement Understanding is reflected in the increasing use that countries in the hemisphere have made of this mechanism, in

¹⁹ Brazil was forced to devalue the real and most members of the Andean Community recorded serious economic imbalances.

²⁰ See Echandi and Robert (forthcoming), for a more specific analysis of particular trends in the use of mechanisms to solve trade disputes under certain specific integration agreements and the WTO.

proportions that even exceed the relative share of their reciprocal trade flows in world trade. Approximately 25 percent of the total dispute settlement cases filed under the WTO were between countries in the Western Hemisphere.²¹

Many of these cases involved countries of the region that were not members of any integration scheme or free trade agreement amongst themselves, and therefore had no alternative dispute settlement mechanism under such preferential agreements. As a result, recourse to the WTO was the only option. It is interesting to note, however, the substantial number of conflicts that have arisen in the framework of the WTO Dispute Settlement Understanding between countries in the region that are both members of a preferential agreement for trade or integration. This is true of Canada, the United States and Mexico, as well as some of the conflicts that have occurred between Mercosur countries and between the latter countries and others with which they have some preferential association agreement, such as Chile.²²

The substantial number of cases between countries in the region that are not members of preferential trade or integration schemes or agreements evidences the importance that an ultimate dispute settlement scheme would have within the context of the Free Trade Area of the Americas (FTAA).

There is another hypothesis as to why countries that have alternative mechanisms at their disposal under preferential arrangements are increasingly turning to the WTO Dispute Settlement Understanding. Clearly, even if a preferential arrangement exists, the challenged measure may involve a violation of obligations under multilateral agreements rather than those stipulated in the framework of preferential arrangements. In this case, recourse to the multilateral mechanism is the only option.

It would seem, however, that other variables also explain the frequent use of the multilateral mechanism to resolve conflicts between members of a bilateral or subregional agreement. In some cases, there may be the perception that the multilateral mechanism might be more effective considering the sensitivity of the issue or conflict in question, and that the subsequent politicization of the controversy in the framework of preferential regional or bilateral relations might make the conflict difficult to resolve. In addition, recourse to the

multilateral system enables alliances to be developed with other countries having similar interests, thus helping intensify the pressure to eliminate or amend the questioned measure. For example, in many conflicts that have arisen in the WTO between countries of the region, other countries of the Western Hemisphere, besides the defendant or complainant, have appeared as interested third parties. Last, use of the multilateral mechanism provides incentives to promote the creation of jurisprudence, which is found to be quite important, particularly when addressing very sensitive issues that also have more global implications and scope.

The satisfactory record of compliance in the WTO shows the effectiveness of the multilateral mechanism and lends it great credibility, which is quite important for countries in the region, particularly when dealing with economies of different sizes and having substantial asymmetries in terms of political and economic power.

Trends in the use of the Dispute Settlement Understanding by Western Hemisphere countries also indicate the importance of existing interrelations between the multilateral trade system and regional and bilateral agreements. This is particularly important in the context of the negotiations in progress in connection with the WTO as well as the FTAA.

These dynamics will create vital synergies between both processes of negotiation, with important implications in the area of dispute settlement. The synergies will probably promote a greater "regulatory migration" between both agreements, as was true for the NAFTA and the WTO agreements negotiated during the Uruguay Round.²³

The foregoing presents major challenges for countries of the region, which, with their aim to create

²¹ More than half the cases are related to the application of unfair trade practices and safeguard measures. In addition, in a number of cases, disputes were related to patent protection and compliance with obligations under the agreements on agriculture, agricultural goods, and textiles and clothing.

²² See Echandi and Robert (forthcoming).

²³ In many free trade agreements in effect in the Western Hemisphere, the trend has been to refer to WTO regulations to govern certain aspects of bilateral trade (such as technical barriers to trade and sanitary and phytosanitary measures), and the provisions of the WTO regulation have been incorporated into the free trade agreements.

a free trade area in the Western Hemisphere while strengthening the multilateral system, need to find the best way to ensure that effective, expeditious and inexpensive regional mechanisms exist to settle disputes, while not detracting from the multilateral system or promoting development of contradictory jurisprudence with similar obligations negotiated in different forums.

CONCLUSIONS

The evolution and use of trade dispute settlement mechanisms by countries in the Western Hemisphere during the past decade demonstrate the vital roles that institutions play in the development and growth of market economies. The success of these integration processes in the region depends on the existence of effective institutional mechanisms that can encourage national governments to uphold their commitments to economic liberalization, even when some powerful domestic sectors oppose it. Hence the importance of legally oriented dispute settlement mechanisms, which provide the economic players with enhanced certainty for long-term business planning. They also represent an institutional shield for national governments that are vulnerable to domestic interest groups that attack the integration process when their interests are affected by it.

Encouraging trends over the past decade suggest progress among the countries of the region toward greater institutional maturity, with enhanced acceptance, confidence and respect for an emerging legal system in the area of economic integration. After three decades during which negotiations were considered the only way to solve disputes related to integration schemes, the 1990s brought a shift in the approach of countries in the region toward legally oriented trade dispute settlement mechanisms. The fact that two subregional economic integration agreements in the hemisphere in 2002 adopted new instruments for this purpose seems to be no coincidence. In both cases, the instruments are based on the principles, concepts and rules of the WTO Dispute Settlement Understanding, and extend further to incorporate solutions to problems that have arisen in the application of multilateral agreements.

Judging from the actual use of these mechanisms by countries in the region, it is difficult to con-

clude with certainty whether the countries are in fact respecting and meeting their obligations under preferential agreements, even in cases when doing so involves a substantial political cost to the current government. Only three regional integration arrangements have consistently and substantially used these mechanisms. Accordingly, in most cases where regional trade agreements have been signed during the past decade, it will take some time to determine whether countries comply on a generalized basis with the dispute settlement resolutions.

The concentration of litigious activity in the area of trade in only three of the approximately 30 reciprocal regional trade agreements is evidence that the effectiveness of most dispute settlement mechanisms provided under trade agreements negotiated during the past decade has yet to be tested. However, there is at least cause to be optimistic in light of the trends with these three agreements in terms of respect for the emerging system of law in the trade area.

In addition, the increasing use of and compliance with resolutions issued by the WTO dispute settlement system also suggests credibility in legally oriented mechanisms among countries in the region. Many countries have resorted to the WTO at least once to defend their trade interests against other trading partners. While it is true that countries that use the mechanism more regularly have a higher relative development index, it is clear that this trend is largely attributable to institutional problems rather than to problems of confidence in or credibility of the system. This shows the need for existing cooperation mechanisms in the region to include in their priorities the exploration of effective mechanisms to strengthen the institutional capacity of governments to optimize use of dispute settlement mechanisms, at both the regional and multilateral levels, to defend their interests.

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