

## **REDUCING LEGAL UNCERTAINTY: A CHALLENGE FOR SUBREGIONAL INTEGRATION IN LATIN AMERICA AND THE CARIBBEAN**

Despite the recovery in intraregional trade over the past three years, intra-group trade, that is trade within the Southern Common Market (MERCOSUR), the Andean Community (CAN) and the Central American Common Market (CACM), remains much weaker than that observed within similar groups in other regions of the world.

This weakness is due essentially to the serious lack of complementarity in the process of eliminating tariff barriers (see chapter 3 of *Latin America and the Caribbean in the World Economy 2004: Trends 2005*, and the study on regional integration entitled: “América Latina y El Caribe: La integración regional en la hora de las definiciones”, which is due to be published shortly and which updates basic information for the year 2005). The reasons include (a) weak institutional capacities; (b) the lack of macroeconomic coordination; (c) inadequate infrastructure and d) the lack of depth in integration-related trade disciplines.

This edition of the Bulletin reviews the mechanisms for dispute settlement within Mercosur, the Andean Community and CACM with a view to drawing conclusions on the extent to which they are used. In order to reform such mechanisms, consideration should be given to the creation of a single dispute settlement mechanism which would replicate the procedures and regulations of the World Trade Organization (WTO).

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### **A GOOD BIENNIUM FOR REGIONAL TRADE INTEGRATION: TRADE IS ON THE RISE, BUT THE POTENTIAL IS UNDERUTILIZED**

The 2004-2005 biennium was characterized by a boom in exports and above all by rises in the prices of the region's main raw materials. This fuelled an upsurge in domestic demand in the member countries of the various integration schemes, expanding trade flows within the subregion for three consecutive years (see figure 1). Despite this, intra-group trade has remained sluggish in comparison with that observed in other regions of the world. Meanwhile, in the period 2000-2005 regional exports accounted on average for 17% of total exports, compared with 34% (double) in Asia and just over 62% in the European Union. The same pattern occurs in the subgroups of the region: Mercosur: 15%, CAN: 10%, and the countries of CACM<sup>[1]</sup> together with the Caribbean Community (CARICOM): 21%. This comparison shows that the countries of the subregions still have not taken full advantage of the opportunities generated by intrasubregional tariff preferences, especially for boosting exports of manufactures with a higher value added, and which are more suitable for export within integration schemes. Legal uncertainty seems to be one of the explanations for this underutilization.

Figure 1

LATIN AMERICA AND THE CARIBBEAN : INTRAREGIONAL TRADE, 1980-2005<sup>a</sup>  
 (Millions of dollars and percentages)



**Source:** Prepared by the authors on the basis of official information.

<sup>a</sup> Includes intra-group and inter-group exports, as well as exports from Chile, Dominican Republic, Mexico and Panama to the rest of the countries of the region.

<sup>b</sup> Authors' preliminary estimates.

### Probing the reasons for this underutilization

The fact that countries have not been taking full advantage of the trade opportunities provided by tariff liberalization—close to 85% of all tariff items and 70% of total trade—is due to major shortcomings in other areas complementary to the process of elimination of tariff barriers and which are necessary if this process is to be effective. These areas include: (a) weak institutional capacities; (b) lack of macroeconomic coordination; (c) inadequate infrastructure; and (d) lack of depth in integration-related trade disciplines.

An important problem to be resolved with respect to the customs union of the region is the legal uncertainty generated by violations of community regulations and commitments undertaken. In an effort to contribute to a better understanding of regional integration and other issues, this bulletin reviews in detail the development of the initial stage of dispute settlement mechanisms in Mercosur and CAN—consultations by countries—as well as available information on the dispute settlement mechanism of the Central American Common Market, so as to draw some conclusions from the empirical evidence thus obtained on the extent to which these mechanisms, which are key indicators of the economic relations of the member countries in the integration arrangement, are used.

### Consultations in the case of MERCOSUR

In order to enable countries to come to an agreement or resolve their differences before they became full-blown disputes, MERCOSUR has created a three-stage system: (i) consultations before the Trade Commission (CCM); (ii) claims before the Common Market Group (GMC), and (iii) resort to the arbitration system for dispute settlement before the legal officers of the MERCOSUR Permanent Review Tribunal (PRT). Although strictly speaking, disputes refer only to differences that are taken to the second and third stages, the consultations made to the Trade Commission are a true reflection of the topics and principal areas in which the most significant differences arise. Between 1995 and 2005, there were 513 consultations, the main ones (see figure 2) being those relating to standards and technical rules (22%); discrimination and tax measures (22%), which in turn include tax discrimination; export duties; import financing; export subsidies and specific duties. These are followed by tariff preferences (14%), import licences and bans (10%), and those grouped as trade facilitation measures (9%), among others. The sector most seriously affected is the agro-food sector (36%), followed by other manufactures (32%), especially metalworking, the chemical industry and textiles. This pattern was already defined at the material time by the MERCOSUR Secretariat in its first half-yearly report for 2004 (MERCOSUR Secretariat, 2004).

Figure 2

MERCOSUR: CONSULTATIONS BEFORE THE TRADE COMMISSION BY TYPE OF NON-TARIFF BARRIER,  
 1995-2005

(Number of consultations and percentage participation)



**Source:** Prepared by authors on the basis of information from the MERCOSUR Secretariat, “Primer informe semestral: un foco para el proceso de integración regional” (2004), and minutes of the meetings of the MERCOSUR Trade Commission (CCM). (<http://www.mrree.gub.uy/Mercosur/ComisionComercioMercosur>).

An analysis of the 45 consultations presented to the CCM during the 2003-2005 triennium reveals that: (i) More than half were made by Argentina and Brazil on issues relating to bilateral trade between them, while Uruguay was the country that used the mechanism least; (ii) Brazil was the target of demands by all its partners, especially Argentina and Paraguay; (iii) the highest number of claims concerned manufactured goods: fertilizers, animal feed, tyres, vehicles, pharmaceutical products, as well as soybean and woods, within the category of commodities (Durán and Maldonado, 2005).

### **Consultations within the Andean Community**

The jurisdictional function in the Andean Community is carried out by the Andean Court of Justice, a collegiate body created by a treaty signed by member States in 1979 and in full operation since January 1984. The actions subject to its jurisdiction are basically the following: (a) □ nullity proceedings against the decisions of the Commission and of the General Secretariat for violating legal standards of the Andean Community; (b) □ actions for failure to comply with obligations under the Community regulatory system. The complaint may be lodged by a member State or by the General Secretariat of the Andean Community (SGCAN), provided the preliminary procedures have been followed,<sup>[2]</sup> under the direction of the General Secretariat, pursuant to the agreement; and (c) □ pre-judicial interpretation, whereby judges of national courts hearing cases to which Andean Community law applies must request an interpretation from the Andean Court of Justice regarding the scope of these regulations.

In the opinion of the Secretariat, “non-compliance by Member States is still of concern” (SGCAN, 2004). Between 1995 and March 2005, 172 complaints were lodged alleging non-compliance, of which 135 (78.4%) had been remedied and 37 (21.5%) remained unresolved. The countries against which the most complaints are filed are the Bolivarian Republic of Venezuela and Ecuador, and they are also the two countries with the largest number of unresolved cases.

As in the case of MERCOSUR, in which pre-judicial consultations were reviewed, in the Andean Community opinions issued as a result of that process were reviewed. Between 1997 and 2005, 486 opinions were issued, of which approximately 22% were on cases filed by the Secretariat of the Andean Community on its own initiative.<sup>[3]</sup> Colombia and Peru made the most use of this mechanism, whereas Bolivia filed the fewest complaints. After the Secretariat itself, Colombia, Ecuador and the Bolivarian Republic of Venezuela were the countries with the most complaints filed against them.

As for the alleged violations, during the period 1997-2005, the most frequent consultations concerned the common external tariff (CET) (89 claims and 19% of total). These were followed by cases on antidumping (13%), safeguards (12%) and non-compliance with community regulations (10%). Together, these four types of measures account for 54% of all opinions issued by the Secretariat during the period 1997-2005 (see figure 3). During the 2003-2005 triennium, the main grounds for pre-judicial claims concerned safeguards (24.6%) with 34 opinions; the common external tariff (CET) (18.8%) with 26 opinions; and antidumping and sanitary and phytosanitary regulations (9.4%), with 13 opinions in each case. The four types of claims accounted for 62.3% of total consultations made during the period.

## ANDEAN COMMUNITY OF NATIONS (CAN): DECISIONS OF THE SECRETARIAT WITH STATEMENT OF GROUNDS, 1997-2005

*(Listed by type of claim)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Secretariat of the Andean Community, 2005.

The economic sectors with the most complaints in 2003-2005 are primarily agriculture (meat, potatoes, fruits, oilseeds, cotton, rice, vegetable oils, fats and powdered milk, among others), with 47 complaints representing 43.8% of total, and manufacturing, 59 complaints or 49% of total. The other claims refer to cross-cutting measures which cover the entire range. The measures that are the subject of the most claims in the area of agroindustrial products (refined oils, canned goods, vegetable fats, dairy products, vegetable oils, and others) are the application of safeguards, phytosanitary measures, and the non-application or delayed application of the CET. In the case of manufactured goods (pesticides, brake linings, pharmaceuticals, water purifiers, stoves and extinguishers, footwear, textiles, vehicles and others) the range of allegations is broader, but the most frequent ones relate to the application of safeguards, violations of rules of origin, delays in the application of the CET and the use of import licences.

### **The case of the Central American Common Market (CACM)**

Since 2003, the Central American Common Market has had a dispute settlement mechanism designed to avoid or avert the violation of rules for legal instruments for economic integration and the reparation of damage that its infringement may cause, reinforcing and speeding up the process of subregional economic integration. Like the MERCOSUR mechanism, the CACM dispute settlement mechanism has three stages: first, a consultation stage, which seeks to resolve differences in an amicable way through direct negotiation between the parties and without intervention by third parties. If these negotiations do not result in a solution or mutual understanding, the second stage open to the countries is appeal to the Council of Ministers, which, as an impartial third party, can proceed to any of the following alternatives: (a) appoint technical advisors or working groups; (b) use its good offices, conciliation, mediation or other settlement procedures or (c) formulate its own recommendations. If, following this effort, there is no agreement within the space of 30 days, the parties can then resort to arbitration, which will lead to a settlement against which there is no appeal or recourse of any kind.

Unlike MERCOSUR and CAN regulations, CACM rules call for confidentiality during the first two stages of the process; hence this study is limited to the cases submitted to the arbitration process, since these are the only ones accessible to the public.

Since the creation of this common market, eight disputes have arisen, of which three remained unresolved as at December 2005: a claim and a counter-claim between Guatemala and Costa Rica relating to dairy products, and another filed by El Salvador against Guatemala. Nicaragua proved to be the country that used the mechanism most during the 2003-2005 triennium, with three cases, while El Salvador was the target of the highest number of claims.

The most common issues are violations of sanitary and phytosanitary regulations and rules of origin, especially with regard to agricultural products such as meat, cheese, dairy and poultry products, and alcoholic beverages. In general, infringements of the rules governing free trade in CACM have continued to decrease, although some of the restrictions that appear in annex A of the General Agreement on Central American

Economic integration are still maintained. These reserve special regimes for the following products (1) Cane sugar, all countries; (2) Unroasted coffee, all countries; (3) Roasted coffee, Costa Rica and Honduras for all countries; (4) Oil derivatives: Honduras for all countries; (5) Ethyl alcohol: Costa Rica with all countries and Honduras with Costa Rica, El Salvador and Nicaragua; and (6) Distilled alcoholic beverages: Honduras with all countries.

### Examining dispute settlement mechanisms: an overall vision.

The principal conclusion to be drawn from this analysis is that non-tariff barriers, especially standards and technical rules, predominate and that there are frequent violations of, or non-compliance with, community regulations, with the consultations being dominated by a handful of categories (see table 1). The resurgence of actions of this type constitutes a threat to the establishment of free trade areas, such as MERCOSUR, CAN and, to a lesser extent, CACM. Countries must work towards harmonization of their rules (especially rules and standards) and towards eliminating sectoral exceptions.

Table 1

Examining dispute settlement mechanisms in three subregional integration schemes in Latin America and the Caribbean

Integration scheme	Subject of most frequent consultations	Percentage of total	Accumulated cases
<b>MERCOSUR</b> <b>(1995-2005)</b>	Standards and technical rules (22%), Discrimination and tax measures (22%), Violations of tariff preferences (14%), and import licences and bans (11%)	70%	513
<b>Andean Community</b> <b>(1997-2005)</b>	Violations of the common external tariff (19%), Antidumping (13%), Safeguards (11%), and infringement of community regulations (10%)	54%	480
<b>Central American Common Market</b> <b>(2003-2005)</b>	Sanitary and phytosanitary measures 37.5% Rules of Origin, 37.5%	75%	8

**Source:** Prepared by the authors on the basis of data on dispute settlements from the Division of International Trade and Integration, ECLAC.

According to the main economic stakeholders, one of the main weaknesses of integration schemes is the legal uncertainty surrounding decisions taken by exporters, importers and investors. Thus, investment in credibility is probably the form of investment that will yield the highest returns. Hence the appeal of efforts to unify dispute settlement systems arising under the set of subregional agreements—CAN, MERCOSUR, CACM and CARICOM—, as well as all those economic complementarity and bilateral trade agreements between all the countries that are part of one or other of these schemes and Chile and Mexico, which do not belong to any of

them. Moving towards a single dispute settlement system, reinforcing their binding force and learning from best practices developed in each of the existing subregional bodies will be other strong signals for triggering growth dynamics and strengthening investments and trade.

At the end of 2005, a meeting of high-level MERCOSUR judges, including the judges from the Andean Court of Justice, agreed to hold periodic meetings in 2006 to share information on the administration of justice in South America (O Estado de São Paulo, 2006). These judges also recognized the need for MERCOSUR countries to advance towards convergence of their national legislations, strengthening the administration of justice through the Permanent Review Court of MERCOSUR.

Advancing towards convergence of a regional dispute settlement system would mean that this system would reproduce WTO regulations and processes in the best possible way, resulting in a sort of regional decentralization of that multilateral body. In this way, not only would the existing duality of the dispute settlement system be eliminated, but a serious and binding one –that of WTO– and another less strict one – that of the regional body– would make it possible to resolve the numerous intraregional trade differences within the region itself, thereby saving substantial resources and facilitating the formation of a critical mass of professionals with the capacity to make rulings in such disputes; this would represent important savings of foreign exchange in subsequent WTO disputes or in dealing with measures of trade defence in the United States or the European Union. To this end, closer links should be forged with the Latin American Integration Association (LAIA), which has already been identified by some of the highest authorities in the region as a suitable entity for assuming this role.

## Bibliography

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For a more in-depth analysis of this issue and how it ties in with other regional integration issues, see Latin America and the Caribbean in the World Economy 2004, Trends 2005, and No. 62 in the Comercio Internacional e Integración Series, referred to above. Both documents may be accessed through the ECLAC website: <http://www.eclac.cl/comercio/>

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<sup>[1]</sup> Exports from the maquila industry and the free zones are included in the total exports of each CACM country.

<sup>[2]</sup> According to Decision 425, the SGCAN shall, on its own initiative or at the request of a country, conduct investigations to determine whether a violation has taken place and shall issue an opinion explaining its reasoning; notice of any representations made shall be given to the member State alleged to be in violation.

<sup>[3]</sup> Many of these findings were based on the interests of private individuals or firms in the relevant countries.