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A RESURGENT MERCOSUR: CONFRONTING ECONOMIC CRISES AND NEGOTIATING TRADE AGREEMENTS

Thomas Andrew O'Keefe

Though the aftershocks caused by the January 2002 implosion of the Argentine economy are still being felt throughout South America, this paper will attempt to illustrate why there are many reasons to remain optimistic about MERCOSUR's future viability. That scenario, of course, carries important implications for the United States' strategy in negotiating a Free Trade Area of the Americas (FTAA) by 2005.

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A Resurgent MERCOSUR: Confronting Economic Crises and Negotiating Trade Agreements

Thomas Andrew O'Keefe

Introduction

Almost from the day it was launched on March 26, 1991, skeptics have predicted the imminent collapse of the Common Market of the South (Mercado Común del Sur — MERCOSUR), while some economists have fretted about the project's supposed protectionist designs to create a trade fortress. The most memorable example of the latter was a 1996 report written by a World Bank economist that relied on out-of-date trade statistics and attributed to MERCOSUR policies that were actually pre-existing national automotive regimes.[1] More recent tirades have tried to blame Argentina's economic meltdown on its MERCOSUR membership.[2] A well-known economist from a New York City investment bank has even gone as far as to proclaim MERCOSUR dead.[3] Given all the invective directed against efforts to integrate South America's Southern Cone economically over the past decade, it is not surprising that MERCOSUR is misunderstood by many in North America.

Despite recent setbacks to intraregional trade flows in the Southern Cone, there is no danger that MERCOSUR is about to disappear. For one thing, the new President of Brazil, Luiz Inácio Lula da Silva, has made MERCOSUR's revival a priority, as underscored by visits to Argentina and Chile even before his official inauguration. Lula appears to understand that part of the solution to the crises afflicting the region lies in deepening the economic and political integration begun by his predecessors. It was MERCOSUR, after all, that permanently banished the border conflicts and arms races that once predominated in the subregion and united the Southern Cone in a mutual crusade to support democratic forms of governance.[4] MERCOSUR was also a catalyst for hundreds of cross border investments, a phenomenon virtually unknown prior to the 1990s and one that needs to be further encouraged as part of a strategy that facilitates the creation of internationally competitive subregional firms. Once economic growth returns to the Southern Cone, the dramatic annual increases in intraregional flows that MERCOSUR experienced prior to 1998 will undoubtedly return, further facilitated by the fact that all four core member states (Argentina, Brazil, Paraguay and Uruguay) now have similar currency regimes.

Another important factor favoring intra-MERCOSUR trade, which is not fully appreciated abroad, is the Latin American Free Trade Association (Asociación Latinoamericana de Integración — ALADI) central clearinghouse mechanism. Under this system, trade deals among all the Spanish-speaking countries of South America, Brazil, the Dominican Republic, and Mexico can be funneled through the Central Reserve Bank of Peru in Lima without the need to make immediate hard currency payments. National accounts are settled at the end of each four-month period, and payment in hard currency is only required to cancel outstanding debits. The actual merchants involved in such trade deals either pay for their purchases or receive payment for sales in their respective national currencies. At the present time, the ALADI central clearinghouse mechanism is particularly helpful to Argentine importers and exporters who currently have little or no access to international trade financing or hard currency.

The purposes of this Agenda Paper are to provide an overview of MERCOSUR's recent history and to highlight the project's surprising resiliency

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in confronting numerous economic hurdles since its founding in 1991. Important political factors that help guarantee MERCOSUR's continued relevance are also discussed. The paper then examines MERCOSUR's dispute resolution system, once considered the weakest link in a purposefully designed fragile institutional framework. Although justifiably condemned as ineffectual for much of MERCOSUR's existence, dispute resolution has recently emerged as an important vehicle for deepening the regional integration process. Though the aftershocks caused by the January 2002 implosion of the Argentine economy are still being felt throughout the region, this paper will attempt to illustrate why there are plenty of reasons to remain optimistic about MERCOSUR's future viability. That scenario, of course, carries important implications for the United States' strategy in negotiating a Free Trade Area of the Americas (FTAA) by 2005.

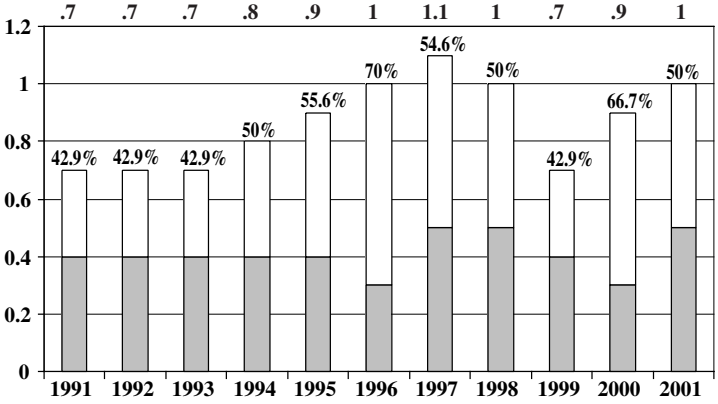
Trade Diversion vs. Trade Creation

Argentina and Brazil are jointly responsible for some 80 percent of total intra-MERCOSUR trade flows. In 1991, MERCOSUR's first year of existence, bilateral trade between the two countries totaled US$3 billion, with a slight surplus in favor of Argentina that is not reflected in the rounded off figures of Figure 1. The next two years saw steady increases in bilateral trade, as MERCOSUR's automatic annual tariff reduction schedule was implemented. During that time, the trade surplus was in Brazil's favor as a result of the 1991 adoption of the Convertibility Plan in Argentina that tied the Argentine peso one-to-one with the U.S. dollar. Convertibility served not only to restore economic stability and growth to Argentina, thus creating a greater demand for Brazilian goods, but also made Brazilian goods cheaper, given the policy of sharp currency devaluation Brazil pursued at the time. Even with the disadvantage of an overvalued currency vis-à-vis Brazil, however, the Argentines were still able to increase the quantity of exports going to Brazil in 1992, 1993, and 1994.[5] Dramatic growth in bilateral trade continued through 1997, although by 1995 the surplus had switched in favor of Argentina. The explanation for this reversal was, in part, the adoption of the Real Plan, which, temporarily at least, left the new Brazilian currency worth more than the U.S. dollar (and hence the Argentine peso). In 1998, total Argentine-Brazilian trade remained almost the same as the

Figure 1. Total Argentine-Brazilian Bilateral Trade for 1991-2001 (In Billions of US$)

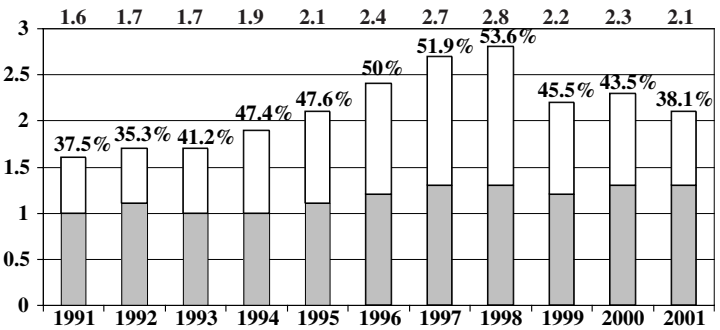
Source: ALADI (Montevideo).

Figure 2. Paraguay's Total Global Exports and Percentages Exported to MERCOSUR 1991-2001 (In Billions of US$)



Source: Secretaría Administrativa del MERCOSUR (Montevideo).

Figure 3. Uruguay's Total Global Exports and Percentages Exported to MERCOSUR 1991-2001 (In Billions of US$)



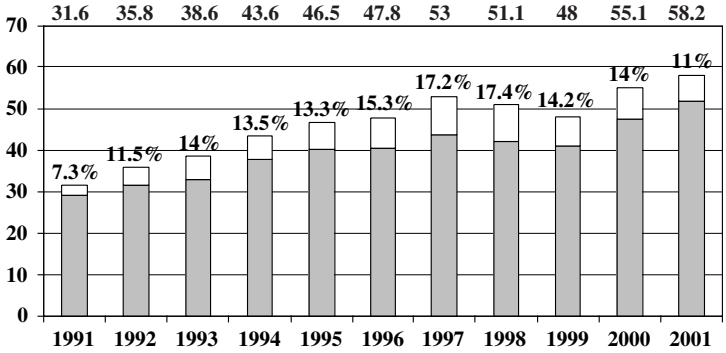
Source: Secretaría Administrativa del MERCOSUR (Montevideo).

previous year's, at just under US$14.7 billion. In 1999, bilateral trade contracted by some 24 percent. Although bilateral trade recovered somewhat in 2000, it dropped once again the following year to 1999 levels.

Despite the significant contraction in Argentine-Brazilian trade flows since 1998, two interesting facts are frequently overlooked. First, total trade between the two countries in 2001, for example, still represented a greater than fourfold increase from the US$2.1 billion total recorded in 1990, the year before MERCOSUR came into existence. Second, since 1995, Argentina has managed to retain its trade surplus with Brazil despite the January 1999 maxi-devaluation of the Brazilian real that, until the peso's sharp devaluation in January 2002, left Argentine exporters disadvantaged with an overvalued currency. The widely reported fears following the January 1999 maxi-devaluation of a mass invasion of Brazilian imports into Argentina never materialized. For one thing, the prolonged Argentine recession that began in 1998 proved more effective in quelling demand for Brazilian imports than threatened safeguard or nontariff measures, which, with a few noticeable exceptions, the Argentines never implemented.

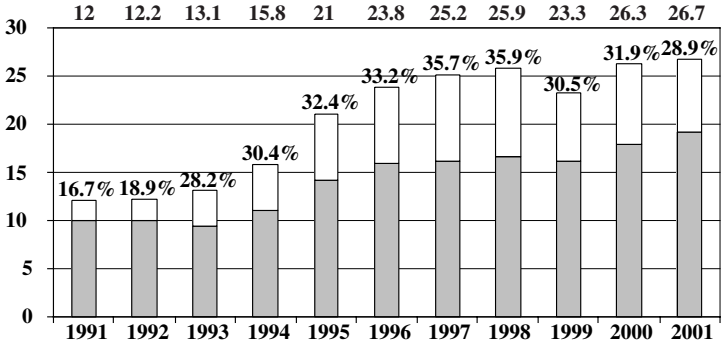
The importance of the subregional market is another encouraging aspect that bodes well for MERCOSUR. In 1991, Paraguayan exports to its MERCOSUR partners hovered at just over 40 percent of its total global exports. The amount, reflected in Figure 2, reached a high of 70 percent in 1996 and settled at about half of Paraguay's total global exports being directed to MERCOSUR by 2001. For Uruguay, the percentage of global exports bound for the MERCOSUR market in 1991 was 37.5 percent, similar to the figure recorded in 2001 (although rates at or just above 50 percent were recorded in 1996, 1997, and 1998). See Figure 3. In Brazil, just over 7 percent of its global exports stayed within MERCOSUR in 1991 (see Figure 4), a percentage that nearly doubled by 1993 and remained more or less stable thereafter, making MERCOSUR Brazil's third most important export market after the European Union and the United States.[6] In Argentina, the share of intra-MERCOSUR trade vis-à-vis trade with the rest of the world went from just under 17 percent in 1991 to approximately one-third of Argentine global exports by 1995 (albeit diminishing somewhat after 1999, as reflected in Figure 5). Even with the post 1998-decline, MERCOSUR remains Argentina's most important

Figure 4. Brazil's Total Global Exports and Percentages Exported to MERCOSUR 1991-2001 (In Billions of US$)



Source: Secretaría Administrativa del MERCOSUR (Montevideo).

Figure 5. Argentina's Total Global Exports and Percentages Exported to MERCOSUR 1991-2001 (In Billions of US$)

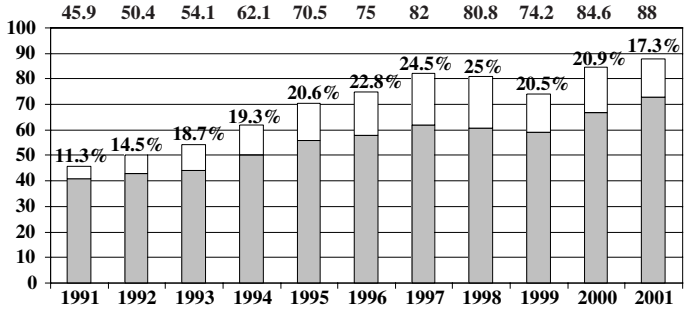


Source: Secretaría Administrativa del MERCOSUR (Montevideo).

export market, ahead of the European Union and considerably ahead of the United States. The importance of the subregional market means that there is now a much greater incentive to resolve crises that may erupt within the bloc rather than encourage withdrawal from MERCOSUR. This is quite different from previous efforts at Latin American economic integration, such as the Andean Pact or Latin American Free Trade Area of the 1960s and 1970s. For the most part, these older integration schemes produced meager increases in intraregional trade flows that national governments easily disregarded when a crisis erupted and they found it more convenient to break their earlier free trade commitments.

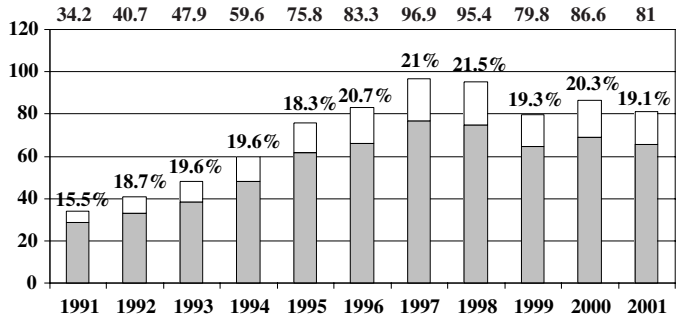
Figure 6, showing the importance of the MERCOSUR export market for the four individual member states as a group, also highlights another interesting phenomenon. Despite fears expressed by some economists that MERCOSUR's adoption of a partial common external tariff (CET) in 1995

Figure 6. Total MERCOSUR Global Exports and Percentages Bound for Intra-MERCOSUR Trade 1991-2001 (In Billions of US$)



Source: Secretaría Administrativa del MERCOSUR and ALADI (Montevideo).

Figure 7. Total Global Imports for MERCOSUR and Percentages Originating within MERCOSUR for 1991-2001 (In Billions of US$)



Source: Secretaría Administrativa del MERCOSUR and ALADI (Montevideo).

would lead to significant trade diversion, this is not borne out by the data.[7] The percentage of MERCOSUR's total global exports remaining within the subregion went from 11.3 percent in 1991 to 25 percent in 1998. Overall, this was a time when MERCOSUR's exports to the rest of the world also experienced noticeable growth. Since 2000, the subregional market has actually decreased in importance as MERCOSUR's exports to the rest of the world have continued to expand. Data in Figure 7, showing the percentage of MERCOSUR's total global imports originating within the subregion, indicate a similar phenomenon (albeit skewed after 1998 by the economic recessions affecting Argentina, Paraguay, and Uruguay). Accordingly, fears that a MERCOSUR customs union would lead to significant trade diversion away from more efficient sources of final goods and inputs from other parts of the world proved to be unfounded. Instead, MERCOSUR has generally augmented new trade opportunities within the subregion, as MERCOSUR's four core member states have also sought to diversify exports to markets in other parts of the world.[8]

A review of the composition of Argentine-Brazilian trade provides further cause for optimism about the future viability of MERCOSUR. When the first attempts were made by Argentina and Brazil in 1986 to open up specific sectors of their economies to free trade under the Argentine-Brazilian Program of Economic Integration and Cooperation (Programa de Integración y Cooperación Argentino-Brasileño — PICAB), many Argentines feared that their industrial sector would be wiped out and that Argentina would be reduced to becoming a net exporter of agro-industrial goods to Brazil. Figure 8 shows that in 1986, manufactured goods represented 34 percent of Argentine exports to Brazil in value terms (that is, calculated in US$), while foodstuffs, primarily agro-industrial in nature, accounted for 60 percent of Argentine exports. By 1992, the proportion of manufactured exports had increased to 39 percent, and foodstuffs had actually decreased to 52 percent. Data for 2000 indicate that this trend continued, with manufactured goods accounting for 46 percent of Argentine exports to Brazil that year and foodstuffs shrinking to 28 percent. Figure 9, showing Argentine exports to Brazil by volume (by number of units, as in tons) for the year 2000, underscores the beneficial significance of this phenomenon. Although foodstuffs (despite their noticeable decline in value share) dominated Argentine exports to Brazil in volume terms, manufactured exports represented a mere 6 percent of Argentine exports in volume terms. This underscores the fact that Argentine-manufactured exports with significant value added have been the greatest beneficiaries of the opening to Brazil.[9]

Another interesting development, illustrated by Figure 8, underscores the growing importance of Argentine fuel exports to Brazil. From a base of 3 percent of Argentina's total exports in value terms in 1986, fuels grew to represent 7 percent of Argentine exports to Brazil in 1992 and reached a remarkable 22 percent in value terms by 2000 (and an even higher percentage when Argentine exports to Brazil are measured by volume, as in Figure 9). These increases, consisting of natural gas as well as crude oil and related byproducts, represent the one major sector that experienced significant trade diversion with the onset of MERCOSUR. Brazil traditionally imported most of its oil from the volatile Middle East. During the 1990s, however, the country began sourcing most of its foreign oil needs from Argentina and other South American countries (hence the explanation for the strong interest in incorporating Venezuela into MERCOSUR). Brazil also began an aggressive campaign to replace

Figure 8. Composition of Argentine Exports to Brazil by Value

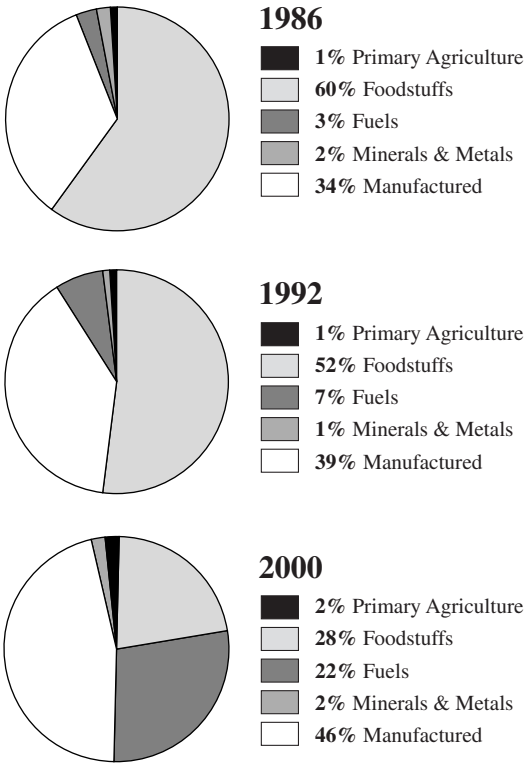
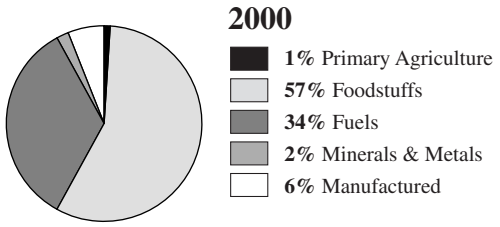


Figure 9. Composition of Argentine Exports to Brazil by Volume



Source: BID-INTAL (Buenos Aires).

energy dependence on oil and hydroelectricity with natural gas. Argentina and Bolivia have both been the biggest beneficiaries of this change in Brazilian energy policy. Any trade diversion in this sensitive sector, however, can be justified in view of the heightened security it affords Brazil by allowing the country to source its energy needs on countries with which it has embarked on a process of economic integration.

Figure 10, illustrating the composition of Brazilian exports to Argentina by value, reveals that in 1986 manufactured goods made up 59 percent of Brazil's exports to its Southern Cone neighbor. Minerals and metal products represented a hefty 20 percent. In 1992, manufactured goods represented 70 percent of Brazilian exports to Argentina, a share that jumped to 82 percent in 2000. On the other hand, minerals and metal products shrank to 13 and 9 percent respectively in 1992 and 2000. As was true of the Argentine export data, the significant value added importance of Brazilian manufactured exports is highlighted by comparing the 2000 Brazilian export data to Figure 11, which shows Brazilian exports to Argentina by volume. In 2000, minerals and metal products represent 68 percent of exports by volume versus 24 percent for manufactured products.

In many ways, the steady increase of Brazilian manufactured exports to Argentina, as a result of the market opening provided by MERCOSUR, was

Figure 10. Composition of Brazilian Exports to Argentina by Value

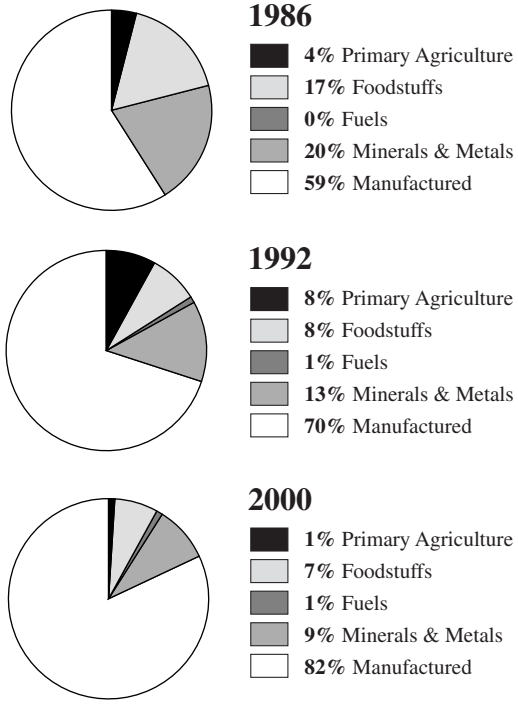
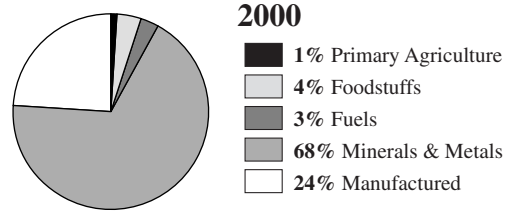


Figure 11. Composition of Brazilian Exports to Argentina by Volume



Source: BID-INTAL (Buenos Aires).

entirely foreseeable, given Brazil's superior industrial park. What was less foreseeable was that this substantial increase would not necessarily come at the expense of the weaker Argentine manufacturing sector. The explanation for this phenomenon lies in the fact that the 1990s saw greater integration and specialization of the Argentine and Brazilian industrial sectors, particularly in the automotive industry. This integration and specialization has largely been the result of managed trade programs rather than the elimination of intra-MERCOSUR tariff barriers and the law of comparative advantages. While not to the liking of free trade purists, these managed trade programs have at least encouraged greater economic interdependence and provide another reason why predictions concerning MERCOSUR's demise are unfounded.

Recent Developments on the Political and Diplomatic Fronts

One of the things frequently overlooked by those who believe MERCOSUR is on the verge of disintegrating is that MERCOSUR has always been much more than a simple effort at economic integration. From the beginning, the project has had important political dimensions, whether in serving as a means of supporting democracy in the subregion or increasing the Southern Cone's geopolitical profile in the international arena. It is those political interests that have often given MERCOSUR momentum and compensated for shortcomings on the trade liberalization front. As one commentator has noted, "MERCOSUR was always intended not as a static, one-off bargain but as an on-going process of regional co-operation."[10] For example, regional infrastructure initiatives, cooperative agendas in education and culture, and heightened interaction among political actors of member states have widened the scope and deepened the level of intra-MERCOSUR relations.[11]

The crisis provoked by the collapse of the Argentine financial system in January 2002 underscored that Argentina's real friends in its hour of need were its MERCOSUR partners. The policy pursued by the Menem administration of "carnal" relations with the United States and Argentina's much vaunted status as a special extra-NATO ally brought it no special favors from the United States and the International Monetary Fund (IMF) when the country sought fresh loans to stave off collapse of its monetary regime. The spreading contagion from Argentina's economic mess has cemented the sense of mutualism between Argentina and Brazil that first appeared after the Mexican peso crisis at the end of 1994, when political leaders in both countries realized their nations were too vulnerable to erratic global financial movements and needed to act together to better withstand them.[12]

In sharp contrast to the perceived callous indifference of the United States to Argentina's plight, Brazil announced in February 2002 that it would open its market to Argentine exports by immediately eliminating any remaining tariff and nontariff barriers (except for phytosanitary requirements to prevent the spread of hoof and mouth disease).[13] Following the June 2002 meeting of the Common Market Council, the Brazilians also announced that they would permit the Argentine automotive industry to export the equivalent of US$2 dollars' worth of goods for every dollar exported by Brazil to Argentina under their bilateral managed trade regime for the automobile sector. This marked a change in a previous version of the managed trade agreement, in effect through 2006, where the exchange was fixed roughly at a one-to-one parity. Furthermore, in August 2002, Brazil's President Fernando Henrique Cardoso announced plans to send a bill to Congress exempting the subsidiaries of Brazilian firms who invest in Argentina, Paraguay, or Uruguay from paying corporate income tax in Brazil. Under the terms of the bill, these firms would also be eligible for loans from the Brazilian National Development Bank (Banco Nacional de Desenvolvimento Econômico e Social — BNDES), even if the investment projects were joint ventures with local firms.[14] President Cardoso did send this initiative to Congress; however, no action has been taken on it.

Ironically, the approval of trade promotion authority in the United States in August of 2002 and the jumpstart this has given to the FTAA negotiations, which will, in turn, serve as a catalyst for renewed European Union-MERCOSUR free trade talks, are bound to have positive effects on MERCOSUR. For example, these events will surely revive the geostrategic value of MERCOSUR as an effective negotiating body for obtaining trade concessions from the developed world. Although this enhanced facility is likely to be of greater benefit to the three smaller MERCOSUR countries, Brazil has been the biggest proponent of this more aggressive strategy. Brazil indeed has a vested interest in keeping MERCOSUR alive, even if it means making concessions to the smaller countries in the short term.[15] The December 2002 free trade agreement the United States finally concluded with Chile underscores yet again the wisdom of the

MERCOSUR countries negotiating as a bloc in the upcoming FTAA negotiations. The Chileans obtained no concessions from the United States on the use of agricultural subsidies or antidumping measures, received limited access to the U.S. market for many agricultural exports, and will be required to pay compensation if they enforce their country's model capital control regulations.

MERCOSUR's Dispute Resolution System

MERCOSUR's institutional framework based, inter alia, on a strong intergovernmental bias and the absence of an independent judicial body "gave governments a high degree of control over the process, ensuring graduality and flexibility."[16] This institutional model was very effective at the initial stages, when interdependence was low and commitment was high, and it proved quite resilient for nearly a decade.[17] It also made the integration process flexible and cost-effective at the initial stages.[18] After all, the primary purpose of MERCOSUR (especially for its two largest members Argentina and Brazil) was to increase trade rather than to administer its effects.[19]

With the maxi-devaluation of the Brazilian real in January of 1999, however, the shortcomings of MERCOSUR's minimalist institutional framework became apparent. National governments attempted to impose unilateral trade barriers to thwart alleged import surges that were illegal under MERCOSUR, while private parties that had been detrimentally affected found there were no institutional bodies within MERCOSUR that could quickly redress their grievances. Reformers focused their efforts on revamping what was perceived as MERCOSUR's weak dispute resolution mechanism. Many of them claimed that what was needed was a permanent Tribunal of Justice akin to that found in the European Union and the Andean Community. The creation of such a court in the MERCOSUR context would allow a venue for aggrieved parties to turn to for decisions that would create binding precedents on the member states.[20] Demands for a more effective dispute resolution system were eventually taken up by the national governments of the smaller member states, who lacked sufficient political leverage to insure unrestricted access to the larger subregional market for their national producers, as a result of unilateral rule changes imposed by the bigger MERCOSUR countries.

This section of the paper will discuss MERCOSUR's present dispute resolution system and reforms that have been recently enacted to make it more effective. There will also be a review of eight recent arbitration panel awards and the role they are likely to play in deepening the economic integration process. Before beginning our discussion, however, it is important to emphasize that there are two basic systems for dispute resolution in the formal MERCOSUR framework. One system for resolving disputes between private investors and a government is found in the "Protocol of Colonia for the Promotion and Reciprocal Protection of Investments from within the MERCOSUR" and the "Protocol for the Promotion and Reciprocal Protection of Investments from outside the MERCOSUR."[21] The second dispute resolution system deals with disputes that may arise between state parties or between an individual or company and a state party(ies) over the application or interpretation of norms and obligations arising out of the integration process. In discussing dispute resolution mechanisms within MERCOSUR, it is also important to note that a third option is available to private parties outside the formal MERCOSUR framework. To the extent that they have jurisdiction over the subject matter, private parties may also resort to the national court system to complain about a state party's failure to adhere to its MERCOSUR obligations.

Unfortunately, it is not possible to comment on the first dispute resolution system's ability to handle conflicts between a private sector investor and a government because it has not yet entered into force. Neither protocol has been ratified, as of this writing. Accordingly, this paper will focus on the second formal MERCOSUR system for dispute resolution.

The Protocol of Brasilia

In December 1991, the presidents of the four MERCOSUR countries signed the Protocol of Brasilia for the Solution of Controversies.[22] This Protocol replaced a temporary, three-step system found in Annex III to the Treaty of Asunción (the agreement signed on March 26, 1991, that formally brought MERCOSUR into existence). Interestingly, Annex III made no provisions for resolving disputes that might arise between private parties and a state party. In contrast, the Protocol of Brasilia not only provides a procedure for resolving disputes that might arise among state parties, but a second procedure exists for disputes between a private party and a state party(ies). The

Protocol of Brasilia was designed to be temporary and eventually was to be replaced by a permanent system.

With respect to disputes arising among state parties, the Protocol of Brasilia requires that the dispute must concern "the interpretation, application or non-compliance of the dispositions contained in the Treaty of Asunción, of the agreements celebrated within its framework, as well as any Decisions of the Common Market Council and the Resolutions of the Common Market Group." As a first step, the state parties should attempt to resolve their differences through direct negotiations within 15 working days, unless the parties extend that time limit.[23] If this proves unsuccessful, then the matter is referred to the Common Market Group. The Common Market Group normally has 30 days within which to issue its recommendations for resolving the dispute. In formulating these recommendations, the Group is allowed to turn to a panel of experts for advice.

If the Common Market Group is also unable to resolve the dispute successfully, then the matter can be submitted at the request of a state party to a three-person, ad hoc arbitration panel.[24] The arbitrators are limited to a maximum of 90 days to resolve a dispute and make an award. They are explicitly allowed to issue preliminary provisional measures to prevent severe and irreparable damages. Any decision they make is by majority vote, is binding on the parties, and cannot be appealed. The actual vote tally is kept confidential, and no dissenting opinions are allowed. The losing party generally has a maximum of 30 days to comply with a decision, unless this time period is briefly suspended in the event further clarification of the decision or an interpretation as to how it should be applied is sought. Failure to adhere to a decision allows the winning party(ies) the right to adopt temporary compensatory measures, such as the suspension of preferential tariff treatment or other concessions, in order to force compliance.

The system established under the Protocol of Brasilia limits the right of an aggrieved private party to complain of the application by a state party or parties "of legal or administrative measures which have a restrictive, discriminatory or unfairly competitive effect, in violation of the Treaty of Asunción, of the agreements celebrated within its framework, the Decisions of the Common Market Council or the Resolutions of the Common Market Group." In other words, private parties are limited to complaining about the affirmative actions of a state and not any omissions, such as the failure of a state party to comply with its MERCOSUR obligations.[25] Another major difference is that a private party complaint can never move beyond the Common Market Group to the third level of binding arbitration unless a state adopts the private party complaint as its own.

Modifications Introduced by the Protocol of Ouro Preto

In December 1994, the presidents of the four MERCOSUR countries signed the Protocol of Ouro Preto, which introduced important modifications to the institutional structure of the MERCOSUR.[26] These modifications also affected MERCOSUR's dispute resolution mechanism as established by the Protocol of Brasilia, in that the newly created MERCOSUR Trade Commission was now authorized to "consider the complaints presented by the National Sections of the MERCOSUR Trade Commission originating with the State Parties or private parties . . . [that] fall within its jurisdiction." The main task of the MERCOSUR Trade Commission is to insure the application of common trade policy instruments with respect to intraregional and global trade. The Protocol of Ouro Preto also added the Directives of the MERCOSUR Trade Commission as additional legal norms upon which a party using the dispute system could base its complaint.

In terms of the procedural rules established by the Protocol of Ouro Preto for resolving complaints filed by a state party with the MERCOSUR Trade Commission, Annex I to the Protocol requires that the complaint be filed with the president pro-tempore of the full MERCOSUR Trade Commission.[27] If the Commission cannot resolve the matter at its next regular meeting, then it is forwarded to one of seven permanent technical committees that assist the Trade Commission in its work.[28] The relevant technical committee has 30 days to make a recommendation or, if there is a difference of opinion, to forward the conclusions of the different experts. If the MERCOSUR Trade Commission cannot resolve the matter, then the dispute with the different proposed experts' remedies are forwarded to the full Common Market Group for it to make a decision within 30 days. If the Common Market Group, in turn, cannot make a final determination or if an errant state party refuses to accept the Group's decision or the earlier decision of the MERCOSUR Trade Commission (if one were forthcoming at that

level) within a reasonable time limit, then the aggrieved state party can proceed to binding arbitration under the Protocol of Brasilia.

Common Market Decision 17/98

In December 1998, the Common Market Council, MERCOSUR's highest institutional body, issued Decision 17/98, which contains the Regulations for fully implementing the Protocol of Brasilia for the Solution of Controversies.[29] With the regulations in place, the final level of MERCOSUR's dispute resolution mechanism involving a three-person arbitration panel could now be utilized. Although the Protocol of Brasilia had been signed in 1991, the long delay in making the system fully effective can be explained, in part, by a Latin American cultural trait of allowing one's adversary in a conflict a face-saving way to retreat gracefully. In addition, during MERCOSUR's early days, commercial disputes were often used by member states as a means of obtaining other concessions from a culpable party rather than actually resolving the problem before them. Both these goals would be frustrated by a system in which the decisions of the arbitral panels are binding and no appeals are permitted.

C.M.C. Decision 17/98 did not make dramatic substantive changes to the provisions found in the Protocol of Brasilia (a shortcoming according to some analysts), but rather further expanded and explained in greater detail the procedural rules established in the earlier Protocol, such as those dealing with the selection of arbitrators. It also reemphasized the changes introduced through the Protocol of Ouro Preto that state-to-state disputes over the interpretation, application, or non-compliance with Directives of the MERCOSUR Trade Commission could be referred to the formal dispute resolution mechanism, as could disputes by private parties against a state party for enforcement of a legal or administrative measure in violation of a Directive.

The Protocol of Olivos for the Resolution of Controversies in MERCOSUR

On February 18, 2002, the presidents and foreign ministers of the MERCOSUR countries signed the Protocol of Olivos that, once it comes into effect, will contain the new transitional dispute resolution mechanism for MERCOSUR. It is designed to replace the 1991 Protocol of Brasilia (and its implementing regulations found in Common Market Council Decision 17/98), although not the innovations introduced to MERCOSUR's dispute resolution system under the 1994 Protocol of Ouro Preto. Before the Protocol of Olivos can enter into force, however, it must be ratified by all four member states. In addition, the Common Market Group must also draft implementing regulations before the new system comes into effect. As was true of the Protocol of Brasilia, the new Protocol of Olivos is temporary in nature and is subject to replacement by a Permanent Dispute Resolution System before the common market aspect of the MERCOSUR project is fully implemented (now scheduled for January 1, 2006).

The Protocol of Olivos addresses some of the criticisms long lodged against MERCOSUR's current dispute resolution system. Although it retains most of the procedural and institutional features of the Protocol of Brasilia, it grants the arbitral panels greater oversight capabilities to help ensure compliance with past decisions they have issued. In addition, it provides state parties with a faster route to the final stage of the dispute resolution system, binding arbitration, by allowing disputes to bypass the heavily politicized Common Market Group.[30]

The most important innovation of the Protocol of Olivos is the establishment of a Permanent Tribunal of Review that is designed to "guarantee the correct interpretation, application and fulfillment of the fundamental instruments of the integration process" and MERCOSUR norms "in a consistent and systematic manner." The Permanent Tribunal of Review will have the power to "confirm, modify or revoke the legal basis and decisions" of an ad hoc arbitral panel and the Tribunal's decisions take precedence over those of the ad hoc body.[31] Furthermore, state parties may request review by the Permanent Tribunal of Review of any dispute that falls within its subject matter jurisdiction if they are unable to resolve fully the matter through direct negotiations (bypassing the Common Market Group and ad hoc arbitration). Finally, the Common Market Council is authorized to establish regulations permitting advisory opinions from the Tribunal.

A Review of Recent Arbitral Decisions[32]

A brief overview of the eight arbitral awards that have been issued to date reveals that MERCOSUR's dispute resolution system has been the glue that has held the integration process

together in recent years, while political leaders have been distracted by the economic and financial crises that have buffeted the region. These eight decisions have clearly defined member state obligations with respect to the free movement of goods, including a clear definition of what are deemed impermissible nontariff barriers. In addition, one arbitral decision has even established outside limits by which a member state must incorporate MERCOSUR legal obligations within its domestic legal order. Although ad hoc in nature, the arbitral decisions have "created a body of law that, even if not binding precedent as would be the situation of the jurisprudence of a tribunal similar to the European [Court of Justice], it is cited as a foundation in subsequent decisions and incorporated therein, thereby supporting a unitary interpretation" of obligations flowing out of the regional integration process.[33] Despite the relatively scarce number of decisions issued to date, this statistic overlooks the fact that hundreds of disputes have entered the system at the first stage and have often been successfully resolved at that level or at the second stage.[34] In addition, the vast majority of the eight disputes referred to binding arbitration originated from complaints made by private sector companies, indicating that "the integration process is not seen as something distant by the private sector. . . ."[35] And the most important development is that "the two countries with the most economic weight [in the MERCOSUR] have accepted, through the dispute resolution procedure, decisions that are obligatory and non-appealable."[36]

The Eight Cases

1. In Re Dispute on Communication No. 37 of December 17, 1997 and No. 7 of February 20, 1998 of the Department of Foreign Trade Operations (DECEX) of the Secretariat of Foreign Trade (SECEX): Application of Restrictive Measures on Reciprocal Trade.

This first case involved a complaint lodged by Argentina against Brazilian license requirements on imported lactate products that Buenos Aires claimed created an impermissible nontariff barrier to free trade. In a unanimous decision issued on April 28, 1999, the arbitral panel gave Brazil approximately seven months to eliminate all nonautomatic import license requirements not based on very limited exceptions that included the protection of public morality and national security; and the life and health of humans, flora, and fauna.

2. In Re Claim By the Argentine Republic Against Brazil on Production and Export Subsidies for Pork Meat.

In this second case, Argentina again lodged a complaint against Brazil, this time alleging that Brasilia was unfairly subsidizing exports of pork meat within MERCOSUR. There was also an Argentine allegation that certain Brazilian currency exchange programs were being abused by Brazilian pork meat exporters so as to profit unfairly from a forward currency exchange type scheme. The ad hoc arbitration panel, in an award made on December 27, 1999, found that the alleged Brazilian subsidized corn feed program that was at the root of Argentina's complaint was not specifically directed at pork producers and, therefore, was not a type of subsidy expressly prohibited by either MERCOSUR or the WTO for that matter. The Argentine complaints regarding the Brazilian PROEX program (that subsidized loans for exporters) were rendered moot when Brazil abolished the program for intra-MERCOSUR exports in April 1999 prior to the panel's decision. Furthermore, the arbitration panel found no evidence that the forward currency exchange schemes had a prejudicial impact on Argentine pork meat producers. Finally, the panel rejected as untimely a fourth Argentine complaint concerning a Brazilian federal tax incentive program submitted after the dispute resolution process had formally begun.

3. In Re Application of Safeguard Measures on Textile Products (Resolution 861/99) of the Ministry of Economy, Public Works and Services.

In this third case, Brazil complained about an Argentine safeguard measure that imposed annual quotas on Brazilian-made cotton textiles.[37] The Brazilians claimed that the Argentine measure not only undermined MERCOSUR's intraregional free trade scheme and unfairly favored imports from nonmember states, but it was incompatible with the WTO's Multi-Fiber Agreement (MFA). In response, the Argentines claimed, inter alia, that the safeguard measure was permitted under the MFA and that there were no MERCOSUR rules governing the issue. Accordingly, the matter did not even belong in the MERCOSUR dispute resolution system because no MERCOSUR obligations were involved. On March 10, 2000, the arbitral panel dismissed Argentina's argument that the panel did not have jurisdiction over the dispute and found that Argentina had imposed a safeguard measure that at the

time was no longer permissible under MERCOSUR rules in the context of bilateral Argentine-Brazilian trade. The panel gave the Argentine government 15 days to abrogate its safeguard measure on Brazilian cotton textiles.

4. In Re Application of Anti-dumping Measures Against the Exportation of Whole Chickens from Brazil.

On May 21, 2001, a fourth decision was issued by an ad hoc dispute resolution panel established under the Protocol of Brasilia. The action was brought by Brazil, alleging that Argentina's imposition of an antidumping duty on Brazilian whole chickens violated MERCOSUR rules concerning the investigation of unfair trade practices between member states and the subsequent imposition of remedies. During the first stage of the dispute resolution process, Argentina refused to negotiate a diplomatic resolution to the dispute with Brazil, arguing that the antidumping duties it levied on Brazilian chicken fell solely within the jurisdiction of the Argentine administrative bodies and courts. Accordingly, the use of the dispute resolution system set up under the Protocol of Brasilia was wholly inapplicable to resolving this matter. Although the ad hoc arbitration panel rejected the Argentine contention that it lacked jurisdiction over the dispute, it did find in favor of Argentina. Acknowledging the limited scope of its review powers as a result of the absence of MERCOSUR norms that directly addressed the issues at hand, the arbitral panel found that the procedure employed by Argentina for investigating allegations of dumping of Brazilian chickens and the subsequent imposition of antidumping measures were reasonable under international trade law and were not used as a subterfuge to thwart intra-MERCOSUR free trade.

5. In Re Argentine Market Access Restrictions for Bicycles of Uruguayan Origin.

An arbitral panel meeting in Asunción, Paraguay, issued the fifth arbitral award pursuant to the Protocol of Brasilia on September 29, 2001, based on a Uruguayan complaint that Argentina imposed tariffs on bicycles made by one Uruguayan company. The arbitral panel issued a unanimous decision in favor of Uruguay, declaring that Argentina's blanket treatment of Uruguayan bicycles made by one company as non-MERCOSUR in origin and therefore subject to the common external tariff or CET, violated Argentina's MERCOSUR obligations. If Argentina had genuine questions regarding the authenticity of the certificate of origin issued for a specific shipment of bicycles, the proper recourse for Argentina was to take up the matter with the Uruguayan issuing authority and to follow the other procedures established in the relevant MERCOSUR rules of origin requirements.

6. In Re Prohibition on the Importation of Remolded Tires from Uruguay.

A sixth arbitral award was issued on January 9, 2002, in a matter brought by Uruguay, alleging that a Brazilian law enacted in September 2000 prohibiting the issuance of import licenses for remolded tires violated a July 2000 MERCOSUR standstill prohibition on new restrictions to intraregional trade flows. The arbitral panel ruled in favor of Uruguay, and Brazil was ordered to issue domestic legislation lifting the ban on imported remolded tires within 60 days. In reaching its decision, the arbitration panel reasoned that Brazil was estopped from claiming that an earlier 1991 law was intended to include remolded tires as "used" tires whose importation into Brazil from that date forward was prohibited. Actual behavior by other Brazilian government agencies since 1991 indicated that remolded tires were not treated as used tires and remolded tires were freely imported into Brazil throughout the 1990s.

7. In Re Obstacles to the Importation of Argentine Phytosanitary Products into the Brazilian Market: Non-Incorporation of Common Market Group Resolution No. 48/96, 87/96, 149/96, 156/97 and 71/98 Which Impedes their Entry into Force in the MERCOSUR.

On April 19, 2002, an arbitral panel issued what has probably been the most strongly worded decision to date and has potentially far-reaching ramifications, given the widespread failure of member states to incorporate into their domestic legal frameworks many norms issued by MERCOSUR's institutional bodies over the past decade. The award arose in a case brought by Argentina against Brazil for failure to incorporate into its domestic legal framework five Common Market Group Resolutions that are intended to create a streamlined phytosanitary system for evaluating and registering foodstuffs and facilitating their commerce among the four MERCOSUR countries. The Argentines claimed that Brazil's continuing failure to adopt these five resolutions created an impermissible trade barrier to Argentine exports. Although the arbitral panel recognized that the five Common Market Group Resolutions in question did not contain explicit time limits for incorporating them into do-

mestic law, relevant international law principles obligated Brazil to incorporate them within "a reasonable period of time."[38] Given that six years had elapsed since the first of these Resolutions were issued (and that all three other MERCOSUR countries had already incorporated them), Brazil's inaction was found to be unreasonable, and the Brazilians were ordered to implement the resolutions within 120 days.[39]

8. In Re the Application of the "IMESI" (Specific Internal Tax) on the Sale of Cigarettes.

On May 21, 2002, an arbitral panel issued its decision in a complaint brought by Paraguay over Uruguay's discriminatory imposition of its specific internal tax (*impuesto específico interno* — IMESI) on imported cigarettes versus domestic cigarettes, further differentiated depending upon whether the cigarettes came from countries that directly bordered on Uruguay (Argentina and Brazil). The Paraguayan government claimed that the differentiated methodologies for calculating the IMESI created an impermissible nontariff barrier. The arbitral panel found the entire Uruguayan scheme discriminatory and in violation of the principle of national treatment found not only in MERCOSUR, but also in ALADI and the WTO. The Uruguayan government was given six months to calculate the value of cigarettes from within MERCOSUR for purposes of imposing the IMESI, using the same methodology for calculating the value of domestic cigarettes.

Conclusion

The current crisis gripping MERCOSUR has not changed the perception of Southern Cone governments regarding the need to manage their foreign and trade policies through MERCOSUR. Instead, the debate has been centered on the particular form of economic integration that MERCOSUR should pursue. In particular, there are those who advocate MERCOSUR sticking to its stated goal of a common market, while others call for dismantling the current imperfect customs union in favor of a free trade area. One commentator, at least, sees danger in MERCOSUR settling for anything less than a common market because successful integration needs a project, a rationale, and a sense of direction. Damage limitation built around an imperfect customs union and weak institutions does not look like a politically saleable, let alone a coherent, regional project.[40] Furthermore, reducing MERCOSUR to a mere free trade area ensures its eventual disappearance, as this subregional free trade area would eventually be encompassed by any future FTAA.

Ironically, settling for a MERCOSUR free trade area could complicate the work of U.S. negotiators in the FTAA process, given that they would now have to deal with the tariff and other trade offers of four individual countries, as opposed to the CET of one bloc. In addition, a weakened MERCOSUR makes it less likely that the Office of the United States Trade Representative (USTR, the executive branch agency in charge of negotiating the FTAA) will be able to withstand the lobbying pressure of protectionist sectors within the United States. For example, a strong MERCOSUR refusing to liberalize its financial services sector, unless the United States agrees to end or sharply limits the use of antidumping within the Free Trade Area of the Americas, provides a convenient political cover for USTR ceding on this issue. Accordingly, the debate on the future direction MERCOSUR should take, as well as its continued health, will have an impact on the FTAA negotiations and the ultimate content of that agreement.

What form the MERCOSUR takes will undoubtedly be strongly influenced by the policies of the new administration in Brasilia. Public pronouncements made by President da Silva, to date, indicate that he favors retaining the original common market goal and moving further in the direction of monetary union and greater political integration through the creation of a MERCOSUR Parliament. Such a policy would complement the historic agreement signed in November 2002 by the MERCOSUR countries and associate members Bolivia and Chile that will allow the free movement of workers among all six countries. In the meantime, MERCOSUR's current dispute resolution system has proved itself surprisingly adept at clearly defining the rules for intraregional free trade and serving to prevent backsliding by member states in their obligations. As a result, it may well be the dispute resolution mechanism that nudges MERCOSUR's politicians back to the project's original vision: The Common Market of the South.

NOTES

1. See Alexander J. Yeats, 1996, "Does Mercosur's Trade Performance Justify Concerns about the Global Welfare-Reducing Effects of Regional Trading Arrangements? Yes!" Unpublished manuscript (Washington, D.C.: World Bank). Yeats' report led to bombastic newspaper headlines in the U.S. media. See, for example, *Wall Street Journal*, 1996, "South American Trade Pact Is Under Fire," October 26; *Journal of Commerce*, 1996, "MERCOSUR Under Siege," October 30.

2. Sebastian Edwards, 2002, "This Argentine Scheme," *The Financial Times*, January 21; Mary Anastasia O'Grady, 2002, "Waiting for a Trade Deal Has Cost Latin States Dearly," *The Wall Street Journal*, June 28.

3. The economist cited is Arturo C. Porzecanski, a managing director of ABN-AMRO Securities in New York City. Stratfor, 2001, "Members' Policies Spell MERCOSUR's Demise" at <http://www.stratfor.com/latinamerica/commentary/0110101600.htm>. Porzecanski repeated this assertion at a conference in New York City sponsored by the Brazilian-American Chamber of Commerce on August 13, 2002, even though the reason for his initial statement in 2001 was Argentina's then "incompatible" trade and fixed exchange rate regimes (something that the January 2002 devaluation of the Argentina peso resolved).

4. Although Bolivia and Chile are associate members of MERCOSUR, which means that they only participate in the intraregional free trade aspects of the project and not the Common Market, they are both signatories to the Protocol of Ushuaia on the Commitment to Democracy in MERCOSUR, the Republic of Bolivia, and the Republic of Chile.

5. This fact should have given pause to those who, as it turns out, wrongly argued that MERCOSUR would disintegrate in the face of a maxi-devaluation of the Brazilian real in January 1999. Despite its overvalued currency, Argentina still managed to increase overall exports to Brazil during these three years. Undoubtedly, the economic stability that Argentina enjoyed at the time was also a factor, in that it allowed Argentine exporters to reduce profit margins to remain competitive in the Brazilian market.

6. Pedro da Motta Veiga, 1999, "Brazil in Mercosur: Reciprocal Influence," in *MERCOSUR: Regional Integration, World Markets*, ed. Riordan Roett (Boulder, Colo.: Lynne Rienner Publishers), 30-31. Da Motta Veiga points out that the benefits of MERCOSUR for Brazil have been far greater than one might infer from this figure. MERCOSUR has been responsible for the most important change of the 1990s in the pattern of Brazil's foreign trade, particularly in terms of favoring goods with a higher degree of technological intensity. It has encouraged small and medium-sized firms in Brazil to export for the first time. MERCOSUR also has served as a catalyst for increased Brazilian foreign investment in the subregion, thereby playing an important role in the internationalization of Brazilian firms.

7. Ann Bartholomew, 2001, "MERCOSUR and the Rest of the World," in *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism*, ed. Victor Bulmer-Thomas (London: Institute of Latin American Studies, University of London), 253. The truth is that this concern was overblown, given that levels of protectionism reduced sharply in MERCOSUR countries during the late 1980s and 1990s, due to implementation of unilateral tariff reduction programs. The simple average, most favored nation (MFN) tariff for MERCOSUR fell from 41 percent in 1986 to 12 percent by 1996. Furthermore, the preferential tariff reductions within MERCOSUR were smaller than the MFN tariff reductions and, as a result, there was a substantial reduction in the average level of protectionism to external countries as well as within MERCOSUR. These reductions in external tariffs, coupled with economic growth, served to encourage trade between MERCOSUR countries and the rest of the world throughout the 1990s.

8. Bartholomew 2001, 240. This conclusion is further buttressed by research findings in a study conducted by Ann Bartholomew of The University of Oxford. Bartholomew notes that during the period 1990 through 1999, while intra-MERCOSUR trade increased at a greater pace than trade with the rest of the world, in terms of total trade, MERCOSUR increased its volume of trade with the rest of the world. This indicates that MERCOSUR not only did not discourage trade with the rest of the world, but a trade augmentation effect may well have resulted, because during the 1990s external trade barriers and barriers to intra-MERCOSUR trade fell.

9. When measured in value terms, manufactured goods represent about half of Argentine exports. Hence, while the quantity of manufactured goods exported may be relatively insignificant, the actual amount of revenue the Argentine economy gains from these exports is quite significant. In other words, while these products represent less in volume terms, the country obtains a very large amount of revenue from them. In general, this is a trend to be encouraged. The best export markets for these types of Argentine goods are the countries in MERCOSUR and throughout Latin America.

10. Andrew Hurrell, 2001, "The Politics of Regional Integration in MERCOSUR," in *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism*, ed. Victor Bulmer-Thomas (London: Institute of Latin American Studies,

University of London), 202. In June 1996, the presidents of the MERCOSUR countries issued a "Declaration on the Commitment to Democracy in the MERCOSUR" that required them to consult and to apply punitive measures to any member state wherein democratic rule was threatened or abolished. The measure was undertaken in response to a threat by General Lino Oviedo to take power through a coup d'état in Paraguay in April of that year. These principles were further developed and made binding in 1998 in the Protocol of Ushuaia on the Commitment to Democracy in the MERCOSUR, the Republic of Bolivia, and the Republic of Chile.

11. Monica Hirst, 1999, "Mercosur's Complex Political Agenda," in *MERCOSUR: Regional Integration, World Markets*, ed. Riordan Roett (Boulder, Colo.: Lynne Rienner Publishers), 43. Hirst notes that besides these initiatives at the local and federal levels, cross-border interaction has been intense among business sectors, social organizations, and political elites, and inter-provincial networking is a reality between the southern states of Brazil and the northern provinces of Argentina.

12. Hirst 1999, 39.

13. Jocelyn Bay-Smith C., 2002, "Brasil Deroga Aranceles a Bienes Argentinos," *El Mercurio*, February 9.

14. Leticia Linn and Juan Carlos Raffo, 2002, "Brasil Acepta Pagar el Precio del Liderazgo Regional," *El Observador*, August 22. In January 2002, Brazil's Agriculture Minister, Marcus Vinicius Pratini de Moraes, proposed that BNDES guarantee payments for a set period and up to a specified limit to Brazilian firms for their exports to Argentina, on the understanding that Argentina would later repay Brazil for the financing. *American Journal of Transportation*, 2002, "Brazil Minister Eyes Funding Exports to Argentina" (January 14).

15. See, for example, Hurrell 2001, 210, who notes that Brazil has a number of important reasons for supporting MERCOSUR as a key component of its economic and foreign policy. First, the direct costs of any reversion to rivalry with Argentina would be very high. Second, a prolonged souring of relations would undermine the strategic objectives of regional integration: to move forward a national industrial project under new global conditions, to increase international bargaining power, and to attract foreign capital and foreign direct investment (FDI). Third, MERCOSUR is critical to Brazil's relations with Europe, which continue to rely very heavily on the continued development of the region to region/E.U.-MERCOSUR ties. Fourth, MERCOSUR provides the political and economic framework for Brazil's broader policy in South America. Fifth, and most important, MERCOSUR is central to Brazil's relations with the United States. The idea of MERCOSUR as a counterweight, as a negotiating instrument with the United States, has never been far beneath the surface.

16. Roberto Bouzas and H. Soltz, 2001, "Institutions and Regional Integration: The Case of MERCOSUR," in *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism*, ed. Victor Bulmer-Thomas (London: Institute of Latin American Studies, University of London), 103. The creation of strictly intergovernmental organs was aimed to prevent isolation of decision-making layers from the national agencies responsible for enforcement. The objective was to engage the national agencies and bureaucracies (particularly the ministries of economy) in decision making responsible for implementation. This approach built upon the poor results of previous experiences in Latin America, where "integration bureaucracies" disconnected from the rest of the national public sector or diplomats with limited ability to push decisions forward within their own administrations usually undertook commitments that had few chances of being implemented.

17. Bouzas and Soltz 2001, 103.

18. Bouzas and Soltz 2001, 107.

19. Bouzas and Soltz 2001, 112-13.

20. The ad hoc nature of the third level arbitration panels under the current system conspires against the development of a "body of common interpretation," as permanent tribunals (as opposed to ad hoc arbitral panels) are more likely to take decisions consistent with established precedent. In addition, while the decisions of the ad hoc arbitral panels under the current system are formally final and cannot be appealed, the practical meaning of "binding" in each member state differs according to the domestic constitutional background. As these verdicts do not have equivalent "supremacy" over domestic legislation in all member states, enforceability is subject to different practical (legal) requirements. Bouzas 2001, 110. For example, Argentina recognizes the principle of supremacy of international law over domestic law, while Brazil and Uruguay do not unless the international law obligation is explicitly incorporated into the domestic legal order by national legislation.

21. The Protocol of Colonia for the Promotion and Reciprocal Protection of Investments from Within the MERCOSUR was signed by the four member states in January 1994. Common Market Decision 11/94 contains the Protocol for the Promotion and Reciprocal Protection of Investments from Outside the MERCOSUR and was issued in August 1994. For an English translation of C.M.C. Decision No. 11/94, see Thomas Andrew O'Keefe, 1997, 2001, 2002, *Latin American Trade Agreements* (Ardsley, N.Y.: Transnational Publishers, Inc.), Appendix 8.

22. For an English translation of the Protocol of Brasilia, see O'Keefe, 1997, 2001, 2002, Appendix 7. The Protocol of Brasilia came into force on April 22, 1993,

after it was ratified by the fourth MERCOSUR member state.

23. It is important to point out that the refusal by a state party to engage in direct negotiations does not impede the complainant from taking the matter to the next step in the dispute resolution system. The Protocol of Brasilia only requires that, as a first step, the parties seek negotiations, but they are not obligated actually to carry them out. See Eve Rimoldi de Ladmann, 2001, "El Cuarto Laudo," *Revista de Derecho del Mercosur*, Año 5, No. 4 (August), 197. Because the negotiations phase can be extended beyond 15 days, this has created another problem: negotiations may continue indefinitely, contributing to a climate of juridical insecurity for the private sector. See Bouzas 2000, 110.

24. Each state party or parties involved in the dispute selects an arbitrator from previously submitted lists of candidates. The third arbitrator is chosen by mutual consent and becomes the president of the arbitration panel; this person cannot be a national of one of the state parties involved in the controversy. If a consensus cannot be reached as to the third arbitrator, then MERCOSUR's Administrative Secretariat in Montevideo chooses him or her by lottery. Each state party or parties on either side of a dispute pays for the services of the arbitrator it chose. The cost of the third arbitrator is shared in equal parts by each side to the dispute.

25. Despite this limitation, it should be emphasized that nothing prevents a private party from trying to use the national court systems to try to seek redress for grievances that may include a state party's failure to comply with its MERCOSUR obligations. Interestingly, this option has been frequently pursued, sometimes leading to anomalous results, in which a court in one country will make a determination contrary to that reached by the national court in another country, yet both involved similar facts. Part of the explanation for such occurrences lies in the fact that under the Argentine Constitution, for example, international law takes precedence over conflicting or nonexistent domestic law, while this is not permitted under the constitutions in Brazil and Uruguay.

26. For an English translation of the full text of the Protocol of Ouro Preto and Annex, see O'Keefe 1997, 2001, 2002, Appendix 10.

27. Interestingly, the Annex to the Protocol of Ouro Preto is silent as to the precise procedure to follow in the event a private party is filing the complaint. Presumably, the matter stays with the National Sections of the MERCOSUR Trade Commission. If the matter cannot be resolved at that level, then the private party must resort to the procedure established under the Protocol of Brasilia or lobby to have the complaint adopted by a state party in order to bring it before the full MERCOSUR Trade Commission.

28. These seven technical committees (down from the 10 originally created in 1995) are 1) Tariffs, Nomenclature, and Product Classification; 2) Customs Matters; 3) Trade Norms; 4) Public Policies That Distort Competition; 5) Safeguard of Competition; 6) Unfair Trade Practices and Safeguard Measures; and 7) Consumer Protection.

29. The text of C.M.C. Decision 17/98 is available in Spanish or Portuguese from the official web site of the MERCOSUR Administrative Secretariat, at <http://www.mercosur.org.uy>. For a more detailed commentary on Decision 17/98, see Ernesto J. Rey Caro, 1999, "Comentario al Reglamento del Protocolo de Brasilia Para la Solución de Controversias en el MERCOSUR," *Revista del Derecho del Mercosur* Año 3, No. 3 (June), 11-19.

30. Yet another criticism leveled against MERCOSUR's current dispute resolution system is that it is subservient to political interests. The fact that professional bureaucrats staff the Common Market Group or MERCOSUR Trade Commission often means that a private party's need of immediate relief is hijacked by larger geopolitical concerns of the state parties. See, for example, Horacio D. Bercún, 1998, "Solución de Conflictos en el Mercosur y la Organización Mundial del Comercio," *Revista de Derecho del Mercosur* Año 2, No. 3 (June), 106-113.

31. In reviewing ad hoc arbitral awards, the role of the Permanent Tribunal of Review is limited to insuring a consistent interpretation of the law applied by the arbitration panel, as developed by the Tribunal itself and in previous ad hoc arbitral awards.

32. The full version of the arbitral decisions is available in Spanish or Portuguese from the official web site of the MERCOSUR Administrative Secretariat in Montevideo, at <http://www.mercosur.org.uy>. A more detailed analysis in English of the first six arbitral awards can be found in O'Keefe 1997, 2001, 2002.

33. Rimoldi de Ladmann, 205.

34. See Jorge E. Fernández Reyes, 2000, "Evaluación de los Mecanismos de Solución de Controversias en el MERCOSUR," *Revista del Mercosur* Año 4, No. 4 (August), 158, fn. 46. The author points out that between 1995 and May 2000, the MERCOSUR Trade Commission alone processed some 374 complaints.

35. Alejandro Daniel Perotti, 2000, "El Segundo Fallo Arbitral del Mercosur o el Amargo Despertar de Nuestro Sistema de Solución de Controversias," *Revista de Derecho del Mercosur* Año 4, No. 2 (April), 144.

36. Daniel H. Rosano, 2001, "El Tercer Laudo Arbitral del Mercosur," *Revista de Derecho del Mercosur* Año 5, No. 1 (February), 164.

37. It is interesting to point out that the Brazilian complaint on this matter was coupled with another filed with the Textile Monitoring Body that oversees implementation of the WTO's Multi-Fiber Agreement. Although the Monitoring Body initially recommended that Argentina drop the safeguard measure because there was no evidence showing that Brazil was actually the cause of any actual or potential harm to the Argentine textile industry, a WTO dispute settlement panel eventually refused to entertain the Brazilian petition.

38. Article 19 of the Protocol of Brasilia states that among the sources of law an arbitration panel established under MERCOSUR's dispute resolution mechanism may consider in making an award are "the principles and dispositions of international law which are applicable to the matter."

39. One of the factors that the arbitral panel considered relevant in making its determination was the fact that under MERCOSUR, legal doctrine established in a previous arbitral decision (In Re Application of Anti-dumping Measures Against the Exportation of Whole Chickens from Brazil), MERCOSUR norms "only enter into effect simultaneously for all of the State Parties of the MERCOSUR when all of them have followed the procedure found in Article 40" of the Protocol of Ouro Preto (that is, incorporation into their respective domestic legal orders). Therefore, Brazil's continuing delay was also interfering with the entry into force of the five norms among the other three states that had already incorporated them.

40. Hurrell 2001, 211.

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