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Judicial Integration in the Americas?

A Comparison of Dispute Settlement in NAFTA and MERCOSUR

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Abstract: The influence of the European Court of Justice (ECJ) on regional integration in Europe is a widely discussed topic in the academic literature. However, outside of Europe, the influence of court-like bodies on integration processes in other regions is much less analysed. Dispute settlement bodies in regional integration schemes outside Europe are not as strong as the ECJ, but they may nevertheless influence regional integration. When judging disputes, court-like bodies have to establish case law in order to be legally consistent with their decision-making – even if precedence effects are formally ruled out by the respective treaties. This case law may lead to increasing integration if the treaties are interpreted respectively. In order to explore the influence of court-like bodies on regional integration outside of Europe, this article compares NAFTA's dispute settlement mechanisms on competition and investment with the dispute settlement mechanism of MERCOSUR. The somewhat surprising result is that although MERCOSUR's dispute settlement mechanism is formally stronger than its counterpart in North America, the latter exercises more influence on the dynamic of regional integration. The reason for this is that due to larger economic interdependence in North America, NAFTA's dispute settlement mechanism is confronted with far more disputes than its counterpart in the South. This leads to many more possibilities for developing case law and for interpreting the respective treaties. The theoretically important conclusion is that not only the formal rules are important for judicial integration in regional integration schemes, but that only the interaction of legal rules and economic demands leads to dynamic regional integration projects.

Keywords: dispute settlement, judicial integration, legalisation, MERCOSUR, NAFTA, regional integration

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1. Introduction

The influence which the European Court of Justice (ECJ) and the preliminary ruling have on the process of European integration is a widely discussed topic in the academic literature (e.g. Burley and Mattli 1993, Fligstein and Stone Sweet 2002, Mattli and Slaughter 1998, Stone Sweet 2004). How far the ECJ is really able to act independently of the interests of the member states of the European Union (EU) is highly debated (e.g. Alter 1998, Garrett et al. 1998). However, most scholars seem to agree that the establishment of the doctrines of direct effect and supremacy of EU law in the 1960s, as well as the mutual recognition principle in the 1970s, had at least a catalysing effect on the integration process during the dark ages of Eurosclerosis, when supranational law making was hampered by *de facto* unanimity vote in the Council (Fligstein and Stone Sweet 2001). In contrast to the European case, the influences of dispute settlement mechanisms on regional integration projects outside of Europe are discussed to a much lesser degree. There have been some sporadic articles which analyse the legalisation of other regional integration projects than the EU (Abbott 2000, Kahler 2000, McCall Smith 2000), but they do not systematically discuss the influence of this legalisation on the processes of regional integration on other continents.

The lack of comparative studies is problematic for theory building, because judicial integration is a complex phenomenon, which is difficult to study using only one case. In the following, we argue that the extent and pace of judicial integration is influenced by formal, legal institutions like the precision and obligation of legal rules and the delegation of dispute settlement to court-like bodies (e.g. Abbott et al. 2000, Keohane et al. 2000), as well as by economic factors like intraregional exchange and the resulting numbers of litigations (see Fligstein and Stone Sweet 2002, Stone Sweet 2004) – in other words, judicial integration results from an interaction between institutional supply and economical demand factors (Mattli 1999). The relative importance and the interaction of such variables cannot be explored using only one successful example of regional integration, because there is not enough variance to exclude some factors or some possible causal relationships. Thus, it seems necessary to compare the European case with dispute settlement mechanisms in

other regional integration projects in order to draw more general conclusions on the legal and economical conditions behind judicial integration.

In our article, we define judicial integration as a process in which course effective regional norms are established by a regional dispute settlement mechanism. Thus, three characteristics have to be met in order to speak of judicial integration. Firstly, dispute settlement bodies develop case law, which must be consistent in order to support their own legitimacy. This case law should establish regional norms or widen the scope of application of national norms to the regional level. Secondly, in order to distinguish the influence of the dispute settlement mechanisms, one has to do a counterfactual test (Fearon 1991). This means the new regional norms must not be expected if the regional dispute settlement mechanisms were not in place. And thirdly, the regional norms need to have a real effect within the region. I.e. they need to be implemented to a significant degree by the member states of a regional integration project. Thus, judicial integration does not necessarily need to go as far as in the EU, where action of the ECJ led to the doctrines of direct effect and supremacy of EU law and thus to the construction of a supranational constitution (Stone Sweet 2004). Such a far-reaching definition of judicial integration would again reduce the number of cases to only one and would fall short of capturing the influence which dispute settlement mechanisms exceed on regional integration projects outside of Europe.

In the following, we analyse the influence of the dispute settlement mechanisms of the North American Free Trade Agreement (NAFTA) and the Common Market of South America (MERCOSUR) on integration within their respective regions. We have chosen these two examples, because both regional integration projects have relatively well established dispute settlement mechanisms. Although the dispute settlement mechanisms are not as independent and powerful as the ECJ in the EU, they are nevertheless regularly used by litigants and may thus exercise some influence on the respective regional integration processes – in contrast to the dispute settlement mechanisms in other regional integration projects like the Southern African Development Community (SADC) or the Association of South East Asian

Nations (ASEAN) , which are very rarely or never used by the respective member states.

In order to analyse the legal and economic factors behind judicial integration in the Americas, our article proceeds in three steps. Firstly, it starts with a theoretical section which operationalises the most important variables, and which establishes some hypotheses about their likely influence on judicial integration. Secondly, the dispute settlement mechanisms of NAFTA are explored. It is analysed, how legalised the NAFTA dispute settlement mechanisms are, to what extent they are used by litigants, and whether this leads to judicial integration. The next section conducts the same analysis for the MERCOSUR dispute settlement mechanism. Finally, the two cases are compared and some general conclusions are drawn.

2. Judicial Integration in Theory

We argue that judicial integration is the result of the legalisation of a regional integration project, as well as the economic interdependence within that region. On the one hand, legalisation produces the discretion for courts or court-like bodies to systematically interpret legal rules in favour of regional integration. On the other hand, interdependence within the regions leads to conflicts of transnational exchange, which are likely to be brought in front of the regional dispute settlement mechanisms. Without such interdependence, legalisation could not develop any effects. And without legalisation, interdependence would have to be governed politically, which denies any influence of court-like bodies.

2.1 Legalisation: The Legal Preconditions for Judicial Integration

The degree of legalisation of a regional integration project can be described along the three dimensions of precision, obligation and delegation (Abbott et al. 2000). Whereas precision and obligation refer to the substance of regional treaties or secondary legislation, delegation means the extent to which dispute settlement is delegated towards more or less independent court-like bodies.

Precision: The dimension of precision refers to the extent and degree of detail of regional rules (Abbott et al. 2000). It may range from general principles, which may be widely interpreted, to very detailed rules, which leave less discretion for courts. The potential for judicial integration is larger, the less precision the regional rules contain. If the rules are very detailed, they leave only limited room for the court to interpret them in favour of more regional integration. In contrast, the court may interpret broad principle much more in its own interest towards more regional integration.

Obligation: The dimension of obligation describes the binding nature of primary or secondary legislation (Abbott et al. 2000). It may range from non-binding recommendations, on the one hand, to the supremacy and direct effect of regional rules on the other hand. In contrast to precision, the potential for judicial integration is larger, the more obligation is expressed in regional rules. If regional rules have a direct effect and are supreme to national ones, there is no room for national interpretations of commitments. In contrast, if regional rules need to be implemented first or have only a recommendatory character, the room for judicial review is small, and regional rules may have no real effect within the region.

Delegation: The dimension of delegation refers to the extent to which dispute settlement about substantive regional rules is delegated to independent courts or court-like bodies. Several indicators can be distinguished for this dimension of legalisation (Abbott et al. 2000, Keohane et al. 2000, McCall Smith 2000). Firstly, the question is who has access to dispute settlement mechanisms. This can either be restricted to the member states of a regional integration project, or it may be extended to private litigants. Secondly, the independence of the court-like bodies needs to be scrutinised. This happens in either *ad hoc* panels which are set up by the member states on a case-by-case basis, or by standing courts whose rules of recruitment guarantee some degree of independence from political influence. And finally, the implementation of court rulings is important. This may range from a recommendatory character of dispute settlement resolutions via sanctions by other member states to direct implementation by national courts. Again, as in the case of obligation, the potential for judicial integration is larger, the more delegated dispute

resolution is; i.e. the easier access to the court-like bodies is, the more independent these bodies are and the more binding their decisions are. If dispute resolution is highly delegated, the influence of the member states is rather restricted. However, if dispute settlement is not that independent, the member states may decide which cases are brought to trial, who decides about them and how far these decisions are implemented.

The basic hypothesis of the legalisation concept is that judicial integration is strong if precision is low, whereas obligation and delegation are high (Abbott 2000).¹ In such a case, the court or court-like body is independent from the member states and its discretion is rather high. Thus, the regional court can systematically decide in favour of its own interest. This is likely to be in favour of more regional integration, because regional integration leads to increasing influence of the regional court. However, the problem of this hypothesis is that it is only built up on the legal characteristics of the regional integration project, and that it neglects economic factors behind regional integration. The hypothesis may be sustained as long as these factors are held constant, but it is unlikely that it would prevail over changing economic conditions.

2.2 Interdependence: The Economic Precondition for Judicial Integration

Judicial integration is an open-ended process which cannot fully be determined by legal rules alone. Instead, it is at least as dependent on agents that use these institutions in their interest and thereby push regional integration forward. One group of relevant actors are of course the regional courts or court like bodies which interpret regional rules in favour of more regional integration in order to increase their own future influence. However, courts cannot act alone, but are dependent on litigants which bring their claims forward. In order for this to happen, there needs to be a transnational exchange (e.g. trade) which leads to a conflict between actors (e.g. about the interpretation of regional free-trade rules). In such cases, the claims may be brought before the regional dispute settlement mechanisms. The court or court-like bodies may then pass decisions which push regional integration forward (e.g. by

¹ In the following, the terms 'high', 'moderate' or 'low' are used in an ordinal meaning, i.e. no absolute values are attached to these ratings.

extending the application of free-trade rules). If this happens repeatedly, the courts need to develop consistent case law in accordance with the *stare decisis* principle in order to maintain the legitimacy of their rulings (Shapiro 2002). If their rulings on similar cases were not consistent, the court-like bodies would lose their legitimacy as independent and neutral arbitrators of transnational conflicts, and they would no longer be accepted by potential litigants and defendants. However, because regional courts cannot enforce their decisions by way of a centralised executive power, they need such general acceptance in order for their decisions to be implemented. Thus, they need to develop consistent interpretations of the legal framework. If such consistent case law is developed, regional rules are established, which may feed back to the behaviour of economic actors (e.g. by increasing intraregional trade). Thus, judicial integration is the result of a steady interaction between regional norms on the one hand, and the behaviour of actors on the other (Stone Sweet 1999).

The economic preconditions for such positive feedback loops are not the same in every region. In order for conflicts of actors to be brought before the regional dispute settlement mechanisms, it is first of all important that transnational exchange, like intraregional trade across national borders, exists. However, such intraregional trade is not only determined by regional rules, but also by economic factors like the development of the participating economies and their production structure. Intraregional trade has the purpose of exploiting economies of scale or comparative cost advantages (Mattli 1999). This means that the regional economies use the advantage of a bigger regional market and produce on a larger scale, or they specialise to some degree in the production of specific goods in whose production they are efficient, and export these goods while importing other goods from their neighbours.

However, the economic preconditions for intraregional trade are that the member states of a regional integration project constitute attractive markets for each other and that they are able to specialise in the production of different goods. This is the case in well developed and industrialised regions of the North, but not in less developed regions in the South (Krapohl and Muntzschick 2008). The member states of the latter are usually dependent on the exploitation of natural resources which they

export to the North and not to their neighbours within the region. Besides, they usually have a relatively low gross national income, which makes them unattractive as export markets. As a consequence, intraregional trade is usually much lower within regions of the South than within regions of the North. This also means that the driving force behind the positive feedback mechanism is much weaker. If there is less trade, there are probably fewer conflicts, there are fewer claims in front of the regional dispute settlement mechanisms, there is less case law, and thus, there is less potential for judicial integration – even if the legal rules should be comparable to those of a respective region in the North.

Consequently, we argue that judicial integration is the result of an interaction between legalisation of a regional integration project and economic interdependence in the respective region. Thereby, legalisation opens up the possibility that court-like bodies may use their available discretion in order to push their own institutional interest in increasing regional integration. Without delegation and obligation, there would either be no court-like bodies to interpret the respective treaties, or their decisions would not have any real impact on the regional integration project. And economic interdependence within the respective regions is needed in order for the courts to receive enough complaints to push regional integration forward. Without enough complaints, the courts would not have the possibilities to develop consistent case law which would then influence the integration processes. Thus, legalisation sets the institutional frame for judicial integration, but the fulfilling of this frame is dependent on economic interdependence and the resulting transnational conflicts. The relative importance of the two factors and their complex interaction cannot be analysed using the single, successful example of the EU. In Europe, both legalisation and interdependence are very much in favour of judicial integration – which explains the strong influence of the ECJ. However, the single example does not provide any variance which would allow for analysis of the relative importance of the two factors. Thus, it is necessary to scrutinise judicial integration in other regional integration projects in which either one of the two factors is less favourable than within the EU.

3. Judicial Integration in NAFTA

By definition, NAFTA constitutes a Free Trade Area, which seeks to abolish most of the tariffs between the United States, Mexico and Canada without establishing a common external tariff. It entered into force on 1 January 1994 as the successor of the Free Trade Agreement between the United States and Canada (CUSFTA). The North American Free Trade Agreement (NAFTA) is the largest market in the world with a share of 32% of the world gross domestic product (GDP) in 2006. The region is highly industrialised and developed with an overall per capita gross domestic product of 31,047 US\$ in 2006. But NAFTA is also characterised by an asymmetry between two highly developed economies (Canada and the USA) and one emerging market (Mexico, which had a per capita gross domestic product of only 9,104 US\$ in 2006).² However, because of this asymmetry, the economic gains to be utilised through intraregional trade and intraregional investment are high. Mexico's comparatively low wages in combination with the secure and tariff-free access of the US-market led to the outsourcing of labour-intensive production from the United States to Mexico (Chase 2003, Schirm 2002). Therefore, intra-regional trade within NAFTA has increased significantly since 1994 and has provided for the emergence of a transnational division of labour which is also based in part on the already existing production networks in some areas of production (Chase 2003: 151). Consequently, approximately 50% of NAFTA member states' exports remain within the region,³ and there is also a high level of intra-regional investment.

3.1 Precision, Obligation and Delegation in NAFTA's Dispute Settlement Mechanisms

Instead of one encompassing regional court like the European Court of Justice (ECJ), the NAFTA-parties have established five different dispute settlement mechanisms. These dispute settlement mechanisms govern different aspects of regional cooperation in North America. The NAFTA-treaty itself provides for three dispute settlement mechanisms: Chapter 11 NAFTA establishes a mechanism for the

² The numbers are taken from the Regional Integration Knowledge System (RIKS) of the United Nations University – Comparative Regional Integration Studies (UNU-Cris), <http://www.cris.unu.edu/riks/web/>, 25.5.2009.

³ WTO International Trade Statistics 2008: World Trade Developments in 2007, http://www.wto.org/english/res_e/statis_e/its2008_e/its08_world_trade_dev_e.pdf, 30/12/2008.

settlement of investment-related disputes in order to assure equal treatment among investors in accordance with the principle of international reciprocity. Chapter 19 provides for a dispute settlement mechanism in respect to antidumping and countervailing duty (AD/CVD) related complaints. These two mechanisms have turned out to be the most important mechanisms for judicial integration within NAFTA. Because of high intraregional trade and investment, both mechanisms deal with topics of great relevance and are extensively used. Contrary to these thematically specific dispute mechanisms, Chapter 20 establishes a residual dispute settlement mechanism that is applicable to all disputes regarding the interpretation or application of the NAFTA-agreement. This mechanism has been used only three times in the past 15 years. In addition, each of the two side-agreements contains a dispute settlement mechanism that deals with the according topic – environment or labour protection. The following analysis will be confined to those dispute settlement mechanisms that turned out to be most important for judicial integration within NAFTA: the mechanisms according to Chapter 11 and Chapter 19.

Precision: NAFTA features a high level of precision on the basis of one encompassing treaty that is complemented by two side-agreements. Altogether, the NAFTA treaty encompasses 22 chapters containing very specific obligations on trade in goods, services, financial services, investment, intellectual property rights, technical barriers to trade, sanitary and phytosanitary measures, safeguard measures, and dispute settlement (Senti 1996). Consequentially, NAFTA is broader in scope of coverage than the WTO-agreement. Moreover, the fact that NAFTA comprises a multitude of annexes that further specify the obligations set out by the main treaty is important. In addition to the NAFTA-treaty as the first volume, these annexes constitute the second volume of the North American Free Trade Agreement. Moreover, three further volumes determine the timetables for the contracting parties to lower their trade restrictions. All in all, NAFTA therefore consists of five volumes (Kaiser 1998: 43) which are further accomplished by two volumes containing the side agreements on environment and labour protection. This leads to the conclusion that NAFTA can be claimed to be a very precise agreement, and that it constitutes one of the most detailed trade agreements that has ever been negotiated (Abbott 2000: 524). This high level precision is made necessary by the condition that NAFTA does

not, unlike the EU, stipulate the adoption of secondary legislation. This absence of secondary legislation also implies that the only way to adapt NAFTA to changing circumstances is to use the varying dispute settlement mechanisms if one aims to avoid intergovernmental negotiations about treaty amendments. Therefore, aside from treaty amendments, the NAFTA dispute settlement mechanisms are the only way to develop NAFTA's normative framework after its enactment. Thus, the role of the arbitrators is necessarily to further develop the already existing law.

Obligation: The precise NAFTA-rules generally generate binding legal commitments. Art. 105 NAFTA explicitly states that the parties shall ensure to 'give effect' to the regulations of the treaty. The NAFTA-rules are at large stated in the form of actions the contracting parties 'shall' take or refrain to take. Permissive terms are used only very sporadically and within a restricted range of coverage (Abbott 2000: 532). Moreover, NAFTA refers to the internal legislation of member states (Aspinwall 2008: 7) and creates strong pressure inter alia to harmonize tariffs, update rules of origin and other standards in order to promote trade (Wayne 2004). This high level of obligation was particularly in Mexico's interest. It was Mexico's objective to attract foreign direct investment and to increase its imports and exports through regional integration within NAFTA. With the involvement in NAFTA, Mexico sought to signal economically relevant actors, especially investors, that its economic policies and conditions are secure, predictable and investor-friendly. This objective was only attainable with the help of a treaty that implies obligation and therefore a 'credible commitment' (Moravcsik 1998) for Mexico. However, the NAFTA treaties are not superior to national legislation and are not directly applicable (like EU law), so the obligation can only be evaluated as moderate.

Delegation: Compared to the highly delegated dispute settlement mechanisms of the European Union and also of MERCOSUR after the Protocol of Olivos, the two discussed mechanisms of NAFTA envision only a low level of delegation, because they do not set up permanent independent courts. Firstly, Chapter 11 establishes automatic access for private litigants (Art. 1116/1117 NAFTA). A private investor from one of the NAFTA-countries, who claims that a member state's government has violated his or her investment obligations under Chapter 11, has resource to this

arbitral mechanism. Besides, the dispute settlement mechanism of Chapter 11 provides that disputes are arbitrated in forums originally designed and predominantly used to resolve private commercial disputes.⁴ Therefore, the adjudication of such claims is largely governed by the procedures contained in the applicable arbitral rules (Tollefson 2002: 162). As a basic principle, Art 1123 NAFTA states that investor-related claims are to be adjudicated by a three-member tribunal for which each disputing party is entitled to select one member. The third member, who acts as panel chair, is required to be jointly appointed by the disputing parties. It is apparent that this dispute settlement mechanism unambiguously constitutes a 'hard case' for the development of consistent case law, because the claims brought to the fore in this mechanism may be arbitrated in three different forums, respectively, by ad hoc panels set up on a case-by-case basis. Under these conditions, consistent case law may only emerge if the respective forums consider each other in their decision-making.

Although NAFTA itself contains no rules regarding the substance of antidumping and countervailing duty, it requires that states act in accordance with their own national AD/CVD laws. This is to be ensured by the dispute settlement mechanism of Chapter 19, which is carried out between the member state in which the natural or judicial person is based and the defendant member state. Chapter 19 states that a private person that has been subject to a final AD/CVD determination may require his or her government to initiate a respective proceeding (Art. 1904 (7) NAFTA). Panels established according to Chapter 19 comprise five arbitrators that are selected from a general roster established by the parties on a case-by-case basis. Thus, dispute settlement according to Chapter 19 is also conducted by ad hoc panels on a low level of independence. The respective decisions are mandatory for all national authorities and cannot be abrogated by any national court. The United States were only willing to accept this 'direct effect' under the condition that the supremacy of the national law of the importing state vis-à-vis NAFTA is ensured. This means that the decisions of Chapter 19 Dispute Settlement Panels have to be in accordance with the national

⁴ One of the following arbitration mechanisms can be used: the World Bank's International Centre for the Settlement of Investment Disputes (ICSID), ICSID's Additional Facility Rules, and the rules of the United Nations Commission for International Trade Law (UNCITRAL Rules).

legal order of the defendant party (Dunker 2002: 153)⁵. In this procedure, an extraordinary challenge procedure exists if a panel exceeds its authority or engages in abusive practices.

While the basic hypothesis of the legalization concept is that judicial integration is strong if precision is low, whereas obligation and delegation are high (Abbott 2000), the preceding section showed that NAFTA possesses a high level of precision and a moderate level of obligation, but only a low level of delegation. In particular, it becomes clear that the discussed dispute settlement mechanisms of NAFTA feature a significantly lower level of delegation than the ECJ, which exerts considerable judicial influence on regional integration within Europe. In light of these preconditions, the concept of legalization would not expect judicial integration to occur within NAFTA. However, our concept argues that attention should also be paid to the degree of transnational exchange in order to fully grasp the dynamics of judicial integration.

3.2 The Establishment of Consistent Case Law in NAFTA's Dispute Settlement Mechanisms

Due to high intraregional trade and high intraregional investment, the dispute settlement mechanisms of Chapter 11 and Chapter 19 are used extensively. Various sources reveal that the mechanism according to Chapter 11 was used more than 50 times.⁶ Regarding the mechanism according to Chapter 19, 58 cases that led to binding decisions by the arbitral panels were settled, while the Extraordinary Challenge Committee was invoked three times. This frequent use of the mechanism should reveal the establishment of consistent case law, although there is *de jure* no *stare decisis* principle in these dispute settlement mechanisms. Article 102 states that NAFTA panels' previous decisions are binding only between the disputing parties and with respect to the particular case.

⁵ Furthermore, national courts have the possibility to counteract the jurisdiction of NAFTA Dispute Settlement in cases that have not yet been decided. Therefore, they may undermine the effectiveness of this Dispute Settlement Mechanism.

⁶ This is not to say that there are more than 50 final decisions. Because investment-related disputes according to Chapter 11 are arbitrated in different forums outside NAFTA, it is not possible to determine the definite number of disputes settled by this mechanism.

Within the dispute settlement mechanism of Chapter 11, the development of consistent case law regarding the question of what constitutes an ‘indirect expropriation’ (Art. 1110 NAFTA) can be observed. In claims regarding indirect expropriation, the owners of a special property claim that a specific regulation of a member state has an adverse effect equal to the expropriation of the property, although the title to the property remains with the owner (Congressional Research Service 2003: 11). Altogether, five final arbitral decisions regarding claims of indirect expropriation have resulted out of dispute settlement according to Chapter 11 NAFTA. Due to the fact that ‘indirect expropriation’ is not explicitly defined in Article 1110 NAFTA, different tribunals have developed a framework of certain factors that create such an ‘indirect expropriation’ in different decisions.⁷ Those factors which are perfectly consistent with each other include the effects of the government action, reasonable reliance by the investor, the degree of the interference with a property right, the extent of the economic harm suffered, the duration of the economic harm and the character of the government action. Although none of the factors is determinative for ‘indirect expropriation’, each is part of a general framework regarding ‘indirect expropriation determinations’ (Edsall 2007: 940). These decisions develop consistent case law regarding the question of what constitutes an ‘indirect expropriation’ and show first signs that this case law could be more investor-friendly than the U.S. law. Due to the fact that Article 1110 NAFTA and the respective U.S. law reveal areas of potential divergence, this would not be expected in the absence of the dispute settlement mechanism. In light of the unfavourable legal preconditions for the development of consistent case law in this dispute settlement mechanism, the development of consistent case law regarding the question of what constitutes an ‘indirect expropriation’ is somewhat surprising and unexpected by the concept of legalization. On the contrary, it supports our argumentation that dispute settlement mechanisms that are invoked repeatedly on the same topic have an interest to develop consistent case law to gain and maintain legitimacy of their rulings.

Within the dispute settlement mechanism of Chapter 19 NAFTA, the binational panels established ‘a de facto doctrine of consistency’ (Pan 1999) by forcing the U.S.

⁷ (1) *Matalclad Corp. v. United Mexican States Award*; (2) *Pope & Talbott v. United States Award*; (3) *SD Meyers, Inc. v. Canada*

Department of Commerce in several cases to apply its policies regarding anti-dumping and countervailing duty measures vis-à-vis private companies from the two other NAFTA member states in a consistent manner. Thereby, the different panels created consistent case law (Pan 1999: 443), which is somewhat surprising for two reasons. On the one hand, there is the fact that panel decisions according to Chapter 19 NAFTA have no formal precedential value and are applicable only to the facts of the particular dispute discourages the development of consistent case-law (US Senate Report No. 103-189). On the other hand, the lack of a core group of panelists that decides pending cases leads to the fact that every case is decided by a new group with only very few panelists serving frequently (Pan 1999: 407). Nevertheless, within three different cases,⁸ this dispute settlement mechanism consistently required the U.S. Department of Commerce to be consistent with its past decisions regarding anti-dumping and countervailing duty measures, unless the Department could provide a reasonable explanation for a change of methodology (Pan 1999: 431). Thereby, the dispute settlement mechanism according to Chapter 19 created a regional norm which would not be expected in its absence.

The first case that was conducive to the development of this consistent case law was a case concerning countervailing duty determination on *Live Swine from Canada*.⁹ Therein, a binational panel according to Chapter 19 ruled that the Department of Commerce may change its own policy only as long as this change is comprised by a reasonable analysis, which was not the case for the particular change at hand. Furthermore, in a case that was dealing with the practice of the Department of Commerce regarding 'Best Information Available' (*Fresh Cut Flowers from Mexico*),¹⁰ the respective panel also stated that the Department of Commerce must apply its own policies consistently. If the Department changes its methodology, this has to be announced publicly. In the particular case, the panel accused the Department of Commerce to misapply its own policy. Moreover, in the case *Oil Country Tubular Goods from Mexico*,¹¹ the panel concentrated again on the issue of consistency. In the case at hand, it dealt with the question of whether the Department

⁸ *Fresh Cut Flowers from Mexico*; *Oil from Country Tubular Goods from Mexico*; *Live Swine from Canada*; *Leather Wearing Apparel from Mexico*

⁹ Final Decision of the Binational Panel, *Live Swine from Canada*, USA-94-1904-01

¹⁰ Final Decision of the Binational Panel, *Fresh Cut Flowers from Mexico*, USA-95-1904-05

¹¹ Final Decision of the Binational Panel, *Oil Country Tubular Goods from Mexico*, USA-95-1904-04

handled the applications of audited and unaudited financial statements in a consistent manner. In contrast to the other cases, the Department of Commerce was said to be consistent regarding the pending question. Nevertheless, it is important that this panel again raised the question of consistency and dealt with it in exactly the same way that the other panels had done before. The same happened in yet another case.¹² Thus, it can be concluded that the panels according to Chapter 19 NAFTA forced the U.S. Department of Commerce to apply its policies in a consistent manner. Thereby, they created case law in terms of the 'de facto doctrine' of consistency. For our conception of judicial integration, it is important to note that the decisions of the Chapter 19 panels in general, and the mentioned decisions regarding the U.S. Department of Commerce in particular, differ from the decisions that can be expected from the U.S. Court of International Trade. Compared to the latter, the NAFTA panels seem more willing to call the decisions of the U.S. Department of Commerce into question (Pan 1999: 442). Besides, every panel decision has been obeyed, leading to the conclusion that decisions according to Chapter 19 NAFTA are implemented by the affected actors and therefore yield a real effect within the NAFTA region.

The emergence of consistent case law is not limited to the cases analysed above, but is a much more general and significant development within NAFTA's dispute settlement. Table 1 gives an overview of four cases of consistent case law, which was developed in the dispute settlement mechanism on AD/CVD measures. In these cases, varying NAFTA-panels created regional norms that could not be expected in their absence. Firstly, two panels created the regional norm that the U.S. Department of Commerce has freedom of choice regarding the question of what constitutes the 'Best Information Available' concerning the calculation of the normal price of foreign goods. Secondly, two further panels developed the 'de facto doctrine' that the U.S. Department of Commerce has to use a tax neutral methodology regarding the adjustment of export prices. Thirdly, regarding their own role, two further panels consistently ruled that panels established according to Chapter 19 have to follow 'general legal principles' that would apply to the corresponding national court. And finally, five panels hardened the regulation that Art. 238 of the Mexican Federal Fiscal Code is the standard of review that Mexico has to use vis-à-vis other

¹² *Leather Wearing Apparel from Mexico*. Final Decision of the Binational Panel, Leather Wearing from Mexico, USA-94-1904-02

countries.

Table 1: Further Cases of Consistent Case law in NAFTA

Regional Norms	Decisions	Constitutive Disputes
Freedom of choice for the U.S. Department of Commerce regarding ' <i>Best Information Available</i> ' ¹³	<p>Failure of a foreign producer to answer a request is enough to apply '<i>Best Information Available</i>'.</p> <p>U.S. Department of Commerce can use '<i>Best Information Available</i>' whenever it has made a reasonable request to the foreign producer.</p>	<p>Certain Cut-to-Length Carbon Steel Plate from Canada (Canada/ U.S.)</p> <p>Gray Portland Cement and Clinker from Mexico (Mexico/ U.S.)</p>
Tax neutral methodology ¹⁴ is required from the U.S. Department of Commerce regarding the adjustment of export prices	<p>U.S. Department of Commerce has to adopt a tax neutral methodology.</p> <p>U.S. Department of Commerce has to adopt a tax neutral methodology.</p>	<p>Certain Corrosion-Resistant Carbon Steel Products from Canada (Canada/U.S.)</p> <p>Certain Cut-to-Length Carbon Steel Plate from Canada (Canada/ U.S.)</p>
Panels according to Chapter 19 have to follow "general legal principles"	Panel must follow the 'general legal principles' that would apply to the corresponding national court.	<p>Oil Tubular Goods from Mexico (Mexico/ U.S.)</p> <p>Certain Softwood Lumber Products from Canada (Canada/ U.S.)</p>
Art. 238 of the Federal Fiscal Code is the standard of review for Mexico	<p>Application of Art. 239 of the Federal Fiscal Code would constitute an undue expansion of the powers and competences.</p> <p>Only applicable standard of review is Article 238 of the Federal Fiscal Code</p>	<p>Carbon Steel Tube – Dumping (Mexico/ U.S.)</p> <p>Flat Coated Steel Products from the U.S. (Mexico/ U.S.)</p> <p>Rolled Steel Plate from Canada (Mexico/ Canada)</p> <p>Polystyrene and Impact Crystal from the USA (Mexico/ U.S.)</p> <p>Hot Rolled Steel from Canada (Mexico/ Canada)</p>

¹³ Regarding the calculation of the normal price of a good, the U.S. Department of Commerce sends a questionnaire to ask for product information from the foreign producer. If the foreign producer does not respond or responds incompletely, the U.S. Department of Commerce has to use the '*Best Information Available*' in order to complete the calculation (Pan 1999: 412).

¹⁴ Tax neutral methodology means that compensations for taxes that are imposed on products sold domestically, but not on products sold for export have to be tax neutral.

All in all, it becomes clear that the two most important NAFTA dispute settlement mechanisms repeatedly exhibit the development of consistent case law. This runs counter to the basic hypothesis of the legalization concept which conjectures at most a low level of judicial integration due to the basically unfavourable legal preconditions for the development of consistent case law within NAFTA. On the contrary, the empirical findings indicate that a high rate of intraregional trade and investment may operate as a catalyst for judicial integration, even in circumstances where the institutional conditions seem to hamper judicial integration. High intra-regional independence regarding trade and investment and the resulting conflicts almost inevitably lead to multiple decisions of dispute settlement mechanisms on the same questions. If this economic demand for judicial integration meets the desire of dispute settlement mechanisms to develop consistent case law in order to gain and maintain legitimacy for their rulings, judicial integration will inevitably occur, even if precedence is explicitly ruled out as in the case of NAFTA.

4. Judicial Integration in MERCOSUR

MERCOSUR, the supposedly most promising regional integration project on the Southern hemisphere (Vaillant 2005), was initiated in 1991 with the Treaty of Asunción by Argentina, Brazil, Paraguay and Uruguay.¹⁵ It is predominantly an economic integration process, but aims as well to achieve certain political, social, and cultural objectives (Cárdena/ Tempesta 2001: 337). A free-trade area has almost been achieved, and a customs union, which provides for the application of common external customs tariffs, is in progress. After EU, NAFTA and ASEAN, MERCOSUR is the fourth largest regional market in the world with a share of 3.16% of the world gross domestic product in 2006. Thus, the economic relevance of MERCOSUR is much lower than that of NAFTA. The region is characterised by developing economies (the gross domestic product within MERCOSUR averaged 5,660 US\$ per capita in 2006), as well as an asymmetry between Brazil and Argentina on the one hand and the small states Paraguay and Uruguay on the other hand (the per capita

¹⁵ Venezuela will become the fifth member of MERCOSUR since it declared it's joining of MERCOSUR in 2006. But the accession has not been ratified yet by all four founding members.

gross domestic product is only 1,542 US\$ in Paraguay, but 5,663 US\$ in Brazil).¹⁶ As a result of low economic development, the MERCOSUR member states cannot utilise significant economies of scale and comparative cost advantages by intraregional trade. Thus, within MERCOSUR, around 14% of the exports remain within the region.¹⁷ Additionally, intra-regional investment is also at a relatively modest level.

4.1 Precision, Obligation and Delegation in MERCOSUR's Dispute Settlement Mechanism

The current system for the settlement of disputes as regulated in the Protocol of Olivos provides for dispute settlement by ad-hoc panels and a Permanent Review Court (Tribunal Permanente de Revisión del MERCOSUR), which acts as a court of second instance. Before the Protocol of Olivos, disputes were settled only in front of the ad-hoc tribunals, and no occasion for revision was given. But with the Protocol of Olivos and the establishment of the Permanent Review Court in 2004, the formal mechanisms for the settlement of disputes were clearly improved. In general MERCOSUR's dispute settlement system concerns all controversies among its member states regarding the interpretation, application or non-compliance with the provisions of the Treaty of Asunción and its different protocols, as well as the Decisions of the Common Market Council (Consejo del Mercado Común), Resolutions of the Common Market Group (Grupo Mercado Común) and Directives of the MERCOSUR Trade Commission.

Precision: In contrast to NAFTA, MERCOSUR features only a moderate level of precision. The basis of MERCOSUR is the Treaty of Asunción amended by the Protocols of Brasilia, Ouro Preto and Olivos. These are complemented by Decisions of the Council of the Common Market, Resolutions of the Common Market Group and Directives of the MERCOSUR Trade Commission. The Treaty of Asunción itself is very general and lacks concrete regulations. The aforementioned protocols and

¹⁶ The numbers are taken from the World Development Indicators of the World Bank, <http://ddp-ext.worldbank.org/ext/DDPQQ/member.do?method=getMembers&userid=1&queryId=135>, 26/5/2009.

¹⁷ WTO International Trade Statistics 2008: World Trade Developments in 2007, http://www.wto.org/english/res_e/statis_e/its2008_e/its08_world_trade_dev_e.pdf, 30/12/2008.

legal acts are more precise, but they clearly fall short of the several volumes of the NAFTA treaty. Besides, the institutional organs of MERCOSUR approve, on average, 120 decisions, resolutions and directives each year. These legal acts deal with every aspect of MERCOSUR, ranging in diversity from its institutional design, common external tariff, investment, technical barriers to trade, safeguard measures or environmental protection. Accordingly, like the EU, the legal framework of MERCOSUR is still evolving through its protocols, decisions, resolutions and directives and is eventually becoming more and more precise. Nevertheless, to date, the precision of MERCOSUR's legislation is far lower than in the EU and NAFTA. This low precision gives judges an important interpretative and rulemaking role in the regional integration process.

Obligation: Like in the NAFTA, the aversion of the South American States against supranational legislation is reflected in the moderate obligation of MERCOSUR's legal framework. In principle, the legal sources of MERCOSUR are the Treaty of Asunción, the protocols, and the various decisions and resolutions of the different organs. The legal acts are directly binding for the member states, but not for legal or natural persons. The legal acts only gain effect as soon as they are integrated in the particular national law, inasmuch as it is necessary in the particular nation state. The prevailing opinion is that the member states have to incorporate the legal acts in case there is no corresponding national provision for them in the respective member state. As a result of the implementation of regional rules by national law, there is no supremacy or direct effect of MERCOSUR rules. Further, it is noteworthy that a distinction in primary and secondary legislation, as in the European Union, is not applicable, because there is no hierarchy between the different legal sources (Tramón 2006: 73 ff). Therefore, the legal acts of the institutional organs are not inferior to the Treaty of Asunción, and the different protocols and the legal acts of the institutional organs can revise the treaty. Because the legal acts of MERCOSUR are not directly applicable and are not superior to national rules as in the European Union, the obligation is similar to the NAFTA treaties and can be stated as moderate.

Delegation: Due to the establishment of a Permanent Review Court with the Protocol of Olivos, the degree of delegation has clearly increased and is to be

regarded as high today. Although the dispute settlement system is aimed essentially at resolving disputes between MERCOSUR's member states, it also provides for the possibility of complaints by private parties. The procedure for private litigants allows submission of a claim to the National Section of the Common Market Group of the individual's residence or business domicile. The National Section decides on the basis of evidence by the litigant whether the claim is acceptable or not. Hence, in principle, the claim is dependent on the political will of the nation states and can be delayed by them. Nevertheless, at least two claims by privates were settled before a MERCOSUR ad-hoc tribunal.¹⁸ Concerning the independence of the dispute settlement mechanism, one has to distinguish between the ad-hoc panels and the Permanent Review Court. The ad-hoc tribunals are set up by the member states on a case-by-case basis. Therefore, three arbitrators are selected from a list, previously designated by each member state. Each member state appoints one arbitrator, whereas the third arbitrator is from a non-involved member state, and is chosen by mutual agreement and chairs the tribunal. In contrast, the Permanent Review Court is composed of five permanent arbitrators. Each state designates an arbitrator for a term of two years, renewable for two consecutive terms. The fifth arbitrator is appointed by mutual agreement of the members for a term of three years, not renewable unless all the members agree otherwise. The composition of the Permanent Review Court in a particular case varies with the number of members involved in the dispute. If two member states are involved, the court has three arbitrators, but if more than two states are parties to the dispute, the court consists of four arbitrators and the chairperson. Due to the composition of the Permanent Review Court, MERCOSUR's dispute settlement mechanism is more independent than that of NAFTA, and delegation can be evaluated as high.

The basic hypothesis of the legalization concept is that the potential for judicial integration is strong if precision is low, whereas obligation and delegation are high (Abbott 2000). The preceding section showed that MERCOSUR features a medium

¹⁸ Laudo del Tribunal Arbitral *Ad Hoc* del MERCOSUR, constituido para entender en la controversia presentada por la República Argentina a la República Federativa del Brasil para decidir sobre 'Subsidios a la producción y exportación de carne de cerdo'

Laudo del Tribunal Arbitral *Ad Hoc* del MERCOSUR, constituido para entender en la controversia presentada por la República Oriental del Uruguay a la República Federativa del Brasil para decidir sobre 'Medidas discriminatorias y restrictivas al comercio de tabaco y productos derivados del tabaco'

level of precision, a medium level of obligation and a high level of delegation. Hence, one should observe a relatively high level of judicial integration within MERCOSUR. When the institutional rules of dispute settlement mechanisms are the most important factors behind judicial integration, we should be able to observe more judicial integration within MERCOSUR than within NAFTA, because precision is lower and delegation is higher within the former.

4.2 The Establishment of Consistent Case Law in MERCOSUR's Dispute Settlement Mechanism

In contrast to NAFTA, the dispute settlement system in MERCOSUR is rarely used. During the 15 years of formal dispute settlement within MERCOSUR, only 13 different disputes have been arbitrated. On the one hand, this is due to the fact that the South American States are traditionally reluctant to solve their disputes in front of a court and prefer to settle them in an informal way and by direct negotiations (Cárdenas and Tempesta 2001: 346). But on the other hand, the low economic interdependence between the member states certainly has an impact on the limited number of disputes. Because of the small number of cases and the different ad-hoc tribunals, the establishment of consistent case law within MERCOSUR seems at first sight to be unlikely. Nevertheless, the first award of an ad-hoc tribunal has evolved into a true 'leading case' for MERCOSUR (Cárdenas and Tempesta 2001: 347).

The first MERCOSUR arbitration tribunal (Tribunal Arbitral Ad Hoc del MERCOSUR) examined a claim from Argentina against Brazil concerning the imposition of non-tariff barriers on bilateral trade.¹⁹ Argentina objected the incompatibility of several Communiqués, which were issued by Brazil, with the Treaty of Asunción²⁰ and with Decisions of the Common Market Council. It was argued that those Communiqués harmed access to the Brazilian market, causing insecurity and

¹⁹ Laudo del Tribunal Arbitral *Ad Hoc* del MERCOSUR, constituido para entender en la controversia presentada por la República Argentina a la República Federativa del Brasil para decidir sobre 'Comunicados Nº 37 del 17 de diciembre de 1997 y Nº 7 del 20 de febrero de 1998 del Departamento de operaciones de comercio exterior (DECEX) de la Secretaría de Comercio Exterior (SECEX): aplicación de medidas restrictivas al comercio recíproco' in: LAUDOS, ACLARACIONES Y OPINIONES CONSULTIVAS DE LOS TRIBUNALES DEL MERCOSUR

²⁰ Annex I of the Treaty of Asunción contains the so called 'Trade Liberalization Program'. In this program the member states commit themselves to the elimination of non-tariff barriers.

uncertainty to exporters and creating a non-tariff trade barrier. Brazil defended the claim arguing that the commitment to eliminate non-tariff barriers went hand in hand with the attainment of the Common Market (Cárdenas and Tempesta 2001: 349). Since the common market was postponed, the commitment to lift non-tariff barriers was invalid. The ad-hoc tribunal had to examine what consequences the delay of the common market had on the regulatory framework of MERCOSUR. The tribunal decided that the integration process is incompatible with member states' unilateral measures (Laudo 1, Paragraph 62, own translation). Further, it was asserted that the Annexes I, II and IV of the Treaty of Asunción contain 'concrete and self-executing obligations', and that these obligations are related to MERCOSUR's core issues, trade liberalization, rules of origin and safeguards (Laudo 1, Paragraph 66). Therefore, the ad-hoc tribunal confirmed the commitment of the member states to lift non-tariff trade barriers and decided in most aspects in favour of Argentina. Brazil immediately announced the withdrawal of the respective Communiqués.

The third ad hoc tribunal of MERCOSUR had to decide on a dispute between Argentina and Brazil concerning the application of safeguard measures on cotton textiles from Brazil.²¹ Like the claim mentioned before, the third ad-hoc tribunal had to decide whether the delay of the common market legitimates the application of safeguard measures. The third ad-hoc tribunal made explicit reference to the first ad-hoc tribunal and confirmed the proposed norms. The same accounts for the fourth and sixth ad hoc tribunals and the first award of the Permanent Review Court. In these cases, the tribunals had – among other things – to decide on the elimination of non-tariff barriers and made reference to the award issued by the first ad-hoc tribunal (Tramón 2006: 53). All these different tribunals consistently decided in favour of further trade liberalisation – a result, which one would not expect from the ruling of the respective national courts. Thus, although the rulings surely did not have the same impact as the famous Cassis-de-Dijon judgement of the ECJ (Alter and Meunier-Aitsahalia 1994), a new regional norm regarding the abolition of non-tariff trade barriers was developed within the MERCOSUR dispute settlement mechanism.

²¹ Laudo del Tribunal Arbitral *Ad Hoc* del MERCOSUR, constituido para entender en la controversia presentada por la República Federativa del Brasil a la República Argentina para decidir sobre 'Aplicación de medidas de salvaguardia sobre productos textiles (RES. 861/99) del Ministerio de Economía y Obras y Servicios Públicos'

In comparison to NAFTA, it should be noted that only examples of the development of consistent case-law can be examined in MERCOSUR. This is certainly due to the small number of cases within MERCOSUR, which prevents the different tribunals and the Permanent Review Court from using their available discretion and pushing judicial integration even further. This empirical finding stands in contrast to the hypothesis of the legalisation concept. We did not observe a higher level of judicial integration within MERCOSUR, but a significantly smaller level than in NAFTA. Thus, the development of case law not only needs a legalised system of dispute settlement, but rather litigants who push judicial integration forward. The relatively small economic interdependence in MERCOSUR leads to the fact that there are fewer transnational disputes and litigants before the MERCOSUR dispute settlement mechanism. Thus, even though the legal framework of MERCOSUR is favourable for judicial integration, the limited interaction between economic demands and legal rules prevents the progression of judicial integration to a higher pace and extent.

5. Conclusion

The analysis of dispute settlement in NAFTA and MERCOSUR demonstrates that judicial integration defined as the establishment of regional norms by courts or court-like bodies is not only a European, but a much more general phenomenon. In both cases, NAFTA and MERCOSUR, the tribunals of the dispute settlement mechanisms developed consistent case law when they were confronted with similar claims, even when such *stare decisis* is explicitly ruled out as in the case of NAFTA. The reason behind this is that the different tribunals need to legitimise their decisions before the member states. Because they cannot refer back to a regional executive power in order to reinforce their decisions, they need the acceptance of the member states in order for these to implement the judgements. Arguably, such acceptance by the member states is most likely if the decisions of the dispute settlement bodies seem to be fair, i.e. that no member state is favoured against the other. This necessarily leads to consistent case law, because the tribunals need to treat similar cases in the same way. As a result, regional norms emerge, which feed back on the

integration process. Of course, in both NAFTA and MERCOSUR, judicial integration is not as strong as in the EU, where the ECJ established the doctrines of direct effect and supremacy of EU law. Compared to this, the impact of the observed case law in NAFTA and MERCOSUR is much lower and does not imply the same constitutionalising effects. However, the case law of NAFTA and MERCOSUR still has some impact on the respective regional integration processes, and consequently, judicial integration seems to be a rather general phenomenon, which regularly occurs if regional integration projects are legalised, and if the respective dispute mechanisms are used.

Table 2: Dispute Settlement in NAFTA, MERCOSUR and EU

	NAFTA	MERCOSUR	EU
Precision	High	Moderate	High
Obligation	Moderate	Moderate	High
Delegation	Low	High	High
Interdependence	High	Low	High
Number of Cases	More than 100	13	High
Judicial Integration	Moderate	Low	High

Another conclusion to be drawn from the two case studies is that the institutional rules of dispute settlement mechanisms alone do not determine the pace and extent of judicial integration. Economic interdependence within the region seems to be at least as important as the extent of legalisation. Without such independence, there would be no transnational conflicts, which would then lead to claims before the dispute settlement bodies. And without such claims, the respective tribunals need not and cannot develop consistent case law. This is clearly observable in the comparison of the two cases. The legal rules of MERCOSUR are more in favour of judicial integration than those of NAFTA, because delegation in MERCOSUR is high and precision is moderate, whereas it is the other way round in NAFTA (for a summary see table 2). This could be used by the MERCOSUR tribunals to develop case law within the wide margins left by imprecise legislation, whereas less independent

tribunals in NAFTA are more constrained by the extensive treaties. However, due to low economic interdependence, the MERCOSUR dispute settlement mechanism has been confronted with very few claims, which means that it has only had the chance to develop one string of consistent case law. In contrast, the NAFTA dispute settlement mechanisms have been confronted with more than 50 cases each, which have provided more opportunities for developing consistent case law. Thus, judicial integration is a complex phenomenon which results from the interaction of two different factors, namely legalisation and interdependence.

This finding concerning the importance of both legal rules and economic interdependence within the respective region illustrates the value of comparison in regional integration studies. If one analyses only the EU, one is not able to weigh the relative importance of these factors. As table 2 demonstrates, both legal rules of the EU and economic interdependence within the Single Market point to the direction of high judicial integration. Thus, the strength and importance of the ECJ comes as no surprise, but it is not necessary to weigh the different factors against each other, because they point in the same direction. Only if one includes additional cases – like NAFTA and MERCOSUR – in the analysis does variance emerge, which allows for the analysis of the relationship of different factors with each other. In NAFTA and MERCOSUR, the legal frameworks and economic interdependence within the respective regions point in different directions in their prediction of judicial integration. Because more judicial integration takes place in NAFTA than in MERCOSUR, such a comparison allows one to conclude that economic interdependence within the respective region seems to be at least as important for judicial integration as the legal framework of the regional integration project. Such a conclusion could not have been drawn from the exclusive analysis of the prominent case of the ECJ.

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