

The MERCOSUR Dispute Settlement System:
A Possible Model for NAFTA?

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I. INTRODUCTION

The North American Free Trade Agreement (NAFTA) dispute resolution system has been inadequate in four major areas. These inadequacies hinder any possibility the system has to function efficiently. The flawed components are regarding procedural time limitations, power-base, panel composition, and system credibility. The Mercado de Comercio del Sur (MERCOSUR), on the other hand, has demonstrated it possesses these four key components that allow it to conduct effective conflict resolution. These components are an imperative function in all resolution mechanisms of multilateral agreements. The objective of this investigation is to examine the dispute settlement system of MERCOSUR and evaluate it as a model for NAFTA. While most critics agree that any macro comparison of MERCOSUR and NAFTA might be problematic, due to inherent differences within the two regional agreements, it is clear that the dispute resolution components within the two systems are comparable. These are common elements found in all regional dispute resolution systems, therefore, making them acceptable for evaluation. The MERCOSUR dispute settlement system can act as a model for the NAFTA mechanism in the areas of time restraints, authority, panel composition, and system credibility.

NAFTA and MERCOSUR are the prominent economic agreements in North and South America, respectively. MERCOSUR began on March 26th, 1991, in accordance to the signing of the Treaty of Asuncion. The association by its member's Argentina, Brazil, Paraguay and Uruguay has propelled them to be the third largest economic bloc in the world. Representing a combined annual GDP of nearly 1 trillion dollars, 52 % of the

entire GDP of Latin America, it is becoming a strong player in global economics. The NAFTA was signed in 1992, but did not go into force until the first of January 1994. The United States, Canada, and Mexico have signed the agreement that plans to eliminate all tariffs on goods and services by the year 2009. By this time the region will be housing 360 million people with an economic output of 6 trillion dollars a year, making it the largest free trade area in the world.¹ Investigation of the MERCOSUR region was conducted directly during a three-week trip to Montevideo, Uruguay and Sao Paulo, Brazil. The methodology included research at the Mercosur Administrative Secretariat, personal interviews with officials within the market, and reviews of literature from the United States and the MERCOSUR countries. Research of the NAFTA system was done primarily through literature within the United States.

¹ Heritage Organization. *NAFTA: Reagan's Vision*. November 14, 2000. <www.heritage.org/libtary/categories/trade/em371.html>.

II. DIFFICULTIES IN MARKET COMPARABILITY

While most critics agree that any macro comparison of MERCOSUR and NAFTA might be problematic, due to inherent differences within the two regional agreements, it is clear that the dispute resolution components within the two systems are comparable. The four components are commonly found in all regional dispute resolution systems, therefore, making them acceptable for evaluation.

MERCOSUR consists of four developing countries that wish to adopt a full-scale common market with integrated commercial policies.² Even though the member-states have given the market an extensive institutional framework, their intentions strive for the entities to act through political cooperation. Decisions are agreed upon by consensus, and each state is responsible for the incorporation of them into their own national legislative systems. This political arrangement is important because the market lacks a supranational governing body.³ As a result, the region must have an effective dispute resolution mechanism to adjudicate cases marred by political breakdowns or inconsistencies.⁴

² The primary objectives of the common market are: a) 'expansion of their domestic markets, through integration is a vital prerequisite for accelerating their processes of economic development with social justice'; b) 'this objective must be achieved by making optimum use of the available resources, preserving the environment, improving physical skills, coordinating macroeconomic policies and encouraging complementarity between the different sectors of the economy, based on the principles of gradualism, flexibility, and balance; c) 'to promote the scientific and technological development of the States Parties and to modernize their economies in order to expand the supply and improve the quality of available goods and services, with a view to enhancing the living conditions of their populations.' See Charles Chatterjee, *The Treaty of Asuncion: An Analysis*, 26 J. WORLD TRADE 63, 64 (1992).

³ Under the Protocol of Ouro Preto, discussions must be held to debate the possibility of a supranational court before the year 2006.

⁴ Cherie O'Neal Taylor, *Dispute Resolution as a Catalyst for Economic Integration and an Agent for Deepening Integration: NAFTA & MERCOSUR?*, 17 NW J. INT'L L. & BUS. 850, 868-869 (1996).

The members of NAFTA, on the other hand, are in a very different situation. Two of the three members, the United States and Canada, enjoy the status of industrialized nations with very healthy economies. Naturally, NAFTA has divergent integration goals from their South American counterpart.⁵ It strives to provide nothing more than a free trade zone within its territory. The main focus is to remain consistent with the policies of the General Agreement of Trade & Tariffs (GATT) by the reduction and eventual elimination of all trade barriers. This approach does not necessitate any sort of institutional or supranational governing body. It only requires that countries and their agencies stay within the guidelines set by agreement of free trade.⁶ As a result, the NAFTA mechanism for dispute resolution does not require great authority.

Conducting a broad comparative study of these two mechanisms can be complicated. The inherent differences are indicated in the titles of both organizations. As defined, MERCOSUR is a “mercado” or “market”. It mandates considerable involvement by its members to create a uniform institution with a codified set of national laws. NAFTA, on the other hand, is defined as an “agreement”. It strives solely to create a free trade zone within its members. One could argue that these differences make them incompatible for discussion. The author Thomas O’Keefe rejects their incompatibility in a study of both integrated regions. He concludes, “Despite the seeming incompatibilities in goals between the NAFTA and MERCOSUR, the tangible results that both economic integration programs will achieve by the turn of the century, make them more similar

⁵ The stated objectives of the NAFTA are found in Article 102 and include: 1) the elimination of both tariff (Article 302) and non-tariff (Article 309) barriers to trade in, and facilitate the cross border movement of, goods and services between the member states; 2) the promotion of fair competition within the free trade area; 3) increasing investment opportunities; and 4) the provision of adequate and effective protection and enforcement of intellectual property rights. See North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., arts. 102, 302 & 309, 32 I.L.M. 289 (1993).

than different.”⁷ A comparison is possible if one looks at individual components within the dispute resolution system. Elements such as time limits, power base, neutrality, and credibility are common areas in all mechanisms of resolution. These specific components have been found to be successful in MERCOSUR and deficient in NAFTA.

⁶ O’Neal Taylor, *supra* note 4, at 863-866.

⁷ Thomas Andrew O’Keefe, Esq., *Potential Conflict Areas in any Future Negotiations between MERCOSUR & the NAFTA to Create a Free Trade Area of the Americas*, 14 ARIZ. J. INT’L & COMP. L. 305, 318 (1997).

III. BACKGROUND ON MERCOSUR

A. Structure of the Integrated Market

In the last month of the year 1994, the signatory countries met in Ouro Preto to draft an addition to the Treaty of Asuncion. The result was the Protocol of Ouro Preto, which gives the common market area structural integrity and legal international jurisdiction. It specifically outlines the institutional structure of its organs. The protocol designates the Common Market Council (CMC) as the supreme body of MERCOSUR. This group consists of the Ministers of Foreign Relations and Ministers of Finance from all four member-states. In addition, it is foreseen that the Presidents of the respective members will play a participatory role in the Council. Beneath them is the executive organ of MERCOSUR known as the Common Market Group (GMC). The Protocol of Ouro Preto states the obligation for the GMC to be composed of four primary officials and four alternates from each member-state. Within this group of eight persons, there must at all times be a representative of the Ministry of Foreign Relations, Ministry of Finance, and the Central Bank. The GMC's responsibilities are to monitor the compliance of the treaty, impose decisions of the CMC, oversee a liberalization of trade program, and to form sub-groups to resolve issues within the market. The Mercosur Administrative Secretariat (SAM) located in Montevideo, Uruguay, assists the GMC in all matters. The final major structural body in MERCOSUR has the supervisory and enforcement duties of trade relations. It is called the Market Commerce Committee (CCM).⁸

⁸ U.S. Department of Commerce. *MERCOSUR*. June 6th, 1999. <<http://www.mac.gov/ola/mercosur/mgi/struct.htm>>.

B. The Structure of MERCOSUR's Dispute Resolution Mechanism

On December 17th, 1991, MERCOSUR's dispute resolution procedures were drafted in the Protocol of Brasilia. The Protocol outlines the process of resolving a conflict between signatory countries. The complaining and defending parties must hold direct negotiations to discuss the dispute within 15 days of the initial complaint. If no resolution is reached, the matter is then referred to the GMC for discussion. After 30 days, failure to reach an agreement requires the formation of an arbitrary tribunal to hear the case. The tribunal consists of three members. Each conflicted party selects one member and the third is designated by the Secretariat and must be from a neutral state (not necessarily from a MERCOSUR country). The neutral arbitrator acts as the presiding member of the panel. All arbitrators are selected from an existing roster submitted by each state at the inception of the treaty. The tribunal must pass a judgment within a 60-day period, with the possibility for an additional 30-day extension. The decision reached must be in accordance to the Treaty of Asuncion, other pertinent trade agreements, CMC decisions, GMC resolutions, CCM directives, and international law standards.⁹

C. History of Arbitration Panels

The arbitration tribunal has been effective in the three cases that it has heard since its creation. In 1998, the first case reached the panel stage after a conflict arose between Argentina and Brazil. A three-member panel, headed by the Uruguayan Dr. Juan Carlos

⁹ No author. *MERCOSUR*. September 19, 2000. <<http://www.mercosur.org/english/default.htm>>.

Blanco, investigated Argentina's claim that Brazil's application of restrictive measures affected open exchange of goods. The arbitrators ruled in Argentina's favor, granting that the measures violated the agreement of gradual elimination of tariffs. Brazil complied immediately with the ruling.¹⁰

The second ad hoc tribunal formed after Argentina and Brazil failed to reach a solution over product subsidies. The conflict began due to various subsidies given by the Brazilian Government to the production and exportation of pork products. An Argentinean Dr. Atilio Anibal Alterini and a Brazilian Dr. Luiz Olavo Baptista formed a tribunal. The neutral and presiding member was Dr. Jorge Peirano Basso of Uruguay. Argentina claimed that the pork product subsidies violated MERCOSUR Decision 10/94, which directly attempts to equalize the application and practice of export incentives of its member-states. They also emphasized the inability of Argentinean products to compete in the Brazilian market. Brazil defended its position by stating its programs did not violate Decision 10/94. They claimed their subsidies were a production incentive and had no effect on exports. The panel agreed with this claim and ruled in partial favor of Brazil. The decision by the arbitrators, on the 27th of September of 1999, addressed the need for Brazil to only change one specific program of export financing. Once again, Brazil complied in full to the panel's decision.¹¹

The last tribunal decision took place earlier this year, after yet another conflict between Brazil and Argentina. In this occasion, Brazil claimed that Argentina's Ministry of Economy violated the free trade agreement with its Resolution 861/99. Argentina had designed the resolution as a safeguard clause for trade. However, Brazil contested that it

¹⁰ MERCOSUR. 'Official Page'. October 12, 2000. <<http://www.mercosur.org.uy/pagina1esp.htm>>.

established yearly quotas on its textiles. Argentina defended its position by stating there was no conflict with MERCOSUR normative. Consequently, they claimed it could not be disputed through the resolution process. The tribunal, headed by Dr. Gary N. Horlick of the United States, ruled in favor of Brazil. They cited the Treaty of Asuncion's Annex IV, Articles 1 and 5, in saying that there exists a general prohibition over the application of safeguard quotas to the internal trade of MERCOSUR.¹² The first three cases to reach arbitration have given the MERCOSUR dispute resolution mechanism an outstanding report card.

¹¹ See *id.* at /paginaesp.htm.

¹² See *id.* at /paginaesp.htm.

IV. BACKGROUND ON NAFTA

A. Structure of the Integrated Market

The institutional framework of NAFTA is outlined in Chapters 18 and 20 of the agreement. Chapter 20 sets up the majority of the structure. The central institution is the Free Trade Commission. It is composed of cabinet-level officials from the three member-states. The parties represent the Canadian Ministry of International Trade, American Trade Representative, and the Mexican Secretariat of Commerce and Industrial Development. The main responsibility of the Commission is to supervise the implementation of the agreement. This occurs through oversight of over thirty NAFTA Committees, Working Groups, and other subsidiary bodies. The NAFTA Secretariat provides assistance to the Commission. It is comprised of national sections in each signatory country. The Secretariat is responsible for the administrative duties of the agreement, specifically in regards to the dispute settlement system. Chapter 18 of the agreement, states general administrative policy on such issues as due process requirements and contact points between nations regarding communication.¹³ This is the basic institutional structure as stated in the North American Free Trade Agreement.

B. Structure of the NAFTA Dispute Settlement System

The NAFTA systems of dispute resolution are found in Chapters 11, 14, 19, and 20. The most extensive mechanism is outlined in Chapter 20. It oversees disputes arising over the interpretation and application of the free trade agreement. In Chapter 20,

¹³ Trakman, Leon E. *Dispute Settlement Under NAFTA: Manual and Sourcebook*. New York: Transnational Publishers, 1997. (pp.7-9)

there are three steps that discuss resolution procedures. Step one encourages the parties to make every attempt to reach a mutual satisfactory solution through consultation. It allows a maximum 45-day period for this consultation. Step two directs the conflict to the Free Trade Commission for discussion. The Commission has a limited amount of resolution techniques it can employ to assist the parties involved. The time limitation for this step is 30 days. Step three would then establish an arbitrary panel to hear the case. Panel reports are considered non-binding, irrelevant to domestic law, and cannot be enforced by domestic courts. Guidelines require a panel to be selected and a final report made in a maximum of 150 days after the arbitration request.¹⁴

Chapter 19 of the agreement does not conform to Chapter 20 rules. It details the procedures of panel review in conflicts regarding Anti-Dumping and Counter-Vailing Duties (AD/CVD). The panel is to substitute domestic judicial review and has the authority of final determination in AD/CVD conflicts. All decisions must be made within 315 days of the arbitration request. Decisions are appealable to the Extraordinary Challenge Committee (EEC). The EEC was not seen as a capable appellate body, and therefore has limited power to overturn panel decisions. The Committee can legally overturn a decision only if misconduct by one of the Parties can be proven.¹⁵ Chapter 11 of NAFTA is the mechanism for all investment disputes. Its main objective is to establish equal treatment among investors with international reciprocity, and due process through impartial arbitrary panels. The last mechanism for dispute resolution is Chapter 14. This chapter addresses all financial services and works in conjunction with the

¹⁴ See *id.* at 10-15.

¹⁵ Eric J. Pan, *Assessing the NAFTA Chapter 19 Binational Panel System: An Experiment in International Adjudication*. 40 HARV. INT'L J. 379, 386-387 (1999).

mechanisms in Chapter 20.¹⁶ Different sections of the agreement detail the various mechanisms for dispute resolution. The one common point in all is the ultimate procedural step of arbitrary panel review.

C. Arbitration Panels

The role of NAFTA arbitration panels has received mixed reviews over the past 7 years. One of the most contentious trade disputes to reach the panel stage is going on at this time. The 1994 agreement granted the American, Mexican, and Canadian trucking companies access to each other's territories. However, the United States has not allowed Mexican trucks onto its highways, citing poor safety of the foreign vehicles. Mexico contends that they are being denied access due to political pressure on the White House by the Teamsters Union. They proceeded to push the conflict to the NAFTA dispute settlement body. The panel has handed down a preliminary decision unanimously in favor of Mexico. On the surface this conflict appears to be resolved, however, the United States could deny access regardless of the panel decision. This case demonstrates the ability of NAFTA panels to reach a decision, but their lack of enforceability.

¹⁶ NAFTA. *Nafta Secretariat*. November 14, 2000. <www.nafta.sec.alena.org/english/index.html>.

V. USEFUL COMPONENTS OF MERCOSUR AND CORRESPONDING INADEQUACIES OF NAFTA

The MERCOSUR organization has four prominent elements that could serve in the improvement of other regional dispute resolution systems, such as NAFTA. First, the time limitations outlined in the conflict resolution mechanism are quite expeditious. A controversy takes a maximum of 45 days to reach an arbitration panel. The swiftness of this process is extremely important in international trade. A prolonged decision-making process could mean severe financial damage to the parties involved. Dr. Juan Carlos Blanco of Uruguay is an advocate of the time limits. He said, “In the first case we used the 60 days allotted, plus the optional 30. We did a very intense but rapid investigation. If the limits allowed a longer time frame, it could have taken a year, and that is too much for important cases that require an immediate solution.”¹⁷ Amazingly, MERCOSUR has the capability of forming a panel and adjudicating a case within 135 days of the initial complaint.

NAFTA time restraints, on the other hand, have encountered intense scrutiny from all parties involved. The conflicting parties and arbitrators have all criticized NAFTA’s time limits for being too slow. The Chapter 19 mechanism has routinely experienced these problems. Article 1904(14) demands all decisions be reached within a 315-day period.¹⁸ However, this policy implementation has not been successful. Of the active and completed cases through 1997 involving disputes with Mexico, more than eighty

¹⁷ Dr. Juan Carlos Blanco. Personal Interview. June 30th, 2000.

¹⁸ Michael S. Valihorer, *NAFTA Chapter 19 or the WTO Dispute Settlement Body*, 30 CASE W. RES. J. INT’L L. 447, 458 (1998).

percent of the cases have been postponed or suspended violating the 315-day rule. An example is the *Flat Coated Steel Products* case between the United States and Mexico. The decision was postponed three times by the binational arbitration panel. It was not made final until one year beyond the desired time limitation.¹⁹ This amount of time could be classified as a good length for an adjudicative body to reach any decision. It is clear, however, that these types of international trade disputes must receive more expedient attention. The MERCOSUR time restraint policies encourage the mechanism's quick movement to avoid stagnation. This fact does not jeopardize the thoroughness of the panel in conducting an investigation of the case.

Second, the MERCOSUR system of resolution of controversies is highly centralized. As a result, it grants the tribunals great freedom and authority. The Protocol of Brasilia, for example, allows the ad hoc panels the ability to dictate provisional relief to a complaining party in any situation it deems necessary. These provisions were created to combat "grave and irreparable" damages caused to the complaining party during the arbitration. The demands are irrefutable and must be complied with until a final agreement is reached. The ultimate decision given by the panels are considered final and binding. There exists no right to an appeal. The losing party does, however, have access to a clarification of the judgment and its compliance.²⁰ Some may label this process as authoritarian; however, it is highly effective because of its mixture of flexibility and forcefulness. The fact remains that the dispute settlement system of a multilateral trade agreement must have the power to rule and restore a peaceful environment.

¹⁹ Gustavo Vega Canovas, *Disciplining Anti-Dumping in North America: Is NAFTA Chapter Nineteen*

In contrast, the NAFTA dispute resolution system is decentralized with four separate chapters assigned to resolve different controversies. Each body has specific jurisdiction and limited power. Chapter 20 is the main body, however, its panel decisions are non-binding. The panels' primary objective is to issue recommendations to the disputants. They are designed to serve the NAFTA objective to remain GATT-oriented. Due to their non-binding nature, they are susceptible to non-compliance.²¹ The lack of authority in the NAFTA dispute settlement mechanism has created inefficiencies. The World Trade Organization (WTO) has been hearing most of the disputes in recent years. This is a direct result of the WTO having a stronger system in operation.²² The NAFTA methods for resolution of controversies clearly need to be amended. A general lack of authority has reached the crucial point where parties elect to take their conflicts for discussion in other forums. This limited power has yielded limited success. NAFTA would greatly benefit from a more centralized mechanism with larger jurisdiction given to its panels.

The third component that MERCOSUR boasts of is the cooperation and compliance demonstrated by the arbitrary tribunals in response to having a neutral member. The arbitrators from conflicting countries have displayed an excellent capability to work together. This is possibly one of the most important factors needed for successful arbitration. Dr. Horlick experienced this first hand as the neutral arbitrator in the third MERCOSUR ad hoc panel assembled. He said, "All of the parties and arbitrators were quite cooperative and worked very well, I was very impressed." He

Serving it Purpose, 14 ARIZ. J. INT'L & COMP. L. 479, 488 (1997).

²⁰ O'Neal Taylor, *supra* note 4, at 861.

²¹ U.S. Department of Commerce, *supra* note 8, at 856, 892.

continued to add, “Being from the United States and neutral was not a problem, on the contrary, it is was a benefit.”²³ The presence of a neutral arbitrator has shown to be very successful. This neutrality reduces the possibility of a biased decision. There exists an individual, with no conflict of interest, to act as an intermediary between the other panelists. Having a neutral third member assures a smoother adjudicative process and a more just decision.

The North American agreement cannot claim a cooperative atmosphere within its panels. NAFTA Chapter 19 has a very unique policy for its panel composition. The group must consist of five persons. Each side in the conflict assigns two members from pre-determined rosters, and both agree upon a fifth. If a common arbitrator is not found, a type of lottery is drawn where the winning party selects the last member outright.²⁴ Due to the fact that parties rarely agree on the last member, this selection process is designed to create natural bias in the arbitration. Three previous cases demonstrate this problem. The *Cement*, *Fresh Flowers*, and *Cookware* cases have all been abandoned following the withdrawal of panelists citing conflicts of interest. Even though procedures state a preference for judges or experts in international trade, many times attorneys will act as members in the binational panels. This creates a serious bias due to the fact the attorneys may have interests in decisions that would impact other issues they represent.²⁵ It is clear, the MERCOSUR mechanism for panel selection is superior in both theory and practice. There is a clear decrease of bias and increase of cooperation.

²² California Trade & Commerce Agency. *CTCA* > September 19, 2000. <www.commerce.ca.gov/international/nafta/Dispute.html>.

²³ Dr. Gary N. Horlick. Personal Interview. September 10, 2000.

²⁴ Michael S. Valihorer, *supra* note 18, at 459.

²⁵ Gustavo Vega Canovas, *supra* note 19, at 491.

Finally, an additional component that is formed from the market's efficiency is the credibility that the process of dispute resolution has achieved in its short nine-year history. Effective dispute resolution mechanisms are imperative in multilateral agreements due to the member's propensity to create conflict. This factor is exponential when it comes to such a concentrated economic relationship as is within MERCOSUR.²⁶ It is necessary for such a system to be endorsed by its users. A mutual relationship is created when an effective resolution process gives credibility, and credibility allows effective use. Dr. Blanco agreed by saying, "The system has advanced greatly, one can see a difference in credibility before and after the arbitrated cases. There has been great progress, and the countries are inclined to use the existing mechanism... they should take advantage of it even more."²⁷ Only three cases have been heard in arbitration, but their success has provided an endorsement for its resolution of controversy. This system allows MERCOSUR to function efficiently. For this fact alone, it is possibly one of the greatest components it possesses.

²⁶ Eric J. Pan, *supra* note 15, at 379.

²⁷ Dr. Juan Carlos Blanco, *supra* note 17.

VI. CONCLUSION

The MERCOSUR agreement can act as a model in the creation of economically-integrated regions around the world. It holds several elements that have proven effective for any dispute resolution system. Its time restraints urge quick and thorough resolutions. The authority the panel possesses gives their decision the ability to be fair and enforceable. Moreover, panel composition naturally alleviates bias and advocates cooperation. All these elements grant the system the credibility needed to become self-sufficient and effective.

This investigation is not meant to minimize the dispute resolution methods of NAFTA. Their inherent differences made them very difficult to compare. NAFTA consists of two developed nations, while MERCOSUR is made up entirely of developing states. Due to the fact that the objectives of each common market are different, they must have distinct systems to reach those goals. However, it is clear that individual elements within each mechanism are a standard of any resolution system. Regional agreements will benefit from studying the MERCOSUR dispute resolution mechanism. It does have something valuable to offer the world today and will continue to as it evolves into the role of a major player in global economics.

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