THE PATH TO CUSTOMS UNION:

THE EUROPEAN EXPERIENCE AND NORTH AMERICAN INTEGRATION

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For my parents

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ABSTRACT

This paper seeks to explore the possibility for the formation of a customs union between Canada, Mexico and the United States to enhance the economic recovery, increase the region's competitiveness and pave the way for a new chapter in U.S. foreign relations. The analysis is developed through a comparative regional study, which examines the European effort that culminated in the Treaty of Rome in 1957 and the completion of a customs union among the Six founding members in 1968. The purpose is not to replicate the European model, but rather to draw the most important themes and lessons from the European experience to help guide and inform North American integration.

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INTRODUCTION

In the first decade of the 21st century, the United States has come face to face with a crisis of legitimacy. Memories of the ostentatious unilateralism of the Bush administration still cause a stir, and as the wars in Iraq and Afghanistan come to an end, a restrained and more calculating superpower has emerged. However, the 2008 financial crisis and subsequent recession have not only dampened spirits, but also lead to serious questions about the future of the U.S. role in the world and its ability to remain pre-eminent. The Occupy Wall Street movement exemplifies this problem well; income inequality, a topic that was almost taboo, questions the sustainability of a political and economic system that has left so many disenfranchised. Furthermore, the Supreme Court ruling of *Citizens United*, giving corporations the status of people and money the equivalence of speech has paved the way for a system of campaign finance that seems more suited for a plutocracy than a democracy. All these domestic challenges serve to tarnish the image of the U.S. abroad and in doing so diminish the soft power that has made the U.S. so successful as a global leader.

Yet this is not the end, as crisis often leads to opportunity. The U.S. faces a crucial decision in the immediate future: to go on as it has until it is no longer that city upon a hill, or adapt to the changing realities of power and dominance, and transcend the self-imposed limits on its success.

The system itself has not failed, but its leaders have. They have failed to be innovative, imaginative, and daring, instead protecting the interests of the few over the prosperity of the many. Such resistance to change is at the heart of America’s current dilemma, and its resolution hinges on a critical choice. The question is no longer whether the U.S. chooses to be isolationist or a crusader, but rather whether it will learn to cooperate. Where this will be tested most is not in its relations with Europe, or the rising powers of India or China, but instead on its doorstep to the north and south. Canada and Mexico are the largest markets for U.S. exports, and also the largest suppliers of energy to the United States. The economic relationship between these three countries is the largest in the world, but since 2001 it has been severely neglected and has suffered as a result. The thickening of the border and protectionist policies has limited the North American economic relationship from realizing its full potential. President Obama's 'Buy America' provision in the 2009 jobs bill illustrates a strong lack of understanding of economic and trade patterns, and the all important production chains. The three economies are inextricably linked with roughly 75% of both Canadian and Mexican exports going to the U.S. market. If the U.S. market suffers, so do its neighbors.

In order to get out of the current slump the U.S. has to be bold. The first task is jump-starting the economy, which requires thinking beyond protectionist trade policies, bailouts and quantitative easing. The frustration on the street, the lamentations in the Sunday newspapers and the criticisms from academics far and wide stem from the same problem— the loss of U.S. economic strength. In order to rebuild the economy and restore the trust of its people, the U.S. needs to show that it can be a great leader once more, and the best place to start is in North America. If the U.S. cannot lead in its own region, then there is little hope that it can lead the world.

The North American Free Trade Agreement (NAFTA) has served its purpose. It drastically reduced trade and investment barriers between Canada, Mexico and the U.S., and quadrupled trade between them since 1994. It is time to move beyond NAFTA and ask what the future of this economic relationship should look like. Despite the anxiety that some have about deeper integration in North America, it is important to note that those who oppose more cooperation may be louder than others, but they are a distinct minority. In fact, opinion polls have shown that the publics of each of the three countries actually favor more economic integration, and also feel that the European Union (EU) is a good model to follow.[1]

A misunderstanding of what integration entails may explain some of the anxiety. Integration itself means many things, but this particular analysis addresses economic integration, that is, the process by which states form economic coalitions that lead to a partial movement towards free trade to secure benefits of a more open economy; economic integration develops in stages that require sacrifices in the degree of control a government has over its economic policy as integration progresses. In the first stage, governments retain a high degree of control, and the last stage is characterized by a significant pooling of sovereignty.

In *Theory of Economic Integration*, Bela Balassa neatly outlines the stages of economic integration; these categories are still used today in slightly adjusted form. Generally, the stages of integration proceed as follows: first states form a free trade area (FTA), eliminating tariffs between them; next is the formation of a customs union, which establishes a common external tariff (CET) to third countries; a common market then establishes the free flow of all factors of production (labor, capital, goods and services); and lastly an economic union entails the harmonization of economic policy, and often includes a monetary and fiscal union.[2] There is also the possibility of another stage, political union, or confederation, in which there is a significant amount of sovereignty pooling so that the individual states function as a single political unit.

1 Robert Pastor, *The North American Idea* (New York: Oxford University Press, 2011), 70-73.

2 EU documentation refers to the CET as the common customs tariff (CCT), both terms can be used interchangeably, but the CCT is often considered less politicized as it removes the word ‘external’, which implies a common external trade policy and possible infringement on sovereignty.

This 'stages' approach is conceptually informative, though it is worth noting that there can be substantial overlap between stages, and in some case, multiple stages can be achieved simultaneously.

Canada, Mexico and the U.S. already have a functioning free trade area, but it has some problems. The majority of its problems, contrary to popular thought, are not due to NAFTA but rather due to things that NAFTA did not address, such as security, labor mobility, social policy, and strong institutions to structure the future agenda and enforce the proper functioning of the agreement. Costly rules of origin procedures have also had a negative impact on the trade relationship, driving up transaction costs. The integration process in North America has been largely misguided, piece-meal and on a dual-bilateral basis, preventing a truly continental market from thriving. The challenges faced by Canada, Mexico and the U.S. are not restricted within their borders; food safety, drug trafficking, immigration, and environmental problems are but a few issues that do not recognize national boundaries. The time has arrived to think beyond NAFTA and develop a region that is competitive, dynamic, and fully equipped to lead the 21st century global marketplace.

If one begins with the assumption that integration is desired, the question that follows is what form should it take? The form is in turn influenced by the objectives—what are the motivating factors and goals to be achieved through the integration process? Given the status of the U.S. economy, the main objective should be improving the economic condition of the state, so that its citizens can enjoy a high standard of living and increased choice through open markets and freer trade. Since the greatest volume of U.S. trade is exchanged with its two neighbors, it seems logical to begin opening up and strengthening these vital relationships by moving toward the next stage of economic integration.

This paper seeks to explore the possibility for the formation of a customs union between Canada, Mexico and the United States to enhance the economic recovery, increase the region's competitiveness and pave the way for a new chapter in U.S. foreign relations. The customs union stage of integration is chosen because it represents a step, not a leap, towards greater integration. The idea of forming a common external tariff (CET) is by no means foreign to the literature on North American integration, but the majority of studies tend to exclude Mexico in the model, or limit their analysis to tariff harmonization without formalized arrangements or institutional changes.[3] Hufbauer and Schott have noted that a CET is not only feasible in North America, but also quite practical. In fact, there is already a high level of similarity between the U.S. and Canada's Most Favored Nation (MFN) tariffs, though Mexico has higher bound rates; however, MFN tariffs can be gradually reduced and harmonized. Estimates show that tariff harmonization and the elimination of compliance costs could lead to a 1% increase in GDP.[4] Furthermore, a CET would eliminate the burdensome rules of origins provisions, which add substantial record keeping and transaction costs to trade. Since barriers to trade between the three countries have already been vastly reduced through NAFTA, movement towards a customs union could help enhance the current economic relationship and gains from trade.

To decide whether the customs union could work in North America, it is pertinent to first look at other examples of customs unions that could lend insight to its application. Though there are a number of customs unions in operation today, such as the South African Customs Union

3 See Danielle Goldfarb, "The Road to Canada-U.S. Customs Union: Step-by-Step of in a Single Bound?" *The Border Papers*, C.D. Howe Institute Commentary, no. 194 (June 2003) http://www.cdhowe.org/the-road-to-a-canada-u-s-customs-union-step-by-step-or-in-a-single-bound/9794 (accessed February 2, 2012); Daniel Schwanen "A NAFTA Customs Union: Necessary Step or Distraction?" *International Journal* 60, no. 2 (Spring 2005): 399-406, http://www.jstor.org/stable/40204297 (accessed February 1, 2011); and Michael Hart and William Dymond, *Common Borders, Shared Destinies: Canada, the United States and Deepening Integration* (Ottawa: Centre for Trade Policy and Law, 2001).

4 Gary Clyde Hufbauer and Jeffrey J. Schott, *NAFTA Revisited: Achievements and Challenges* (Washington, DC: Institute for International Economics, 2005), 474.

(SACU), the East African Community (EAC), and the Common Market of the South (Mercosur), this study chooses to focus on the EU. There are a number of factors that influence this case selection. Though the EU as it stands today is not the optimal choice for North America to emulate (as will be discussed in detail below), there is still a great deal that can be learned from the European integration project, especially the early years of integration.

The original Six member states (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) are more similar in political culture and level of political and economic development with North America than the other customs unions.[5] This implies that the states will have similar methods for organizing economic and political life, institutions, shared customs, and legal systems that allow for the identification of changes or transformation in each of these and how they relate both within and outside the state. Second, the Six also combined economies that were large, internationally oriented, and highly industrialized. Power asymmetries also existed between the big two players, France and Germany, and the other member states.

This is important because North America is a highly industrialized, vast economic bloc, in which the asymmetry in power is marked. It is therefore important to understand how countries with large economies integrate with smaller economies, and how differences in power and influence shape the integration process. Furthermore, this helps to lend insight on how and why integration is initiated. The EU is also a useful model because it provides a laboratory; its processes are multidimensional and complex, and tracing the evolution of their development, as well as the successes and failures can allow for a better understanding of how integration

5 Please note that any pre-1990 references to Germany throughout the paper specifically refer to the Federal Republic of Germany.

functions in practice.[6] Moreover, it adds depth to understanding regional integration by highlighting the various actors, preferences, and institutions involved, providing a broader picture of the process; this in turn allows for key assumptions and lessons to be drawn from the European model.

The analysis is set in the comparative regional integration framework, and chooses to "compare cases in comparable logical moments or lapses of time" instead of "comparing different regionalization processes in the same historical moment or lapse of time."[7] As a result, this study will focus on European integration from the 1950s to the completion of the customs union in 1968. This is done to provide the best possible comparator to the integration process in North America, where the EU has not yet fully formed into the complex model it is today. This also prevents the common problem of treating the EU as *sui generis*, which eliminates any possibility for comparative study by overemphasizing the uniqueness of the European project.

In fact, European integration is most often explained as a process initiated because of a reaction to the horrors of two world wars that nearly destroyed the continent. Though this was a factor, it is questionable that it was the *main driver* of integration; if it was, then all countries (especially the United Kingdom) would have joined at the outset, and the competing European Free Trade Association (EFTA) would not have been established in 1960.[8] Other analyses stress changing preferences and the key leaders involved, but again these are parts of the explanation,

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6 Alex Warleigh-Lack and Ben Rosamond, "Across the EU Studies-New Regionalism Frontier: Invitation to Dialogue," *Journal of Common Market Studies* 48, no. 4 (September, 2010): 998, http://proxyau.wrlc.org/login?url=http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN=52904376&site=ehost-live (accessed February 1, 2012).

7 Philippe De Lombaerde, Fredrik Söderbaum, Luk Van Langenhove and Francis Baert, "Problems and Divides in Comparative Regionalism," in *Comparative Regional Integration: Europe and Beyond*, ed. Finn Laursen (Surrey: Ashgate, 2010), 25.

8 Walter Mattli, *The Logic of Regional Integration, Europe and Beyond* (Cambridge: Cambridge University Press, 1999), 5.

not the answer themselves. Thus the European integration process is a combination of political and economic factors that interact to produce specific policies. Since these processes occur in all forms of political organization at both the local, national and intergovernmental level, lessons from the European model can thus be generalized.

There are two leading schools of thought in comparative regionalism: first, classical integration theory, which is influenced by neo-liberal institutionalism and regime theory, which looks at the formal processes of integration, focusing on the interactions among states; second, the new regionalism attempts a more holistic approach and tries to understand the role of various actors, such as interest groups, business networks, non-governmental organizations, transnational corporations and everyday citizens.[9] It is important to note that the new regionalism grew from a movement in the 1980s to better understand European integration during the revitalization of the single market. Though this study will use new regionalism as a tool of analysis, it is clear that many analysts of the time period this study examines did not consider these effects or include them in their analysis. As a result, most of the research in the early years of European integration on the influence of actors beyond inter-state bargaining is quite limited, though there are indications of these processes at work.

There are a number of variables to consider when evaluating the process of regionalization. First it is important to understand why states join—is there a common interest, what are the objectives, what are the origins? Once a grouping is established and has a goal, the next step is to understand how it goes about implementing it, basically, how does the region function? Who is involved in the decision-making process, what is the structure of the

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9 For a detailed discussion of this see *Regionalization in a Globalizing World, A Comparative Perspective on Forms, Actors and Processes*, ed. Michael Schulz, Fredrik Söderbaum and Joakim Öjendal (London: Zed Books, 2001).

organization, what issues does it address, and does it have a mechanism to enforce compliance? As well, it is worth examining whether the region impacts socialization processes; is there popular support, cross-border interest group activity, epistemic communities, or a sense of community, is there a preference for joint problem solving? Lastly, the impact of regionalization must be assessed. What affect has it had on the domestic economy, the regional economy, on political relationships, and on third countries? Has it changed state behavior in the domestic, regional, and international arena? These factors all help to understand the various forces that shape integration projects, and lend insight into how the process of regionalization transforms preferences, attitudes and behavior.[10] Simply put, it helps explain why states integrate, how they do it, and what affect the process has on the states involved.

These questions will serve as the foundation for inquiry to help answer why the Europeans decided to create a customs union, how they negotiated the agreement, how they subsequently completed the customs union, and what costs and benefits they incurred from the project. The sum of these answers will help establish key themes in the European integration project, and what can be learned from the experience. Furthermore, it will be clear whether the European drive to complete the customs union can be replicated in North America, and what the challenges or concerns for such an endeavor would be. This is a valuable intellectual exercise as it not only sets out to better understand the processes of regional integration, but also seeks to apply them to a region that is in the early stages of development. Yet at the same time, North America is a region that, like the EU, is made up of various identities, a topic that Seymour

10 Alex Warleigh-Lack, "The EU in Comparative Perspective: Comparing the EU and NAFTA," in *Comparative Regional Integration: Europe and Beyond*, ed. Finn Laursen (Surrey: Ashgate, 2010), 46.

Martin Lipset and others have described at length.[11] Through all these identities, however, a common continental perspective does emerge, and it is this lens through which integration in North America will have to be viewed over time.

It is true that this would be a shift in U.S. foreign economic policy, as traditionally it has favored multilateral free trade over regional agreements. But as the U.S. learned with the 1965 Auto Pact, the 1987 Canada-U.S. Free Trade Agreement (CUSFTA) and NAFTA in 1994, regional free trade agreements have substantial trade creating effects because they often reduce barriers to trade much faster than at the international level. Furthermore, because Canada and Mexico are the largest markets for U.S. exports, reducing barriers to trade to the contiguous neighbors creates lower transportation and transaction costs, the possibilities for economies of scale, as well as more consumer choice.

The EU learned of the benefits from regionalization early on, as extra-EU exports and intra-EU imports tripled from 1958 to 1970. For a grouping of countries that had just been completely devastated economically by the most destructive war in history, this revitalization should not be taken lightly. The founding members of the EU were aware that either they could continue as they were, remain weak and lose their influence in the world, or they could adapt. Though the United States is nowhere near that level of economic collapse, it should not sit idly by and wait for it to happen before acting. The self-proclaimed sovereignty defenders will scoff at the idea of a more cooperative, compromising, and regionally innovative U.S., but this lies again at the heart of the current problem in U.S. domestic and foreign policy— the crisis of legitimacy. The U.S. has struggled with its place in the world since its founding, and somewhere along the road it forgot how to be a benevolent leader. In 1967, J. William Fulbright wrote,

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11 See Seymour Martin Lipset, *Continental Divide* (New York: Routledge, 1991) and Joel Garreau, *The Nine Nations of North America* (Boston: Houghton Mifflin, 1981).

> It may be…that America will succumb to becoming a traditional empire and will reign for a time over what must surely be a moral if not a physical wasteland, and then, like the great empires of the past, will decline or fall….But if I had to bet my money on what is going to happen, I would bet on this younger generation—this generation who reject the inhumanity of war in a poor and distant land, who reject the poverty and sham in their own country, this generation who are telling their elders what their elders ought to have known, that the price of empire is America's soul and that price is too high.[12]

America may remain the preeminent power in the world for some time, but that will not last forever, nor does it necessarily mean that the remainder of its time on top will positive. If the U.S. truly wants to repair its image abroad and become the leader of its rhetoric and aspirations, then it needs to prove once again, as it did after the Second World War, that its ideals and its system are worthy of emulation. In fact, America has "largely conquered not with tanks but blue jeans, Big Macs, and movies—and of course, the country's founding ideals."[13] Success is the measure of soft power, and currently, with an 8.3% unemployment rate, 1.5% real growth rate, and over $1 trillion in public debt, the country seems like the antithesis of success.

Clearly it is time to try something new. Regional integration may provide the solution to the both the economic and political problems the U.S. is suffering from, and as a result, it is worth examining this option. Lord Salisbury once wrote that "[the] commonest error in politics is sticking to the carcasses of dead policies," and states that have the capacity to adapt to and even anticipate the changing times will be on the receiving end of success, power and influence.[14] Regionalization has exploded in the post-Cold War era, and it is a trend in contemporary international relations that simply cannot be ignored. The U.S. took initial steps in this realm

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12 J. William Fulbright, "The Price of Empire," in *Political Thought in America: An Anthology*, 2nd ed., ed. Michael B. Levy (Prospect Heights: Waveland Press, 1988), 570-571.

13 Andrew Kohut and Bruce Stokes, *America Against the World* (New York: Henry Holt and Company, 2006), 64.

14 Martin Wight, *International Theory: The Three Traditions* (Leicester: Leicester University Press, 1991), 189-90.

often in protest to the slow pace of progress in multilateral trade talks, but now it has an opportunity with its neighbors to decide the pace, scope and depth of integration, and shaping it in a way that best benefits the U.S. in particular and North America in general. The destiny of this country since its founding has always been tied to its neighbors, and to this continent. It would be wise, therefore, to look not for the path at a distance, but the one that is laid before its feet.

CHAPTER 2

EUROPE AND THE CUSTOMS UNION ISSUE:
LAYING THE FOUNDATION FOR INTEGRATION

Integration has both economic and political motivations, and in the early stages of development, the European Union balanced both considerations in charting its path. To fully comprehend the EU today, it is imperative to investigate its origins. Why, in fact, did the Six founding members choose the form of integration that they did? What did they hope to achieve by this process and how did they intend to do it? These questions form the basis of inquiry into the origin of the idea of creating a customs union in Europe. Understanding where this idea came from can help build a better picture of what motivated this particular choice and how it gained salience among the Six. Furthermore, it begs the question as to what other alternatives to customs union were being considered, and why they did not make the final cut?

This section seeks to outline the origin of the customs union idea, the debates on integration that shaped the discussion, how the customs union was settled on, and its eventual adoption by the Six. The aim is to show the process of deliberations, bargaining and compromise that underscored this decision, as well as the key factors that influenced this particular choice. As well, the institutional set-up of the European Economic Community (EEC) will be considered, and the role it plays in fostering the Community's development. The multifarious factors that shaped the Community each had a unique role to play, but it was the initiative of the states, and certain individual actors that left their lasting impact on the direction of the integration project.

Experimenting with Customs Unions

The European Union has travelled a long and arduous path to achieve the complex form that it is today. The institutions, processes and people that make up its many parts have been shaped by old ideas that underwent revival and new ideas that responded to the challenges of the times. Despite recent economic setbacks, the EU remains the most successful and comprehensive integration project ever attempted. Though commentators are quick to make proclamations of the imminent 'demise of the EU' amidst the European debt crisis, there remains little evidence that this is the case. In fact, tracing the history of its development it is clear that the EU has remained resilient through numerous challenges, and claiming the current debt crisis as the 'be-all and end-all' of this dynamic organization of states is a gross overstatement.

The foundational document of the EU, the Treaty Establishing the European Economic Community (also referred to as the Treaty of Rome), is a testament to its triumph. Years of negotiations, failure, political posturing, and ultimately compromise, transformed the future of its six founding members. Article 9 states that the creation of a customs union is the basis for the establishment of the Community. It is well worth asking how this became the foundation of the EEC, and why this particular path was chosen. When, in fact, did the Six recognize the need for a customs union and what obstacles did they face in building consensus on this goal? Such an investigation will lead to a better understanding of the economic integration process as well as a deeper appreciation of the Six and their determination "to lay the foundations of an ever closer union among the peoples of Europe."[15]

15 "Treaty Establishing the European Economic Community," March 25, 1957, EUR-Lex, Access to European Law (1957), Article 11.

The idea of a customs union in Europe was not new when the foreign ministers of the Six discussed it at Messina in 1955; attempts at building customs unions in Europe stretch as far back as the late eighteenth and nineteenth century. The key motivation for lowering tariffs was to limit interference with trade and travel, but governments often resisted as tariffs provided an important source of revenue. Often, a single shipment could potentially cross a number of territories, facing duties and other obstacles to its final destination, making imports very expensive. The Habsburgs joined Austria and Hungary into a customs union in 1773 due to this very problem, and there were many similar projects in the British Isles and France as well. Germany is an interesting example because it was the only country in Western Europe that achieved economic unity before political unity through the establishment of the Zollverein in 1834, comprising of 18 German states. Its success encouraged others, like Italy, to attempt such a feat as well, hoping to transcend political divisions and expand the size of the market to compete with growing economic powers.[16] There were also larger attempts such as between France and Belgium in the 1840s, which ultimately failed due to political squabbling. The Austro-German customs union, which initially had high hopes for success, also failed in 1918 following the collapse of the Habsburg Empire. Academics were engaged in the customs union debate as well. In his 1890 article, "L'Union Douanière Européene," Count Paul de Leusse argued for an agricultural customs union between France and Germany, with a centralized tariff bureau in Frankfurt— an idea that was truly contemporary. Though it seemed like a good idea, customs unions in the 19th century, for the most part, only seemed to work within pre-existing empires.

The earliest success of the 20th century was the creation of the Belgium-Luxembourg Economic Union in 1921. Luxembourg had previously been part of the Zollverein, but wanted to

16 W.O. Henderson, *The Genesis of the Common Market* (Chicago: Quadrangle Books, 1962), 90.

end ties with Germany after the war and thus looked to France or Belgium for economic partnership. Given the size of Luxembourg compared to Belgium it was a rather easy feat to establish a customs union. Also, the fact that there were no provisions in the Treaty that ensured a common market for *all* factors of production, such as labor and capital, political discord was minimized and made the achievement of the customs union all the more simpler. The fact that both states also shared a common currency, the Belgian franc, made financial policy and payment transfers far less controversial as well. The Belgium-Luxembourg Economic Union was not seamless, however, and many disputes ensued over turnover taxes and excise duties. Despite this, the administrative organs were effective in bridging the gap and diffusing problems in many areas, which was a key reason for the union's success.[17]

The Benelux Economic Union, comprising of Belgium, Luxembourg and the Netherlands, was quite different from its inspirational predecessor. While in exile during the Second World War, leaders of the three governments drafted an agreement to build a customs union to aid with economic recovery after the war. This treaty was signed in 1944, before the countries were even liberated. The original intent of the Benelux was to remove customs duties, apply a common external tariff, harmonize rates of excise duties, remove quantitative restrictions to trade, and allow for the free movement of capital and labor. The key difference between the Benelux and the Belgium-Luxembourg Economic Union was that it was not a union between one large and one small member, but two relatively equal, and one small member. Such a union required considerable compromise and adjustment along the way, usually taking the form of endless ad hoc ministerial agreements. Fortunately, in the aftermath of the war customs duties were relatively easy to abolish, as tariffs had lost a great deal of meaning; many duties were

17 J.E. Meade, H.H. Liesner and S.J. Wells, *Case Studies in European Economic Union* (London: Oxford University Press, 1962), 57.

suspended to allow for price stability.[18] As a result, the customs union was completed within two and half years.

Though the customs union enjoyed rapid completion, issues remained in the unification of excise duties and turnover taxes and quantitative restrictions. The former was linked to balance of payments problems, because Belgium relied more on indirect taxation for budget revenue, whereas the Netherlands relied more on direct taxation; this naturally posed a problem in unifying tax rates because it would have either resulted in revenue loss for the Belgians, or the Dutch would be forced to shift to more indirect taxation. This problem persisted throughout the union's existence, and many politically sensitive products were highly protected. Removing quantitative restrictions on intra-Benelux trade was also a challenge, but eventually picked up speed in the 1950s and was largely successful in all areas accept agricultural products.

Establishing the common market was no simple task either, and it was never completed. There was a particular problem with the free movement of capital due to different financial policies of the three countries; the Dutch balance of payments problem only added to the complexity. There were very strong fears that capital would move from the deficit country, the Netherlands, to the surplus country, Belgium, and these fears were well founded. In fact, as capital controls were lifted, a substantial amount of capital movement from the Netherlands to the Belgium-Luxembourg Economic Union took place.[19] In a post-war economy one might also expect the free movement of labor to be taken advantage of; it would make sense for the growing Dutch population to look for work in the higher wage Belgian job market, but this was not the case.[20] In fact, the Dutch emigrated in far greater numbers to Canada, Australia and the United

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18 Ibid., 62.

19 Ibid., 176.

20 Ibid., 177.

States. The details on the free movement of labor were also not very clear at the outset, and governments used a permit system (similar to issuing visas), which many saw as cumbersome. To streamline the process, the Benelux developed the Treaty of Labor, which dealt with issues such as wage rates and equal treatment of workers, but it was not ratified until 1960.

It is worth noting that the Benelux also did not have supranational authority like the European Coal and Steel Community (ECSC) or the EEC after it. Instead, the three governments negotiated each and every issue at the ministerial level to reach agreement, which contributed to delays in a process that increasingly resembled patchwork. Three councils were established in the original 1944 treaty that dealt with customs duties, quantitative restrictions on imports and exports, and coordination of commercial treaties with third countries. The work for each council was completed under a number of committees made up of representatives from each country. In 1947 the process was reformed to include a steering committee known as the Board of Presidents that would help set the agenda, which was to be supported by a permanent secretariat. The Benelux underwent administrative reform again under the 1959 Treaty of Economic Union, which included more supranational institutions such as the Arbitral College, but overall, it retained its intergovernmental characteristics.

So why is this important to understanding the origins of the EEC? Simply put, the drive towards economic integration was not a new concept that emerged after WWII. In fact, the European continent has a long history of attempts at economic union, from the unification of territories within a state, the creation of economic empires, to economic cooperation among two or more sovereign nations. Each attempt varied in its goals, but the Benelux is especially important because it set a rough template for the EEC. The Benelux, unlike many other attempts at economic union, combined the goals of customs union and common market at the outset.

Experiments in establishing a customs union have both failed and succeeded, yet the idea remained deeply rooted in the European consciousness, experiencing a tremendous revival in the 1950s. What then were the causes for this revival?

An Idea Reborn and Reformed

To fully understand the cause for the revival of economic integration in the 1950s, one must look to the political impetus for this movement. Though the idea of European unity is deeply rooted in antiquity, this particular strand took hold in the inter-war period of the 20th century. In the aftermath of the Great War, scholars, philosophers and politicians began a serious search for a permanent peace in Europe. The *Pan-Europa* movement, led by Austro-Hungarian Count Richard Coudenhove-Kalergi, quickly gained ground; it was influenced not only by an aversion to war, but recognition of the growing power of the United States and the newly formed Soviet Union.[21] Thus, European integration has been driven not only by a desire for peace, but also for the preservation of the great powers of Europe. This is especially true in the immediate post-war years. When Churchill called for a 'United States of Europe' in a speech at the University of Zurich in 1946, his words echoed earlier calls of idealistic Pan-Europa. However, Churchill did not view European integration in the same way as many of its ardent followers. In fact, Churchill subscribed to the 'unionist' position on integration, which called for a European consultative assembly that would ultimately defer any decision-making capacity to a committee of government ministers. This was by no means a revolutionary shift in inter-state relations. In

21 Desmond Dinan, *Ever Closer Union: An Introduction to European Integration*, 2nd ed. (Boulder: Lynne Rienner Publishers, 1999), 12.

contrast, the ‘federalists’, like Altiero Spinelli (who played a role in the formation of the EEC), believed that a united Europe could be achieved through transcending traditional notions of sovereignty; the first task would be to create a constitution for the United States of Europe. This, however, did not come to pass, and the unionists succeeded in creating an institution with limited reach in 1949, the Council of Europe.

Jean Monnet, considered a father of European integration, was not enamored by the populist underpinnings of the European movement or the Council of Europe; he strongly believed in European unity, but through functional integration pushed for at the highest levels of government. To assist economic recovery in France after the war, President Charles de Gaulle charged Monnet to develop the French Modernization Plan; but it was the Marshall Plan, which set out to reconstruct Western Germany along with Western Europe that triggered an idea in Monnet’s mind that would revitalize the French economy.[22] France had already occupied the coal-rich Saar region of Germany and wanted to prevent the recovery of the industrial Ruhr valley out of fear that its revitalization would create a powerful and warmongering Germany yet again. Upon the formation of the Federal Republic of Germany in 1949, the International Ruhr Authority was established to oversee production in the industrial heartland. France was, however, only one of the powers in control of this new administrative institution, and furthermore, there were strict limits on steel production, which stifled optimal growth.

Monnet approached Prime Minister René Pleven and Foreign Minister Robert Schuman, proposing a supranational coal and steel community. Schuman immediately responded positively to the plan that would later bear his name. It was clear that success required approval of the French, German and U.S. governments, and thus they were each consulted on the proposal.

22 Ibid., 19.

Chancellor Adenauer strongly favored Franco-German reconciliation and jumped on the idea; Secretary of State Dean Acheson also supported the initiative, particularly because it was a European idea that both France and Germany were enthusiastic about. Britain, however, was absent from discussion on this proposal, and only found out about it after its public announcement; though invited to join in the ECSC, Britain preferred to stay out not only because of the original snub, but also because it was distrustful of the supranational nature of the organization. Schuman did open up membership to other countries, but it was clear at the outset that his (and Monnet's) conception of 'Europe' was restricted. The heart of integration was the Franco-German relationship, and the other European countries that would make up this dynamic project were Belgium, the Netherlands, Luxembourg and Italy. Such a balance would keep France and Germany as the engine of integration.

Monnet truly believed that integration of the coal and steel sectors would be the first step towards greater economic and political union through "an accretion of integrative efforts…in a sector-by-sector linkage of specific economic areas and activities," which would help develop a common market.[23] However, sectoral integration was challenged in the early 1950s with the failure of the European Defence Community (EDC). Monnet himself even admitted that the creation of a European Army was too large a task for the time; Europe needed more political and economic integration before taking such a giant leap in transcending one of the most fundamental pillars of state sovereignty.[24] Its failure, however, was still seen as a major blow to the sectoral approach, and other ideas for European unity again began to emerge.

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23 Derek W. Urwin, "The European Community: 1945 to 1985," in *European Union Politics*, ed. Michelle Cini (New York: Oxford University Press, 2004), 17.

24 Robert Bowie, interview by Francois Duchene, May 12, 1987, interview 020, transcript, European Oral History, The EUI Series of Interviews, Washington, D.C.

It was at this time that the idealistic rhetoric was lowered and the economic dimension began to gain greater ground. It was different from previous attempts in that it did not focus on specific sectors, but rather tried to establish a broad consensus of economic goals. First, national tariffs came to be seen as increasingly cumbersome in the post-war environment, slowing economic growth. Second, Western European states became progressively aware of West Germany's centrality to European trade and economic recovery, and needed to find a way to bind the country to its dependent markets to ensure stable growth. From 1873 to 1931, European states had actively and enthusiastically bargained with each other for lower tariff rates, and by 1931 tariffs became less important than other non-tariff barriers to trade such as quantitative restrictions.[25] The move towards the establishment of a customs union was thus largely influenced by the desire to eliminate quotas.

With the rapid growth of foreign trade beginning in the 1950s, there were numerous protectionist attempts on the part of European governments through non-tariff barrier regulation of the markets. This was based on a classical understanding of free trade, that suggests some trade restrictions are necessary to prevent comparative advantage from completely reallocating production; the modern argument suggests that the bigger the market, the greater large-scale production, fiercer competition and gains in productivity will result. The U.S. used the latter as its basis for encouraging the Europeans to aim for the creation of a single market along the lines of the United States.[26] State Department documentation on the U.S. position toward the European Recovery Plan also suggests that the U.S. favored the "[p]rogressive replacement of bilateral trading arrangements by more effective multilateral arrangements for expanding intra-

25 Alan S. Milward, *The European Rescue of the Nation-State* (Berkeley: University of California Press, 1992), 120.

26 Michelle Egan, e-mail message to author, March 8, 2012.

European trading, looking, if possible, toward an eventual European customs union."[27] Yet the Europeans remained skeptical. Even in previous attempts at economic union, history showed that economic cooperation did not always lead to perfect free trade, in fact, many barriers remained, and some sectors became very vocal for protectionism. Many also doubted that economic union would build greater political consensus, as even the economic success of the Zollverein did not prevent the outbreak of civil war in 1866. However, as foreign trade experienced a significant boom from 1954-57, reticence towards free trade underwent a shift, and for some countries, export led growth became a rallying cry.

Not yet a sovereign state until 1955, the Federal Republic of Germany exhibited tremendous economic strength in Europe. Its recovery was remarkable and it became starkly evident that Germany was the 'pivot' of West European trade.[28] Foreign trade between the ECSC partners grew at a faster rate than trade with other European countries; as well, the share of exports destined for the U.K. from the Six began to shrink (with the exception of Germany), a direct result of intra-ECSC trade. The Netherlands was most dependent on Germany, with its exports in 1957 to the FRG totaling 5.5% as a share of GNP.[29] Milward explains that "as far as the rate of growth of foreign trade is concerned Western Europe in the 1950s needed Germany even more than Germany needed Western Europe," and thus it was essential to bind Germany to the other states commercially, which in the end "gave increasing force to the idea of the customs

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27 U.S. Department of State, "Summary of the Department's Position on the Content of a European Recovery Plan," Harry S. Truman Library, Clifford Papers (August 26, 1947) http://www.trumanlibrary.org/whistlestop/study_collections/marshall/large/index.php?sortorder=category#Marshall%20Plan%20and%20Strategic%20Considerations%20of%20the%20United%20States (accessed March 15, 2012).

28 Milward, 167.

29 Ibid., 139, 167.

union."[30] With the disastrous failure of the European Defense Community (EDC), political integration, and more importantly, Monnet's idea of sectoral integration received declining support. Even Monnet's pet-project, the European Coal and Steel Community (ECSC) came to be seen as far too supranational and *dirigiste* by its member states who wanted a more liberal trading order.[31] Federalist arguments were becoming unpopular, and a compromise would need to be struck on the next stage of integration.

The Dutch, who had very strong commercial interests with Germany, began to champion the idea of a customs union as early as 1952, but their support for a customs union was not always constant. The French, in part due to pressure from the U.S., originally proposed to create a customs union between France and the Benelux in 1947 at the meeting of the Committee of European Economic Cooperation (CEEC). The first reason for this was to expand their markets, and second to protect them from Germany's growing economic strength. It is important to note that at this time Germany's political future was still uncertain, and unlike France, which preferred to keep the Germans down, the Belgians and the Dutch preferred to see Germany fully revived, and did not like its exclusion from the proposed customs union. As well, the proposal was not taken as seriously, as the economic and political motivations that would later surface in the mid-50s had not yet emerged.

Yet the growing Dutch balance of payments problem served to encourage the Netherlands, and others to look for economic cooperation among its neighbors.[32] In 1950, Dutch

30 Ibid., 167.

31 Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca: Cornell University Press, 1998), 97.

32 Pierre-Henri Laurent, "Paul-Henri Spaak and the Diplomatic Origins of the Common Market, 1955-1956," *Political Science Quarterly* 85, no. 3 (September 1970): 393, http://www.jstor.org/stable/2147876 (accessed October 19, 2011).

foreign minister Dirk Stikker proposed his Plan of Action at an Organization for European Economic Cooperation (OEEC) meeting, which built upon the concept of Schuman's proposals to free trade through the integration of specific sectors that would benefit most. Stikker proposed that the OEEC conduct studies into various industries to see where trade liberalization would be most beneficial, but again, this proposal received strong opposition, especially from the U.K. One of the main concerns was that it would be an extremely arduous process to complete sectoral integration on this scale—one of the reasons Monnet's later proposals for cooperation on atomic energy and transportation also created strong opposition and hesitation.

These early attempts did provide the Dutch with an important take-away lesson on European integration—that any such initiatives would ideally need to include both the U.K. and Germany, and that if an external tariff was established it would have to be no higher than any tariff established by the Benelux to become a feasible incentive for their membership.
The earlier French proposal was rejected in large part because the Dutch feared that it would create a continental bloc of European states that would hinder transatlantic relations and isolate the U.K., which was essential for security.[33] The shift in position from supporting limited sectoral integration to customs union actually happened over a very short period of time and it was largely in response to a change in perception of what constituted security. Facing pressure from the U.S. to rearm, the Dutch began to ask, "Where did the real danger lie? In a land attack by the Soviet Union? Or in losing the battle for reconstruction and thus the economic and social competition with the Soviet system?"—the second answer became a basis of Dutch support for the customs union.[34]

33 Moravcsik, 173.

34 Milward, 174.

The turning point was also closely related to the failure of the EDC. During the September 1952 meeting to discuss the EDC draft treaty, newly appointed Dutch foreign minister Johan Willem Beyen encouraged the temporary EDC assembly to examine options for economic integration, because he firmly believed that focusing solely on political initiatives would produce little consensus. Though it was unclear early on what this economic integration would look like, Beyen began to center his mind on the customs union. He believed that elements of the European Political Community proposals, which included the abolition of quotas and tariffs, a common external tariff, common socioeconomic policies, and a single market, should be pursued. Beyen believed that the EPC should be specifically focused on the creation of a customs union involving automatic reductions of tariffs at set stages; this would also require a supranational authority that would act to ensure tariff reductions.[35] Other elements, such as the common market could be added on as required. This was an entirely new way of thinking about the tariff issue, and it is likely that the ECSC supranational model largely influenced Beyen's proposal.

As a lawyer, Beyen was drawn to the idea that this new arrangement should be enshrined in a legally binding treaty to ensure states would not neglect their obligations, putting an end to ad hoc national bargaining.[36] But tides were changing in Europe at this time, with Schuman's term as French foreign minister coming to a close, Gaullist sentiments resumed in France, and any grand proposals for integration would not be well received until Edgar Faure took the post of Prime Minister in 1955. The Beyen Plan was not included in the final EDC treaty, which was not necessarily a negative turn of events. In fact, it further served to prove Beyen's point that

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35 Pierre-Henri Laurent, 375-376.

36 Milward., 187.

political integration on its own, and sectoral integration in particular was not the way forward for the Six. The interesting thing about the Beyen Plan was that it did not die with the EDC, and in fact his ideas continued to be discussed and eventually served as the basis for the customs union.

The customs union, however, was not the only idea on the table, as other governments scrambled to create alternative proposals for integration after the EDC treaty collapsed. Belgian foreign minister Paul-Henri Spaak, concerned that Monnet's belief in functionalist spillover was being proven wrong, urged Monnet to come up with other ideas to revive the integration project. Monnet strongly believed that centralized planning in the form of supranational organizations was the only way to guarantee political and economic integration.[37] He did not believe that sectoral integration had failed, and instead felt that the EDC was simply a wrong choice at that time. His proposals focused on industries that were already heavily regulated and controlled by their governments, which he thought would be easiest to integrate. Transport, conventional power and atomic energy became the new initiatives that Monnet put forward to Spaak.

Two other options were seriously considered during this time. First, was the establishment of a European free trade area, excluding agriculture and any semblance of supranational organizational structure; this would be open to a wider range of European countries than the customs union. Both Great Britain and Germany were strong supporters of this industrial FTA option (the European Free Trade Association (EFTA) would eventually be established in 1960 by Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the United Kingdom, to provide as a counterbalance to the EEC). The next option was to maintain the status quo and work towards greater trade liberalization through the OEEC and the General Agreement on Tariffs and Trade (GATT)—a global multilateral, not a European approach. Great

37 Moravcsik, 139.

Britain supported this option as well, and especially lobbied stringently for it when it was clear the FTA would fail.[38] France also supported this approach initially, being primarily concerned with protecting its agricultural industry and fearing German dominance in any European economic union.[39]

The proposal first sent to the Six for negotiation was that put together by Spaak and Monnet—transport and energy. But this was now April 1955 and Monnet did not garner the same level of support as he once did, even in his native France.[40] The Germans were also not keen on this idea, seeing sectoral integration as too *dirigiste*; moreover, the latest plan sought to establish another High Authority replicating the ECSC model onto Monnet's new favored sectors, transport and energy. This, the Germans could not stomach. What is more, the proposal had completely ignored the Beyen Plan, instead pushing for Monnet's particular vision of European integration. This time, Monnet was not to have his way. The Dutch decided to revive the Beyen Plan and create a counterproposal to the Spaak-Monnet plan. Just two days after Spaak submitted the plan to the Six, the Benelux foreign ministers began to reconsider their options. In the end it came down to three: create a European FTA, continue with sectoral integration and expand the High Authority, or push for the customs union. Ultimately, they found compromise on all three positions and on May 20th, sent their proposal to the Six; it comprised of the following:

- No common transport policy, but support for the common development of road construction, railway electrification and transport improvements;

38 Andrew Geddes, *The European Union and British Politics* (New York: Palgrave Macmillan, 2004), 35.

39 Milward, 175.

40 Paul-Henri Laurent, 387.

- Joint research, but not joint production of atomic energy, along with strengthening of cooperation in other areas of energy;
- A customs union of the Six with attributes of a common market and a timetable for completion, also keeping open the option for a FTA.[41]

The Beyen Plan had thus not been lost and underwent a momentous renewal. By expanding it to contain the possibility for other economic integration projects, the Benelux foreign ministers created strong prospects for success at the Messina conference in June 1955 that would put each of the proposed plans on the table. Unlike the Spaak-Monnet Plan, which was the product of classical European political entrepreneurship, the plan put forward by the Benelux was the product of hard bargaining and compromise among its member states. The obvious irony is that Spaak was the Belgian foreign minister, but seemed quite out of touch with his ministry at the time and seemed to initially go out of his way to oppose their proposals.

Preferences, Bargaining and the Road to Rome

Before embarking on a discussion of the ultimate compromises reached at the conferences leading to the Treaties of Rome, it is pertinent to examine what factors shaped the preferences of each of the states involved. This will also help explain why the U.K. was virtually absent from much of the discussion (though always invited) and why the chosen course of action became the logical path for European integration. Moravcsik argues that their commercial interests, not high politics, directly influenced the positions the Big Three took.[42] Such an analysis de-emphasizes the role of supranational entrepreneurship and geopolitical factors, and instead focuses on

41 Ibid., 195.

42 Moravcsik, 87.

economic motivations for government preferences. In fact, there is some salience to this argument, because if one traces export patterns in Western Europe during this time, it becomes clear that the percentage of trade headed for colonial or developing markets as opposed to the percentage of a country's intra-European trade had an impact on the economic model preferred by each state.

As Table 1 shows, Great Britain remained highly dependent on its preferential trading markets, which made up 50% of all exports; in contrast, only 13% of U.K. exports ended up in markets of the Six.[43] Therefore, the U.K. had an incentive to protect its preferential access to colonial and commonwealth markets, and the FTA would have been the optimal choice for its economic situation at that time. But France was also concerned about its preferential markets, as 27% of French exports were destined for its overseas territories, and France was also deeply concerned about industrial competition from Germany. Germany relied on markets both inside and outside of the Six, with 29% of exports going to the Six and the same percentage to other European states; where Germany was starkly different from both Britain and France was in colonial exports, which totaled less than 1% of total exports.[44] Thus, Germany preferred a wider European FTA to best serve its trading patterns, but also found utility in the customs union idea, so long as the external tariff would remain very low and agriculture, transport and atomic energy were not included.

43 F.V. Meyer, *United Kingdom Trade with Europe* (London, UK: Bowes & Bowes, 1957), 122.

44 Moravcsik., 88-89.

Table 1. Distribution of Exports by Destination, Pre-EEC*

Country	Colonial/Overseas Territories	EEC Countries	Other Members of OEEC
Germany	0.8%	29.2%	29.4%
France	27%	25.2%	16.4%
United Kingdom	53%	13%	12%

Source: F.V. Meyer, *United Kingdom Trade with Europe* (London, UK: Bowes & Bowes, 1957), 122; and F. Roy Wills, *France, Germany and the New Europe, 1945-1967* (Stanford, CA: Stanford University Press, 1965), 265.

*U.K. figures are from 1954, France and Germany's figures are from 1958.

It is also worth noting that the customs union had little support from academic economists at the time, who projected that any net gains in income as a result of trade creation through the customs union would not be greater than the percentage rate of the ad valorem tariff that previously diverted trade; therefore, the gains from such an arrangement were considered not worth the political cost in creating it.[45] Scitovsky's prediction was most alarming, estimating that the average increase in GDP for the Six as a result of the customs union would be a meager 0.05%, hardly enough to justify its creation.[46] At the same time, it must be pointed out that many of these 'predictions' were estimations based on hypothetical trade numbers and it was not yet clear how growth could be accurately measured by these static calculations. The real question then, is whether the key decision makers bought into these skeptical estimations. Though there were definitely many reservations, a consensus began to form over the utility of a customs union. Governments began to doubt the advice of economists based on the economic boom experienced in the mid-50s.

45 Milward, 122.

46 Ibid., 122.

In many countries, exports were increasing faster than production, and productivity increased in those states whose rate of exports increased most rapidly. Governments wanted to maintain this growth of productivity and income and started to become receptive to a variety of new options that would secure such growth, including the customs union.[47] The rapid growth in purchasing power as a result of this growth in trade also helped to bring issues of trade to the top of the agenda in the mid-50s. At the same time, it was clear early on that the European states did not want complete free trade, given the devastation their economies had suffered at the end of the war. Instead, they slowly began to gravitate towards neo-mercantilist policies that would grant both protectionism and trade liberalization at the same time, a feat that could only be guaranteed through focusing on Europe first.

The Messina Conference convened in June 1955 to discuss the various options on the table. Both Spaak and Beyen put their proposals together and circulated it as a draft agenda for the conference. All Six ECSC members were in attendance, but the British, who were invited, decided not to join. Monnet was also absent. Though Messina did not produce any agreement on exact details of what should be done, it did succeed in creating a general consensus on the areas that each government wanted more European-wide cooperation. Each state lobbied hard for the proposals they most supported, and there was clearly some overlap in preferences. Spaak served as an effective leader and worked to build consensus on general areas of integration as opposed to specific technical details.[48] This was reflective of the final communiqué of the conference because it did not focus on any single set of preferences, but rather combined the various proposals together, satisfying each negotiating party.

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47 Jeffrey Harrop, *The Political Economy of Integration in the European Union*, 3rd ed. (Northampton: Edwards Elgar Publishing Ltd., 2000), 60-61.

48 Dinan, 30.

The communiqué outlined the customs union (which Germany specifically desired), as well as sectoral integration in transport, agriculture and conventional and atomic energy as future areas of cooperation. Other measures included were fiscal and monetary harmonization, social policy, the free movement of labor, regulation of competition, a European investment fund for poor regions, and safeguard clauses. It was decided, however, that further deliberations were needed, and the leaders all agreed that a special committee of experts would have to be established to study the impact of economic integration on each of the agreed upon sectors.

It is important to note that this committee procedure, using technocrats and high-level negotiators was the embodiment of the process of European integration, especially in its early years.[49] This committee, referred to as the Spaak Committee and chaired by its namesake, met in the fall of 1955. Messina, in many ways, reproduced the original goals of the Benelux Economic Union, with the exception of the broader principle of the common market, which would eventually find its way into the Spaak Committee's agenda.[50] In the toughest six months of bargaining that were to follow, the committee of experts set the blueprint for Rome and laid the foundation for the European Economic Community (EEC).

The Spaak Committee convened in the fall of 1955, to which the British were again invited. They ultimately withdrew from the talks in December over opposition to the customs union. The experts that made up the committee certainly did not espouse the impartiality that the later European Commission would swear to operate by. Instead, each representative fiercely championed his government's position, making consensus difficult. By October, discussion among the experts effectively came to a halt and was replaced with direct bargaining between

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49 Youri Devuyst, *The European Union Transformed: Community Method and Institutional Evolution from the Schuman Plan to the Constitution for Europe* (Brussels: P.I.E.- Peter Lang, 2005), 57-58.

50 Derek W. Urwin, *The Community of Europe: A History of European Integration Since 1945*, 2nd ed. (New York: Longman Publishing, 1995), 74.

government officials.[51] The experts had compiled reports on all the major proposals and it became the task of the foreign ministers to sift through them and begin the hard bargaining. It became clear early on that the customs union and nuclear energy were the proposals most favored by Germany and France. As a result, both rapidly took center stage and many other agenda items were dropped, or somehow meshed within them, such as agriculture and transport. It took a full six months of negotiations in the Spaak Committee before final agreement was reached, which was to be followed by another year of intergovernmental negotiations. In the end the Spaak Committee outlined plans for a customs union with the goal to establish a common market, agricultural policy, atomic energy union, and supranational institutions to facilitate, guide and monitor this new project. The introduction of the Spaak Report clearly states the underlying impetus for these policy choices, and sets the template for what would eventually come out of Rome:

> The purpose of a **common European market** must be to create a vast area of common economic policy, constituting a powerful production unit, and allowing continual expansion, increased stability, accelerated raising of living standards, and the development of harmonious relations between states in the union.[52]

The road to Rome was a long one. In October 1956 the last round of negotiations began to reach a final decision on the Spaak Committee proposals. To the very end, each government bargained hard for their interests. The French began to push for social policy harmonization and preferential treatment for their overseas territories, along with the proposal dearest to their hearts, agriculture. Germany was most reluctant about French demands to harmonize social regulation

51 Moravcsik, 143.

52 Paul-Henri Spaak, Carl Friedrich Ophuels, Jean-Charles Snoy, Félix Gaillard, Ludovico Benvenuti, Lambert Schaus, and Gerard Marius, *Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères,* Bruxelles, April 21, 1956, 13 [translated, emphasis added].

relating to vacation pay, gender equality, wages, and also the right to withdraw or veto the transition to the second stage of tariff cuts, basically asking for an escape clause.[53] The key problem was that there was little chance any treaty that excluded agriculture, preferential treatment for French overseas territories, and adequate safeguard clauses would pass a vote in the French Assembly. This greatly worried the Germans who knew their only options were either an FTA or customs union; the issue was that an FTA would only be possible with British support, which was highly unlikely at this stage, and thus Germany was left to bargain with France. France was also strained economically at this time, and therefore pushing a very hard bargain. In the end, Germany conceded more than it probably intended to, but within a year an agreement was reached. The treaty was signed in March 1957 and within three months all six governments ratified it. The European Economic Community (EEC) and the European Atomic Energy Community (Euratom) were born.

The Impact of Interest Groups: A Closer Look at Inter-State Bargaining

The picture painted above on the process of European integration is a classical one. Though it is true that the formation of the EEC was largely the work of technical elites without overwhelming democratic participation, various other actors within the individual states were involved in influencing the decision-making process. These actors in turn helped to shape the preferences of their governments that set the boundary lines for negotiations. Interest group formation at the European level has historically coincided with the creation of new European-level institutions. In the 20th century, origins can be traced to the implementation of the Marshall Plan and creation of

53 Moravcsik, 144.

the OEEC, which spurred the development of ninety new organizations set up explicitly to build a relationship with the new institution. The ECSC also fostered the creation of many interest groups, beginning in 1953, including the Federation of Iron and Steel Workers of the European Communities, the Committee for Study of Coal Producers, and various trade unions to name a few. These groups not only tried to keep informed of the activities and decisions of the ECSC High Authority, but at times also attempted to influence the decision-making process, either at the European level or by lobbying their national governments.[54]

By the time the EEC was under negotiation, the coal and steel industries had well established interest groups that were connected across the ECSC member states. Though they did exert some influence during the Rome negotiations, they did not intensify their efforts until the ECSC and EEC were combined under the Merger Treaty in 1967; with power transferring from the High Authority to the EEC, the coal and steel industries wanted to ensure that gains made under the ECSC would not be compromised.[55] Trade unions, however, did effectively lobby their national governments during the negotiations at Rome. There were three important international trade union confederations that existed during this time: the International Confederation of Trade Unions (ICFTU), which was non-communist, non-Christian, and formed following the Marshall Plan; the World Federation of Trade Unions (WFTU), which split from the ICFTU because of its communist leanings; and the International Federation of Christian Trade Unions (CISC), which was the smallest of the three. These trade unions as well as others at the state level, lobbied the

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54 Dusan Sidjanski, "Pressure Groups and the European Community," *Government and Opposition* 2 (1967): 398.

55 Jean Meynaud and Dusan Sidjanski, *Les groupes de pression dans la coummunauté européenne 1958-1968* (Bruxelles: Editions de L'Institute de Sociologie, 1971), 15-16.

governments of the negotiating parties in hopes of including concrete measures for raising living standards of average Europeans in the Treaty.[56]

Though they did not get the exact provisions they wanted, they did succeed in having a body created within the EEC framework that would allow for civil society actors to have permanent representation and access to the Community structure through the European Economic and Social Committee (EESC). The unions also lobbied and were in strong support of a directly elected European parliament, which did come to fruition. It is important to note that the power of union interest was far stronger in the ECSC given its focus on the highly unionized sectors of coal and steel. With the advent of the EEC, the Commission preferred to consult more with technical experts as opposed to union leaders; also, the unions were often too fragmented at the European level once the EEC took effect as the issue areas it covered often overlapped and were so much larger than the ECSC.[57]

Industry was also intimately involved in the process. The Bundesverband der Deutschen Industrie (BDI), the Deutscher Industrie und Handelstag (DIHT), and the German section of the International Chamber of Commerce periodically issued statements stressing the importance of tariff reductions during the Beyen Plan discussions; given the size of German industry, it is no surprise that these groups exerted strong influence, though they supported a wider free trade area to a customs union, unless the tariffs could be guaranteed to be sufficiently low.[58] The German government also created a special tariff committee in 1953, which included government

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56 Patrick Pasture, “Trade Unions as a Transnational Movement in the European Space 1955-65,” in *Transnational European Union: Towards a Common Political Space*, ed. Wolfram Kaiser and Peter Starie (New York: Routledge, 2005), 116.

57 Ibid., 120-121.

58 Wendy Asbeek Brusse, *Tariffs, Trade and European Integration, 1947-1957* (New York: St. Martin’s Press, 1997), 188.

representatives, industry, agricultural and trade unions in order to build the negotiating position that would best benefit the German economy at the Messina negotiations. Farmers played an even more important role as agricultural policy was hotly debated; the provisions outlined in the Treaty created a truly common policy, with 75% of major policy decisions on agriculture to be shifted to the EEC level, which would have a significant impact on farmer's incomes due to product pricing.[59] However, the brunt of agricultural lobbying took place after Rome, once the details of the Common Agricultural Policy were being negotiated.

An examination of the Treaty shows that the majority of its key decisions would be made *ex post*, not *ex ante*. This meant that the most difficult negotiations would proceed after the Treaty entered into force and the minute details of the various provisions would have to be worked out. Where this was not true was in the realm of tariff reductions. The method for these reductions, as outlined in the Spaak Report found little objection, as they were general in nature. To explain, it would not be until after the Treaty's entry into force that the process of determining the exact level of the CET would take place, an issue that was far more contentious than the reduction of internal barriers. In fact, the third wave of interest group activity at the European level increased substantially in 1958, when the Union of Industries of the EEC (UNICE), the Committee of Professional, Agricultural Organizations of the EEC (COPA), and the Committee of Consumers and Interprofessional or Specialized Organs (COMITEXTIL) were formed. Many other groups were created as the Community grew and took on more regulatory and decision-making responsibilities.

It cannot, however, be overemphasized that the underlying political will for the integration project mitigated any substantial opposition to the entire idea of customs union and

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59 Leon N. Lindberg, "Decision Making and Integration in the European Community," *International Organization* 19, no.1 (Winter 1965): 67, http://www.jstor.org/stable/2705685 (accessed February 2, 2012).

the Treaty. In fact, "the formation of an integrated core Europe of the six founding member states encountered little societal opposition and could build on a growing permissive consensus."[60] The only major opposition came from various socialist parties, which were ardently opposed to the formation of the customs union because it did not fit their vision for the future of Europe, which called for greater government control of the economy and full employment.[61] However, Europe and the rest of the world were moving towards trade liberalization, as evidenced by the creation of the GATT; there was wide agreement that protectionist policies and state planning of the past had failed, and it was time to boldly try something different. This is a very important aspect of the regional integration experience in Europe. The consensus on the necessity of integration for political unity and a strong desire for economic liberalization and revitalization, served as the basis for the success of the negotiations that took place among the member states. Furthermore, it spawned the formation of diverse transnational communities that looked beyond their national borders to build coalitions among similar interests. The role of elites was instrumental as well; Monnet was one of many political entrepreneurs who worked within the state to garner support for the idea of a core Europe, giving the movement a strong political backing. It was the combination of these various factors that shaped the preferences and bargaining positions of the Six at Messina and Rome.

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60 Wolfram Kaiser, "Transnational networks in European governance: The informal politics of integration," in *The History of the European Union: Origins of a trans- and supranational polity 1950-72*, ed. Wolfram Kaiser, Brigitte Leucht, and Morten Rasmussen (New York: Routledge, 2009), 12.

61 Richard T. Griffiths, "European Utopia or Capitalist Trap? The Socialist International and the Question of Europe," in *Socialist Parties and the Question of Europe in the 1950s*, ed. Richard T. Griffiths (Leiden: E.J. Brill, 1993), 14.

The European Economic Community

Standard textbooks on economic integration tend to separate the process of integration into various ‘stages’ or degrees. What is most interesting about the agreement that was reached at Rome is that it laid out plans to achieve both a customs union and common market at the outset. Article 9 outlines that the customs union is the basis for the Community and Article 2 states:

> The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.

This statement is strikingly similar to that put forward in the Spaak Report, reinforcing the fact that the common market was the ultimate goal, but at the same time various measures needed to be implemented before it could be achieved. It is important to note, that it was also uncertain whether a full common market could ever be fully realized. The Treaties of Rome, as exemplified by Article 2, are a reminder that this was a document born out of great compromise, and thus it seeks to tackle various areas of each state’s interests while still retaining an overarching goal. The states recognized that a customs union would eventually require a common market for goods and all factors of production, and enshrined these concepts in the founding document so that there would be no going back.

The final treaties were also very specific but vague in some key areas. The timetable to introduce various measures was a striking feature of the Treaty; a twelve-year transitional period that was to be divided into three, four-year stages, which would lead to the progressive reduction of customs duties and the creation of the CET. Movement from the first to second stage was made conditional on unanimous agreement that the objectives outlined in the first stage had been achieved.[62] Duties on exports were to be eliminated by no later than the end of the first stage (within four to six years), but duties on imports remained a thorny issue as tariff levels varied among the different countries. Uniform reductions would have had a tremendously uneven effect, so the Treaty outlined a timetable for tariff reduction that was sensitive to this issue.[63] For the first stage of the transitional period a 25% reduction on duties was set as the goal; by the end of the second stage, a 50% reduction was expected, followed by complete elimination of internal customs duties by the end of the transitional period.

The CET was a particularly strong example of compromise. The Benelux was most eager for the customs union as its members wanted to open Western Europe to more international trade, and as the Benelux had the lowest tariffs of the Six, it stood to benefit most. The formula decided for the CET was to calculate the arithmetical average of the four customs areas (France, Germany, Italy and the Benelux). This prevented bargaining over each and every customs duty, and also allowed tariff rates to remain relatively low. However, the Six still secured protection for their 'vital' industries in the form of various lists outlined in the Treaty that set special rates for these products. The most intriguing of these lists was the controversial List G, which included seventy customs positions to which the Member States could not come to agreement. Furthermore, each Member State was authorized to add more products to List G, not exceeding 2% of their total value of imports from third countries, using 1956 as a base year.[64] As can be expected, List G expanded beyond its original seventy positions quite rapidly.

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62 "Treaty Establishing the European Economic Community," Article 8 (3), 17.

63 Serge Hurtig, "The European Common Market," *International Conciliation*, Carnegie Endowment for International Peace, no. 517 (March 1958): 345.

64 Leon Lindberg, *The Political Dynamics of European Economic Integration* (Stanford: Stanford University Press, 1963), 206.

List G covered a wide range of products with accounted for 15.7% of all EEC imports from non-member countries in 1957, with a total value of $2671 million dollars; three-quarters of these items were raw materials for which the Member States had very high tariffs to begin with, and others were industries that states feared would not be able to face competition from the enlarged market.[65] France wanted special protection for aluminum, cork, bromine, wine, petroleum products, machine tools and wood pulp, whereas Germany and the Benelux, who imported these goods, wanted low duties on them; at the same time the other countries extracted a number of protections on List G as well. Discussions on List G began early on and were held at the ministerial level, with the majority of sessions being private, excluding Community officials. Instead of negotiating each item on the list, items were arranged into groups—with the easiest to compromise on at the top of the agenda. Many concessions were made by each state: France and Italy accepted lower duties on industrial products, Germany accepted higher duties on food products and raw materials, and the Benelux conceded to higher tariffs across the board.[66]

What is interesting about this is that each state was so clearly committed to the success of the customs union and common market, that they were willing to make serious compromises on very sensitive issue areas. It also exhibited the pattern of negotiation that was established in the earliest of discussions; the Community operated as a continuous problem solver, not willing to accept absolute positions, pushing the limits of the impossible.

The elimination of quotas, or quantitative restrictions on imports and exports was also an important aspect of the Treaty. Quotas were to be eliminated according to an OEEC formula, but with a more flexible timetable. Within one year, Member States were expected to convert their

65 Ibid., 211.

66 Ibid., 216.

bilateral quotas into global quotas to eliminate discrimination against Member States, and to also increase their aggregate global quotas by no less than 20% of their total value, benchmarked against the previous year. The minimum increase of each product would be 10%. The goal here was to gradually increase quotas until they became irrelevant. This formula was very successful as the last quotas related to industrial products were removed by December 1961.[67] On agriculture and transport the Treaty remained quite vague, which is interesting because the French lobbied so vigorously for the inclusion of the former. Agriculture would be dealt with under the Common Agricultural Policy (Article 39), which would slowly evolve from the 1960s onward, undergoing the most significant reforms in the 1980s.[68]

The Treaty of Rome also established three important funds deemed essential to achieving the overarching objectives of the Treaty. First, was the European Social Fund, which was set up to assist in creating employment opportunities for workers and to raise the overall standard of living in the Community; the European Investment Bank was established to facilitate economic growth and expansion through the use of loans and guarantees; and the European Development Fund was set up specifically to assist with the development of French overseas territories. These funds are important because they attest to the various dimensions of motivation underlying the creation of the EEC. This was not a group of countries brought together simply for economic reasons; if the EEC just wanted to facilitate trade it would have followed more classical lines and complemented processes of the GATT and OEEC.[69] The political dimension cannot be ignored and serves as a reminder that the Six were committed to preventing any further disasters on the

67 D. Lasok and W. Cairns, *The Customs Law of the European Economic Community* (Deventer: Kluwer Law and Taxation Publishers, 1983), 46.

68 For an overview of the CAP see Eve Fouilleux, "The Common Agricultural Policy," in *European Union Politics*, ed. Michelle Cini, 246-263 (New York: Oxford University Press, 2004).

69 Hurtig, 347.

continent, be they economic, political or military. To do so required difficult compromises and a vision that extended beyond the problems of the day. Nothing exemplifies this vision better than the institutions created by the Treaty of Rome that provided a permanent forum for discussion, cooperation, and endless problem solving.

The institutions were inspired by and reflected the ECSC, but none were as supranational as the High Authority. Its closest comparison was the Commission, the guardian of the treaties. Commissioners would be appointed by their governments, but were not to represent their government's views; in fact, Commissioners were required to take an oath "neither to seek nor to take instructions from any government or body," remaining impartial in their duties.[70] The main role of the Commission is to manage the day-to-day business of the Community and draft proposals on new legislation pertaining to the Treaties. The key intergovernmental institution is the Council of Ministers, which is the ministerial level of the Community, meeting four times a year to set political priorities. The Council is responsible for approving the budget, passing Community law, signing agreements with third parties and ensuring the coordination of general economic policies. Voting procedures in the Council were set by majority, qualified majority, or unanimity, depending on the issue being addressed.

The Council was also given a rotating presidency to be chaired by each member for a period of six months. The Assembly, later to become the European Parliament, originally comprised of 142 delegates from each of the member states, with the number of seats decided by the size of each state's population. The delegates were to be elected by their parliaments (now by popular vote) and were responsible for drafting proposals to be considered by the Commission and Council. The last, and arguably, most important institution was the Court of Justice.

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70 Urwin, *The Community of Europe: A History of European Integration Since 1945,* 81.

Consisting of seven judges, the Court was given the responsibility of interpreting and applying Treaty law. The Court has played a pivotal role in the development of the EU, ensuring adherence to the Treaties and building the credibility of the Community as a whole.

Each institution has contributed to the success of the EEC. The drafters of the Treaty planned for what they believed would be the inevitable transformation of the Community. In 1964, Spaak gave a speech to the Consultative Assembly of the Council of Europe and said, "Those who drew up the Rome Treaty…did not think of it as essentially economic; they thought of it as a stage on the way to political union."[71] Though it is contestable that all the individuals involved truly believed this, Spaak makes an interesting point. He was certainly part of the group that wanted greater political unity; after all, he was an ardent supporter of Monnet. Yet the negotiations of the Treaty as outlined above, show that there were various motivations and interests involved, and that ultimately, the final result was a compromise on each position. Therefore, the institutional design was influenced by each of the requirements of every proposal. If the underlying force had been simply political, then a more supranational Commission would have been established. Since this was not the case, it is arguable that the Six had both political and economic motivations for establishing the EEC.

The institutions that were created thus provided an effective mechanism for continual cooperation, negotiation and evolution of the Community. Spaak's comment alludes to a fact each of the drafters of the Treaty certainly agreed upon; it was not to be a static document, but rather the first of many steps in a dynamic process of integration. Many sections were left vague for this very reason. It allowed for the issues to be adaptable, without restricting them to a set plan. The customs union was clearly outlined and described in stages because it was a

71 Ibid., 76.

tremendously technical undertaking that required a great deal of uniformity in effort and practice. The other proposals however, such as agriculture and transport, required a different approach; but since cooperation was guaranteed in the Treaty, and institutions provided to discuss their future, there was really no need to be specific on what these policies would look like at the outset. Furthermore, the broad concept of the common market, outlined as the 'four freedoms' of goods, capital, services and labor, remained an overarching goal that is still incomplete. Its inclusion as one of the key bases of the document shows an acknowledgement and awareness of the fact that the customs union, which was the heart of the Treaty, would eventually transform the economic interactions of the Six, leading to a new phase in the integration project—the common market. Achieving both customs union and common market was not thought of as a process that would necessarily be completed simultaneously, but there was an admission that both processes were complementary, and that in the end, the customs union would require the common market for its full benefits to be realized. The best way to ensure that this evolution would continue was to create strong institutions to guarantee the Treaty and foster a sense of common purpose and interest among the Six.

The Formation of a Region

At this point, it is worthwhile to take a look back and examine how the processes described above fit within the regional integration framework and what key themes characterized integration in Europe. First, the origins of European unity reach far into antiquity, but it was in the historical context of the inter-war and post-WWII period that gave the idea greater salience and power. Notably, the customs union proposal came from the Benelux, not the traditional drivers of integration, France and Germany. Second, it is clear that the Six shared common interests and objectives to avoid future political/military conflicts and revive the struggling economies through trade liberalization. Third, there was a strong consensus and popular support for the idea of a core Europe, which in turn fostered the political will necessary to strike compromises and make hard bargains. As a result of the overwhelming belief in the European integration project, there was a strong preference for joint problem solving, evidenced not only in the negotiations leading up to Rome, but in the institutions that were created from the Treaty. These institutions reflected the *ex post* nature of the Treaty, and were established to ensure continued leadership, dialogue, cooperation and a mechanism to enforce the new agreement. Key themes that characterized the process are as follows:

- Forward thinking—combining the goals of customs union and common market at the outset shows that the Treaty was not to be a static document and that the Community would have to continually adapt to new challenges;
- Continental vision—though there were differences in opinion of what 'Europe' encapsulated, there was agreement on the need for a broad consensus and inclusive solution;
- Desire to maintain influence—Monnet emphasized the centrality of France and Germany to drive integration forward, and by doing so, maintain a leadership role in the region, and possibly, the world;
- Economic motivators—the biggest supporters of the plan were the smaller Benelux countries, which relied most on trade with Germany. Also, pre-Rome trade patterns showed strong economic interdependence among the Six;
- Committee procedure—deliberations often involved experts and technocrats, and the majority of key decisions were made at the highest levels of government; and
- Influence of individual actors and interest groups—political entrepreneurs such as Monnet, Spaak and Beyen were instrumental in the project, but trade unions, industry, and other civil society actors operating at both the national and European level influenced the preferences and bargaining positions of the Six as well.

The sum of these themes validates the fact that Europe was in the process of regional integration, and that its regional identity was shaped by both old and new ideas that defined the shape, scope, and direction of the integration project. Historical events that bound the destiny of the Six together, and the subsequent development of the Community had a significant impact on state behavior. There was an impetus for cooperation, innovative thinking and inspired leadership to pull Europe out of its slump and create a region that could compete and thrive in the 20th century and beyond

CHAPTER 3

THE CUSTOMS UNION:
FORMATION, OBSTACLES AND PERFORMANCE

When the Treaty of Rome is examined in detail, it becomes quite clear that the task the Six set before them was not a simple one. As shown above, the basis of the Treaty was to create a customs union, and eventually, a common market, but the drafters knew that it would not stop there. They inserted transport, agricultural and social policy into the text, as well as detailed provisions on competition policy and the free movement of capital, services and labor. There was awareness that to achieve a common market, the free movement of goods was not enough, and that as the market adapted over time, the scope of the Treaty would need to adjust as well. In fact, this is possibly a reason why parts of the Treaty were left quite vague; it does not seem that the drafters were certain of what the common market would eventually look like, but they approximated the issues that would come up, or areas to be affected, and included them in the Treaty in vague terms. If these had been left out, then the Treaty would have remained static—its purpose fulfilled at the completion of the customs union. Writing in the next step was a way to guarantee progress beyond the customs union and generate cooperation on a whole range of issues that would slowly become interconnected.

The customs union, however, remains at the heart of the integration project, and without its rapid success, further integration would not have been possible. It is therefore surprising that in most introductory texts on the EU, the completion of the customs union is given so little attention. It is often relegated to a few sentences on why it differs from a FTA, followed by an acknowledgement of its completion eighteen months ahead of schedule. Not much is really said about how the Six consolidated the customs union and effectively laid the foundation for the common market. This section endeavors to do just that by outlining the stages and progress of the customs union, the challenges in establishing the common external tariff, and the unique role of the courts in creating Community law. This will be followed by an evaluation of the customs union through an examination of trade patterns, and a look at the issues that plagued the Community as it transitioned to its next stage of integration. The intention is to shed light on the process of integration, clearly outline its costs and benefits and extract the most important lessons learned from the European experience.

Implementation of the Customs Union

The completion of the customs union requires the achievement of two separate but related tasks; first, the removal of all internal customs duties and quantitative restrictions having equivalent effect, and second, the harmonization of tariffs to third countries, to create a common external tariff (CET) towards non-member states. In theory, once internal customs duties are eliminated, barriers to trade within the customs union are effectively quashed, and the signatory states can shift their focus to building a common commercial policy to the outside world. Practically speaking, this is hardly the case. The key problem is that the process of harmonization that replaces national law with the new Community rules is an ongoing process—so the declaration of the *désarmement douanier* on July 1, 1968, was quite arbitrary. It is true that a significant level of tariff harmonization had been achieved, as will be shown below, rendering any existing tariffs negligible, but a full customs union was not achieved at that point. Despite this, the effects of the customs union were already being felt, and the system was evolving on a daily basis.

Article 14 of the Treaty outlines the schedule by which tariff reductions were to be achieved. The transitional period for completion of the customs union was set out over a period of twelve years in which duties and other charges of equivalent effect would be progressively eliminated. After the Treaty's entry into force, member states were asked to "refrain from introducing between themselves any new customs duties on imports or exports or any charges having equivalent effect, and from increasing those which they already apply in their trade with each other."[72] This meant that in practice, the member states had to freeze all their duties and charges; thus the basic duty, on which all reductions were based, were those in effect on January 1, 1957.

The reductions were broken up into three stages, with the first coming into effect one year after the Treaty's entry into force, at which point member states were to "introduce between themselves a duty on each product equal to the basic duty minus 10%."[73] Every subsequent reduction would require a reduction of duties across the board, amounting to 10% of total customs receipts, and reducing the duty on each product by 5%. Total customs receipts, as outlined in Article 14 (4) were "calculated by multiplying the value of [a Member State's] imports from other Member States during 1956 by the basic duties." The complete schedule for tariff reductions, as outlined in the Treaty, aimed to reduce 25% of the basic duty at the end of the first stage (1/1/1962), 50% of the basic duty at the end of the second stage (1/1/1966), and the remaining duties during the third stage. The Treaty did not outline the schedule for reductions in stage three, leaving that up to the Council of Ministers to decide by qualified majority after a proposal from the Commission.

72 "Treaty Establishing the European Economic Community," Article 12.

73 Ibid., Article 14 (3).

Articles 30-37 deal with quantitative restrictions on trade, which were also to be progressively abolished. After one year of entry into force, Member States were required to convert bilateral quotas into global quotas, based on the principle of non-discrimination. The first reduction was to take place at the same time "to bring about an increase of not less than 20% in their total value as compared with the preceding year," with each global quota increased by not less than 10%.[74] Subsequent reductions were slated to occur on an annual basis, and by the tenth year each quota was to be not less than 20% of national production. A year-by-year timetable was not laid out because the elimination of quantitative restrictions would also be discussed at the international level through the GATT framework. The Commission would then issue a timetable as successive negotiations were completed; leaving the timetable open for negotiation gave the EEC a bargaining chip in the GATT discussions.

From late 1958 through 1959 it was clear that though action to liberalize trade in the industrial field was relatively homogenous among the Six, the agricultural sector was starkly different. Germany noted significant technical problems converting quotas on fruit and vegetables into global quotas due to the sensitive nature of the agricultural sector, citing that this would be an area where the Commission would need to be heavily involved to fix an agreement.[75] Member States held off on establishing increased quotas and reducing duties, instead playing a game of wait-and-see. The key reason for this was the tremendous influence of the agricultural lobbies at both the national and European level. In fact, the Directorate General for Agriculture in the Commission established a special department within it that would allow for non-governmental groups to have direct access to the directorate; the Commission encouraged

74 Ibid., Article 33 (1).

75 Commission of the European Economic Community, *Second General Report on the Activities of the Community*, September 18, 1958-March 20, 1959 (March 31, 1959), 61.

interest groups to meet frequently and present common opinions to the directorate to help with the formulation of policy.[76] Not only would this foster the creation of a strong policy network of agricultural interests, but it would also allow the Commission to ensure that it balanced the interests of all states when formulating policy or clarifying regulations.

Fearing possible harmful effects from the reduced tariffs, some states introduced new internal taxes to offset losses. Though such measures are often acceptable under the Treaty, the Commission still worried that it would shift an unnecessary burden onto consumers and advised Member States to refrain from imposing such taxes. There was also the continuing problem of Member States substituting taxes for duties of a fiscal nature, which they were required to report to the Commission. Products under review included tea, wines, other fermented beverages, spices, coffee, manufactured tobacco, cigarette paper, and mineral oil and its derivates. Though Germany had reduced duties on coffee and tea substantially, at the same time it increased taxes to consumers on these products; the Benelux enacted a similar measure, placing excise duties on wine and vermouth.[77] Though it was within the bounds of the Treaty for states to levy consumer taxes on products, duties of a fiscal nature were to be removed, with the exception of a few cases in which the duties were allowed to remain for a limited period. The diverse range of products granted exemptions certainly posed a problem if the Member States continued to practice such measures over a prolonged period of time.

Despite the many obstacles faced in first two years of the EEC, initial calculations estimated that the volume of trade within the Community would increase by 3-5% for Italy, Germany and the Benelux countries who already had liberalized on a significant scale; for

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76 Lindberg, *The Political Dynamics of European Economic Integration*, 70.

77 Commission of the European Economic Community, *Second General Report on the Activities of the Community*, 55.

France this figure was estimated to be 15% given the devaluation of the franc in 1959.[78] To optimize the success of integration, the Commission worked diligently to harmonize various bureaucratic practices. On January 1, 1959, the Commission introduced a customs circulation certificate for goods, which would cover trade within the Community. Its main purpose was to ensure that a product originating from within the Community could be easily identified and labeled for free circulation. For goods originating from non-Member countries, the certificate would be filled in by the exporter and certified at the port of entry, where relevant duties would be collected; this ensured that all customs authorities would use the same documents for customs purposes, thus streamlining the process of clearance as products crossed multiple borders. Though there would always be problems in uniformly implementing the new procedures and using common documentation, the Commission's efforts to harmonize these bureaucratic procedures early on shows that they knew the process of integration would be tedious, involving many small changes over time.

From mid-1959-1960 the effects of the first round of tariff reductions were finally being felt. The economic effects of the reductions were not the same across the board as Member States varied considerably in their rates of customs duties before the Treaty went into force (with the exception of the Benelux). Customs protections were slowly being chipped away for raw materials, finished industrial goods, most agricultural products in France and Italy and some industrial products in the Benelux. Treaty infringements were on the decline as well, affecting less than 1% of intra-Community trade.[79] In fact, as Table 2 shows, intra-Community trade was doing quite well. The fall in intra-Community trade from 1957-1958 can be attributed to the

78 Ibid., 54.

79 Commission of the European Economic Community, *Third General Report on the Activities of the Community*, March 21, 1959-May 15, 1960 (May 1960), 81.

lagged effects of the implementation of the Treaty provisions. However, the situation improved considerably in 1959, with a 19% increase in intra-Community trade from the previous year, and over 15% from 1957. The reason for this improvement is due to increased economic expansion and the direct and indirect effects of the Treaty's application.

Table 2. Intra-Community Trade 1957-1959

Year	Total Value of Trade (in millions of dollars)
1957	7,030
1958	6,787
1959	8,077

Source: Commission of the European Economic Community, *Third General Report on the Activities of the Community* (March 21, 1959–May 15, 1960), May 1960, 133.

The drop in average prices of exports by 5% between 1958-1959 helped trade expansion, as the export prices of other industrial countries generally remained the same. The devaluation of the franc in December of 1959 contributed to this expansion as well as it greatly increased competition between manufacturers in the Six. Essentially, the Member States did not restore prices to previous levels after the slump, but rather continued to make reductions in hope of expanding their markets— their plan worked. Exports of the Six rose by 2.390 million dollars in 1959, with more than half of this resulting from exports from one Community country to another.[80]

Internal tariff reductions continued, often ahead of schedule, prompting the Council to speed up the reductions twice during the transitional period. It is worth noting that the Commission consulted with the Committee of Permanent Representatives (Coreper), which is

80 Ibid., 134.

made up of representatives of the Member States, with ambassador ranking who prepare the work of the Council, before making the speed up decisions. Since Coreper is well connected to its national constituencies and interests, consultation was essential to ensure that national governments and businesses were ready for the acceleration of reductions. By 1965, intra-Community duties on almost all industrial products were already 30% of the basic duty, and though agricultural duties remained higher, they were between 45-50% of the basic duty—quite an achievement from where they started just eight years ago. The progress was clear in the figures and felt in the economy, as between 1958 and 1966 the value of merchandise trade between the Six tripled from 6800 million to 22,900 million units of account.[81]

What they had achieved in just nine years was far beyond what they could have imagined when they set out to create the customs union. All of this seems to have happened with much ease, with a few roadblocks along the way. However, the removal of internal duties is just one part of creating a customs union. The CET, which evolved alongside the reduction of internal duties, was a much slower and difficult process. Though 1968 is often regarded as the date at which the customs union was completed, it is hardly the case. A part of the customs union was completed, but the vital element that sets a customs union apart from a free trade area— the CET—was yet to be fully established. A look back through the years of its implementation will shed light on what occurred.

81 Commission of the European Economic Community, *Tenth General Report on the Activities of the Community*, April 1, 1966–March 31, 1967 (June 1967), 14.

Challenges with the Common External Tariff

Establishing the common external tariff was a far more difficult task than removing internal duties on trade. At the end of 1957 an Interim Committee was established to begin detailing what would be required to complete the CET. When the Commission picked up this project in 1958 it realized that figuring out the arithmetical average of the four customs areas (Germany, France, Italy, Benelux) was the least of their worries. There were clear structural differences in the separate tariff systems that had to be reconciled. They had to find a way to reduce and consolidate over 20,000 positions and sub-positions on tariff rates to just 6,000 to 7,000 in total—a monumental task; this would be done by juxtaposing the tariff schedules and creating a uniform customs nomenclature. By 1959 this process was plodding along and it was hoped that within two years of entry into force of the Treaty, the juxtaposition of customs tariffs would be complete; the draft that was completed that year did not, however, include products from List G, nor did it establish the arithmetical average.[82]

The Commission realized that in order to see the full benefits of the customs union, harmonization of the national tariffs to third countries had to be achieved simultaneously to internal duty reductions. Thus, a vigorous effort was put forth to settle the duties on the CET, with a final solution reached on March 2, 1960. The exception to this, again, was List G, which would not have a uniform tariff rate until May 1964. Much of the enthusiasm and urgency for the CET was in order to prepare for the next round of GATT tariff negotiations. In order for the EEC to get the most out of the negotiations, it needed to present a united front—any discrepancies in duties would have led to cherry picking tariff rates that in the end would have eroded the

82 Commission of the European Economic Community, *Second General Report on the Activities of the Community*, 73-74.

achievements the EEC had already made with regard to the customs union. The Council also wanted the reduction of customs duties to be extended to non-member states enjoying MFN status with the Six so as to expand trade in and out of the Community. This could only be accomplished if the Member States agreed to uniform duties to third countries, otherwise, a divergence of trade could be expected as third countries export to the Member State with the lowest tariff, but still gain access to the entire market.

The way to accomplish this was to create a common customs nomenclature. The good news was that the Commission did not have to start from scratch. In fact, in 1948 a European Customs Union Study Group was created to examine how such a nomenclature could be built. The Study Group used the Geneva Nomenclature, which was completed in 1931 under the auspices of the League of Nations, as their starting point. The final classification system was adopted by Convention on February 15, 1950. This system is referred to as the Customs Cooperation Council Nomenclature (CCCN), named after the Customs Cooperation Council, which was established on the same day, to meet once a year to review the nomenclature and its implementation. The Six had all signed the Convention in 1950, which served as a strong basis for the CET Nomenclature; the Member States wanted the CCCN to apply directly to the Community system (with some exceptions) so that it would not diverge greatly from established international norms.[83] By February 1960, the draft of the nomenclature was complete, with only 72 items (or about 3% of total tariff lines) lacking a fixed duty.[84]

The main challenge of the classification system is that trade patterns can change, and new products enter the market, which requires the nomenclature to adapt to these changes.

83 Lasok and Cairns, 152.

84 A tariff line refers to a single item in a country's tariff schedule, and a heading classifies these 'lines' into product categories.

Asymmetric application of the CET also has serious repercussions as “tariff classification not only determines the rate of customs duty to be applied, but also serves other purposes, such as the levying of domestic taxes, the preparation of trade statistics and the precise designation of goods in a number of administrative documents.”[85] For this reason a Committee on Common Customs Tariff Nomenclature (now the Customs Code Committee) was established under Article 1, with representatives from each Member State and a Commission representative as Chairman. Its main task was to examine all questions relating to the nomenclature submitted either by a Member State or the Chairman, and draft its opinion to the Commission, which would then draft classification notes to clarify the nomenclature.

There were also a number of problems with implementing the CET that remained to be sorted out as well. Customs duties of a fiscal nature still posed a problem—Member States continually added their own fiscal duties that distorted the tariff rates. As well, technical problems resulted from the use of mixed duties (ad valorem and minimum levies) with products containing multiple types of duties. These problems were especially visible with regard to particular products such as manufactured tobacco and petroleum products. Because each state has its own internal fiscal system and organization of state monopolies, it is especially hard to harmonize duties in these areas. In fact, after the first alignment of national tariffs to the CET the number of applications for opening tariff quotas increased substantially for products on List G, and other items in accordance with Article 25.[86] As well, the first speed up in alignment did not include agricultural products, a big portion of intra-Community trade that remained under the administration of the Common Agricultural Policy (CAP), which had its own timeline for

85 Lasok and Cairns, 154.

86 Commission of the European Economic Community, *Fifth General Report on the Activities of the Community*, May 1, 1961–April 30, 1962 (June 1962), 37.

reductions. The first approximation of national customs tariffs to the CET for agricultural goods would not take place until 1962, and even then, its scope was limited. All other customs tariffs were, however, made uniform among the Member States with the general and complete framework of the CET nomenclature by 1962, with only minor differences persisting.

At the same time it must be noted that harmonization of the nomenclature on paper is very different than harmonization in practice—a problem that would plague the CET for many years to come. This means that interpreting the nomenclature can be subjective and vary by a country's custom and standard practice; because the valuation of a duty is based upon the heading that an item falls under, the customs agent must be accurate in assigning a product to a specific category.

Since the CET took time to implement, the collection of tariffs at the frontier continued as usual. Article 201 of the Treaty explains that once the CET was complete, the Commission "shall examine the conditions under which the financial contributions of Member States provided for in Article 200 could be replaced by the Community's own resources, in particular by revenue accruing from the common customs tariff."[87] Until that point, the Community's funding had come from individual Member States' national contributions. In 1970, the Community finally had its own resources, which also comprised of agricultural duties, customs duties and the Value Added Tax (VAT). For the CET, Member States were to keep 25% of the duty as a collection fee to cover the costs of customs clearance, and the rest would go to the Community budget. The implementation of this collection procedure also took time, as some Member States attempted to break the rules by adding an additional customs fee or classifying goods under a heading that resulted in a higher tariff rate.

87 "Treaty Establishing the European Economic Community," Article 201.

To show the difficulty inherent in establishing the CET, one only has to look at the number of duties that corresponded with the CET in 1967, ten years after the Treaty went into effect. Table 3 shows the national duties of the Member States that correspond to the CET duties. It is clear from this chart that Germany and the Benelux were most efficient in implementing the CET, as only 2% and 18.2% of their national tariffs, respectively, were higher than the CET. This means that a majority of their national tariffs were either equal to the CET, or charged a lower rate. In contrast, France still maintained 71.5% of its national tariffs above the CET values, and Italy's record was not much better at 54.8%. This is important because it shows that implementation of the CET was not uniform, and varied greatly among the Member States. Furthermore, these figures were taken just a year before the customs union was declared complete; from the discrepancies shown below, it is obvious that the EEC still had a way to go before completing the customs union.

Table 3. Percentage of national duties and corresponding duties in CET

Member State	Duties = to CET	Duties > CET	Duties < CET
Germany	41.4%	58.4%	0.2%
Benelux	23.5%	58.3%	18.2%
France	19.8%	8.7%	71.5%
Italy	32.2%	13%	54.8%

Source: Commission of the European Economic Community, *Tenth General Report on the Activities of the Community*, 64.

Despite any setbacks and slowness to fully adopt the CET, the Council issued Resolution (EEC) No. 950/68 on June 28, 1968, which officially entered the CET into force. This meant that from that point on, responsibility for all tariff legislation was now transferred to the Community level; the only thing the Member States could do was suspend tariffs. As well, Member States were no longer able to introduce new charges on direct imports from non-member states, as per ruling of the ECJ. It is important to note, that though the CET went into force in 1968, there were still some exceptions to its application. First, under Article 26, manufactured tobacco imports to the Benelux and Germany's quota on unwrought aluminum were exempt from the CET; about 40 tariff headings and sub-headings on agriculture were also excluded. Furthermore, products that were covered by the ECSC Treaty were not to have the CET applied until January 1, 1972. What this means in practice, is that though the Member States aligned their national tariffs to the CET, they did not fully implement them.

The Role of Community Law and the European Court of Justice

A true customs union had not been achieved in 1968, but the foundation had been effectively laid. The hard part was about to begin, as the Commission had to ensure the uniform implementation of the CET, which is still imperfect today. The conclusion reached in 1968, was that differences in domestic legislation remained the largest obstacle to realizing the customs union. Under the Treaty, one way to remove this obstacle was under Article 100 through the process of harmonizing legislation by Council Directives on recommendation by the Commission. This would not only assist with the proper application of CET nomenclature, but also settle issues regarding customs valuation, origin, and the transit of goods within the Community.

It goes without saying that the Treaty has had a significant impact on the domestic law of its Member States and formed the basis of Community law, which exists as a separate entity.

However, Community law has evolved over a long span of time, and in the early years of integration, defining the relationship between the Community institutions and its Member States was a challenge in and of itself. Though there are many self-executing provisions within the Treaty, there are many more that require the Member States to implement legislation or procedures to have the provisions take effect. Thus, the Member States have always retained a high degree of autonomy. Yet at the same time, creating the customs union required a level of legislative cooperation, which, at the outset, was a little unclear. In fact, the Treaty goes into a great deal of depth in defining the make-up and function of the customs union, but it says little about Member State legislation in relation to it. This is exactly why, at the end of the transitional period, the customs union was incomplete. The Member States had harmonized their national tariffs, but that was just one part of what a fully functioning customs union would entail. The implementation of the customs union requires harmonized legislation on customs matters, otherwise, trade distortion, deflections, and overall discord within the Community could result. Article 27 of the Treaty seems to make-up for this lack of legislative coordination:

> Before the end of the first stage, Member States shall, in so far as may be necessary, take steps to approximate their provisions laid down by law, regulation or administrative action in respect of customs matters. To this end, the Commission shall make all appropriate recommendations to Member States.[88]

Though Chapter 3 deals specifically with the approximation of laws in the Community to maintain the functioning of the common market, the inclusion of Article 27 within Chapter 1 (on the customs union) shows that the drafters of the Treaty understood that harmonizing legislation would be required on the road to the common market, which was closely linked to the success of

88 “Treaty Establishing the European Economic Community,” Article 27.

the customs union.[89] The problem, however, with Article 27, is that the instrument it gave to approximate legislation is incredibly weak; recommendations made by the Commission are non-binding, and as a result, Member States either choose not to comply or effectively delay compliance to a time that suits them. Therefore, the goal of approximating legislation by the end of the first stage was not achieved, and the Commission made very few recommendations, as it was deemed largely ineffective.[90]

The Council and the Commission, did, however, have other means to enforce the Treaty; since the customs union is so closely linked to the creation of a common commercial policy, Articles related to the latter could be invoked as "the result envisaged by the commercial policy cannot be obtained if the tariff is isolated from that legislation."[91] Simply put, the functioning of the common market and the success of the commercial policy depends on uniform customs legislation. In fact, customs legislation is often the subject of negotiation in trade agreements, such as determining customs value and rules of origin, which inevitably link the two areas together. The Council has often used Article 235, which allows it to adopt rules necessary to achieve the provisions laid out in the Treaty, in areas where the Treaty does not expressly give it the powers to do so, but are considered of fundamental importance to its functioning.

An interesting case in which this Article was used is in Council Regulation 802/68/EEC on rules of origin. The Regulation also invokes Articles 111 and 113 (commercial policy) and states that "the provisions of this Regulation relate both to commercial policy with regard to third countries and to the free movement of goods within the community, and in particular to uniform

89 L.J. van der Burg, "The Customs Tariff and Customs Legislation in the European Communities," *The Common Market Law Review* 7, no.2 (1970): 186, http://heinonline.org.proxyau.wrlc.org/HOL/Page?collection=kluwer&handle=hein.kluwer/cmlr0007&type=Text&id=186 (accessed January 6, 2012).

90 Ibid., 187.

91 Ibid., 193.

application of the common customs tariff," and since the relevant Articles of the Treaty do not give the Community power to make binding provisions defining the origin of goods, the Council relied on Article 235 to grant it such powers.[92] The Council thus passed Regulation 802/68/EEC defining origin:

- Goods wholly obtained or produced in one country shall be considered as originating in that country;
- A product in the production of which two or more counties were concerned shall be regarded as originating in the country in which the last substantial process or operation that is economically justified was performed…resulting in the manufacture of a new product or representing an important stage of manufacture.[93]

First, being a Regulation, and not a Directive, this took immediate effect and had the legal force of national law; thus, no further implementing measures were required by the Member States. Second, it clearly defined the origin of goods, giving the Community greater uniformity in the application of the CET. A point of mention is required for the description of products produced in more than one country. The Council essentially describes origin here as belonging to the country that contributes the greatest value added to the manufacturing process, which greatly clarified the problem of dealing with production chains. With a single rule of determining origin, combined with the existing certificate of origin, Member States' application of customs law became a little less ad hoc.

Infringements of Community law can tell an interesting story as well. Since the implementation of Community measures is solely in the hands of government, infringement can often be a sign that a Member State does not have the means to implement a particular Directive,

92 Regulation (EEC) No 802/68 of the Council of 27 June 1968 on the common definition of the concept of the origin of goods, *Official Journal* L 148, 28/06/1968 P. 0001 – 0005.

93 Ibid.

or that it is facing domestic resistance. For example, the Council issued a Directive in 1965 on the definition of a ‘medicinal product’, and asked governments to remove harmful products or those with no therapeutic effect (as defined in the Directive) from the market; it also noted that every product would have to be tested and certified.[94] Germany did not implement the Directive for years because the government had no federal agency that could do the required testing. This was an important lesson, because it highlighted the need for better consultation with Member States and the problems of harmonization. In 1967 two VAT Directives were adopted, which would establish “a general, multi-stage but non-cumulative turnover tax to replace all other turnover taxes in the Member States.”[95] Italy delayed implementation because its political parties were strongly opposed to the VAT, believing that it favored large vertically integrated enterprises, and also worried about a possible rise in consumer prices.[96] Only when the Member States (that had already implemented the Directive) began pressuring the Italian government, was there a move to resolve the dispute. The Community learned a very difficult lesson through this process, in that “integration experiments are only as strong as the weakest governments involved in them.”[97] Harmonization of national law and practices can thus face tremendous difficulty if all Member States are not committed and capable of ensuring their implementation.

A discussion on the implementation of the Treaty also cannot ignore the importance of the ECJ. Though the highest courts of the Member States at times have been reluctant to submit

94 Council Directive 65/65/EEC of 26 January 1965 on the approximation of provisions laid down by law, Regulation or administrative action relating to proprietary medicinal products, *Official Journal* 022, 09/02/1965 P. 0369 – 0373.

95 European Commission, “How VAT Works,” Taxation and Customs Union, http://ec.europa. eu/taxation _customs/taxation/vat/how_vat_works/index_en.htm (accessed February 24, 2012).

96 Donald J. Puchala, “Domestic Politics and Regional Harmonization in the European Communities,” *World Politics* 27, no. 4 (July 1975): 511, http://www.jstor.org/stable/2010012 (accessed February 4, 2012).

97 Puchala, 511-512.

cases to the ECJ for a decision, many preliminary rulings made by the Court have formed an important basis of Community law.[98] Article 177 gives the Court jurisdiction in issuing preliminary rulings on the interpretation of the Treaty, the validity of interpretation of acts by Community institutions, and the interpretation of statutes established by an act of the Council. This has been used effectively in a number of controversial and not-so-controversial cases. With regard to the CET Nomenclature, the *Turkey Tails* case is worth mentioning.[99] The dispute was over the classification of a product imported by a Hamburg company described as 'turkey rumps', and had been given the heading 'poultry cuts' by the customs authority.

First, the Court made clear that the national authorities were not allowed to interpret the terms by which goods are described, and had to rely on Community procedures for doing so, if there were doubts about a product.[100] The Court also ruled "that goods not falling within any heading of the Tariff shall be classified under the heading appropriate to the goods to which they are most akin…to be decided on the basis not only of their physical characteristics but also of their use and commercial value."[101] The classification 'poultry cuts' was deemed inaccurate and it was suggested that the sub-heading 'backs and necks', which refers to cuts of slaughtered poultry parts, seemed closer to the description. Classification as 'backs and necks' also gave the product less commercial value and market price, thus making the tariff rate lower than classification under 'poultry cuts'. However, the product was even better described as cuts of poultry "which are deliberately separated from the backs and which form as such the residual

98 Michel Waelbroeck, "The Application of EEC Law by National Courts," *Stanford Law Review* 19, no.6 (June 1967): 1257, http://www.jstor.org/stable/1227438 (accessed January 6, 2012).

99 Case 40/69: *Hauptzollamt Hamburg v. Bollman* [1970] E.C.R. 69.

100 Lasok and Cairns, 157.

101 Ibid., 158.

parts after the bird has been cut into pieces" and because the product had this conversion factor (been changed into a new form), it was classified as 'edible offals', with an even lower tariff charge.[102] The Hamburg company was thus refunded the appropriate charges and an important precedent on the interpretation of the customs nomenclature closed.

What the *Turkey Tails* and plethora of cases like it show is that it was incredibly important that all goods be classified in the exact same way as to prevent any price distortions and unfairness in the market. This was important for items falling under the CAP, because of the nature of price controls established with regard to its market organization. Over the years, the case law on interpretation of CET headings has grown substantially and formed an important part of Community law.

Evaluating the EEC Customs Union

Since the EEC was created, there have been numerous attempts to evaluate its economic performance. There are a number of costs and benefits to the creation of a customs union; before launching into an examination of the actual costs and benefits incurred by the EEC, it is pertinent to outline the theoretical costs and benefits, or rather, what we should expect to see. Table 4 outlines the impact of various actions as a result of the formation of a customs union. An important qualification to make, however, is that the EEC set out to establish a customs union and common market simultaneously. As a result, additional impacts would occur from the creation of a common market, mainly, from the adoption the removal of all barriers to factor movements, including labor and capital, which are not included in this discussion.

102 Ibid., 158.

Table 4. The Impact of Customs Unions

Action	Impact
Removal of tariffs between member countries	• Free movement of goods • Increased competition, specialization • Economies of scale, lower unit costs • Increased consumer choice, lower prices • Attract foreign direct investment • Expanding production, technical efficiency • Low cost suppliers can increase exports to member countries, but in the short term, their consumers will face higher prices since supply is imperfectly elastic. Will either change as a result of industry expansion along its domestic supply curve, or the creation of a common price on products • Geographically limiting
Establishment of a common external tariff to the outside world	• Elimination of rules of origin between member countries • Reduction of transportation and transaction costs • Bargaining power in international trade negotiations, improved terms of trade • Trade creation • The higher the external tariff rates, the more adverse its impact on third countries, possibly leading to trade diversion if the lowest-cost producer is not within the customs union for a product adversely affected by the increased tariff • Member countries give up independence in setting tariff rates • Possibility for a common commercial policy

Though liberal economist would argue that any customs union, as it increases free trade, would ultimately increase the sum total of welfare in the world, others have sought to challenge this assumption and test the results for themselves. Jacob Viner was a pioneer in evaluating customs unions and coined the terms trade creation and trade diversion.[103] Trade creation takes place when “economic integration leads to a shift in product origin from a domestic producer whose resource costs are higher to a member producer whose resource costs are lower,” thus allocating resources in such a way as to increase overall welfare as costs are reduced; trade diversion does just the opposite by shifting “product origin from a nonmember producer whose

103 Jacob Viner, *The Customs Union Issue* (New York: Carnegie Endowment for International Peace, 1950).

resource costs are lower to a member-country producer whose resource costs are higher," moving away from the free-trade allocation of resources and thus reducing welfare.[104] Both can be experienced through economic integration, and thus integration can be considered a partial movement to free trade; to fully evaluate the net benefit to countries requires an empirical examination of the issue.[105] This is exactly what Viner argued, in that economic integration itself does not produce automatic increases in welfare, and as a result, trade creation and trade diversion were instrumental in evaluating the effects of integration.

J.E. Meade expanded upon Viner's theory, adding several other factors to examine the effects of customs union. Meade suggested that the initial height of tariffs and the size of cuts, competitiveness or complementarily of the economies taking part, elasticity of demand and supply, change in the amount of consumer surplus, effect on the terms of trade, and the relative incomes from whom trade was diverted, be taken into account.[106] However, the key problem with Meade's methodology was that it used measures of the static effects of trade creation and trade diversion, meaning those effects that occur directly upon the creation of the integration project. This is problematic because it is often the dynamic effects of integration such as influences on competition, investment and the balance of payments, that have a significant effect. This is why in addition to examining the static effects, one must examine the possible effects had integration not occurred.

Bela Balassa further developed these theories to produce real estimates of trade creation

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104 Dennis R. Appleyard, Alfred J. Field and Steven L. Cobb, *International Economics,* 6th ed. (New York: McGraw-Hill Irwin, 2008), 388.

105 Ibid.

106 John Pinder, "Positive Integration and Negative Integration: Some Problems of Economic Union in the EEC," *The World Today* 24, no. 3 (March 1968): 92, http://www.jstor.org/stable/40394094 (accessed December 15, 2011).

and trade diversion. Balassa's methodology used *ex post* income elasticity of import demand (YEM), which is the ratio of average percentage change in imports to the Gross National Product (GNP), expressed in constant prices. Balassa theorized that under the assumption that income elasticity of import demand would have remained unchanged without integration, that the rise of income elasticity of demand for intra-area imports would thus indicate gross trade creation. Trade diversion would therefore be seen by a decline in the income elasticity of demand for extra-area imports, and trade creation proper would be "indicated by a *rise* in the YEM for import *from all sources* (partners and the outside world)."[107] If the latter occurs, then that suggests that the EEC was made more receptive to imports overall through integration, and that the move away from domestic production was relative.

To measure these effects, Balassa compared the YEMs from 1953-1959 (before the EEC took effect) to the YEMs from 1959-1970. What he found was that in the early stages of economic integration, particularly the introduction of the customs union, trade creation had not only been significant, but it also exceeded trade diversion in absolute terms many times. This trade creation was in part a result of intra-industry specialization in manufacturing and economies of scale; in fact one-tenth of the growth rate of the common market in 1970 (or 0.5% of GNP) could be attributed to gains from economies of scale due to the rationalization of production.[108] The YEM for intra-area imports went from 2.4% (1953-1959) to 2.7% (1959-1970); basically, every 1% increase in GNP resulted in a 2.7% increase in intra-area imports in the period 1959-1970, a sign that integration was working. The largest increases in YEM occurred in fuels, chemicals, machinery, and transport equipment. Overall trade diversion did not

107 Appleyard et. al., 390.

108 Bela Balassa, "Trade Creation and Diversion in the European Common Market: An Appraisal of the Evidence," in *European Economic Integration*, ed. Bela Balassa (Amsterdam: North Holland Publishing Co., 1975), 117.

take place as, the YEM remained unchanged at 1.6%, but diversion did occur for specific products, such as non-tropical food, beverages, tobacco, chemicals and other manufactured goods.[109] Approximately 10% trade creation proper was observed, mainly due to the rise in the YEM for total imports. Balassa's analysis is important because it takes the dynamic effects of economic integration into consideration, and in doing so shows that integration within the EEC from 1959-1970 most certainly resulted not only in trade creation, but an increase in overall welfare.

It is important to note, however, that not all economists agree with Balassa's analysis, and other means of evaluating the effects on trade by a customs union have emerged over time. Yet there is no hard and fast rule for measurement, and Balassa's approach still remains useful today, though some contests its conclusions; in the end, economists generally agree that the effects on trade from the formation of a customs union are positive, though the overall effects may be small.[110] As well, even where trade is diverted, the prices on consumers generally tend to fall due to the removal of tariffs, thus overall welfare from the creation of a customs union tends to be positive.[111] As the external tariff to the outside world is reduced, one would expect to see further increases in welfare, but as was seen in the previous section, the EEC had particular trouble with Member States that imposed other fiscal measures on its citizens to the effect of a duty, which rendered the reduction of the CET practically null. This is important because it differentiates the theory on customs union from the actual practice. There are a number of loopholes Member States can use to protect their industries; though some of these measures are legal under the terms of the Treaty, many others are not authorized and thus produce negative

109 Appleyard et. al., 390-391.

110 Harrop, 65.

111 Ibid., 59.

effects. This is why at the end of the transitional period the Commission noted that the customs union was not fully complete.

Wilfried Prewo also conducted analysis on the effects of the customs union on trade flows, but whereas many scholars had examined the size of trade creation and trade diversion by looking at the union's effect on imports, Prewo set out to examine the union's effect on the EEC's export performance. His study looked at the export performance of the EEC countries between 1959-1965 and 1959-1970. He disaggregated the national economies by sectors, and then used a general equilibrium model to link all the sectors together, netting out the effects of growth on trade flows "to the extent that they would have persisted in the absence of the establishment of the EEC."[112] The economies of each country were disaggregated into seventeen sectors (eleven of which were treated as producing traded goods, and were the focus of the analysis). Prewo observed that from 1959-1970 the share of intra-EEC exports rose by 50%, and the total share of EEC-exports to third countries declined by 24%. However, though there was a redirection of exports from extra to intra-EEC countries, these decreases occurred in specific sectors, while others, such as manufactures, benefitted from the customs union, outweighing the decreases in other areas. Agricultural and food products experienced double export creation due to increases in intra-EEC exports, and exports to third countries increased as well, though between one-half and one-third of internal export creation.[113]

Table 5 shows the negative and positive percentage change in exports, by country, and provides evidence that the effects were not uniform across the board. It is interesting to note that within the time period 1959-1965, relatively early in the integration process, half of the Member

112 Wilfried Prewo, "Integration and Export Performance in the European Economic Community," *Weltwirtschaftliches Archiv* 110 (1974): 2, http://www.jstor.org/stable/40438741 (accessed December 15, 2011).

113 Ibid., 14.

States experienced a decrease in total exports, but within five more years, every state experienced an increase. Italy had the largest percentage increase in exports both to intra-EEC countries and nonmembers, followed by France, Germany, the Netherlands, and Belgium-Luxembourg. This is fascinating because both Italy and France were high tariff states, and it would be expected that low-tariff countries would experience the highest increase in exports, as the customs union lowered tariffs to previously high-tariff countries. However, the increases in competition, as a direct result of the customs union, encourages previously high-tariff states to shift from inward-looking trade policies to an export-oriented strategy, causing increases in exports. As lower tariff rates lead to an increase in imports, countries adjust their trade strategies to remain competitive and establish equilibrium in the balance of payments. It is also worth noting, in this particular case, that France also benefitted from the devaluation of the franc at the end of 1958.

Table 5. Percentage Change in Exports, by Country (1959-1965 and 1965-1970)

Country	Year	Intra-EEC Exports	Extra-EEC Exports	Total Exports
Belgium-Luxembourg	1965 1970	-8.7% 12.1%	-8.9% -1.3%	-8.8% 7.6%
France	1965 1970	31% 92%	-16% -2%	-1.7% 28%
Germany	1965 1970	24% 68%	4% 31%	10% 43%
Netherlands	1965 1970	24% 62%	-26% -19%	-4% 17%
Italy	1965 1970	107% 161%	13% 34%	39% 70%

Source: Wilfried Prewo, "Integration and Export Performance in the European Economic Community," *Weltwirtschaftliches Archiv* 110 (1974): 19-26.

The negative figures experienced by Belgium and Luxembourg across the board from 1959-1965 are possibly be due to the fact that intra-Benelux preferences were abolished, leading to a decline in traditional exports of intra-Benelux trade. It took some time before Belgium and Luxembourg could match their decreases in exports that would have gone to the Netherlands with exports to other EEC partners; by 1970 these negative figures all turn positive. This is also a possible reason why Dutch exports to third countries suffered the largest decline, with the exception of fuels and chemicals, all other sectors experienced a drop in exports. It must be kept in mind that the Benelux countries already had the lowest tariff rates within the EEC, and in some cases had to increase rates on certain tariffs to match the CET. As a result, one would expect that the effects of the customs union would have a minimal effect on these countries as they were already very open to trade, and could not liberalize further without creating imbalances within the Community. Thus, the Benelux took early sacrifices while the other three caught up—as the level of trade liberalization leveled out, a change in the trade volumes occurred.

Overall, intra-EEC trade among the EEC increased substantially, but the smaller Benelux countries seem to have witnessed less increases in their exports early on. This is vital to understanding the effect of market size on economic integration. As states compete to build economies of scale, the larger the market size, the greater means for competition.[114] Though the Netherlands and the Benelux showed positive signs of export growth from 1965-1970, the early years were slow; as a result, Germany, Italy and France benefitted the most from customs union, especially in the early years. If one were to look at the figures in absolute terms, Germany comes out on top, not only as the top total exporter, but also as the leader in intra-EEC exports, mostly

114 Prewo, 28.

due to the vast size of its market.[115] As would be theoretically expected, Germany's largest increase in intra-EEC exports was to the previous high-tariff states, France and Italy. The states with the previously highest tariff rates benefitted the most in percentage terms because their markets opened up substantially from previous levels, fostering a boom in both imports and exports. To fully grasp the scope of the EEC project, one only has to look at the trade figures. It is quite apparent that the EEC became a formidable trading bloc.

Table 6. Extra-EEC Trade with the World, Exports & Imports (in billions of ECU*)

Year	**Total Exports**	**Total Imports**
1958	64.2	68.6
1960	78.5	82.1
1970	200.8	210.9

Source: *Eurostat, External and intra-EU trade Statistical Yearbook, Data 1958-2009* (Luxembourg: Publications Office of the European Union, 2010), 14-16.

*1 ECU= 1 USD

As has been shown in the above analyses, economic integration has the most beneficial effects when the following conditions are met: a higher level of preunion tariffs combined with a low common external tariff; an elastic supply and demand; greater number of members in the union; ease of switching from higher-cost domestic source to lower-cost member source; greater preunion per-unit cost differences between two sources; and greater opportunities for economies of scale and attracting FDI.[116] Of course, countries should also be geographically contiguous to gain the most from reduced transport costs.

115 Ibid., 23.

116 Appleyard et. al., 395.

Reflections on the Customs Union

Looking back at the path chartered by Belgium, France, Germany, Italy, Luxembourg and the Netherlands, one cannot help but feel a sense of awe at the accomplishments of the early years of integration. Historic rivalries were transcended and an entirely new organizing principle for relations among the Six set down. In many ways, the EU has achieved the impossible, but to do so, its founding members had to imagine the world beyond what is was, and create the foundations of what could be. This was not pragmatism, this was daring. It was exactly what was needed at a time when the past had exhausted all alternatives and there was a strong sense among the peoples of Europe that something had to change. This change, could have, in fact, taken different forms, but for reasons outlined above, the path chosen was one that would lead to a customs union, and eventually, common market. This decision was not easily arrived at, and the lengthy negotiations, bargaining and compromise are a testament to the fact that this was not going to be a simple feat. Despite claims of supranationalism, the Community that was created was anything but. The states have always retained a strong degree of autonomy, but have learned to cooperate for the common interest. It is this willingness to see beyond traditional forms of international organization and interaction, the ability of states to feel a sense of unity and community with its neighbors, and to ultimately recognize that prosperity can be achieved through cooperation just as well, if not more successfully than unilateralism, that has served as the foundation of the EU's greatest achievements. This cooperative spirit has yielded vast benefits; from 1958-1972 total trade grew three-fold, and intra-community trade increased by a factor of nine, an amazing achievement.[117]

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117 European Commission, *The Customs Policy of the European Union* (Luxembourg: Office for Official Publications of the European Communities, 1999), 6.

This is not to say that integration has been perfect. The customs union, though declared complete eighteenth months ahead of schedule, was not really at full operating capacity. Internal border frontiers still existed and did customs checks; customs clearance procedures and documentation were not applied uniformly; national customs legislation was not fully harmonized; the CET was not applicable to all items, and some duties still remained within 15-25% of the basic duty; and the Member States still used protectionist measures internally to distort prices and help national industries. It is important to realize that completing the customs union even within the twelve-year transitional period, would have been impossible, but in 1968, the foundation was effectively set, and the remaining benchmarks would have to be met in incremental adjustments. The Member States were aware of this, and at the moment *désarmement douanier* was declared, they continued on the work they had been doing for years. Thus, the declaration was the acknowledgement of the enormous progress achieved at that point, but also a reminder that much more had to be done. To explain, just a few days after the customs union was 'complete' the Commission asked the European Economic and Social Committee (EESC) to review progress to date and outline those areas to which the Community should focus its attention.

In the opening paragraph, the report states that the completion of the customs union is an "important milestone," but "it merely marks the end of one stage and implies the need to press ahead with the process of economic union in a dynamic, systematic fashion."[118] As the previous sections have shown, the Treaty envisioned the creation of a common market as well, for which the customs union would provide the basis for this next leg of integration. What the Treaty did

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118 Economic and Social Committee of the European Communities, *Consultation and Advice of the Economic and Social Committee on the General Situation of the Community* (Brussels, 76th plenary session on 26/27 February 1969), 6.

not outline, however, was how this was to be achieved. With the customs union, most stages in the process were clearly laid out, and items not accounted for underwent a lengthy ad hoc process of eventual compromise and cooperation. Yet it was these latter processes that produced the greatest challenges, leaving a slew of issues that remained unsolved by 1968. The EESC noted the following remainder issues as the key obstacles to further integration: retention of controls at internal frontiers; lack of tax harmonization; need to harmonize customs legislation; survival of varying health, veterinary and technical rules and regulations; the imperfect state of freedom of establishment; and difficulty adjusting supply and demand for agricultural produce.[119]

Though there were many other hurdles to pass, these related expressly to the transition from one stage of integration to the next. However, to successfully move on to the next stage, the first had yet to be fully realized. One of the problems noted in the report were the differences in Member States' views on key political issues; this has in fact been true since the beginning of the integration project, and remains even today. The fact is that differences will always exist, but the political will to transcend these differences can ebb and flow, which is why the Committee specifically noted the necessity for political will to foster economic integration.

The leftover issues of the customs union required an abundant political will to solve, as the process became ever more technical and bureaucratic. Harmonizing customs legislation was just the proverbial tip of the iceberg; technical and administrative obstacles to trade remained, and differences in economic, financial and tax legislation still had to be approximated.[120] Though this process was already underway, the numerous ad hoc committees and technical nature of the

119 Ibid., 7-8.

120 Ibid., 8.

project made progress quite slow. As well, as the market evolved, Community procedures had to constantly adapt, leaving little room for the type of ambiguity enshrined in the Treaty. The EESC report concluded by asking the Member States to focus on achieving the tasks they originally set out, but also to look beyond the Treaty and take those actions that would result in more than just a harmonization of national policies. European integration has always been about more than pure economic consideration, and the Committee proudly stated that the "creation of a free, humane society should be the grand design of European unity."[121] Though this seems awfully lofty and idealistic, it does, at its heart, speak to the force that has propelled European integration forward. In fact, the Treaty of Rome was equally ambitious, and had it not been for that desire to attempt the impossible, the Six may not have realized their full potential.

Given the experience of the original Six on their path to customs union, what lessons can be gleaned from this analysis that could be useful to other integration projects? First, economic integration is a highly technical process that often takes place at very high levels of government, but it also involves various actors from the private sector, such as industry, business, and civil society groups. Thus, strong leadership, understanding of unique national interests, and cooperation are key to success. The development of the EEC also showed that integration is a dynamic and evolutionary process, and that any treaty that places limitations on this adaptation will undoubtedly fail to capture the full benefits of integration. The Treaty was left vague in a number of areas for many reasons, but mainly because the scope of this project was so large and thus so unfamiliar, that it would take a degree of flexibility and trial and error to realize its key aims. Third, schedules (specific or roughly defined) for the completion of various benchmarks should be set for the early stages of the process. This is imperative, as it motivates states to meet

121 Ibid., 18.

their deadlines, but it also ensures that the project is taken seriously. The sections of the Treaty that were most vague and provided no benchmarks, such as transport and energy, were either given insufficient attention, and often fell off the priority list. Next, member countries should prepare for obstacles, because they most definitely will arise. The authors of the Treaty were aware of this, and thus included various Articles (27,177, 235) that would allow the Council or the Commission to take action deemed necessary for the implementation of the Treaty. They were further assisted by the ECJ, whose rulings not only helped settle contentious disputes, but also set important precedents in the development of a Community legal order.

Fifth, the impact on national legislation must be considered early on. This was one of the greatest challenges of the EEC, and remains an obstacle in many sectors even today. The Treaty was virtually silent on harmonizing national legislation, and did not provide strong mechanisms for implementation in this area. This caused delays in the realization of the CET, and the asymmetric application of customs procedures. Sixth, integration does not take place in a bubble, and actors at multiple-levels within states and the international community can have a big impact. When specific issues affected industry interests, such as the CAP, interest groups were heavily involved in lobbying their governments to secure vital subsidies.[122] Also, the various rounds of GATT tariff negotiations showed the EEC that they must present a unified front to protect the interests of the Community. Furthermore, international tariff reductions subsequently led to the customs union project being sped up twice. Though the Member States were ready for this, the potential for problems could have arisen had they not been on the same page in the negotiations. Lastly, member countries have to be willing to compromise and maintain a sense of community that can foster the political will necessary for such a project. The technical nature of

122 See Lindberg, *The Political Dynamics of European Economic Integration*, 219-260.

integration in itself can be daunting, as was seen with the development of a common customs nomenclature, but this does not mean that it cannot be accomplished. It is true that the Member States' national interest has always and will always come first, but the interests of the Community are always kept in mind. Thinking beyond national boundaries can be difficult, but it has been the cornerstone of the European integration project.

Reflecting on the creation of the customs union in the European Community is a reminder that economic integration is a slow, evolutionary and intricate process that is the product of the aspirations of its Member States. As a result, the European project in itself could not and probably would not be replicated, as it set out to address the specific issues of the region. However, this study does not seek to create a carbon copy, but rather to learn from the European experience those processes of integration that lead to success and failure. By identifying the key themes and lessons that the Six learned on their path to customs union, one can begin to understand the complexity of the process, while shedding light on those mechanisms that lead to success. In fashioning a model that could apply to North America, these items must be kept in mind and serve as guiding principles, and in some cases, warnings, of what can be expected. One of the most important lessons from the European experience is a simple one: be bold. The Treaty was unabashedly ambitious, and set out to do what many at the time thought to be unimaginable, but as T.S. Eliot reminds us, "Only those who risk going too far can possibly find out how far one can go."[123] The European experience has shown us the possibilities, and it is for us to decide our limitations.

123 T.S. Eliot, preface to *Transit of Venus: Poems by Harry Crosby* (Paris: Black Sun Press, 1931).

CHAPTER 4

PROSPECTS AND CHALLENGES FOR NORTH AMERICAN INTEGRATION

Compared to Europe, the integration process in North America has been limited. It is essential to understand why this is the case because as the European experiment has shown, origins are important. The reasons countries choose to integrate and the objectives they hope to achieve by doing so set the pace and scope for the integration project. The Europeans took a long view and painted with broad-brush strokes—Canada, Mexico and the United States had a short-term and limited vision, and thus were careful to color inside the lines. This has major implications for deciding what the next step, if any, should be in the North American integration project. This section seeks to answer this question by first laying out the origins of integration in North America, juxtaposing it to the European experiment. The differences will be clear. Doing so will also provide an accurate basis for evaluating NAFTA with criteria based on the objectives that the agreement hoped to achieve. The purpose is to show that NAFTA achieved exactly what it set out to do, but because it was so limited to trade liberalization, and influenced by ill-placed fears of a loss of sovereignty, many issues were left behind. As a result, North America suffers from an incomplete integration process that is characterized by asymmetry and ambivalence.

The aim of this section, and purpose of this project is to ask people to think differently about North America, but also to be open to ideas for improving the relationship among our three countries, so that we can fully extract the benefits of economic cooperation. This paper explores one possibility for North America's future, and sets out to examine if the next step in the integration process is possible, what challenges it may face, and if the European experience can help illuminate the way for solving our common problems.

The Origins of North American Integration

Historically speaking, Canada, Mexico and the United States have shared a relationship characterized by ambivalence. Their sentiments towards each other are deeply rooted in their unique colonial pasts, which have played a major role in shaping the values and attitudes of each state towards its neighbors and the world.[124] All three countries, at one time or another, have either pushed for another's attention, or asked to be left alone. This ambivalence is related to the asymmetry of power on the continent, with the U.S. becoming oddly insecure as time passes. Though there have been points in history where the level of cooperation has been notable, such as the 1854 Reciprocity Treaty, the 1909 Boundary Waters Treaty, the 1942 Bracero Program, the 1964 Maquiladora Program, and the U.S.-Canadian Automotive Agreement of 1965, only in the 1980s did the relationship among the three countries fundamentally change.

Something happened in the 1980s that made the interests of all three neighbors converge. First, there was a growing trend towards regionalism. Europe, which had been integrating since the 1950s, took a big leap to complete the common market with the Single European Act in 1986. The trading bloc's ability to pull itself out of the 1970s recession was seen by many as a model worth emulation.[125] The economic impasse of the 70s inspired the revitalization and emergence of many regional projects, such as the Southern Common Market (MERCOSUR), the South African Development Community (SADC), the Association of Southeast Asian Nations

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124 For further reading on this topic see Greg Anderson and Christopher Sands, "Fragmegration, Federalism, and Canada-United States Relations," in *Borders and Bridges: Canada's Policy Relations in North America*, ed. Geoffrey Hale and Monica Gattinger, 41-58 (Don Mills: Oxford University Press, 2010); Anthony DePalma, *Here: A Biography of the New American Continent* (Cambridge: The Perseus Group, 2001); Pastor (2011); and Jorge I. Domínguez and Rafael Fernández de Castro, *The United States and Mexico*, 2nd ed. (New York: Routledge, 2009).

125 Jeffrey A. Frankel, *Regional Trading Blocs in the World Economic System* (Washington DC: Institute for International Economics, 1997), 4-7

(ASEAN), and the Economic Community of West African States (ECOWAS). The U.S. was strongly committed to international trade liberalization through the Uruguay Round, but as it became clear that the Europeans were looking ever inward and not willing to budge on key agricultural tariff reductions, a new reaction emerged. The U.S. broke from the exclusive multilateral trade framework with two minor, strategic agreements—the U.S.-Israel Free Trade Agreement, and the Caribbean Basin Initiative, and this might have led other countries to consider a trade initiative to the U.S.

Canada, largely due to the new movement towards trade liberalization led by Prime Minister Brian Mulroney and the Conservative Party, along with key industry and business leaders, proposed in 1985 a Canada-U.S. Free Trade Agreement (CUSFTA) and concluded an agreement in 1988.[126] American trans-national corporations were experiencing big changes in the organization of production beginning in the mid-1970s. The new division of labor created highly competitive global and regionally integrated production networks.[127] These complex supply chains required the establishment of effective free trade regimes that allowed products to move across borders without facing high tariff barriers. Europe took the lead here again, having eliminated internal tariff barriers among its member states—the U.S. thus faced stiff competition from the highly integrated European market. Japan was also emerging as a strong competitor as well. Therefore, it was the perfect time for Canada to initiate a free trade agreement, as the U.S. would embrace the opportunity to increase its market share and create efficiencies in production.

Significant change had arrived in Mexico as well, with the election of Carlos Salinas in 1988. A Harvard educated economist, Salinas came to office with reform on his mind. He

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126 Ibid., 6-7.

127 Marianne H. Marchand, "North American Regionalisms and Regionalization in the 1990s," in *Regionalization in a Globalizing World, A Comparative Perspective on Forms, Actors and Processes*, ed. Michael Schulz, Fredrik Söderbaum and Joakim Öjendal (London: Zed Books, 2001), 200.

recognized the failure of the import-substitution industrialization policy that had driven the country into a sea of debt and set out to liberalize Mexico's economy. President George H.W. Bush had suggested a free trade agreement between the U.S. and Mexico shortly after Salinas' election, which at the time he rejected, citing economic instability; however, if Bush was willing to help with the debt problem, Salinas was also willing to consider free trade, but the debt had to be reduced first.[128] In March 1989, the U.S. Treasury Secretary announced the 'Brady Plan' that would grant debt relief for highly indebted countries in exchange for economic reforms and assurances for debt collectability by principal and interest collateral. This shift from debt repayment, to forgiveness and restructuring had an impact on Mexico's negotiations with the IMF and World Bank. Salinas' advisors were successful in convincing the IMF of their proposal "whose purpose was not to pay but to recover growth," an unprecedented achievement at a time when the IMF had been consistently firm on repayment, currency devaluation, and subsequent slow recovery.[129] The success of this policy was significant; in 1988, Mexico's public debt was 63.5% of its GDP, but by 1994, this figure was reduced to 22.5%.[130] Though the debt-to-GDP ratio still remained quite high, this was a major achievement in a very short period of time.

When Mexico was ready to start pursuing free trade deals in 1990, it did not first turn to the United States. Mexico was primarily concerned with securing foreign direct investment, and at the 1990 meeting of the World Economic Forum at Davos, Switzerland, Salinas tried to foster interest from Japan and the EU. The Japanese were not very interested in the proposal, and the Europeans were preoccupied with the newly independent eastern bloc countries that would need

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128 Carlos Salinas de Gortari, *México: The Policy and Politics of Modernization*, trans. Peter Hearn and Patricia Rosas (Barcelona: Plaza & Janés Editores, S.A., 2002), 12.

129 Ibid., 21.

130 Ibid., 35.

serious economic support in the coming years.[131] Salinas then decided to pursue the offer proposed by Bush a year earlier, hoping that the Americans were still willing to negotiate. He could not have had better timing.

Negotiating the North American Free Trade Agreement

When Mexico signaled it was ready to talk to the U.S. about free trade, it did not envision a trilateral deal. Shortly after Mexico's proposal, Secretary of State James Baker called the Canadian ambassador in Washington to inform him of it.[132] Mulroney was simply not interested; as he saw it, Canada traded too little with Mexico for a FTA to be useful, and Canada already had a separate agreement with the U.S. (CUSFTA). However, Mulroney established a task force to examine the idea. The task force concluded that giving Mexico access to the Canadian market would not pose a major threat to domestic industry (with the exception of agriculture and textiles), but also that remaining absent from the talks would effectively create a hub-and-spoke model of bilateral FTAs, where the U.S. would benefit most through a divide and conquer strategy.[133] There was also a fear that a surge of U.S. bilateral deals would dilute the importance of the Canada-U.S. relationship and distract the U.S. from its northern neighbor.

At first, Mexico was open to the idea of including Canada, but when it became clear that the Canadians were primarily interested in protecting the gains they had already made with their previous deal and securing a few key concessions, the northernmost partner became more of a

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131 Maxwell A. Cameron and Brian W. Tomlin, *The Making of NAFTA: How the Deal Was Done* (Ithaca: Cornell University Press, 2000), 62.

132 Ibid., 64.

133 Ibid., 64.

hindrance than asset at the negotiating table. The Canadian team even walked out of the talks at several points in the process to take a stand on priority issues, such as U.S. trade remedy laws. What Mexico quickly realized was that it had the most to win and the most to lose from the trade talks because it had nothing to fall back on. However, the U.S. was also concerned about Canadian involvement particularly because the CUSFTA was a difficult sell to the Canadian public years earlier. There was a real concern that Canada might pull out of the NAFTA negotiations before they were completed and thus prevent the U.S. and Mexico from having a trade deal. To allay these fears, the three trade ministers met before the start of negotiations, where they agreed that if Canada were to drop out, Mexico and the U.S. could continue the negotiations themselves.[134]

It is important to note, however, that much of the conflict and bargaining over NAFTA did not occur at the inter-state level, but within each state itself. In Canada, the Business Council on National Issues (BCNI), headed by the CEOs of Canada's largest corporations, was instrumental in getting the trade talks high on the government's agenda, and it offered strong support from the business community.[135] Furthermore, over 160 corporations (20% of which were foreign owned) donated $5.2 million to the Canadian Alliance for Trade and Job Opportunities to lobby for the FTA.[136] This was helped by support from the governing federal party and career bureaucrats who were strongly committed to a policy of trade liberalization at the time. Certain provinces also gave their support; Quebec was hoping to build a trade policy more independent from the rest of Canada, and Alberta set its sights on the prospect of a

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134 Carla Hills, e-mail message to author, March 8, 2012.

135 Robert O'Brien, "North American Integration and International Relations Theory," *Canadian Journal of Political Science* 28, no. 4 (Dec. 1995): 711, http://www.jstor.org/stable/3232007 (accessed April 18, 2011).

136 Ibid., 714.

continental energy market. However, there was also opposition to the deal from a coalition of women's, labor, nationalist, environmental and cultural groups that feared a 'race to the bottom' and loss of Canadian identity as it merged closer to the U.S. market.

A similar opposition movement emerged in the U.S., where the narrative was framed as a populist struggle against the forces of globalization. The Citizens' Trade Campaign (CTC), the Alliance for Responsible Trade (ART), Pat Buchanan's 'America First' campaign (which framed the debate as one over sovereignty), and Ross Perot's 'United We Stand America', provided the most ardent opposition.[137] Though the extreme populist groups mostly relied on misinformation campaigns that tugged at the basic insecurities of the population, the others cited real concerns. This is evident by the fact that two side agreements on Labor and the Environment were included in the final text. The governments responded to pressure from these two groups, which were well organized and effective in explaining their concerns. In fact, one of the key problems with the interest groups was that they were large in number and not well coordinated amongst themselves (with a few exceptions). The issue areas that they covered also varied extensively, and at times, many of these groups clashed with each other.[138]

Though the drive for the FTA in Mexico was largely an elite, state-led process, some opposition had formed. A majority of the opposition was created by general discontent over domestic restructuring policies in the 1980s, which led to a decline in per capita GDP by 12% and real wages by 45%.[139] What is interesting is that in the U.S., interest groups targeted the domestic legislative process, whereas Canadian and Mexican interest groups lobbied at both the domestic and transnational level; in fact, opposition groups in Canada and Mexico "joined hands

137 Marchand, 205.

138 Ibid., 206.

139 O'Brien, 715.

early on and coordinated their campaigns by sharing information and providing mutual support," especially women's groups, which were hardly represented in the U.S.[140] High-level Mexican officials from Salinas' cabinet were also instrumental in lobbying Congress to seal the deal. Salinas himself was also very effective at building support for the FTA, selling it as a way to bring Mexico into the First World—given the economic hardship the country was facing, it seems that a popular consensus formed around trying this new endeavor to see what it could bring. Salinas was also thinking ahead. He worried that once he left office, his successor would turn back all the reforms he had enacted; a FTA would solidify the commitment to trade liberalization and ensure that his reforms could not be reversed.[141]

The trend that emerges through these pressures and processes is that a region was beginning to take shape. Negotiating the FTA led to the formation of transnational epistemic communities of business leaders, political elites and civil society actors that began to interact in an entirely new manner. Just as the political tides were changing towards recognition of a new reality in global commerce and the utility of regional integration, business interests converged to provide indispensible support as they searched for a new method to reinvigorate the economy and increase competition. Therefore, it was not just the exogenous shocks of economic downturn and competition from Japan and Europe that propelled the three countries of North America down the path to integration, but also the ideational processes and convergence of domestic political interests that provided the catalyst for the project.[142]

This new attitude towards the structure of international trading relationships broadened

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140 Marchand, 206.

141 Marchand, 201.

142 Stephanie R. Golob, "Beyond the Policy Frontier: Canada, Mexico, and the Ideological Origins of NAFTA," *World Politics* 55, no.3 (April 2003): 375, http://www.jstor.org/stable/25054227 (accessed February 1, 2011).

the policy options available to the U.S., and in turn allowed for its two neighbors to step forward with proposals that in previous years would have made Canada and Mexico feel uneasy. It is important to note that in Mexico, anti-Americanism was on the decline as the number of immigrants from Mexico to the U.S. increased.[143] This made Mexico far more open to the idea of a deeper trade relationship with its neighbor. In Canada, the impetus for a closer relationship with the U.S came from a desire for more FDI and trade liberalization. Goldstein and Keohane have argued that foreign policy change is often influenced by new ideas that arise at times of uncertainty, which gives decision makers opportunities to experiment with new policy options.[144] This is exactly what occurred in the 1980s and early 1990s; responding to economic downturn and a change in the organization of production, Canada, Mexico and the United States had formalized their relationship through NAFTA and set out on a new stage in their relationship. However, each country's primary concern was, for different reasons, to maintain their sovereignty. This is precisely why a customs union was not considered during the NAFTA negotiations; first, neither country wanted to give up independence in setting its MFN rates, and second, the CUSFTA already provided a working template for the region.[145] This resulted in a limited agreement that did not look beyond basic trade liberalization, and subsequently failed to include provisions that would lead to deep integration.

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143 Robert Pastor, e-mail message to author, March 13, 2012.

144 Judith Goldstein and Robert O. Keohane, "Ideas and Foreign Policy: An Analytical Framework," in *Ideas and Foreign Policy: Beliefs, Institutions and Political Change*, ed. Judith Goldstein and Robert O. Keohane (Ithaca: Cornell University Press, 1993), 17.

145 Jaime Serra Puche, e-mail message to author, March 13, 2012.

Evaluating NAFTA: Objectives, Institutions, and what was Left Behind

To understand why more integration could be beneficial to North America, it is pertinent to first examine the agreement that started the formal process along. In order to properly evaluate NAFTA one must look at its objectives. First, the agreement set out to build a FTA, which is nowhere near the ambition of the European drive for a customs union and common market. Instead of building 'an ever closer union', NAFTA aimed to "strengthen the special bonds of friendship and cooperation among [its] nations."[146] Second, its objectives were clear: "the progressive elimination of tariff and non-tariff barriers to trade in goods and the establishment of reciprocal national treatment obligations regarding trade in services and investment."[147] Tariffs on goods outlined in the CUSFTA (which was carried into NAFTA), were eliminated between Canada and the U.S. on January 1, 1998, and almost all goods originating from Mexico became duty free in 2008.[148] Three speed-up decisions in 1997, 1998, and 2002 helped this process along. The gains from these reductions are clear in the figures—between 1994 and 2010 trade between the three countries tripled and foreign direct investment increased by a factor of six.[149]

Though other objectives were mentioned in the agreement, such as harmonizing health and technical standards and enforcing basic workers' rights, the mechanisms to implement these measures were weak. In fact, the most distinguishing characteristic of NAFTA is that it created

146 "The North American Free Trade Agreement," January 1, 1994, *NAFTA Secretariat*, http://www.nafta-sec-alena.org/en/view.aspx?x=343 (accessed January 5, 2012).

147 Frederick M. Abbott, "Integration without Institutions: The NAFTA Mutation of the EC Model and the Future of the GATT Regime," *The American Journal of Comparative Law* 40, no. 4 (Autumn, 1992): 936, http://www.jstor.org/stable/840798 (accessed February 28, 2012).

148 Foreign Affairs and International Trade Canada, "Tariff Elimination," Trade Negotiations and Agreements, http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/tariff-accel.aspx?lang=en&menu_id=48&view=d (accessed February 9, 2012).

149 Pastor, *The North American Idea*, 8.

weak and almost no institutions with little authority. This is largely the result of U.S. distrust of supranational institutions, and Canadian and Mexican fears of U.S. dominance, though one could argue that stronger institutions would effectively reduce U.S. dominance in the region. The key problem in North America is that though the economies have become more integrated and transnational interests have become stronger, the governance structure and policy process of the region has not kept up with the pace of economic integration.[150]

To explain, NAFTA created a number of committees on various topics that would address issues as they arose; the setup is very ad hoc, highly inter-governmental and practically useless. Furthermore, NAFTA Summit Meetings of the three leaders have grown sparse and serve simply as photo-ops as opposed to real forums for discussing shared problems. The executive body of NAFTA, the Free Trade Commission, which is made up of the three trade representatives of the signatories, meet rarely and do little to set the agenda. The Commission has no real power: it cannot mandate the approximation (or harmonization) of legislation, cannot put forward binding proposals, nor does it have a permanent bureaucracy that could provide policy continuity as the administrations of the three countries change hands. Also, NAFTA created its own dispute resolution mechanism, which unlike the WTO mechanism, consists of an ad hoc panel of non-permanent arbitrators; since the WTO mechanism is far more advanced and has the effect of precedent setting, the NAFTA countries tend to take their cases there instead of settling disputes with the NAFTA dispute settlement mechanism.[151] Such an aversion to permanent and effective regional institutions in North America has hampered the formation of a

150 Karl Meilke, James Rude and Steven Zahniser, "Is 'NAFTA Plus' an Option in the North American Agrifood Sector?" *The World Economy* 31, no. 7 (July 2008): 926.

151 Center of Research for Development, "Specific projects of our work program 2003," Organization for Economic Cooperation and Development, http://www.oecd.org/dataoecd/27/26/35074872.pdf (accessed February 28, 2012).

true sense of community as well as a mechanism for continued dialogue, agenda setting and problem solving.

Though there are critics that suggest NAFTA has had a negative effect on the economies of its three signatories, the data has proven otherwise.[152] Much of the confusion in evaluating the agreement comes from the methodology employed for measurement. Sydney Weintraub illuminates this problem by explaining that when NAFTA was being sold to the public, its benefits were explained in oversimplified and incorrect terms. For example, a causal link was drawn between increased export value and job creation, causing analysts to focus on measuring the merchandise trade balance among the NAFTA countries as an indicator of job creation.[153] This measurement, however, misses the mark because job gains or losses are difficult to attribute directly to trade policy, as they are largely the result of domestic macroeconomic policy or increases in efficiency due to automation, for example.[154] Weintraub suggests that more accurate criteria for evaluating NAFTA should focus on: total trade among NAFTA members, intra-industry trade and specialization, labor productivity, the effect on the competitive position of industries, effects on the environment (as a result of the side agreement's objectives), and institution building or greater cooperation. Figures 1, 2 and 3 examine some criteria that are helpful in understanding the impact of the agreement.

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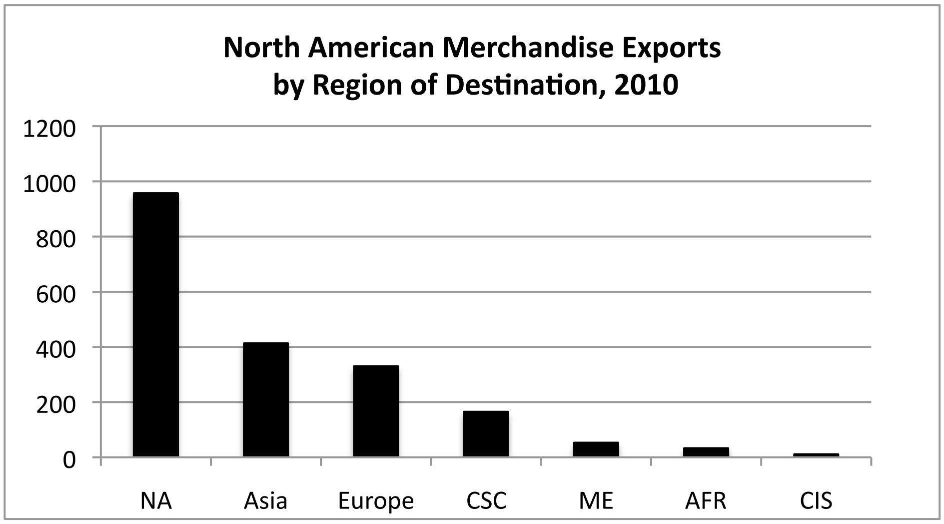
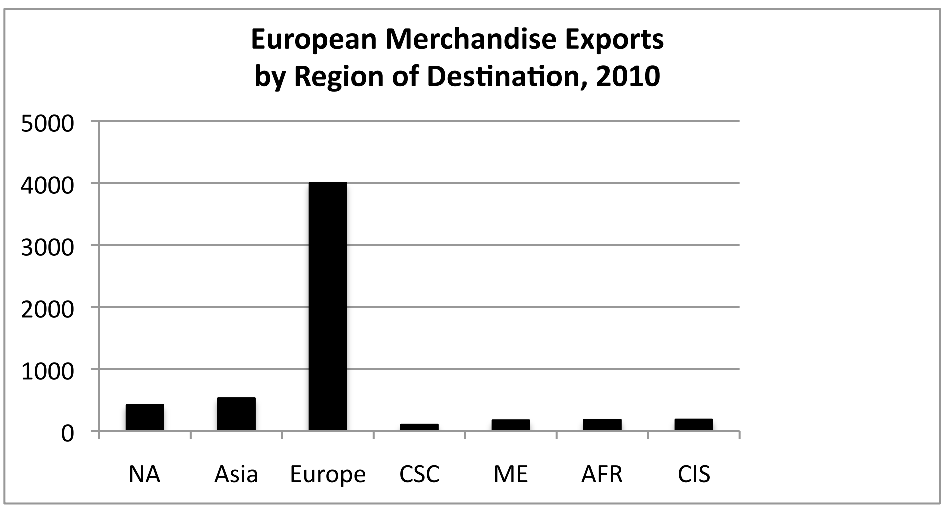
152 For critical analysis of NAFTA see John Audley, Demetrios G. Papademetriou, Sandra Polaski and Scott Vaughn, *NAFTA's Promise and Reality: Lessons from Mexico for the Hemisphere* (Washington DC: Carnegie Endowment for International Peace, 2004) and Robert E. Scott, "The High Price of Free Trade," *Economic Policy Institute*, Briefing Paper, no. 147 (November 17, 2003).

153 Sidney Weintraub, *NAFTA at Three: A Progress Report* (Washington DC: Center for Strategic and International Studies, 1997), 5-6.

154 Ibid., 9, 12.

Figure 1. Merchandise Exports by Regional Destination, 2010 (in billions of USD)





Source: World Trade Organization, International Trade Statistics, 2011 (1958-2009), 12-13.

Note: NA (North America), CSC (Central and South America & the Caribbean), ME (Middle East), AFR (Africa), CIS (Commonwealth of Independent States).

Figure 1 shows the flow of merchandise exports by regional destination. Both North American and European figures are shown to offer a better understanding of the economic effects of a deeper regional integration project. The first graph shows that the majority of exports from Canada, Mexico and the United States are destined for the North American market for a total of $957 billion. Intra-regional trade in North America is thus quite strong, with 50% of all North American exports going to NAFTA countries. Europe is the most integrated region in the world with 71% of all exports, worth $3.998 trillion going to the European region. However, about 65% of all European merchandise exports go directly to EU members, still a high figure.[155] These figures are interesting because not only do they show the differences in regional integration schemes, but also that North American economies are oriented towards trade with their direct neighbors.

Figure 2 shows U.S. exports and imports with Canada and Mexico from 1994 to 2011. It is clear that since NAFTA, both imports and exports with Canada and Mexico have steadily risen, with the exception of a slight drop from 2001-2003, and a more significant drop after the effects of the 2008 financial crisis. Despite the crisis, trade has rebounded, and though it is not at pre-crisis levels, it is certainly on the rise. The high level of U.S. imports from both Canada and Mexico is not just a reflection of U.S. consumption, but also includes the import of intermediate goods for re-export. Therefore, it also reflects the growth of intra-industry and intra-firm trade since NAFTA's entry into force. The most integrated sector is the auto industry, which in 2005 accounted for 20% of intra-NAFTA trade.[156] Internal reforms in Mexico to attract foreign investment from the U.S., Japan and Germany have been an important factor in the expansion of this production chain, which has taken advantage of specialization in parts manufactures and assembly plants to where it is most efficient. American cars are no longer just made in America, but are part of an intricate production chain that is truly North American. High levels of intra-industry trade and specialization imply a strong degree of economic integration and a re-

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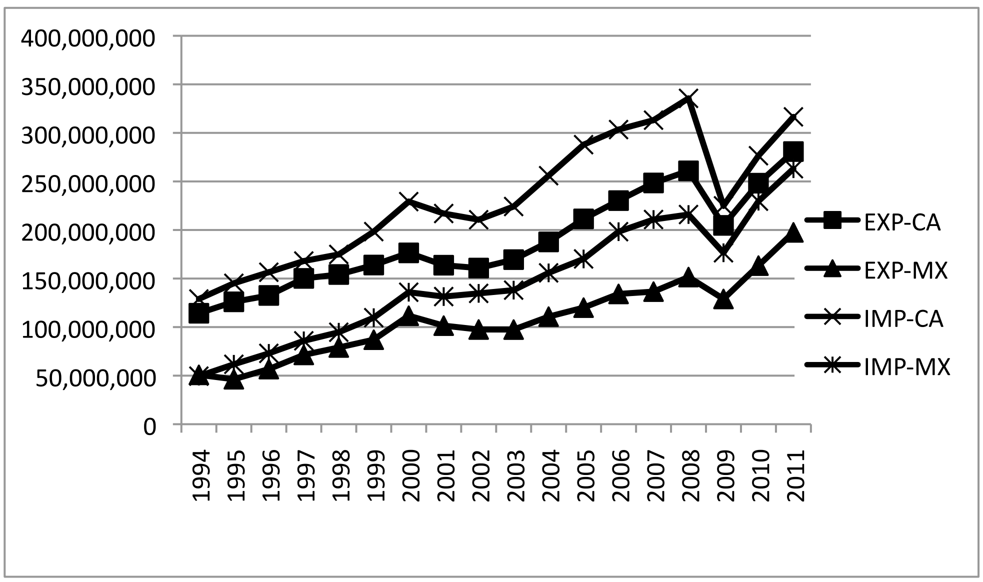
155 World Trade Organization, "International Trade Statistics, 2011," www.wto.org/stats (accessed February 28, 2012), 12.

156 Hufbauer and Schott, 19.

orientation of production, which allows for economies of scale to develop. In fact, 80% of U.S-Mexico trade is intra-industry.[157] The value of U.S. content in imports from Canada and Mexico further illuminates the growing importance of production chains in North America; "a full 40% of the value of U.S. imports from Mexico is made of content produced in the United States," and for Canada that figure is 25%.[158]

Figure 2. U.S. Exports and Imports with Canada and Mexico, 1994-2011(in thousands of USD)



Source: U.S. International Trade Commission, Dataweb, http://dataweb.usitc.gov/scripts/INTRO.asp

Note: Figures used are U.S. total exports and U.S. general imports.

Labor productivity is another important figure in assessing the impact of trade agreements because productivity levels reveal the impact of trade on real wages. As productivity increases, real wages should increase as well. The U.S. has had the most stable growth of labor

157 Ibid., 20-21, 37.

158 Christopher E. Wilson, *Working Together: Economic Ties Between the United States and Mexico* (Washington DC: Woodrow Wilson International Center for Scholars, 2011), 17.

productivity of the three countries, and Mexico has not felt any major shift in its productivity levels. A flexible work force, skills, and the use of technology all affect labor productivity. Canada has lagged behind the U.S. in labor productivity, largely due to the fact that Canada has less capital per worker than the U.S.; research and development (R&D) and the use of information technology (IT) to enhance productivity has also been a stronger feature of the U.S. market than in Canada.[159] Canada also has more capital-intensive sectors that do not benefit as much from IT, such as mining and energy, which account for a large portion of Canada's output.[160] Despite the lag, Canadian labor productivity levels are still quite good, but would definitely benefit from some improvements.

Mexico's productivity levels, on the other hand, have been far from impressive. This is a strong reminder that trade in itself is not enough, and that Mexico still has a long way to go before it can catch up with its neighbors. It is important to note, however, that trade has not made Mexican labor productivity any worse than it was before, but in fact, it has highlighted to Mexico what it needs to improve internally to catch up. To explain, Mexico can do a lot more to "improve its human skills, attract investment, and have its firms be competitive in both home and foreign markets."[161] Domestically, Mexico also needs to focus on economic and social policy, specifically improving the education system, improving infrastructure, and creating more opportunities for its rural populations. A strong macroeconomic policy is also important; the drop in productivity shortly after NAFTA's entry into force is strongly related to the Mexican peso crisis of 1994-1995, which led to a drop in real wages.[162]

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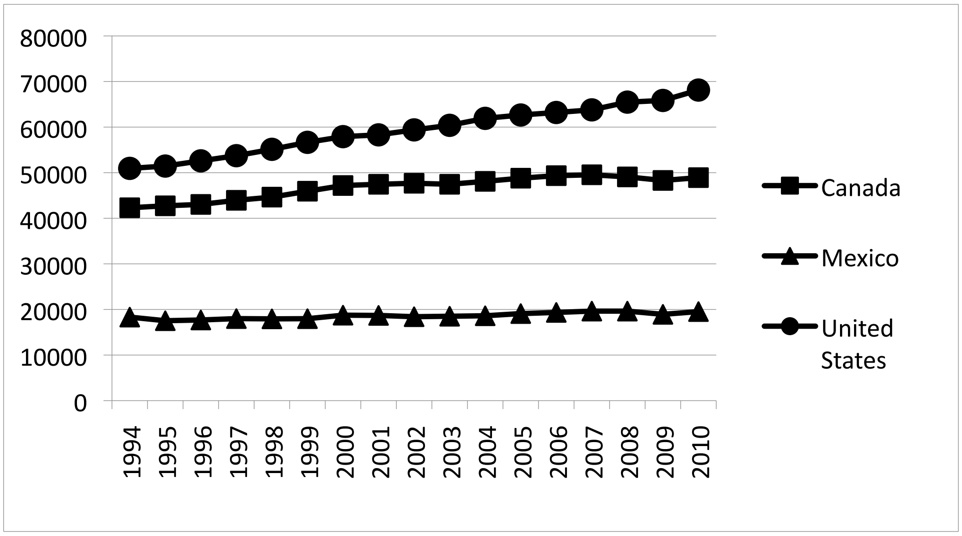
159 Hufbauer and Schott, 143.

160 Ibid., 43.

161 Weintraub, 20.

162 Hufbauer and Schott, 44.

Figure 3. Labor Productivity per Person Engaged, 1994-2010



Source: Key Indicators of the Labor Market Database, http://kilm.ilo.org/kilmnet/

Note: Data calculated at constant 1990 USD at PPP (in thousands of dollars)

The gap in productivity between Mexico and its northern neighbors further emphasizes the lack of a social charter in the NAFTA. The North American Development Bank was intended to assist with this gap in a very limited way, by providing funding for environmental and sustainable development projects. However, the bank does not address Mexico's most pressing development concerns. What NAFTA needed was something similar to the European Regional Development Fund (EDRF), whose goal is to correct the imbalance between Europe's regions. The ERDF does this through investment in local companies, infrastructure, telecommunication, environmental, energy, and transport projects, as well as by offering various financial instruments and technical assistance.[163] This would require the U.S., Canada and Mexico to recognize the income inequality gap, which they failed to do during NAFTA negotiations. Mexico is well aware of its development problems, and has been actively working to reduce

163 European Commission, "Regional Policy," http://ec.europa.eu/regional_policy/thefunds/regional/index_en.cfm (accessed March 14, 2012).

them. The poverty rate in Mexico declined from 42.5% in 1995 to 26.3% in 2000, and again to 18% in 2008—still a high figure, but the reduction is an important indicator of domestic policy change.[164] There is still much work to be done, and Mexico is traveling down the right path; to fully realize its goals it will undoubtedly need more help from its largest trading partners who have a direct stake in its stability and development.

What is clear from this analysis is that though NAFTA succeeded in accomplishing what it set out to do, the items left out of the integration process served as the greatest disappointments. Issues of labor mobility, border security, trade remedies, and regulatory convergence, are but a few items that never made it to the agenda. As a result, the problem of illegal migrant workers from Mexico to the U.S. market has not been addressed, a uniform strategy for securing our borders was never developed (the Smart Borders initiative went the old route of dual-bilateralism), and the North American market is limited in its potential due to the slew of non-tariff barriers (labeling, product certification, etc.) that prevent a truly free market of goods and services from becoming a reality. Therefore, the anger at NAFTA is largely misplaced—we should not be upset at what NAFTA did accomplish, but rather at what it failed to imagine.

The objectives of Canada, Mexico and the U.S. were limited to an agenda of trade liberalization. There was no grand ambition for institutional oversight, community building or continuity—NAFTA was the solution of the moment. It would help the U.S. put pressure on the Europeans for stalling GATT negotiations and strengthen its global economic competitiveness; Canada was looking for a means to secure its 'special relationship' with the U.S., increase FDI

164 Ibid., 51., and OECD, "Growing Unequal? Income Distribution and Poverty in OECD Countries," (October 2008), http://www.oecd.org/document/4/0,3343,en_2649_33933_41460917_1_1_1_1,00.html (accessed March 14, 2012).

and exploit economies of scale; and Mexico desired to ascend to the First World, break out of economic stagnation and secure a relationship with the U.S. that would prevent it from turning to protectionism. It was not a long-term plan, and as a result, the issues that would emerge after its implementation could not be dealt with effectively in its limited framework.

A North American Region

Given the descriptive account of integration in North America and an assessment of NAFTA, it is important to reflect on what this tells us about integration on this continent. First, each country maintains a degree of ambivalence towards its neighbors and thus favors integration arrangements that have the least impact on national sovereignty. Second, it is clear that something fundamentally changed in the 1980s and 1990s that offered an opportunity for a policy shift. The effect of exogenous economic shocks, and the convergence of ideational processes and domestic political interests provided the perfect catalyst for the regional building project to take place.

However, it is important to note that regionalization as such was not a priority, in fact, what the NAFTA negotiations make clear is that the U.S. in particular did not see the agreement as a choice of regionalism over multilateralism, but rather as an opportunity to take advantage of the geographic proximity and supply chain integration of North America.[165] Furthermore, within a year of its signing, WTO members returned to finish the Uruguay Round, an explicit policy outcome the U.S. was hoping would come about in response to its bilateral (and trilateral) trade liberalization efforts. As well, the lack of U.S. interest in deepening NAFTA is evident in its

165 Carla Hills, e-mail message to author, March 8, 2012.

proceeding policy priority, the Free Trade Area of the Americas (FTAA), which ultimately failed. The underlying U.S. interest has been in trade liberalization in general, not in specific region-building projects. As such, it looked to *widen* the gains from NAFTA, not *deepen* them. So what does this tell us about North American integration? Key themes that have characterized the process are as follows:

- A commitment to trade liberalization—integration has been focused on achieving this specific goal, on which the three countries share a broad consensus;

- Short-term vision—the NAFTA had a specific set of goals it set out to accomplish. The *ex ante* nature of the agreement highlights the fact that the negotiators were not looking for a long term, evolutionary integration process, but a solution for the moment;

- Dual-bilateralism—though NAFTA was a trilateral agreement, common issues continue to be tackled on a dual-bilateral basis, which leads to a lack of continental vision and sense of community. Canada and Mexico compete for U.S. attention while largely ignoring the benefits of approaching the U.S. on an issue together;

- Asymmetry—in terms of economic and military power, Canada and Mexico are severely disadvantaged by the U.S., and thus often hostage to U.S. will and the priorities of whatever administration is in power;

- Weak institutions and ad hoc structure—due to U.S. concerns over sovereignty, no strong institutions were created to implement, monitor or continue the dialogue of the integration process. As well, the NAFTA committees and working groups have proven largely ineffective;

- Lack of political will—with the exception of the meeting of the minds between Mulroney, Reagan/Bush, and Salinas, the North American leadership since then has given the region a low priority, and has not implemented any new and innovative ideas to improve the economic relationship;

- The influence of civil society, business, and industry—the people of North America seem to be operating as if the region truly does exist, often partaking in transnational lobbying, and pushing their national governments to address the concerns NAFTA did not deal with. Business and industry were also heavily involved in supporting NAFTA, and due to increasing economic interdependence, built epistemic communities that transcend national borders.

These themes highlight the main distinguishing feature of North American integration—its ideological basis. Canada, Mexico, and the United States negotiated NAFTA on the mantra of trade liberalization, whereas the Six founding members of the EU set out to build a lasting peace on the continent through stable and highly organized economic development. The Europeans were motivated not just by economic considerations, but a political desire for community building and joint problem solving. This has real implications for the shape, scope and direction of the integration process; market forces have largely shaped North American integration, where each government has reacted to economic changes (recession, production chains, improved border security, regulation) as they occur. This is also why economic integration in North America will continue in the absence of government involvement, but in the end, it will be limited by the lack of leadership and direction.[166]

NAFTA did not establish a mechanism for long-term planning, or even an institution that could respond to emergency challenges. This is why after 9/11 there was a scramble to improve border security, while at the same time, preventing any impediments to trade. Closure of the borders after the attacks had an immediate impact on the economies; trucks were backed up on the Windsor Bridge for twenty miles to enter Detroit, and Ford, Toyota and Chrysler either shut down plant operations or closed down a number of assembly lines—grinding trade to a halt.[167] A recent initiative proposed at the end of 2011, the Beyond the Border Action Plan, attempts to address these concerns, though it is a bilateral Canada-U.S. proposal. Its goal is to develop 'a shared vision for perimeter security and economic competitiveness' through early detection of threats, a cooperative response and greater collaboration between border authorities, improving

166 Meilke et. al., 927.

167 Pastor, *The North American Idea*, 115.

the traffic flow at the border through common practices, and more streamlined customs procedures.[168] It is still too early to tell whether this initiative will produce real results; if past policies are any indication (like the Security and Prosperity Partnership), it is best not to hold our breath.

After the 2008 financial crisis and subsequent recession, the three governments did not meet to coordinate on a continental recovery plan, but instead passed individual stimulus packages through their legislatures. The 'Buy American' provision of the JOBS Act is but another example of a misunderstanding of economic integration and the lack of acknowledgement the U.S. gives to its two largest trading partners. Reinvigorating the U.S. economy not only requires strong domestic macroeconomic policy but also a recovery plan that recognizes the global and regional reality of trade relationships. In fact, very few Americans are aware that 6 million U.S. jobs are dependent on U.S trade with Mexico.[169] If the reality of the economic relationship were acknowledged we may be able to develop more comprehensive and successful responses to economic problems.

Though North America began formal regional economic integration in 1994, as a region, it appears as an uncommitted bystander in the process. Significant links have been created between business, industry, civil society, government agencies, and academia that have formed a real transnational policy community, which, in principle, support deeper economic integration.[170] The greatest impediment to integration does not come from below, but from the lack of political leadership. Domestic political squabbling plays a major role in preventing real achievements

168 The White House, "United States-Canada Beyond the Border: A Shared Vision for Perimeter Security and Economic Competitiveness," Action Plan (December 2011) http://www.whitehouse.gov/the-press-office/2011/12/07/fact-sheet-us-canada-beyond-border-and-regulatory-cooperation-council-in (accessed March 14, 2012).

169 Wilson, 21.

170 Warleigh-Lack, "The EU in Comparative Perspective: Comparing the EU and NAFTA," 51.

from being made, with the debate on integration (when it is ever had) usually shaped by a misunderstanding of what integration entails—the most extreme opponents claim that the issue is not even one of trade liberalization, but one of sovereignty.[171] One of the key reasons for this is because the only regional project North America has serious embarked upon has become a scapegoat for domestic political problems that it has not caused. It is clear from the above analysis that integration has helped North America grow in economic strength, and that more can still be accomplished. However, the framework that NAFTA created is insufficient, and it is time to think of what else can be done. It is true that there are vast limitations to integration in North America, but the majority of these are self-imposed restraints. North America is a region, but "the very idea of 'North America' has not penetrated our consciousness."[172] Perhaps we simply have not let it.

The Path to Customs Union: A Possibility for North American Integration

The discussion above has outlined the characteristics that define North American integration, and subsequently, the challenges to future integration on the continent. It has also shown that NAFTA has been largely successful and achieved the goals it set out to accomplish. However, it has reached its potential and is suffering from growing pains. A prime example is recent attempts at regulatory convergence; this project has been undertaken in a dual-bilateral way, and results

171 John B. Sutcliffe, "Critical Interpretations of Integration in North America and the European Union: A Comparative Evaluation," in *Comparative Regional Integration: Europe and Beyond,* ed. Finn Laursen (Burlington: Ashgate Publishing Company, 2010), 77.

172 Robert Pastor, *The North American Idea*, 3.

have been mediocre at best.[173] Though some authors argue that using the existing framework or expanding it can solve North America's trade and policy problems, there is little evidence to suggest this is the most logical route.[174] Perhaps it is all right if we agree that the current set-up is sufficient and that there is no need for deeper integration. At the same time, we must ask ourselves whether we are satisfied with the results, and if more can be done. The question then rests on whether it is better for the countries of North America to work together to solve common problems, or continue to approach each issue as it arises in a piece-meal, dual-bilateral way?

It is clear that NAFTA did not address all potential economic and policy issues that affect North America today. In fact, NAFTA was crafted for the concerns of the time, and it did not create a framework that would evolve as the integration process grew more complex. Thus, as policy issues have become 'intermestic', transcending traditional domestic policy approaches, the governance structure of North America has failed to adapt to these challenges.[175] As a result, there seems to be a strong normative case for the need to integrate further, not only to share the burden of today's complex policy problems, but also to tackle these issues in a contemporary and dynamic framework.

This paper argues that a customs union is the next viable step for North American integration. Though some critics argue that a customs union creates more barriers to trade, the previous section on the EEC customs union shows that it actually creates more trade than it diverts. In fact, an FTA like NAFTA is more likely to divert trade "because the FTA grants preferences to goods originating inside its boundaries without providing to imports from third

173 See Michael Hart, "Trading Up: The Prospect of Greater Regulatory Convergence in North America," United Nations Publications (2007).

174 See Daniel Schwanen (2005).

175 See Domínguez and Fernández de Castro (2009) for more discussion on the nature of 'intermestic' relations between the United States and Mexico.

countries the corresponding customs union benefit of free circulation once within a common tariff wall."[176] What this is referring to are the restrictive rules of origin (ROO) requirements of NAFTA, which are possibly the most restrictive of any FTA. In fact, ROO costs are estimated to amount to 2-3% of the NAFTA GDP.[177] The reason ROO have such a negative effect is because they "dilute the expansionary effects of integration through their distortionary effects on factor prices, sectoral production and trade flows."[178] Simply put, ROO divert trade, but also have the effect of raising prices on consumers due to the added administrative costs placed on exporters.

Exporters must fill out a certificate of origin to qualify for NAFTA preferential treatment; one way to calculate ROO is through a qualifying percentage, in which a certain percentage of the product has to 'originate' within the FTA. In the NAFTA agreement, the qualifying percentage for preferential treatment is 60% origin, and for autos this benchmark rises to 62.5% origin. This can be a particularly challenging requirement to meet, given the fact that production chains have become quite global, and that any single country's input could be minimal in the overall creation of a product. This makes it difficult to calculate the exact percentage of the product that originates within the FTA. As a result, many exporters choose to pay the MFN tariff (a practice NAFTA was supposed to prevent) instead of spending the time to sort out the possibility of qualifying for NAFTA preferential treatment.[179] In the end, the consumer absorbs the cost. This weakens the argument for FTAs because they are more restrictive to third-country producers and divert more trade than customs unions. Rules of origin thus "become new forms of

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176 Abbott, 919.

177 Goldfarb, "The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?" 2.

178 Alex Jameson Appiah, "Applied General Equilibrium Model of North American Integration with Rules of Origin," (doctoral dissertation, Simon Fraser University, November 1999), 200.

179 Alex Huelsemeyer, "Toward Deeper North American Integration: A Customs Union?" *Canadian-American Public Policy*, Occasional Paper, no. 59 (October 2004), 15.

hidden protection that restrict world trade and reduce global welfare."[180]

A customs union eliminates ROO by creating a CET and preventing the problem of transshipment, but it does more than eliminate these cumbersome requirements; it can also increase predictability for investors, expand output and trade, possibly increase employment, and increase choice and provide lower prices for consumers.[181] North America already has a customs union in computer equipment, so it is not outside the realm of possibility that this can expand to other sectors. Looking back at the European experiment to create a customs union, the following questions arise: is it possible to harmonize MFN tariffs between Canada, Mexico and the U.S., if so, how? What would happen to the tariff revenues? Is a common trade policy feasible? And can this process be completed without creating new institutions or by improving old ones?

Harmonizing the MFN tariffs between the three countries is the most important factor in creating a CET. The first challenge is to ensure uniformity in the tariff lines, similar to the juxtaposition process that the Europeans undertook at the outset. Currently Mexico has 12,027 tariff lines, the U.S. has 9,300, and Canada has 7,993. The major advantage that North America has over Europe in 1957 is that today all three countries have adopted the Harmonized System (HS) of tariff classification, which the Europeans created in 1952 under the Customs Cooperation Council, now the World Customs Organization (WCO). In the last fifty years, the WCO has made substantial progress in harmonizing customs policy around the world, but in the end, it relies on its members to voluntarily comply with its suggestions.[182] As a result, variations in tariff lines, nomenclature, origin and valuation procedures still exist. Though it is a lot more

180 Appiah, 164-65.

181 Goldfarb, "The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?" 2.

182 Brenda Chalfin, "Global Customs Regimes and the Traffic in Sovereignty: Enlarging Anthropology of the State," *Current Anthropology* 47, no. 2 (April 2006): 247, http://www.jstor.org/stable/10.1086/499548 (accessed February 28, 2012).

challenging to harmonize these processes worldwide, the EU has shown that on a regional level it is not only possible, but also beneficial to creating more efficient regional trade. Mexico will have to adjust the most in this process, but it is worth noting that the difference in tariff lines between Mexico and its neighbors is very similar to the difference in tariff lines between Italy and the five other founding members of the EU.

The majority of North American customs union proposals to date tend to focus on a sectoral approach to harmonization.[183] These projects favor an effort similar to the CET created for computer equipment—basically, they examine the sectors that are easiest to harmonize and work through them one by one. But that CET went into effect in 2004 and there is no news of the next priority sector to be harmonized. Essentially, a sector-by-sector approach will be an extremely slow and tedious process. Also, this approach limits compromise because it focuses on one item at a time, without bargaining over other product lines. Thus, each party will be less willing to budge if there is no guarantee that it will get something in return for a concession.

For example, when the Six sat down to negotiate tariff lines, they first set out by placing their tariff lines in particular 'lists' from easiest to negotiate, to the non-negotiable (List G). Working through the lists, they agreed on across the board reductions by either settling on the lowest tariff, or applying an arithmetic average. Often this was settled by bargaining over particular sets of lines; thus individual countries were willing to compromise on a particular line, given its tariff line was upheld on another product. All these lists were settled within two years of negotiations, and List G was not settled until seven years after the Treaty of Rome went into force. The point is that this economy-wide approach to reductions is better at compelling cooperation; as well, since it is not sector-specific, it allows for the gains from reductions to be

183 See for example, Wendy Dobson, "Shaping the Future of the North American Economic Space: A Framework for Action," C.D. Howe Institute Commentary, no. 162 (2002).

felt in more than one area, improving overall economic welfare.

North America could embark on a similar process. It is first important to layout the limitations by making a list of the non-negotiable tariff lines. Next, the three countries would have to harmonize their tariff structures, an equally difficult challenge because of the variations in particular sectors of each country.[184] This will require juxtaposing the entire tariff lines and settling on an agreed upon nomenclature. To decide where to begin, Canada, Mexico and the U.S. should look at tariff lines that have differences of less than 10% (which are good candidates for harmonization) and organize these into a list to begin negotiations. Working through the lowest tariffs first will build confidence in dealing with more difficult ones down the line.

The highest U.S. MFN tariffs are in peanuts, tobacco, textiles, clothing and footwear, whereas the highest MFN tariffs for Canada are in dairy products, animal products and clothing.[185] Mexico's MFN tariffs are higher on average than both Canadian and American tariffs across the board. Where they are highest is in animal and dairy products, coffee and tea, sugars, textiles and clothing.[186] Hufbauer and Schott note that the U.S. is unlikely to endorse a CET if it includes textiles and agriculture.[187] However, it is possible to still move forward on a customs union without negotiating on the most sensitive sectors right away, but there would have to be an agreement and set date to eventually negotiate the sensitive sectors in the future.

Most commentators seem to suggest that alignment of the tariff structures will require

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184 Huelsemeyer, 15.

185 Goldfarb, "The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?" 21 and U.S. International Trade Commission, *Dataweb*, http://dataweb.usitc.gov/scripts/ INTRO.asp (accessed February 8, 2012).

186 U.S. International Trade Commission, *Dataweb*.

187 Hufbauer and Schott, 475.

harmonization on the lowest tariff.[188] In most cases, this will require Canada and Mexico to harmonize their tariffs to U.S. levels, which on the whole are the lowest (with some exceptions). About 40% of U.S. and Canadian MFN tariffs are within 1-2% of each other, and will be easy to adjust.[189] For other tariff lines, it is possible to agree on an arithmetic average, so long as the tariff is not substantially increased. The most difficult tariff structures to reconcile will likely be in agriculture and textiles, which are shaped by diverse preferential trade agreements, such as the African Growth and Opportunities Act (AGOA). Appiah notes that the optimal level of the CET for North America lies in between the most liberal case and the most protectionist case; this means that just reducing the CET to the lowest rate of the three countries may not be most efficient to overall welfare.[190] Thus an arithmetic average or fair compromise can continue to afford a level of protection to important industries as they adjust to new competition, while still reducing barriers to trade.

A common criticism against creating a customs union is that it reduces the autonomy of its members in setting their own tariff rates. Though this is true, to a degree, it also worth reminding critics that most countries have already given up significant tariff autonomy by progressively binding tariffs to standards set in both GATT and WTO negotiations.[191] Therefore, a customs union is not a far-fetched proposal, but a refinement of processes that states already engage in at the global level. Since member states cannot change the level of CET on their own, it does pose the potential problem of a tariff remaining high, even if domestic conditions call for

188 Huelsemeyer, 15.

189 Goldfarb, “The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?” 18.

190 Appiah, 166.

191 Hart and Dymond, 31.

a reduction.[192] There must therefore be a mechanism by which states can consult one another and agree to undertake gradual reductions in tariff levels. Subsequent reductions of multilateral tariffs through various rounds of GATT and WTO talks have resulted in steady reductions, leaving many tariffs to be bound to zero. This weakens the argument for protectionist trade practices, such as ROO, because they have a negative impact on overall welfare.

The point of departure, however, is the second component of a customs union, which is a common commercial policy towards non-members. Dobson notes that a common external trade policy would be favored by Canada because it would require trade remedy laws to be harmonized.[193] Incidentally, Mexico would find this beneficial as well because it would prevent the use of trade remedies by the U.S., thus reducing the number of commercial disputes. This could also potentially lead to the creation of a common competition policy, which Canada and Mexico had pushed for during the NAFTA negotiations. However, Dobson remains skeptical about a common commercial policy because of its potential to compromise the independence of the countries involved as they would have to negotiate third party deals together, including a unified front at the WTO.[194] Hufbauer and Schott argue that a CET could be pursued without going the route of a common commercial policy; they propose allowing each country to employ a ROO 'snapback' provision if it suspects the occurrence of substantial trade deflection.[195] Since this would largely be based on an agreement of good faith, it is unclear how this would actually work in practice, and whether it would simply be subject to state abuse.

Though sovereignty would remain a concern, the greatest challenge to a common

192 Appiah, 164.

193 Dobson, 21.

194 Dobson, 22.

195 Hufbauer and Schott, 474.

commercial policy and creation of full-fledged customs union are the existing number of FTAs that Canada and Mexico have concluded with other countries, which are incompatible with U.S. FTAs.[196] This is problematic because the FTAs would have to be renegotiated to include all members in the customs union. ROO requirements in each FTA would thus be reconciled, eliminating conflicting ROO provisions.[197] To get a sense for the scope of this endeavor, Table 7 shows the overlap and disparities in current FTAs of each country. Though there is a significant amount of overlap, there are also major disparities; particularly the FTAs Mexico has with Japan and the EU, as well as Canada's FTA with the EU, which is currently under negotiation. However, even in cases where there is overlap, the substance of the agreements may differ, and thus each FTA would have to be examined on a case-by-case basis.

Two key obstacles immediately present themselves. First, it is uncertain whether the signatories of the FTAs would be willing to renegotiate, and not only because such negotiations can take a number of years. There is the possibility that many hard-won concession can be lost if an FTA is reopened. Second, getting new FTAs through Congress will also prove difficult if the president does not have fast-track authority. Thus, if the administration is committed to pursuing a full-fledged customs union, it is essential to garner significant support from the public by clearly explaining the benefits of this endeavor. The success of this policy requires, above all, political will.

196 Jaime Serra Puche, e-mail message to author, March 13, 2012.

197 Karl Meilke et. al., 934.

Table 7. Free Trade Agreements of NAFTA Members

United States	**Mexico**	**Canada**
NAFTA	NAFTA	NAFTA
Chile	Chile	Chile
Colombia*	Colombia	Colombia
Israel	Israel	Israel
Peru	Peru	Peru
Republic of Korea*	Republic of Korea**	Republic of Korea**
	European Free Trade Association (EFTA)	European Free Trade Association (EFTA)
	European Union (EU)	European Union (EU)**
Jordan		Jordan*
Singapore		Singapore**
Dominican Republic-Central America (CAFTA)***	Costa Rica	Costa Rica
	El Salvador-Guatemala-Honduras (Northern Triangle)	Dominican Republic**
	Nicaragua	El Salvador-Guatemala-Honduras-Nicaragua**
Morocco		
Australia		
Oman		
Panama*		
Bahrain		
	Latin American Integration Association (LAIA)	
	Protocol on Trade Negotiations (PTN)	
	Japan	
	Global System of Trade Preferences among Developing Countries (GSTP)	
		Caribbean Community (CARICOM)**
		Ukraine**

Source: World Trade Organization, (RTA-IS), http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx

*Signed, but not yet implemented

**Under Negotiation

***Includes the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua

To deal with the slow transition towards a harmonized trade policy, it may be possible for each country to maintain ROO provisions on products that do not originate from a country with which they have a FTA. As FTAs are renegotiated, such provisions can be phased out. This would allow for the gradual progression towards a common commercial policy. The three countries would also have to harmonize preferential tariffs applied to developing countries, and the entire tariff rate quota (TRQ) mechanism for sensitive products. As of 2000, Canada, Mexico and the U.S. notified the WTO of 21, 11, and 54 TRQs, respectively; there is some overlap in these quotas, which could serve as a starting point for harmonization.[198] Canada and the U.S. also give preferential tariffs to varying developing countries, and this would have to be reconciled on a case-by-case basis. The best-case scenario would be to develop a regional policy on preferential trade agreements.

However, North America would have the added challenge of reconciling diverging opinions over special arrangements, such as the U.S. embargo on Cuba. Little has been written on how this problem could actually be solved. It is highly unlikely that Canada and Mexico would simply accept U.S. policy on every special case, thus a customs union would have to take certain exceptions into account. Despite these challenges, the possibility for a common trade policy does exist. It certainly cannot be completed all at once, but if the countries focus on the least politically charged sectors and work their way through the rest, it is feasible. The agricultural sector, though very sensitive, shows a great deal of promise due to the high level of trade in this sector among North American countries; Canada and the U.S. currently have a CET in beef, and it is possible that as agricultural production among the three countries becomes more

198 Karl Meilke et. al., 933.

integrated, that a common policy in this area will eventually develop.[199]

It is without doubt that the borders would retain a significant role in North America, and it is unlikely that removing internal border controls, as happened in the EU, would be feasible here. As a result, the focus should be on streamlining, harmonizing and developing a more efficient border without compromising on security. A more efficient border with uniform customs practices can help facilitate trade, and it would also be an asset in implementing the provisions of a customs union, ensuring that exceptions to the agreement are not breached. Standardizing paperwork with something similar to the EU's customs circulation certificate and developing common practices for inspections and clearance will go a long way in moving this process along. Though this ultimately implies that a full-fledged customs union like the EU's is not possible in the near future for North America, it does suggest that movement towards a customs union that is specifically tailored to address the needs of this continent is a plausible goal. The EU customs union took over twelve years to implement—undertaking a similar process would undoubtedly be a long-term project. Thus, a variation of Dobson's idea of an 'evolutionary customs union' seems to be the best option for North America.[200]

Given the complexity of the integration process, and the less than impressive performance of the NAFTA committee structure, it is difficult to imagine how this process can be completed without creating new institutions or by improving the old ones. As the European experience showed, states will consistently delay implementation of new rules for various domestic, political or structural reasons. As a result, it is imperative to have a body responsible for overseeing the implementation of the agreement. For example, the Free Trade Commission

199 Ibid., 935.

200 Dobson, 22.

(FTC), which is described in Article 2001 of the NAFTA, is comprised of cabinet-level trade representatives from the three countries who meet once a year. The FTC has both an oversight capability, and the ability to create working groups to examine specific issue areas. The key problem, however, is fairly obvious; a once a year meeting is hardly sufficient to deal with the vast array of issues the three countries face. The cabinet-level secretaries also have other priorities, and thus cannot give the FTC year-round attention. If a customs union is to be pursued, it will require continuous monitoring and oversight.

The FTC currently does not even have a headquarters, since it simply rotates its annual meeting location among the three countries. To foster continuity in the policy process and to ensure that issues brought to attention are not forgotten, the three countries would be better served by an FTC that included deputy cabinet-level officials as well as expert bureaucrats from the trade and commerce departments of each country to assist in monitoring progress, responding to questions, and setting the agenda for future FTC meetings, which need to occur on a far more regular basis. In order to allay fears of a supranational institution, it may be helpful to rotate the location of the FTC every two years. These need not be in the capitals either, in fact, the FTC may be better served by locating in industrial or business centers so that it can better respond to economic needs instead of getting caught up in political debates.

Furthermore, it is imperative that in any integration scheme all sectors of civil society are included in the process. The European trade unions secured the European Economic and Social Committee (EESC) in their lobbying efforts, which would allow for civil society actors to have permanent representation and access to the Community structure. Basically the EESC is a consultative body that allows economic and social interest groups to voice their opinions on EU policy and issues. This not only creates dialogue between the inter-governmental structures and the people and industries they affect, but also allows like-minded interest groups to form coalitions and find cooperative ways to achieve their common goals. North America would benefit from a similar structure that offered various groups of society the opportunity to put forth ideas, comment on legislation, and provide real insights on what is actually happening on the ground, without getting lost in disconnected political debates. Such a forum could also provide guidance as to where to begin the integration process, and where to be more careful in the application of new projects.

One of the key reasons a stronger institutional structure is needed for a customs union is that it involves many more rules and procedures to be implemented among its member states. This is why the NAFTA dispute resolution mechanism will most likely require reform, so that it will be sufficiently equipped to deal with customs disputes, as highlighted in the discussion of the ECJ. This will require the reform of the ad hoc tribunal system to a more stable structure that can rely on a degree of continuity in rulings and processes. As the three countries iron out customs procedures, valuation, and the like, they will need an effective mediator if a country is not implementing the new rules accurately, or distorting them through other practices.

This is particularly important because the distribution of customs revenues will have to be enforced on an agreed upon formula. Some authors have suggested using the model of the South African Customs Union (SACU), which calculates the amount of revenue allocated to each country by its portion of total intra-union trade and its GDP.[201] The EU has employed a system in which the territory of point of origin keeps 25% of the duty for its administrative costs, while the rest of the duty goes towards the community's central budget. The amount of revenue each country collects from the imposition of tariffs must be considered in the distribution

201 Goldfarb, "The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?" 16.

decision. Table 8 shows that the U.S. collects far more in tariff revenue than its two neighbors. The difference in the figures is a product of a greater volume of imports destined for the U.S. market compared to the relatively smaller markets of Canada or Mexico. As a result, the most likely revenue sharing agreement to be saleable in North America would have to be more similar to the SACU model than the EU. This would require a revenue sharing formula that is trade-weighted.

However, the EU model has a particular benefit, in that a set amount of tariff revenue becomes part of the Commission's 'own resources' that make up the EU budget. This revenue (along with member states' contributions and the VAT) funds all the operations of the community, including a large number of programs that help with member states' economic development. A portion of revenue collected from import duties could be reserved for a common body, such as a North American Investment Fund, which would assist with infrastructure and development projects to further improve the trading relationship.[202] This would be particularly helpful to Mexico in closing the development gap, but it would also be tremendously beneficial for critical infrastructure improvements. Approximately 80% of North American trade is transported by road, yet funding for improving these vital arteries remains low.[203] In order to have a more efficient and modern border a real effort must be made to assist in the secure and steady transport of people and goods. Furthermore, a proper Investment Fund could help improve North-South linkages within Mexico, thus connecting the rural southern population to greater trade opportunities with the U.S. and Canada.

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202 The idea of a North American Investment Fund can be found in Pastor's *The North American Idea*, 165, 171. Though he deals with a direct contribution from member states, I am just expanding on the idea by adding a revenue source.

203 Robert Pastor, *The North American Idea*, 26.

Table 8. Revenue from Import Duties, FY 2011 (in billions of USD)

Country	Total Tariff Revenue
United States	26.7
Canada	4.0
Mexico	3.0*

Source: U.S. Customs and Border Protection, "Import Trade Trends FY 2011 Mid-Year Report," http://www.cbp.gov/xp/cgov/trade/trade_programs/trade_trends/, Public Works and Government Services Canada, "Public Accounts of Canada 2011" http://www.tpsgc-pwgsc.gc.ca/recgen/txt/72-eng.html, and World Bank Data, http://data.worldbank.org/country/mexico.

*Mexico data is from FY 2000.

Note: Currencies converted to reflect 2011 USD based on the 2011 average exchange rate. Currencies have been converted to USD using the 2011 average rate. (http://www.oanda.com/currency/historical-rates/)

In his study on the effects of a customs union in North America, Appiah showed that the gains from a customs union would be high, particularly due to the current level of restrictiveness and trade-diverting effects of ROO.[204] The European case supports this evidence, as countries with the highest pre-union tariffs experienced the largest percentage increases in intra-union trade. The reduction of both internal and external tariff barriers in the EEC caused previous high tariff states to shift from inward-looking trade policies to an export-oriented strategy, which caused significant increases in export levels. Due to the asymmetric size of its market, Germany benefitted the most in real terms from the customs union, and it would be reasonable to assume that a similar trend would emerge here with the U.S. market. As well, since the U.S. is a globally oriented trader, the effect of this market opening could possibly be even greater than the expansion of the German market after the implementation of the customs union, since Germany was far more dependent on intra-community trade. Since Canada's market size is considerably smaller than the U.S., and also because its MFN tariffs are not very restrictive (with the

204 Appiah, 164.

exception of a few sectors), Canada would most likely make more modest gains from a customs union. However, because a customs union could eventually lead to the formation of a joint commercial policy, it would effectively eliminate U.S. trade remedy penalties that Canada greatly dislikes.[205]

Mexico has the potential to reap great benefits from a customs union because its MFN tariffs are quite high. If done right, it could experience the tremendous increase in trade felt by Italy as barriers to trade were reduced. However, the important element that cannot be ignored is the development gap between Mexico and its two neighbors. Increased trade for Mexico will not be enough, and it will need to continue to modernize and expand its economy. If Mexico is to be an equal partner in this customs union, Canada and the U.S. must be committed to closing the income inequality gap. This requires a commitment to ideas like the North American Investment Fund, and trilateral solutions for Mexico's key challenges. Obviously, improving Mexico's security and eliminating the influence of the drug cartels is an important factor in this, but it is important not to separate this problem from the overarching development problems of the country. If Mexico's economy is expanded, and the standard living of its people improved, there will be less incentive to turn to illicit activities. Furthermore, there would be less incentive for illegal migration to the U.S. in search of better job opportunities if good opportunities exist within Mexico itself. Making Mexico stronger economically, socially and politically, will not only enhance the country, but also improve its relationship with its two neighbors. It is absolutely mind-boggling that Canada continues to treat Mexico as a junior partner in North America, when the Mexican GDP as of 2011 has surpassed Canada's. Mexico is an indispensible partner in North America, and its two neighbors should give it a lot more credit than they do.

205 Huelsemeyer, 17.

It is interesting to note that immediately after 9/11, the debate in Canada "[was] no longer *if* increasing integration should take place, but *how* Canada might negotiate the terms of a new agreement."[206] The business community was getting behind this idea as well, most notably the Canadian Council of Chief Executives (formerly BCNI), which was instrumental in building support for CUSFTA and NAFTA.[207] The political community began to see the benefits of deeper integration, but enthusiasm has ebbed and flowed. Not long after the recession hit, former Canadian trade minister David Emerson argued that the next step in the Canada-U.S. economic relationship was to pursue a customs union. Emerson noted that he "isn't worried that Canada may lose sovereignty…[because] Ottawa would gain influence in a joint trade policy deal," and that a customs union would help "secure more predictable trading relations" with the U.S., sheltering the relationship "from the vagaries of U.S. politics."[208] There certainly are a growing number of supporters that encourage policy makers to think a little bigger about the problems facing our countries, and it is these innovative proposals that need to be examined.[209]

The proposals floating in Canada, however, have one key exception—they do not include Mexico in a significant way. This is a mistake. If Canada wants to approach the U.S. about a new idea to transform the relationship, Mexico should be a part of it, and not just because of the scope of the trading relationship, but also because a joint appeal will garner more attention from U.S. policy makers. It is worth reiterating the fact that the main proposal for the EEC did not come

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206 Emily Gilbert, "The Inevitability of Integration? Neoliberal Discourse and the Proposals for a New North American Economic Space after September 11," *Annals of the Association of American Geographers* 95, no.1 (March 2005): 207, http://www.jstor.org/stable/3694038 (accessed March 14, 2012).

207 Gilbert, 206.

208 Steven Chase, "Customs union needed, Emerson maintains," *The Globe and Mail*, February 4, 2009.

209 See Danielle Goldfarb, "Beyond Labels: Comparing Proposals for Closer Canada-U.S. Economic Relations," C.D. Howe Institute Backgrounder, No. 76 (October 2003) http://www.cdhowe.org/beyond-labels-comparing-proposals-for-closer-canada-u-s-economic-relations/9812 (accessed March 13, 2012).

from the largest member states, but from the smaller countries of the Benelux.

Overall, a customs union would be the logical next step to deeper integration in North America, but it is up to its leaders and its people to decide what path they wish to take. As this section has shown, Canada and Mexico are key trading partners of the U.S., but the U.S. attitude towards its two neighbors has been more characterized by disinterest than true friendship. The sheer volume of trade that crosses the southern and northern borders is simply astonishing. In 2011, U.S. exports to Canada totaled $281 billion, and to Mexico, $198 billion; U.S. imports from Canada amounted to $317 billion, and from Mexico, $263 billion.[210] The trade relationship is significant, but since the U.S. remains committed to a multilateral agenda, and is consistently distracted by security concerns, it has not given the region the attention it deserves.

The Trans-Pacific Partnership (TPP) is a case in point, and may serve as a distraction from key U.S. economic priorities.[211] The TPP, which currently includes Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, and Vietnam, makes up just 6% of U.S. trade with the world; though this is hardly a significant figure, it would substantially change if Japan were to enter the equation.[212] It is unclear whether this initiative is just an attempt by the U.S. to maintain a presence in the region, or if it is primarily an economically motivated project? From the economic perspective, the TPP tell us that the U.S. is trying to focus on a broader multilateral agenda in an attempt to generate a new wave of trade and investment rules, which it wants East Asian markets to be tied to. Canada and Mexico have only recently showed interest in joining the project, though this is probably motivated by a fear of being left behind by their largest trading

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210 U.S. International Trade Commission, *Dataweb*.

211 Robert Pastor, "North America or Asia? The 21st Century Choice for the United States," *Perspectives on the Americas*, University of Miami Center for Hemispheric Policy (January 23, 2012).

212 Mireya Solis, "Last train for Asia-Pacific Integration? U.S. Objectives in the TPP Negotiations," Waseda University Organization for Japan-US Studies (Working Paper no. 201102, July 27, 2011), 10.

partner. The TPP thus raises important questions that have not been clearly answered. Does the U.S. truly believe that orienting trade towards East Asia is the best policy option for the future? And if so, why is it insisting on the most stringent standards on intellectual property, labor and environment, which certainly will not provide a strong enough incentive to attract all East Asian markets to the TPP?

Furthermore, the increasing number of agreements the U.S. establishes with non-NAFTA countries will effectively erode the tariff preferences Canada and Mexico currently benefit from, which will ultimately result in a weaker North American market. If Canada and Mexico become involved in the negotiations, it would be beneficial for the three North American countries to develop a consensus on what they hope to achieve through the TPP before heading to the negotiating table. This would ensure that the concerns of the North American market are accounted for and not watered down by extensive multilateral bargaining. However, if shallow multilateral and regional trade agreements (as the TPP will likely become) do not eventually provide adequate economic benefits, "then a deepening of the NAFTA relationship may be the easiest avenue towards the improved economic efficiency required to meet increased competition from China, Brazil and elsewhere."[213] Deeper integration in North America, as shown above, would benefit the U.S. most, yet it seems almost oblivious to this fact. A customs union is a viable option, but the fate of integration on this continent remains at the mercy of the political will of its leaders, which lack the vision, boldness and ingenuity of the European project launched in 1957.

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213 Karl Meilke, et. al., 928.

CHAPTER 5

CONCLUSION

The problems facing the policy makers of today have grown increasingly complex as the world has become far more interconnected. Domestic challenges that once could be dealt with in the domestic context have become regional or global issues that require cooperative solutions. In fact, the greatest challenges of our time, terrorism, climate change, and sustainable economic development cannot be solved by any single nation. However, tackling these priorities also demands effective leadership. Since the end of the Second World War, the rest of the world has often looked to the United States to take on that role, yet it has constantly been tugged and pulled between its revolutionary and isolationist historical impulses. In assuming global responsibility, the U.S. has often forgotten the significance of its immediate neighbors and ignored the warning of John Quincy Adams to avoid searching for distant monsters to destroy. Yet the problem, and the solution to America's problems do not lie at a distance.

The U.S. has been distracted by two wars in the Middle East that have lasted longer than intended, and is currently threatened by the possibility of conflict with Iran. The country's national debt has soared, and its people have suffered, with unemployment taking its toll on the promise of the American Dream. U.S. soft power in the world has declined, as favorability among non-Western countries continues its downward trend.[214] If the U.S. hopes to remain a model worth emulation, it must lead by example. In the 21st century, the U.S. may be better served as a beacon to the world than as a crusader. If the U.S. is truly committed to trade

214 Pew Research Center, "60%-U.S. Favorability Ratings Around the World Remain Positive," Pew Global Attitudes Project, http://pewresearch.org/databank/dailynumber/?NumberID=1321 (accessed February 9, 2012).

liberalization and economic recovery, it needs to expand the policies that work, and prevent being distracted by those that do not. The NAFTA was a successful agreement that increased trade and foreign investment between its neighbors by enormous figures. Yet the full benefits of this trading relationship have not been realized because NAFTA was an agreement for the moment. It did not plan for the evolution of the North American market, and therefore left the integration process in a stagnant state. The U.S. market is incredibly connected to Canada and Mexico, and if it really wants to jump start its recovery and maintain economic growth, it should consider deepening its relationship with its neighbors.

This paper has examined the possibility for the formation of a customs union in North America, the next stage of economic integration. To do so, it has analyzed the possibility, potential and challenges to this policy option through a comparative regional study with the European effort that culminated in the Treaty of Rome in 1957. The purpose was not to replicate the European model, but rather to draw the most important lessons from the European experience to help guide and inform North American integration. An examination of the North American integration project to date has shown that though this continent faces its own unique challenges, particularly related to the asymmetry of power, the feasibility for deeper integration remains positive. In the end, the greatest impediment to North American integration is a simple one: politics. The Europeans did not experience this problem because there was a strong consensus and popular support for the idea of a core Europe, which in turn fostered the political will necessary to strike compromises and make hard bargains. The idea of North America has not yet resonated with our policy makers, and as such, regional solutions are rarely considered.

What this paper hoped to achieve was to inspire a different way of thinking about the relationship between Canada, Mexico and the United States, and engage the reader in an intellectual exercise to question whether as a country, as a region and as a people, we have truly examined each and every option on the table before brushing it aside as impossible. When Europe began its integration project fifty-five years ago, many questioned its merits. Even today, facing economic crisis, criticism is strong. Yet the European Union has undergone numerous crises throughout its history, and survived all of them. Its reaction to crisis has also always been the same—more, not less integration, as evidenced by the recent signing of the fiscal pact. The region has adapted and remained influential in the world; its soft power, despite crisis, has also not declined, as states still seek to join the union. On March 9th 2012, all 136 members of the Croatian parliament voted in favor of accession to the EU; Iceland, Macedonia, Montenegro, Serbia and Turkey remain candidate countries.

Regional integration offers a possible solution to North America's economic, social and political problems. The importance of this relationship should not be understated, nor should the U.S. continue to treat its neighbors as distant foreigners. But Canada and Mexico have an important role to play too. Canada must start treating Mexico as an equal partner, and Mexico must reach out to Canada as it did during the NAFTA negotiations, to build consensus on priorities for the continent. Post-NAFTA, the U.S. has not shown leadership in this region, and "if less can be expected of the United States, more will be required of the rest."[215] Canada and Mexico cannot sit back and wait for the U.S. to pay attention to their concerns, but instead, they should work together to reinvigorate a trilateral dialogue on common problems. Thinking trilaterally will be a major challenge to policy makers that have continually tackled the agenda in the traditional bilateral way. But this is not impossible. Jean Monnet once wrote "people only accept change when they are faced with necessity, and only recognize necessity when crisis is

215 John W. Holmes, *Life with Uncle* (Toronto, University of Toronto Press, 1981), 88.

upon them."[216] North America has just faced a crisis, and is still dealing with the recovery; but its policy makers remain prisoner to a way of thinking that limit the potential of a diverse, innovative and inspiring people, who should demand more of their leaders.

216 Jean Monnet, *Memoirés* (Librarie Arthème Fayard, 1976), 304-305.

APPENDIX A

IRB APPROVAL: EXEMPTION NOTICE

AMERICAN UNIVERSITY
WASHINGTON, DC

IACUC / IRB
RESEARCH COMPLIANCE OFFICE

March 19, 2012

Protocol #: **11215**
Title: **The Path to Customs Unions: The European Experience and North American Integration**

Determination date: September 28, 2011

Dear Inveer Barbee:

On September 28, 2011, the above-mentioned protocol was reviewed and it was determined that this research meets the criteria for exemption. You may now begin the research.

This research was determined to fit under Category 4 of the Code of Federal Regulations Title 45 §46.101(b)

> (4) Research involving the collection or study of existing data, documents, records, pathological specimens, or diagnostic specimens, if these sources are publicly available or if the information is recorded by the investigator in such a manner that subjects cannot be identified, directly or through identifiers linked to the subjects.

Any proposed changes to the protocol that could potentially change the exemption status, must be submitted to the IRB for review and approval prior to implementation, unless such a change is necessary to avoid immediate harm to subjects.

Any unanticipated problems that involve risks to subjects or others must be reported to the IRB in accordance with American University policies and procedures.

If you have any questions regarding this approval, please contact the IRB office at 202-885-3447.

Sincerely,

Matt Zembrzuski,
Research Compliance Manager/ IRB Coordinator

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