

CHAPTER 14

North American Free Trade Law

In previous chapters, we discussed principles of international trade law, including the General Agreement on Tariffs and Trade (GATT) agreements, the role of the World Trade Organization (WTO), laws regulating import competition and unfair trade, and laws governing access to foreign markets. We examined how the growth of free trade principles, or *trade liberalization*, has led to increased trade in goods and services and fostered an environment for economic development and globalization. That discussion focused on trade liberalization at the global level. For example, we saw how the principles of normal trade relations (NTR) are applied globally: If a nation reduces the tariff rate on a product imported from one NTR country, then it must automatically and unconditionally apply that rate to similar products imported from all NTR countries. Safeguards are another example of trade regulation at the global level. Increased tariffs temporarily imposed on a product to protect or safeguard a domestic industry from injury due to a flood of competing imports must be applied globally to imports of similar products coming from all WTO member countries and not just from a select few.

Although the focus of our discussions, up to this point in the book, has been on global trade, many regional trade issues are equally as important. Countries often enter trade agreements with each other that grant lower tariffs and other trade privileges that are more favorable than those granted to the rest of the world. These agreements may create regional free trade areas where goods and services can be bought and sold with few or no tariffs or other trade restrictions. Some free trade areas also have special rules for the cross-border movement of people, for protecting the environment of the region, or for cooperation on workplace health and safety issues. Regional trade areas might be created for economic, political, foreign policy, or security reasons. For example, the United States may enter into a free trade agreement with a Latin American country partially for economic reasons, but also with the hope that it will slow the production of illegal narcotics and drugs.

However, the creation of free trade areas seems inconsistent with the philosophy and objectives of global free trade. After all, is it not protectionist if two or more countries single themselves out for even lower tariffs on goods traded between themselves than on goods imported from countries outside the trading area? Some supporters of global free trade would argue that, indeed, it is protectionist. Others argue that any effort to reduce trade barriers is a positive step, and those efforts eventually will spread to other countries. Moreover, regional agreements can address specific social, economic, and political issues that are incapable of being addressed globally.

This chapter examines the North American Free Trade Agreement (NAFTA) among Canada, Mexico, and the United States. These countries have agreed to rules that give the goods and services of each country even more favorable treatment than that given to most other WTO member countries. In addition to customs and tariff regulations, the agreement also addresses many broader issues of common concern, such as cooperation on labor and environmental issues and cross-border trucking.

THE PHILOSOPHY OF ECONOMIC INTEGRATION

Of the numerous paradigms of economic integration, some involve comprehensive economic integration, while others are more limited in scope. The economic union created in the United States upon ratification of the Constitution in 1789 offers a good starting point for analysis.

Federal Model

The U.S. Constitution is so justly celebrated for its political attributes that its deeply economic character is often overlooked. During the first years of American independence, the states had different currencies and



erected barriers against “imports” from other states. The resulting economic calamity inspired the economic provisions of the Constitution, a revolutionary compact among the states through which the states agreed to have their economies managed as a single unit by a strengthened federal government. Under the Constitution’s Commerce Clause (Article I, Section 8, Clause 3), the states gave the federal Congress the exclusive power to manage trade among the states and with foreign nations. The federal court system—established by the Constitution’s Article III—has interpreted this Clause as striking down any state law that would impede the free interstate movement of goods or people or any state law that would discriminate against businesses based in other states. This effectively created a highly integrated common market: the federal union.

Congress has used the Commerce Clause to grant the federal government primacy in the regulation of competition law issues. Article I, Section 8, Clause 5 gives the sole power of issuing currency to the federal government. Congress used that power to create the Federal Reserve System, which centrally controls the nation’s monetary policy. Article II of the Constitution gives treaty-making power to the president, with Senate consent, and Article I, Section 10 absolutely forbade the states from entering into treaties. This concentrated all control over commercial policy toward other nations, expressed in international trade and customs treaties, in the hands of the federal government. In short, the loosely confederated American states united into a tight customs union and gave the federal government sweeping powers to create and regulate a vast common market encompassing the continent. In the economic arena, states retained control of legal areas in which the fundamental rules came from the states’ Anglo-Saxon common-law tradition, such as contract and corporate law and the regulation of insurance. Even in those areas, the federal judiciary could review and strike down any state law that impinged on the federal common market.

The American experiment is now more than 225 years old and has convincingly proved the economic principle that completely eliminating commercial barriers among political entities, by permitting businesses in each to specialize in areas of competitive advantage and create a larger market for the best products, economically benefits the citizens of all states that join the union. Yet because such change necessarily brings short-term harm to those who cannot compete in the larger market, and those likely to be harmed inevitably have political power, it has proved quite difficult for other nations

to forge economic agreements on the scale of the U.S. Constitution. We will now review the attributes of other, less comprehensive types of economic unions.

Free Trade Area

A **free trade area (FTA)** and a federal system represent the two extreme ends on the continuum of integration. An FTA develops when two or more countries agree to eliminate or phase out customs duties and other barriers to trade among the member countries. Because only products originating in the FTA countries may be shipped duty-free, there is no need for the countries to have common commercial policies toward countries outside the FTA. For example, because Japanese steel imported into Mexico cannot be reimported duty-free from Mexico to the United States, there is no need for Mexico and the United States to place the same customs duties on Japanese steel or have a common commercial policy toward Japan. Free trade agreements vary greatly in the degree to which FTA members have common policies for regulating business in their countries. Nevertheless, as with any system with common norms, an FTA needs a good dispute settlement mechanism.

The United States is a party to many FTAs. Table 14.1 lists some of these FTAs.

Customs Union

A **customs union** is more ambitious in scope than an FTA. In an FTA, there is free trade only in goods produced within the FTA. In a customs union, there is free trade in all goods that come through any of the union members, even imports from outside the customs union. Thus, Brazilian sugar imported into France should move from France into fellow European Union (EU) member state Germany just as freely as French wine would. By contrast, Brazilian sugar imported into Mexico may not freely move into the United States under NAFTA, whose free trade area applies only to products created in free trade area countries.

Because of this distinction, a customs union can only function if all of its members agree to a common tariff on imports from outside the union. Thus, the EU has a common customs tariff and, under its operating treaties, has the power to negotiate with other countries on behalf of all member states. The United States cannot negotiate with France over tariffs; it can only negotiate with the EU as a whole. This structure ensures that no outsider can gain an advantage by routing its imports through one member state.



Table 14.1 FREE TRADE AGREEMENTS (2017)

COUNTRY	EFFECTIVE DATE
Israel	1985
Jordan	2002
Chile	2004
Singapore	2004
Australia	2005
Bahrain	2006
Costa Rica	Part of CAFTA-DR 2006
Dominican Republic	Part of CAFTA-DR 2006
El Salvador	Part of CAFTA-DR 2006
Guatemala	Part of CAFTA-DR 2006
Honduras	Part of CAFTA-DR 2006
Nicaragua	Part of CAFTA-DR 2006
Morocco	2006
Oman	2009
Peru	2009
Colombia	2011
Panama	2011
South Korea	2012

In turn, the need of a customs union to have a single tariff policy for products from outside the union means that the members of the union must arrive at other common policies. If they are to impose common tariffs on a specific product, the member states must develop a consistent policy toward that product. For example, European nations have widely divergent interests in free entry of agricultural products, yet they must establish a common policy toward imported beef products from the United States and Australia. Similarly, the need to agree on a common tariff on products from a specific nation requires a common commercial policy toward that nation, even though the union members may have widely divergent views toward the nation's military or political policies.

Common Market

A **common market**, also called an *economic community*, goes further than a customs union. While a customs union ensures the free movement of goods within the union, a common market seeks to further facilitate free competition within a group of nations. To do so, it protects the right of all enterprises and persons within the area to do business, invest capital, and sell their services anywhere within the area without discrimination on the basis of national origin.

If they are to achieve free economic competition in a common market, the members of the market must

establish certain common rules. If companies can compete everywhere within a market, the member nations must develop common policies and laws on what anti-competitive behavior is and how to curb it. To prevent national governments from unfairly favoring local firms over those from other member states, the members must develop rules on using tax dollars to subsidize industries. So that manufacturing concerns will not have a cost advantage in a particular nation, minimum market-wide environmental and consumer protection standards are appropriate.

For policy to be meaningful, it must be transformed into law. Its enforcement needs to be entrusted to a court with jurisdiction and power to enforce its rulings if the member states are to comply effectively with the standards and laws. Without effective enforcement, each member state can continue to operate its own protectionist barriers.

One way to substantially enhance commerce within a multinational market is to eliminate currency risk for businesses within that market. This can only be achieved by adoption of a common currency by all actors within the market. Adopting a common currency necessarily implies developing and maintaining a common monetary policy on things like how much of that currency to release into the market and what short-term interest rates to charge financial institutions. In addition, the member states need to agree on an institution



that will protect and enforce that policy. The most significant customs union and common market, the EU, will be discussed in the next chapter.

Compatibility of Trade Areas with the WTO and GATT

At first glance, the principles underlying the formation of trade areas seem to contradict the basic principles of the WTO and GATT, which require nondiscrimination and reciprocity among all members. How can members of an FTA or customs union treat those members more favorably than other WTO members? Article XXIV of the GATT states:

[T]he provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area Provided that: (a) with respect to a customs union, ... the duties and other regulations of commerce imposed at the institution of any such union ... in respect of trade with contracting parties not parties to such union ... shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union. ...

This section has been used to lower the rates of external tariffs within a trade area for the benefit of non-FTA WTO members. This achieves the goals of GATT for the benefit of WTO members.

THE NORTH AMERICAN FREE TRADE AREA

The North American Free Trade Area is comprised of Canada, Mexico, and the United States. These countries have different economic and political systems as well as different cultures, languages, geographies, and climates. Nevertheless, they have a long history of close economic ties. Together they encompass the largest free trade area in the world, with a market of about 481 million people and a combined gross domestic product of more than \$21 trillion. (References to dollars in this chapter are to U.S. dollars or their equivalent unless otherwise noted.) The North American Free Trade Area was created in 1994 after a heated political debate. Its purpose was to spur trade and investment in North America and to improve the standard of living throughout the continent. Proponents in the United States viewed the creation of a free trade area in North America as a means of increasing U.S. exports of goods and services

to Mexico, while promoting investment in Mexico, job creation, and economic growth. It was also seen as a means of reinforcing political ties with Mexico, fostering broader participation in democracy there, building a stronger Mexican middle class, stabilizing swings in the Mexican peso and Mexican economy, and stemming illegal immigration. It was also hoped that Asian manufacturers would invest in Mexican plants to gain favorable access to markets in the United States and Canada.

Critics claimed that NAFTA would cause a tremendous loss of manufacturing jobs in the United States, as well as hurt American agriculture. Perhaps the best-known critic was former independent presidential candidate Ross Perot, who claimed that the people of the United States would hear a “giant sucking sound”—the sound of jobs leaving America for Mexico, where wages were lower. It was also feared that American firms would relocate to Mexico to take advantage of reduced operating costs resulting from Mexico’s lax labor and environmental laws. Proponents countered that NAFTA included “side agreements” calling for cooperation on labor and environmental issues.

In the United States, there was far greater concern about entering into a free trade area with Mexico than with Canada. While the U.S. and Canadian economies were similar, and had already been linked by a U.S.–Canadian free trade agreement since 1989, there were and remain vast differences between the United States and Mexico. The United States and Canada are in advanced stages of economic development, with comparable levels of productivity and per capita gross domestic product. Canada and the United States are far more similar to each other than to their southern neighbor.

Mexico, on the other hand, is a developing country with a per capita GDP that is approximately 30 percent that of the United States, a poverty rate estimated as high as 50 percent, and the highest income disparity among Organization for Economic Cooperation and Development (OECD) member states. Also, Mexico has had a history of greater government control over industry, government ownership of key industrial sectors, higher tariffs, and greater barriers to foreign investment than has either the United States or Canada. Despite the controversy, the North American Free Trade Area was created on January 1, 1994, by the *North American Free Trade Agreement* (NATA). Nevertheless, the controversy continues to the present time as demonstrated in the bitter clashes regarding globalization in general, and NAFTA in particular, in the 2016 presidential campaign between Hillary Clinton and Donald Trump. Clashes



regarding NAFTA continued after the election with the Trump administration's threats to renegotiate the free trade agreement and impose tariffs on imports originating from Mexico. What, if any, proposals and amendments originate from this controversy remain to be seen, but it appears likely that some of NAFTA's terms will be renegotiated.

CANADA-U.S. TRADE

Canada and the United States are each other's largest trading partners, with two-way trade in goods and services totaling more than \$662 billion in 2015. In 2015, the United States exported \$337.3 billion in goods and services to Canada and imported \$325.4 billion from Canada. Of Canada's total imports of goods, about 53 percent come from the United States, while almost 77 percent of Canada's exports of goods are destined for the United States. This trade created a \$11.9 billion surplus in services trade for the United States and a \$15 billion deficit in goods for 2015. The largest categories of products traded between the countries are automotive products, lumber, agricultural products, oil and gas products, machinery, and industrial goods. Canada has a population of 35 million (compared to 323.9 million in the United States).

Mexico-U.S. Trade

Two-way trade in goods and services between the United States and Mexico totaled more than \$583 billion in 2015. In 2015, the United States exported \$267.2 billion in goods and services to Mexico and imported \$316.4 billion from Mexico. Of Mexico's total imports of goods, about 48 percent come from the United States, while almost 80 percent of Mexico's exports of goods are destined for the United States. This trade created a \$9.2 billion surplus in services trade for the United States and a \$58 billion deficit in goods for 2015. The largest categories of products traded between the countries are machinery, agricultural products, and industrial goods.

Today, most Mexican products enter the United States duty-free or at a very low tariff rate. Most U.S. goods enter Mexico duty-free. Mexico offers U.S. firms low production costs, plentiful labor, easy transportation to the U.S. market, employees who respect and want to work for U.S. firms, and consumers that respect U.S. product brand names. Mexico's population is more than 121 million people, with almost three-quarters living in urban areas.

Until the mid-1980s, Mexico had a tightly controlled and protected economy. Its policies restricted imports and discouraged foreign investment. Many key industries were (and some remain) in the hands of government-owned monopolies. Foreign companies that wanted to do business there had to break through a mass of government bureaucracy, red tape, trade barriers, corruption, and outdated highway, transportation, and telecommunications infrastructures. Hampered by inefficient industries, Mexico during the 1970s and early 1980s suffered low productivity, staggering rates of inflation (as high as several hundred percent a year), and overwhelming foreign debt. Its foreign income was almost totally dependent on exports of oil and petroleum products.

New government policies in the late 1980s and 1990s opened the Mexican economy to trade and private investment. In 2000, Mexico announced that it had signed a trade agreement with the EU allowing European products to enter Mexico at reduced tariff rates. Privatization and deregulation also continued into this decade. Railroads, airports, natural gas transportation, telephone companies, banks, and power generation have all benefited from privatization. As a result of an influx of foreign capital, technology, and management skills, Mexican companies have become far more efficient. Mexican-made products have improved in quality and are now competitive in world markets. By 2000, inflation was down to the single-digit range and unemployment was at an all-time low, and these trends have largely continued. As a result, Mexico has become less dependent on oil exports and now has a more broadly based economy. It is safe to say that much of Mexico's economic success since 1993 has been attributable to political and economic reform and to factors other than just NAFTA.

The United States has considerable cross-border investment in both Canada and Mexico. The United States has more than \$386 billion in foreign direct investment in Canada and more than \$107 billion in Mexico. Canadian foreign direct investment in the United States is more than \$261 billion. Mexican foreign direct investment in the United States is considerably smaller at more than \$17 billion.

The North American Free Trade Agreement

The *North American Free Trade Agreement* (NAFTA) created a free trade area between Canada, Mexico, and the United States on January 1, 1994. NAFTA is

not a customs union or common market like the EU. On trade issues, the EU deals with other countries as outsiders and represents its members in trade negotiations at the WTO. NAFTA does not. NAFTA instead fosters trade and investment among Canada, Mexico, and the United States by reducing tariffs and nontariff barriers. It also facilitates transportation of goods, provision of services, and financial transactions among the three countries. Each country continues to maintain its own tariff rates applicable to imports from outside the area. (Actually, NAFTA countries adopted a common external tariff on certain computer parts in 2004, but NAFTA is still not considered a customs union.) Each country continues to establish its own economic policies and represents itself in the WTO system.

Long before NAFTA existed, many Mexican goods shipped to the United States were already receiving special tariff preferences under the **Generalized System of Preferences (GSP)**, which were available to selected products imported from any qualified developing country. Under the GSP, many Mexican products already qualified for either a low tariff or no tariff at all. Canada offered similar preferences for Mexican goods. The purpose of these programs was to encourage trade with developing countries to aid in their economic growth. However, the impact of NAFTA is much broader and much more important than GSP preferences.

Survey of NAFTA's Coverage. Historically, trade agreements focused on the lowering of tariffs, but NAFTA is a trade agreement that does more than just eliminate duties between Canada, Mexico, and the United States. It liberalizes trade in goods and services, contains specific provisions for protecting intellectual property rights, makes cross-border investment easier, and protects the interests of foreign investors from arbitrary government action. It allows easier access for commercial trucks and for business travel between the countries. NAFTA encourages cooperation between governments on antitrust policy dealing with monopolies and unfair methods of competition, worker safety, child labor, and environmental protection. Thus, NAFTA is far broader in scope than most typical trade or investment agreements. Only the EU treaties and perhaps the WTO system are as broad in scope as NAFTA.

NAFTA Trade and Tariff Provisions. NAFTA's basic trade and tariff provisions are patterned after and similar to those contained within the WTO system. Similarities include national treatment, nondiscrimination,

tariff reduction, and elimination of nontariff barriers. NAFTA tariff preferences only apply if the goods are of North American origin, and as we will see in the next section, this requires that you learn how to use the complex rules of origin. NAFTA set a limit of 15 years for the gradual phasing out of tariffs on goods that originated in North America. On January 1, 2008, all normal tariffs on goods originating and traded between Canada, Mexico, and the United States were eliminated.

National Treatment

NAFTA's **national treatment** principle is similar to that found in the WTO system. It states that once goods arrive from another NAFTA country, they must be treated without discrimination and no differently than domestically made goods. For example, the United States cannot require that only Mexican-made beer contain a certain alcohol content without setting the same standard for U.S.-brewed beer. Of course, the rule has wide application to all U.S. laws, regulations, and taxes and to a wide range of goods. This provision also applies to regulations of individual U.S. states and Canadian provinces.

Elimination of Nontariff Barriers. Most quotas, import licenses, and other barriers have been eliminated. Of course, each country may impose import restrictions to protect human, animal, or plant life or the environment. Other special rules permit greater restrictions in key economic sectors, including automobiles, agriculture, energy, and textiles.

NAFTA prohibits new **export taxes** on goods, unless the taxes are also applied to similar goods sold for domestic consumption. **Customs user fees**—fees imposed on importers to help fund the cost of customs enforcement and port services—were eliminated by 1999. NAFTA also addresses issues related to customs administration, the public disclosure of customs regulations, fairness-in-labeling requirements for products, and other barriers to trade.

Continuing Nontariff Barriers. Despite NAFTA, Mexico, Canada, and the United States have all been accused of maintaining nontariff barriers. Following are some examples of trade problems that continue.

The United States argues that Mexico has found other ways to block or slow down U.S. imports. Mexico has imposed antidumping duties and safeguards on agriculture and chemical products. It employs burdensome customs procedures that make it difficult for U.S. firms to export to Mexico. U.S. firms complain



that regulations change without notice and are applied unfairly toward Americans. Some types of goods can only be entered through certain ports. Goods with counterfeit U.S. trademarks easily pass into Mexico without inspection at the border. Mexico has used sanitary and phytosanitary provisions to keep out U.S. farm products, even when health and safety were not at stake. For instance, it imposed agricultural inspections at the border, instead of in the United States at the time of packing, resulting in long delays. Some shipments were turned back at the border for mere typographical errors.

Similarly, in the *2015 National Trade Estimate Report*, prepared by the Office of the U.S. Trade Representative (USTR), the United States alleges that Canada continues to maintain compositional standards for raw milk used in cheesemaking that severely limits U.S. access to the Canadian market. The importation of fresh or processed fruits and vegetables in packages exceeding standard package sizes, varietal controls on grains, warehousing policies applicable to alcoholic beverages, and limitations on the sale of foods fortified with minerals and vitamins remain as nontariff barriers to U.S. products. A new concern relates to the impact of the geographical indications restrictions on 170 foodstuffs and beverages contained within the Canada-European Union Comprehensive Economic and Trade Agreement entered into in August 2014.

The Canadian government continues to restrict U.S. content in broadcasting media. Conventional over-the-air broadcasters must ensure that 60 percent of their overall broadcast time and 50 percent during evening hours consists of Canadian programs (this requirement is more than 50 percent of the channels received for cable television and direct television broadcast services). Thirty-five percent of popular musical selections broadcast on radio must qualify as Canadian. Even Canadian residents traveling to the United States are restricted in their access to U.S. goods. There is no duty-free allowance for Canadian residents visiting the United States for fewer than 24 hours. Residents visiting for more than 24 hours and those visiting for 48 hours are allowed C\$200 and C\$800 in duty-free goods, respectively.

RULES OF ORIGIN

NAFTA tariff rates apply only to articles that originate in Canada, Mexico, or the United States. A foreign product cannot simply be channeled through one North American country for sale in another North American

country to avoid the payment of duties. For example, European or Asian products cannot be brought into Canada and then imported duty-free into the United States as a product of Canada. In order to know which products qualify for NAFTA's duty-free treatment, one must consult the applicable rule of origin.

Rules of origin are a critical issue to importers and exporters. They offer the sole way to determine the rate of duty or even quotas that might apply to the product being bought or sold.

Only goods that qualify under NAFTA's rules of origin can obtain NAFTA tariff rates. The most important general rules are (1) the goods must be *wholly produced or obtained* in Canada, Mexico, or the United States and (2) the goods may contain non-originating inputs (components or raw materials), but must meet the regional value content requirements or the tariff shift rules of origin found in Annex 401 of the NAFTA agreement.

Goods Wholly Produced or Obtained in North America

NAFTA applies to goods wholly produced or obtained in North America. These goods may not contain any non-North American parts or materials. NAFTA Article 415 states that the qualifications apply only to minerals mined in North America, vegetables grown in North America, live animals born and raised in North America, fish and fish products, waste, and scrap derived from production in North America. "Produced or obtained" does not mean "purchased." The definition also includes goods produced in North America *exclusively* from the raw materials just mentioned. Thus, NAFTA applies to coal mined in Tennessee, lead mined in Canada, cotton grown in Mississippi, and cattle born in Mexico and raised in Mexico or Texas. It also includes silver jewelry made in Arizona from silver mined in Mexico and taco shells made in Mexico entirely from corn grown in Iowa. The producer, however, must be able to trace *all inputs to raw materials mined, grown, or born in North America*.

Annex 401 Tariff Shift Rule of Origin

The **substantial transformation test** is used to determine the country of origin of goods imported into the United States when the goods are produced or assembled in more than one country. This test is difficult to apply, and different courts often come up with different results. The variation in court decisions leads to great uncertainty in applying the test to any given



case and complicates importers' sourcing decisions. NAFTA avoids this problem by setting out a simpler rule for when a foreign or non-North American product is "transformed" into a product of North America. NAFTA substitutes a tariff classification change for the vague substantial transformation test. When non-North American goods or materials are brought into a NAFTA country, they can be transformed into a product of North America as long as each non-North American input undergoes a tariff classification change as specified in NAFTA Annex 401. The Annex 401 rules of origin may be based on a *change in tariff classification*, a *regional value-content requirement*, or both, depending on the requirements for that particular product. This is known as the **tariff shift rule**. Annex 401 rules can be found in the *General Notes of the Harmonized Tariff Schedules*.

Changes in Tariff Classification. To know if a product imported into the United States has undergone a change in tariff classification, you must refer to the General Notes found at the beginning of the *Harmonized Tariff Schedules (HTS)* of the United States. The following example demonstrates how a product's tariff classification can change.

The harmonized system breaks down product classifications into ten digits. Countries that have adopted the HTS system have "harmonized" their classification of products internationally at the subheading level. After the first six digits, each country assigns its own numbers. For example, a down-filled comforter (HTS 9404.90.85) is classified in Chapter 94 (which covers a conglomerate of unrelated manufactured articles, including furniture), heading 9404 (covering bedding and similar furnishings, stuffed), subheading 9404.90 (other than sleeping bags), and tariff item 9404.90.85 (down-filled comforters).

To determine the import duty on a North American product, you must know the product's tariff classification at the subheading level. Imagine that you are in the business of making goose down comforters in the United States and Canada. You import unfilled cotton comforter shells from China and goose down fill from Europe. You want to know the U.S. rate of duty on the finished down comforters made at your Canadian plant. You also want to know the correct country-of-origin label to put on the comforter. So, you consult the HTSUS. Your main "non-originating inputs" are the European down (subheading 0505.10) and the cotton shell (subheading 6307.90). You also

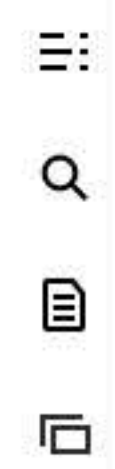
know that the finished comforter is classified under subheading 9404.90. You find the *General Notes* that contain the NAFTA tariff shift rules and read the following:

A change to subheading 9404.90 from any other chapter, except from headings 5007, 5111 through 5113, 5208 through 5212, 5309 through 5311, 5407 through 5408 or 5512 through 5516.

Because the non-originating components, the down fill and the unfilled shell, are not in Chapter 94 and are not within any of the exceptions specified, they qualify as having undergone a tariff shift when they are changed to subheading 9404.90. Thus, we have learned that the finished down comforter may be assembled in Canada and shipped to the United States under the rate for Canadian-made comforters and are not subject to any quotas on comforters of Chinese origin (and if we do a little more research we would learn that the comforter can be labeled "Made in Canada"). But suppose we had instead imported Chinese-made cotton fabric and sewed it into an unfilled shell in Canada, filled it with down, and shipped it to the United States. Ironically, the fabric itself falls within subheading 5208 through 5212, and, according to the exceptions to the above rule, would *not* amount to a qualified tariff shift.

Now, consider pastries that are made in Canada for shipment to the United States. Pastries, breads, cakes, and biscuits fall under subheading 1905.90. Assume their only non-North American input is flour imported from Europe. The rule of origin for pastries in heading 1905 states that the item will be treated as a North American product if it undergoes "A change to heading 1905 from any other chapter." The pastries would qualify for NAFTA tariff treatment because the European-made flour was classified outside of HTS Chapter 19. However, the baker must be careful. If the pastries had been made from a prepared mix (containing flour, shortening, sugar, baking powder, etc.), they would not qualify as a North American product because mixes are classified under Chapter 19, the same chapter as the pastries themselves.

Regional Value Content Requirement. For most products undergoing a transformation in North America, the rule of origin will be based on its tariff classification. In limited cases, NAFTA requires a specified amount of **regional value content** (a similar rule is used for trade in automobiles and parts). For example, a rule might require that at least 50 percent of the value of



a finished product be North American. Regional value may be calculated either by *transaction value* or *net cost* methods. Transaction value is the price actually paid for a good. The net cost method removes sales and marketing costs, shipping costs, and certain other expenses from the calculation. The value of non-North American materials is then subtracted from the total cost of the product. Usually the regional value content must be at least 60 percent for the transaction value method and at least 50 percent for the net cost method. The value of packaging materials and containers in which a product is packaged for retail sale must be taken into account as either North American or non-North American materials, as the case may be.

Transaction Value Formula

$$RVC = \frac{TV - VNM}{TV} \times 100$$

Net Cost Formula

$$RVC = \frac{NC - VNM}{NC} \times 100$$

- RVC = Percent regional value content
- TV = Transaction value of good, FOB basis
- VNM = Value of non-originating material
- NC = Net cost of good

The importer may generally choose which method it wants to use. (For an example of the calculations, see Exhibit 14.1.) For automobiles and auto parts, however, only the net cost method may be used.

Goods with Minimal Amounts of Non-North American Materials. If the amount of non-North American materials in a finished product is minimal (defined as less than 7 percent of the total cost of the product), the product will still be eligible for NAFTA tariff rates. Thus, if Japanese thread is used to sew together the sleeves on an otherwise 100 percent Mexican-made jacket, and the thread is less than 7 percent of the total cost of the jacket, the finished jacket can be exported to Canada or the United States under NAFTA tariff rates.

The NAFTA Certificate of Origin

A NAFTA **certificate of origin**, or CO (see Exhibit 14.2), is required for all shipments moving among the United States, Canada, and Mexico. It certifies that the goods qualify as having originated in North

America for purposes of preferential tariff treatment under NAFTA. COs are required for all *commercial* shipments entering the United States where the total line item value for a good (*not* the total shipment value) is more than \$1,000. For goods below these values, the invoice must state that the goods qualify as an originating good for purposes of preferential tariff treatment under NAFTA. A CO may cover a single shipment or it may be a *blanket certificate* that covers multiple shipments of identical goods. A CO is not required for temporary imports, such as those sent for repair or servicing. COs are not required for noncommercial shipments.

It is the responsibility of the exporter to provide a CO to the importer. The CO may be prepared by the exporter or by the exporter's customs agent with a written power of attorney. Frequently, the exporter is not the actual producer of the goods (as in cases where the exporter is a distributor or other intermediary). In this case, the exporter may complete and sign the certificate only with knowledge that the goods in fact originated in North America or if the producer has provided a written statement to that effect. An exporter that does not want to disclose the producer's identity to the importer may state that the producer's name is "available to Customs on request" (see field 3, Exhibit 14.2). It is unlawful to prepare or present a CO that is known to be false, inaccurate, or incorrect. If the preparer discovers an error in the certificate, it must be corrected within 30 days, with written notice of the corrections sent to all parties. COs may be completed in the language of either the exporting or importing country.

When completing the CO, follow the rules carefully. U.S. Customs and Border Protection Form 434 contains instructions on the reverse side (not reproduced here). Field 7 (*Preference Criterion*) requires a letter code indicating the reason why the goods are entitled to NAFTA treatment (i.e., that "wholly they may meet one of the rules of origin"). The form looks simple, but it is not intuitive, so caution must be used in preparing it.

U.S. importers must actually be in possession of an original CO before making entry or claiming the NAFTA tariff rate. If the importer does not have the certificate, the claim will be denied and penalties can be assessed. Faxed copies are accepted as originals. An importer who discovers errors in a certificate must notify Customs in writing within 30 days and pay any additional duties owed as a result. The importer must keep the certificate on file for five years.

Exhibit 14.1

Rules of Origin Example

Product: Wooden Furniture (HS # 9403.50)
Non-North American Inputs: Parts of furniture classified in 9403.90
Rule of Origin:
"A change to subheading 9403.10 through 9403.89 from any other chapter; or
A change to subheading 9403.10 through 9403.89 from subheading 9403.90, provided there is a regional value content of not less than:
a) 60 percent where the transaction value is used, or
b) 50 percent where the net cost method is used."

Explanation: Wooden furniture can qualify for NAFTA tariff preference under two scenarios—a tariff shift, or a combination of a tariff shift and regional value content requirement.

The first option—the tariff shift rule—requires that all non-originating inputs be classified outside of HS Chapter 94 (furniture and bedding). Since the non-originating inputs (furniture parts) are classified in Chapter 94 (subheading 9403.90), then the product cannot qualify based on tariff shift. However, it may still qualify based on the second part of the rule.

The second option has two components—a tariff shift requirement and a regional value content requirement. The tariff shift requirement is satisfied since the non-originating input (furniture parts) is classified in subheading 9403.90 as specified by the rule. The product must meet its regional value content requirement using the transaction value or the net cost methodology.

Given the following values, furniture qualifies for NAFTA tariff preference using the net cost methodology. The calculation is found below, with the following example.

Producer's Net Cost	\$182.00 each (not including shipping, packing royalties, etc.)
Transaction Value	\$200.00 each piece
Value of Non-Originating Parts	\$90.00

Transaction Value Method	Net Cost Method
$\frac{(200 - 90)}{200} \times 100 = 55$	$\frac{(182 - 90)}{182} \times 100 = 50.5$
Good does not qualify under transaction value method because it does not have at least 60 percent regional value content.	Good qualifies under net cost regional value requirement because it has at least a 50 percent regional value content.

Source: U.S. Department of Commerce, 1995 as updated 2016.

Standards and Technical Barriers to Trade

All countries can maintain product regulations to protect public health, consumer safety, the environment, and areas of public welfare. However, NAFTA encourages that standards and technical regulations not be used as a nontariff barrier. For instance, Mexico cannot set unnecessary technical regulations and long, drawn-out approval processes for the sale of telecommunications equipment only to discourage entry to the Mexican market by U.S. or Canadian firms. Technical

requirements for telecommunications equipment such as telephones may only require that the equipment not harm the telephone network in order to be approved for use or sale. Standards can be set for energy efficiency in appliances, safety in automobiles, or chemical additives in food. NAFTA requires that each country notify the others when the development of a technical regulation or standard begins, give public notice of the proposed regulations, and provide a 60-day comment period for interested firms or individuals to submit their arguments and concerns.



Exhibit 4.2

NAFTA Certificate of Origin

U.S. DEPARTMENT OF HOMELAND SECURITY
Bureau of Customs and Border Protection

OMB No. 1651-0098
See back of form for Paperwork Reduction Act Notice.

NORTH AMERICAN FREE TRADE AGREEMENT
CERTIFICATE OF ORIGIN

Please print or type

19 CFR 181.11, 181.22

Bill of Lading / Air Waybill No. :

1. EXPORTER NAME AND ADDRESS		2. BLANKET PERIOD			
TAX IDENTIFICATION NUMBER:		FROM			
3. PRODUCER NAME AND ADDRESS		TO			
TAX IDENTIFICATION NUMBER:		4. IMPORTER NAME AND ADDRESS			
TAX IDENTIFICATION NUMBER:		TAX IDENTIFICATION NUMBER:			
5. DESCRIPTION OF GOOD(S)	6. HS TARIFF CLASSIFICATION NUMBER	7. PREFERENCE CRITERION	8. PRODUCER	9. NET COST	10. COUNTRY OF ORIGIN

I CERTIFY THAT:

- THE INFORMATION ON THIS DOCUMENT IS TRUE AND ACCURATE AND I ASSUME THE RESPONSIBILITY FOR PROVING SUCH REPRESENTATIONS.
- I UNDERSTAND THAT I AM LIABLE FOR ANY FALSE STATEMENTS OR MATERIAL OMISSIONS MADE ON OR IN CONNECTION WITH THIS DOCUMENT.
- I AGREE TO MAINTAIN AND PRESENT UPON REQUEST, DOCUMENTATION NECESSARY TO SUPPORT THIS CERTIFICATE, AND TO INFORM, IN WRITING, ALL PERSONS TO WHOM THE CERTIFICATE WAS GIVEN OF ANY CHANGES THAT COULD AFFECT THE ACCURACY OR VALIDITY OF THIS CERTIFICATE.
- THE GOODS ORIGINATED IN THE TERRITORY OF ONE OR MORE OF THE PARTIES, AND COMPLY WITH THE ORIGIN REQUIREMENTS SPECIFIED FOR THOSE GOODS IN THE NORTH AMERICAN FREE TRADE AGREEMENT AND UNLESS SPECIFICALLY EXEMPTED IN ARTICLE 411 OR ANNEX 401, THERE HAS BEEN NO FURTHER PRODUCTION OR ANY OTHER OPERATION OUTSIDE THE TERRITORIES OF THE PARTIES; AND
- THIS CERTIFICATE CONSISTS OF PAGES, INCLUDING ALL ATTACHMENTS.

11a. AUTHORIZED SIGNATURE		11b. COMPANY	
11c. NAME (Print or Type)		11d. TITLE	
11e. DATE (MM/DD/YYYY)	11f. TELEPHONE NUMBER	11g. E-MAIL	PLEASE REMOVE THIS BOX!

CBP Form 434 (11/16)



Standards and technical regulations in Mexico are called *normas*. *Normas* are either mandatory—the *Normas Oficiales Mexicanas*, or “official norms”—or voluntary, known simply as *Normas Mexicanas*. They are drafted by dozens of committees operating under the aegis of the Mexican Ministry of the Economy, the *Secretaría de Economía* (formerly the *Secretaría de Comercio y Fomento Industrial*). *Normas* are published in the *Diario Oficial de la Federación*, which is similar to the *Federal Register* in the United States. Mexico has hundreds of mandatory standards and more than 6,000 voluntary ones. Many U.S. exporters argue that these are really used to discourage the sale of their goods in Mexico. Other examples include lack of notification to U.S. parties before changing regulations and inconsistency with which customs agents apply the law.

Marking and Labeling Rules

The country-of-origin marking and labeling rules are set out in Annex 311 to NAFTA and enacted in the national customs regulations of the United States, Canada, and Mexico. The rules are not uniform among the three countries. The country-of-origin rules for marking and labeling goods are not the same rules that determine the country of origin for tariff purposes. It is actually possible for an item to be deemed a product of a NAFTA country for marking purposes without being eligible for lowered NAFTA tariff rates.

In an important case, the U.S. Court of Appeals held in *Bestfoods v. United States*, 165 F.3d 1371 (Fed. Cir. 1999), that only Annex 311 principles apply to NAFTA imports. The case was strongly argued by the maker of “Skippy” brand peanut butter, who wanted to be sure that its well-known “all-American” product obtained a “Made in U.S.A.” label. The peanut butter was made in the United States from “peanut slurry”—a gritty, peanut-based paste—imported from Canada. Bestfoods argued that it should be allowed to label “Skippy” as “Made in U.S.A.” because the U.S. process substantially transformed the peanut slurry into a product with a “new name, character, or use.” However, the court held that NAFTA Annex 311 replaced the old “name, character, or use” test for North American trade. A reading of Annex 311 shows that the processing of Canadian (or Mexican) peanut slurry into peanut butter in the United States does not result in the type of tariff change that would transform the slurry into a U.S. product.

Mexico’s marking and labeling requirements have been controversial. The *Normas Oficiales Mexicanas* contains specific labeling requirements for certain products (e.g., appliances, electronics, textiles, and food products). All others fall into more general requirements. Mexico’s labeling requirements are strict and often burdensome to U.S. and Canadian exporters. The cost of compliance is often so difficult that many small exporters cannot afford to sell their products in Mexico. Mexico has dictated the content, form, size, and even the appearance of product labels. The Spanish-language labels must include the generic name of the product, the name and address of the importer and exporter, the contents, and the country of origin. Instructions and warnings as to use and care of the product may be enclosed separately, but an invitation to read them must appear on the label. Product warranties must be clearly stated. However, in March 2011, the Mexican government announced a simplified labeling procedure for certain food and beverage products in border areas. These procedures exempted specified products from the Spanish-language requirement within designated “special zones” within the border regions. However, there are several required disclosures that must be included on such labels as well as required filings with the Mexican government.

Items Not Requiring Marks. Annex 311 exempts certain items from marking requirements: items incapable of being marked, items that would be injured by marking, items that cannot be marked except at a cost disproportional to the cost of the goods, items in containers that indicate the country of origin to the ultimate purchaser, crude or bulk materials, personal items for use by the importer and not intended for sale, items produced more than 20 years prior to importation, original works of art, and a few others.

TRADE IN GOODS: SECTORAL ISSUES

Sectoral issues are issues of concern to a particular industrial, agricultural, or service sector of the economy. Examples might be automobile manufacturing and assembly, telecommunications, agriculture, or financial services. NAFTA has specific provisions that reduce tariffs and liberalize trade and investment in these and other sectors. The most important and most



controversial industry in North American trade relations is motor vehicles and parts.

Trade in Motor Vehicles and Parts

Perhaps no other sector has been affected by NAFTA as much as the automobile industry. Mexico had long tried to manage its automobile industry through strict trade and investment restrictions. For instance, prior to NAFTA, automobiles sold in Mexico had to contain a minimum of 36 percent Mexican-made parts. Tariffs were 20 percent on cars imported into Mexico and 13.2 percent on automobile parts (as compared to a 2.5 percent tariff on the import of Mexican-made cars into the United States). The result was a Mexican auto parts industry that was largely inefficient and noncompetitive in world markets. Of course, many modern automotive parts and assembly plants in Mexico are owned and operated by U.S., European, and Japanese firms. As discussed later in this chapter, cars assembled there cannot be released for sale into Mexico without meeting Mexican customs regulations and without the payment of duties. Cars assembled there from U.S. parts can only be returned to the United States at lowered tariff rates if they meet the strict requirements of U.S. customs law.

Canada and the United States eliminated duties on each other's automobiles even prior to NAFTA. By 2004, all three countries had eliminated tariffs and restrictions on automobiles, trucks, buses, and automotive parts originating in North America. However, restrictions on the cross-border trade in used cars will continue for many years to come.

Special Rules of Origin for Automobiles. To qualify for duty-free treatment, a motor vehicle that is made or assembled in North America must contain a specified percentage of North American content. For motor vehicles, these rules supersede the regional value content rules for other products, discussed earlier in the chapter.

Beginning in 2002, the content requirement for passenger cars rose to 62.5 percent. The same content requirements apply to engines and transmissions for these vehicles. Compliance with the rules requires complex calculations and the tracing of component parts throughout the supply chain. One of the major purposes of local content rules has been to encourage investment in North America. For example, Japanese manufacturers found it more efficient to build vehicles in North America than in Japan, in order to meet the North American content requirements.

Trade in Textiles and Apparel

The NAFTA textile provisions are of major significance because of the U.S. position as a major textile importer (with a large domestic industry arguing for protection from low-cost imports) and the role of Mexican plants in assembling apparel for sale in the United States. Prior to NAFTA, imports of Mexican textiles and apparel were limited by quotas in the United States and Canada. Mexico also had 20 percent tariffs on U.S. textile products. By 2004, Canada, Mexico, and the United States had phased out all quotas and tariffs on textile and apparel goods that meet the North American rules of origin. Now, textile quotas can only be used as a temporary safeguard in "emergency" situations.

There are specific rules of origin covering trade in textiles. They are complex and arcane, based largely on political considerations. Even the most experienced textile manufacturers and importers require an expert customs attorney and customs broker to move textiles and apparel across borders in North America.

With the expiration of the *WTO Agreement on Textiles and Clothing* in 2005 and the end of textile quotas and most trade restrictions at the global level (other than temporary safeguards), Chinese plants have rapidly begun to take the textile and apparel business away from plants in Mexico, the Caribbean, and Central America. China has quickly become the world's leader in low-cost textile production and is the largest supplier of textiles and apparel to the United States, Europe, and Japan. The international textile industry will surely undergo many more changes in the coming years.

Trade in Agriculture

Trade in agricultural products between the United States and Canada totaled more than \$46 billion in 2015 according to the USTR. The United States bought \$22 billion of agricultural goods from Canada, which made Canada the United States' largest supplier of agricultural imports. U.S. agricultural exports to Canada in 2015 were \$24 billion, which made Canada the United States' largest agricultural market. Agricultural trade between the United States and Mexico is equally impressive. Mexico was the United States' third largest agricultural export market with sales in excess of \$18 billion in 2015. U.S. imports of agricultural products from Mexico totaled \$21 billion, which made Mexico the United States' second largest supplier of agricultural imports after Canada in 2015.

Prior to NAFTA, Mexico only permitted the import of U.S. agricultural products under a strict licensing scheme. Agricultural products were also protected by high tariff rates. The most sensitive products were corn, beans, sugar, powdered milk, and corn syrup, among many others. The United States also maintained protection on a variety of Mexican fruits and vegetable products intended to protect American farmers. NAFTA required an end to Mexico's licensing of agricultural imports and a phased-out end to tariffs. All tariffs on agricultural products originating in North America were eliminated by January 1, 2008. The 2008 deadline caused widespread protests throughout Mexico and remains controversial. Although large-scale American producers are pleased with open access to Mexican markets, many Mexicans argue that their system of small farms is threatened. Most Mexicans do not want to entertain the possibility that their country would one day be unable to produce its own corn, beans, and customary foods.

Agricultural Rules of Origin. NAFTA tariff preferences apply only to agricultural products that originate in North America. There are special rules of origin covering North American agricultural products. For example, for fresh or frozen juice (all single fruit juices, such as orange juice) to have "originated" in North America, the juice must be made of 100 percent North American fruit. Other bulk commodities, excluding juice, can have up to 7 percent non-North American content. There are other special rules of origin for sugar refining, peanuts, vegetable oils, and dairy products. For example, only North American milk can be used to make butter, cheese, yogurt, or ice cream, traded under NAFTA preferential rates.

Government Procurement

NAFTA allows North American companies to compete for contracts for the supply of goods and services to agencies of the three governments. In 2016 and 2017, NAFTA's government procurement rules applied to contracts for goods and services greater than \$77,533 and construction contracts greater than \$10 million for federal departments and agencies. For government-controlled enterprises, these amounts are \$387,667 and \$12.4 million, respectively. The agreement does not cover weapons, equipment, and systems needed for national defense.

When a government agency announces its request for submission of bids, it must publish the

technical specifications, qualifications for suppliers, and time limits for submission. Bids from suppliers in all NAFTA countries must be treated without discrimination. Each country has established a bid protest system that allows firms to challenge procurement procedures and awards. Countries will exchange information on bidding procedures to encourage cross-border bidding, particularly from small- and medium-sized firms.

Emergency Action to Protect Domestic Industry (NAFTA Safeguards)

When NAFTA was negotiated, it was clear that increased competition from foreign firms would cause some economic disruption and job loss, particularly to inefficient, uncompetitive, and outdated companies. NAFTA permits the United States, Canada, or Mexico to take very limited emergency action to safeguard a domestic industry. Emergency action may be taken only where increased quantities of a particular good are a *substantial cause of serious injury, or threat thereof to a domestic industry producing a like or directly competitive good* and only with the *consent* of the country from which the goods were exported. Generally, the right to invoke emergency safeguards under NAFTA is more limited than under WTO rules. For example, the country imposing the safeguard must agree with the exporting NAFTA country on trade compensation. The compensation must be equivalent in monetary terms to the safeguard action taken. For instance, if the United States seeks to impose safeguards on imports of light bulbs from Mexico, in order to save the U.S. lightbulb industry, then it will have to agree to concessions having substantially equivalent trade effects.

If a NAFTA country imposes emergency safeguards on certain imported goods arriving from all WTO member countries worldwide, then these *global safeguards* may be applied to the products entering from another NAFTA country only if they comprise a *significant share of the total imports* of that type of good and contribute importantly to the serious injury.

TRADE IN SERVICES

NAFTA provisions on cross-border services are aimed at facilitating trade in services in North America. The provisions affect a wide range of service providers,



including transportation and package delivery, consulting, banking, insurance, and others. The principles of national treatment and NTR trade apply. No NAFTA country may require a North American service provider to have a residence or office within its borders. Each country will be able to continue to certify and license professionals, such as doctors, lawyers, and accountants; however, the countries are working to recognize the foreign credentials of a professional, especially foreign lawyers and engineers. For instance, many professional organizations from NAFTA countries are negotiating *mutual recognition agreements*. Once ratified by state and federal governments, they will permit recognition of professional licenses in all three countries. Citizenship requirements to obtain a professional license have been eliminated.

Financial Services

U.S.–Canadian cross-border investment in financial services was largely opened in 1989. Thus, the most important impact of NAFTA’s financial services provisions is that they open Mexican financial service industries to investment by U.S. and Canadian companies. Banks, insurance companies, securities firms, and other financial service providers are now able to open branches and offices throughout North America. Most restrictions were phased out by 2000, permitting 100 percent foreign ownership of Mexican financial institutions. Similar provisions apply to insurance companies (100 percent U.S. ownership of some Mexican insurance companies was permitted as early as 1996) and other finance companies (commercial credit, real estate lending, leasing, and credit card services).

Transportation

Nearly 90 percent of goods sold across the 2,000-mile U.S.–Mexican border—some five million truckloads a year—move by rail or truck transportation. In the past, both U.S. and Mexican truck regulations have severely limited truck access. On the U.S. side, Mexican trucks were limited to a 25-mile incursion across the border. Typically, carriers on one side of the border had to hand over their cargo to transfer companies that specialize in moving goods through customs. The trucks and cargo were thoroughly inspected for customs compliance, illegal stowaways, drug smuggling, plants, and invasive insects. After inspection and a short trip across the

border, the shipments were then handed over to truckers on the other side, perhaps in San Diego or Laredo for transport to their destination, or held in a warehouse for pickup. The long lines of trucks waiting to cross the borders caused traffic congestion, idling engines, fuel consumption, pollution, and delays costing millions of dollars every year. Concerns over terrorism worsened the situation.

NAFTA addresses the issue of cross-border road transportation. The agreement frees up cross-border road transportation by eliminating the intermediate transfer of cargo and eliminating the increased fees, costs, and delays that result. NAFTA does not affect regulations applied to purely domestic truck or bus transportation, and drivers will always be bound by the “rules of the road” in any foreign country in which they operate a vehicle. NAFTA does, however, permit U.S. and Canadian trucking companies to make deliveries and pickups in Mexico and permit Mexican trucking companies to have similar access to their customers north of the border. The three countries are developing common safety standards for vehicles— tires, brakes, truck and cargo weight, etc.—and driver’s license certifications, including testing. NAFTA also permits the cross-border ownership of trucking companies. As of 2001, U.S. and Canadian companies were able to own a 51 percent interest in Mexican trucking companies and a 100 percent ownership interest after 2004. Despite the lifting of restrictions, U.S. and Canadian companies are still subject to long waits and other legal barriers to obtaining necessary permits.

No NAFTA provision has been more controversial or more difficult to implement than the open roads provisions. It has pitted the truckers’ union, environmentalists, and U.S. citizens concerned about the safety of Mexican trucks against the Mexican trucking industry, farmers, importers and exporters, and other shippers. During the 1990s, the Clinton administration refused to admit Mexican trucks beyond the border zone until Mexican safety standards were on par with those in the United States and Canada. In the following 2001 decision, a NAFTA **arbitral panel**, which consists of five members who are experts in trade or law, ruled that the United States was in violation of NAFTA. As you read, consider the regulatory nightmare of enforcing U.S. safety standards on millions of Mexican trucks arriving in the United States every year.



In the Matter of Cross Border Trucking

No. USA-MEX-98-2008-01 (2001) (North American Free Trade Agreement Arbitral Panel)

BACKGROUND AND FACTS

To move goods between the United States and Mexico, shippers typically dealt with three trucking firms. Goods were shipped to a storage facility in a border town. The trailer was then detached from the tractor and picked up by a drayage company that moved it across the border, where a truck in that country picked it up to haul it to its final destination. The process was inefficient, and the border delays were a trucker's nightmare.

This handing off of cargo was necessary because the United States prohibited Mexican trucks from carrying goods through to their U.S. destination for safety reasons. According to U.S. government studies, as many as 40 percent of the five million Mexican trucks that entered the United States in 1999 failed to meet U.S. safety requirements. Mexico does not have the same rigorous standards for driver regulation and truck inspections as does the United States, nor does it register or track safety statistics on its carriers. U.S. trucks must undergo periodic safety inspections by qualified personnel employed by the trucking company. Canadian regulations are similar to those in the United States, and Canadian drivers have been permitted on U.S. highways for decades. The United States maintained that because it can inspect less than 1 percent of the Mexican trucks arriving in the United States, it could not open its border to Mexican trucking companies until Mexico also adopted comprehensive regulatory standards as tough as those in the United States and Canada. Mexico acknowledged that when its trucks operated in the United States they must comply with U.S. standards, but that the United States could not dictate Mexican regulatory standards.

The United States also restricted Mexican investment in U.S. trucking firms. Mexico argued that the United States did not treat Mexican trucks as favorably as it did trucks from the United States and Canada and that the United States violated NAFTA open investment rules by prohibiting Mexican ownership of U.S. trucking firms. The United States countered that under NAFTA Mexican trucks must be treated the same as U.S. and Canadian trucks only where there are "like circumstances" and that Mexican regulations were so unlike those in the United States and Canada that more restrictive treatment of Mexican trucks was warranted. An arbitral panel was convened to hear the dispute in 2000.

FINAL REPORT OF THE PANEL

Mexico asserts that no NAFTA provision entitles a party to impose its own laws and regulations on the other. This would be an unacceptable interference in the

sovereignty of another state, and certainly not something to which any party to NAFTA has committed. Therefore, Mexico [argues that it] is under no obligation under NAFTA to enforce U.S. standards, despite cooperation between the United States and Mexico to make the regulatory systems compatible [since 1995]. However, according to Mexico, the United States has made adoption of an identical system of motor carrier regulation a condition of NAFTA implementation, even though NAFTA contemplates that harmonization would not be a condition.

According to the United States ... Mexico cannot identify its carriers and drivers so that unsafe conduct can be properly assigned and reviewed. Without such carrier safety performance history, the United States cannot conduct a meaningful safety fitness review of Mexican carriers at the application stage. The United States also contends that it would be futile to try to perform inspections of Mexican carriers in Mexico because "Mexican carriers are not required to keep the types of records that are typically reviewed in these inspections." In contrast to Mexico's system, the United States notes that "Canada's truck safety rules and regulations are highly compatible with those of the United States." Thus, "when Canadian-based commercial trucks cross into the United States, federal and state transportation authorities can have a high level of confidence that those trucks comply with U.S. standards and requirements at least to the same degree as U.S.-based trucks. That confidence level is bolstered by a fully functioning, computerized bilateral data exchange program." Given all of these considerations, the "United States has ... concluded that the 'circumstances' relevant to the treatment of Mexican-based trucking firms for safety purposes are not like those applicable to the treatment of Canadian and U.S. carriers." Accordingly, "the United States maintains that it may apply more favorable treatment to U.S. and Canadian trucking firms than to their Mexican counterparts without running afoul of Chapter 12's national treatment or most-favored-nation rules."

Article 1202 [national treatment] provides: Each Party shall accord to service providers of another Party treatment no less favorable than it accords, in like circumstances, to its own service providers. Similarly, Article 1203 [NTR] states: Each Party shall accord to service providers of another Party treatment no less favorable than it accords, in like circumstances, to service providers of any other Party or of a non-Party. In its most succinct terms, the disagreement between the United States on the one hand, and Mexico and Canada on the other, is over whether the "in like

continues



continued

circumstances" language permits the United States to deny access to all Mexican trucking firms on a blanket basis, regardless of the individual qualifications of particular members of the Mexican industry, unless and until Mexico's own domestic regulatory system meets U.S. approval.

[T]he Panel is of the view that the proper interpretation of Article 1202 [and 1203] requires that differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety... . Similarly, the Panel is mindful that a broad interpretation of the "in like circumstances" language could render Articles 1202 and 1203 meaningless. If, for example, the regulatory systems in two NAFTA countries must be substantially identical before national treatment is granted, relatively few service industry providers could ultimately qualify. Accordingly, the Panel concludes that the U.S. position that the "in like circumstances" language permits continuation of the moratorium on accepting applications for operating authority in the United States from Mexican-owned and domiciled carriers is an overly broad reading of that clause.

The United States claims that Mexico does not even allege that there is any interest on behalf of Mexican nationals to invest in U.S. trucking firms [T]he prohibition on allowing Mexican investors to acquire U.S. companies that already have operating authority, on its face, violates ... NAFTA Articles 1102 and 1103 ... even if Mexico cannot identify a particular Mexican national or nationals that have been rejected.

Decision. The panel unanimously held that the U.S. restrictions on the Mexican trucking industry violated NAFTA. The inadequacies of the Mexican safety regulations were not sufficient reason for the United States to refuse applications from Mexican-owned trucking

companies to operate on U.S. highways. The ruling preserved the right of the United States to hold Mexican trucks to the same regulations, safety standards, and inspections as any other vehicle on U.S. roads. Mexican drivers can be required to meet the same licensing and performance standards as U.S. drivers and observe all "rules of the road." Under special situations, the United States may establish different procedures to ensure that Mexican trucks and drivers comply with U.S. law, so long as the procedures are in good faith and not more restrictive to trade than necessary. The U.S. restrictions on investment are not valid because investment does not raise a safety issue.

Comment. Was the U.S. position strictly motivated by safety concerns? American truckers and organized labor have generally been opposed to opening the border. Mexican drivers make less than their American counterparts, and the border opening places them in competition with American drivers. Do you think this affected the U.S. government's position in the 1990s?

Case Questions

1. What were the panel's holdings with respect to the various restrictions on the free operation of the Mexican trucking industry in the United States?
2. As noted in the comment to this case, was the opposition to the operation of Mexican trucking companies in the United States based primarily on safety or economic considerations?
3. Does the example of the trucking dispute prove that despite NAFTA's free trade provisions, there are some areas where trade will never be free or without restrictions? Why or why not?

In response to the arbitral panel decision, the George W. Bush administration made efforts to give Mexican trucks full access to American highways. The Department of Transportation passed regulations to ensure that Mexican trucks complied with the same regulations that apply to American trucks. For example, the regulations require that all trucks comply with safety, environmental, and fuel efficiency standards. Mexican trucks are required to undergo registrations, safety inspections, and equipment checks. Drivers must have a federal license from Mexico and comply with all U.S. safety regulations, including those limiting the number of hours of continuous driving. Mexican trucking companies must implement drug and alcohol testing, maintain insurance, and keep safety-related records. U.S. law enforcement officers can run license checks on Mexican

drivers. Mexican trucks may enter only at authorized points of entry when inspectors are present.

In the early 2000s, the truckers' union and environmentalists sought to block implementation of the NAFTA trucking provisions. A lawsuit was brought against the Bush administration, arguing that the administration had failed to comply with U.S. environmental laws. A federal appeals court agreed, but the U.S. Supreme Court unanimously reversed the decision in favor of the government. In *Department of Transportation v. Public Citizen*, 541 U.S. 752 (2004), the Court held that the government could implement the NAFTA transportation rules without an environmental impact statement addressing issues such as the effect on increased traffic, fuel consumption, and air pollution. Despite Court approval and the efforts of the Bush



administration to ensure truck and driver safety, the U.S. Congress failed to implement the NAFTA cross-border transportation rules. Furthermore, the subsequent Obama administration canceled the cross-border trucking pilot program. Mexico responded to the failure to implement the cross-border transportation rules by imposing \$1.5 billion in retaliatory tariffs on manufactured goods and \$1 billion on U.S. agricultural products.

In July 2011, the United States and Mexico signed an agreement permitting unlimited access to the United States for Mexican trucks for a trial period of three years. The agreement required that all drivers qualify for necessary approvals and permits and agree to electronic monitoring to track hours of service, periodic drug and alcohol testing, and assessment of English language skills. All trucks must meet U.S. safety standards. Mexico agreed to reduce its retaliatory tariffs by 50 percent as a sign of good faith and eliminate such tariffs as soon as the first Mexican truck was allowed to enter the United States. This occurred in October 2011 when a truck operated by Transportes Olympic crossed the border at Laredo, Texas, carrying a steel drilling structure to Garland, Texas. The cross-border trucking dispute is a prime example of the difficulties and delays encountered by more controversial provisions of free trade agreements.

Telecommunications

NAFTA eliminated all tariffs on telephones, cellular phones, and trade in telecommunications equipment by 2004. Given that the number of telephones per capita in Mexico is only a fraction of the per capita number of phones in the United States, Mexico is considered a giant untapped market for all forms of communications equipment and services. NAFTA provides that Canadian, Mexican, and U.S. telecommunications companies have nondiscriminatory access to all North American public telecommunications networks. They must be granted access to public and private (leased) lines and networks, and only conditions that are reasonable and necessary may be imposed on this access. Access to public telecommunications networks must be at rates related to the cost of operations. Technical standards may be imposed only for safety or to prevent damage to the equipment. Mexico's telephone system had been operated as a government-owned monopoly from 1972 to 1990, as *Telefonos de Mexico*. Today the company is privately owned and is even traded on the New York Stock Exchange. In the 1990s, Mexico developed a law that ended the monopoly on telecommunications and opened the Mexican market to foreign investment. Since then,

many U.S. and Canadian telecommunications companies have teamed up with Mexican companies to take advantage of growing opportunities in the telecommunications market. More recently, the United States and Mexico disagreed over Mexican rules making it more difficult and costly for U.S. firms to connect international calls into Mexico. The United States complained to the WTO and requested a dispute settlement panel. In 2004, the panel ruled in favor of the United States and held that Mexican regulations discriminated against U.S. firms in violation of the WTO *General Agreement on Trade in Services*.

CROSS-BORDER INVESTMENT

Prior to the late 1980s, Mexico had a history of strictly regulating or even prohibiting foreign investment. For instance, Mexico required that foreign investors include local participants—Mexican stockholders or partners—in any new factory or investment venture. If a foreign firm wanted to purchase an interest in a local company, Mexico usually limited them to a minority, noncontrolling interest. Mexico, as with many developing countries, required foreign manufacturing firms located there to export finished goods to other countries for foreign currency. Investors in manufacturing companies were required to use a certain portion of domestic content in the finished goods, thus discouraging imports. Limits were placed on how much money could be transferred out of the country. A common requirement was that foreign investors had to introduce their most advanced technology to the host country.

In the 1980s, Mexico turned away from the philosophy that government control is in the best interest of the country and recognized that the threat of expropriation and nationalization of industries would drive away foreign investors. Mexico became more hospitable toward foreign investment. It still exercises some control over foreign investment, particularly in the energy and petroleum industries, telecommunications, and a few other industries, but to a lesser extent than it did in the past.

NAFTA's Investment Provisions

NAFTA's investment provisions can be summarized as follows:

- NAFTA investors must be treated fairly, equitably, and in full accordance with basic principles of international law.
- NAFTA investors must be granted the basic protections of NTR (to be treated at least as favorably as investors from outside



- North America), *nondiscrimination*, and *national treatment* (to be treated no less favorably than a country's own investors or domestically owned firms are treated).
- NAFTA governments must adopt *open investment policies* and eliminate most restrictions on private investment from firms based in other NAFTA countries.
 - Private property of a NAFTA investor may not be expropriated by the government without due process of law and the payment of fair compensation.
 - Private investors may request an arbitral tribunal to hear an *investor claim* for money damages against a NAFTA country for violating the NAFTA investment provisions. NAFTA countries may invoke other procedures for settling investment disputes between themselves.

NAFTA's Investment Policies. Investors from all three countries can now establish new companies and purchase existing ones across North American borders. In addition, NAFTA sets limits on the government regulation of North American-owned companies. (These provisions were largely intended to break down the investment barriers in Mexico.) No NAFTA country can require a minimum level of local participation or ownership by nationals (other than in certain industries in which exceptions to this rule have been reserved). No NAFTA country may place restrictions on the conversion of foreign exchange and transfer of money between accounts in another NAFTA country. Similarly, no country may either require or prohibit a firm from transferring profits earned by a subsidiary in one NAFTA country to another NAFTA country. There can be no performance requirements on a NAFTA investor, such as minimum export requirements (where the host government requires foreign-owned firms to export a certain percentage of goods or services produced by the local subsidiary) or domestic content or purchasing requirements (where the host government requires that a minimum percentage of raw materials used in local operations be purchased from local companies). Governments may not require that parent companies in one NAFTA country transfer advanced technology (via patents, licensing, or "know-how" agreements) to a subsidiary in another NAFTA country, and they may not require that senior managers and corporate directors be of any particular nationality.

Environmental Measures Applicable to Investments. Mexico does not have the strict environmental laws that the United States has. For many U.S. firms, compliance with U.S. laws can be costly. When NAFTA was negotiated, heated debate surrounded the issue of whether U.S. companies, especially polluting ones, would flock to open plants in Mexico to avoid U.S. law. As a compromise

in the negotiations, NAFTA provides that "it is inappropriate to encourage investment by relaxing domestic health, safety, or environmental measures. Accordingly, a [NAFTA country] should not waive ... such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment."

Exceptions to the Investment Agreement. Canada reserved the right to review acquisitions of local companies exceeding a set threshold. In 2017, the review threshold was C\$1 billion or more under the *Investment Canada Act*. Canada also restricts foreign investment in cultural industries (such as publication and distribution of written materials, film, video and music recordings, and television, cable television, and satellite broadcasting), commercial aviation, energy and mining, telecommunications, and fishing. Real estate ownership may be restricted as primary responsibility for property law rests with the provinces. In Mexico, several sectors of the economy are reserved exclusively for the state. These sectors include petroleum exploration and exploitation; telegraphic services; electric power generation, transmission, and distribution; nuclear energy; and airports. Other sectors are reserved exclusively for Mexican nationals. These sectors include retail sales of gasoline, non-cable radio and television services, development banks, and domestic transportation for passengers, tourism, and freight (except messenger and package delivery services). The United States excluded investments in nuclear power, broadcasting, mining, customs brokerages, and air transportation and may block the takeover of U.S. firms on the basis of national security.

Protecting Investors from Expropriation. The legal requirement that governments must compensate owners of private property whose property is taken for public use is a virtually universal concept. It is based on the notion that at times governments must take private property for public purposes, or for uses such as conservation or environmental protection, and that the property owners should not have to shoulder the cost of the public welfare. NAFTA Article 1110 states that no NAFTA country may expropriate property of a NAFTA investor, unless it is done pursuant to internationally accepted rules, that is, that private property may only be taken for a public purpose or for public use on a nondiscriminatory basis, using procedures that are open, fair, and in accordance with due process of law, and fair compensation must be paid according to the market value of the property taken.

The *Metalclad Corp. v. United Mexican States* case is one of the most interesting and controversial cases to



come out of NAFTA. This is a case involving a U.S. firm that attempted to build a hazardous waste landfill in Mexico. It was told that all permits necessary to build the facility had been obtained. After making significant progress to complete the project, the municipality where the landfill was claimed one additional permit was missing, and the state issued a decree turning the property into a wildlife refuge. Work was ordered stopped, and Metalclad requested that an arbitral tribunal award damages.

Investor Claims and Dispute Settlement Procedures. Investor claims are actions for damages brought by a NAFTA investor before an arbitral tribunal against a host NAFTA government for having violated NAFTA investment rules. Investor suits maybe brought either under the arbitration rules of the U.N. Commission on International Trade Law (UNCITRAL) or, as in the *Metalclad* award, the International Centre for the Settlement of Investment Disputes (ICSID). ICSID is an organization closely allied with the World Bank and is headquartered in Washington, DC. Investor suits may be brought by either citizens or corporations of another NAFTA country or by investors from other countries that have substantial business activities in a NAFTA country. For example, if a parent company in Sweden owns an incorporated subsidiary company in the United States, then the U.S. subsidiary may make investments in Canada or Mexico according to the open investment policies of NAFTA. Investors may bring suits for monetary damages (no punitive damages are allowed) or restitution of property, but not to force a government to change its laws or policies (as can a WTO panel wherein the cases are brought by complaining governments). There are usually three arbiters, selected by the parties, and their awards are binding on the parties. The awards are effective only for that case and do not establish binding rules that countries must follow in future disputes. NAFTA governments may also bring dispute actions against each other, not for damages, but to compel compliance with NAFTA rules.

There were 77 notices of intent to submit a claim filed pursuant to Chapter 11 of NAFTA between 1994 and 2015. Thirty-five of these claims were filed against Canada resulting in total payments equaling C\$172 million. Twenty-two claims were filed against Mexico resulting in total payments of \$204 million. Twenty claims have been lodged against the United States, but it has not lost a case to date. These payouts to investors are in addition to the millions of dollars in defense costs incurred by the respective governments. However, although these numbers appear large, it is important to place them in the context of the size of the free trade zone created by NAFTA and amount of foreign investment within its three member states. Cases such as *Metalclad Corporation v. United Mexican States* are rare. The vast majority of cases filed against national governments have been dismissed without any award of damages. In this regard, the result in *Metalclad* has proven to be the exception rather than the rule.

OTHER NAFTA PROVISIONS

In negotiating NAFTA, the United States was able to see the broader implications of free trade and investment in North America. For instance, what if an unscrupulous company in Mexico produces counterfeit software and smuggles it across the border in violation of the copyrights of a U.S. company? Or suppose that a firm emits poisonous gas or pollutants from a smokestack at its Mexican plant, and they are carried by air currents to the United States? What if the top managements of several competing companies meet in Denver or Mexico City and fix consumer prices for a product that they all make? Although these problems undoubtedly occurred prior to NAFTA and are tremendous issues that no one trade agreement is likely to change, the U.S. negotiators of the agreement used the opportunity to address them openly.



Metalclad Corporation v. United Mexican States

International Centre for the Settlement of Investment Disputes
No. ARB(AF)/97/1 Award of the Arbitral Tribunal (August 30, 2000)

BACKGROUND AND FACTS

In 1993, a Mexican firm, Coterin, received a permit from the Mexican government to build a hazardous waste treatment plant in the La Pedrera valley in the state of San Luis Potosi, near the city of Guadalucazar. Metalclad,

a U.S. company, was interested in acquiring Coterin. Several Mexican government authorities assured Metalclad that Coterin had obtained all required construction permits for the facility. One month later, Metalclad purchased Coterin. In 1994, amid much opposition to

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the plant from local residents and environmental protestors, the city of Guadalcázar ordered a halt to construction, claiming that no municipal permit had been obtained. Metalclad responded that the Mexican federal government had told it that no further state or municipal permits were needed. Metalclad even promised to create a reserve for native species and a local scientific advisory council, give discounts for local waste, contribute to local charities, and provide some free medical services to local residents. But, without reason, the city informed Metalclad that it could not begin operations. In 1997, the state governor issued a decree designating the landfill as a protected ecological and wildlife area, putting an end to Metalclad's business there. Having expended \$16.5 million on the project, Metalclad requested that a NAFTA arbitral tribunal be convened to resolve the dispute. The company maintained that it had not been given fair and equitable treatment, the Mexican regulations lacked transparency, and that Mexico had in fact expropriated their property without payment of fair compensation.

AWARD OF THE ARBITRAL TRIBUNAL

For the reasons set out below, the Tribunal finds that Metalclad's investment was not accorded fair and equitable treatment in accordance with international law, and that Mexico has violated NAFTA Article 1105(1).

Prominent in the statement of principles and rules that introduces NAFTA is the reference to "transparency." The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under NAFTA should be capable of being readily known to all affected investors. There should be no room for doubt or uncertainty on such matters.... The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA. Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. Moreover, the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear. The Town Council denied the permit for reasons which included, but may not have been limited to, the opposition of the local population, the fact that construction had already begun when the application was submitted ... and the ecological concerns regarding the environmental effect and impact on the site and surrounding communities. None of the reasons included a reference to any problems associated with the physical

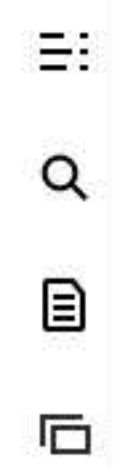
construction of the landfill or to any physical defects therein. The Tribunal therefore finds that the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility.

Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA. The Tribunal therefore holds that Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.

NAFTA provides that "no party shall directly or indirectly ... expropriate an investment ... or take a measure tantamount to ... expropriation ... except: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation. Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably to be expected economic benefit of property even if not necessarily to the obvious benefit of the host State. By permitting or tolerating the conduct of Guadalcázar ... Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA.

NAFTA provides for the award of monetary damages and applicable interest where a Party is found to have violated a Chapter 11 provision. With respect to expropriation, NAFTA specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make a profit, future profits cannot be used to determine going concern or fair market value. Rather, the Tribunal agrees with the parties that fair market value is best arrived at in this case by reference to Metalclad's actual investment in the project. For the reasons stated above, the Tribunal hereby decides that the Respondent shall pay to Metalclad the amount of \$16,685,000.

Decision. Through the actions of city, state, and federal officials, Mexico had violated Metalclad's investor rights. The Mexican regulations were not transparent, the procedures were unfair, and Mexico's actions were an indirect expropriation of Metalclad's property. As a U.S. investor in Mexico, Metalclad was not granted fair and equitable treatment.



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Case Questions

1. What was the panel's decision with respect to the restrictions placed on Metalclad's operations by Guadalcazar?
2. The *Metalclad* decision and similar cases have been criticized as placing the rights of foreign investors ahead of the rights of local communities

with respect to fundamental concerns such as environmental protection. Is this criticism valid? How would you resolve the fundamental conflict between protection of local community interests and investor's rights? Should the community pay for actions that interfere with the expectations of foreign investors? Why or why not?

Intellectual Property Rights

Intellectual property rights (IPRs) are generally protected by national law but are also the subject of several international conventions (e.g., the *Berne Convention*) and agreements (e.g., TRIPS). Intellectual property is covered in greater detail in Part Four of this book. NAFTA adopts the basic tenets of these international agreements and builds on them. NAFTA's provisions protect the IPRs of North American firms. No country can make citizenship a requirement for IPR protection. Applicants for trademarks, copyrights, and patents must be treated equally and without discrimination. NAFTA guarantees that any IPR is freely transferable by the owner to another party.

Trademarks. Trademarks and service marks are protected under NAFTA for 10 years and can be renewed indefinitely. The owner of a registered trademark has the right to prevent others from using identical or similar signs for goods or services if it would result in a *likelihood of confusion* (which is presumed unless the offender can prove otherwise). Specific provisions prohibit the use of the names of geographical regions (e.g., Tennessee Whiskey), unless the products are actually derived from that area. Actual use of a trademark cannot be a condition for filing an application for registration. NAFTA requires fair procedures for obtaining a trademark, including notice and an opportunity to be heard. Registration may be canceled if the trademark is not used for an uninterrupted period of at least two years.

Copyrights. Copyrights are protected equally in all three countries. Computer programs are protected as literary works, and motion pictures and sound recordings are protected for at least 50 years. (Canada has made some exceptions for "cultural industries.") NAFTA prohibits the importation of copies of a sound recording made without the producers' authorization.

Patents. Patents must be made available for any invention "in all fields of technology" (including pharmaceuticals), whether it is a product or process. It must be new, result from an inventive step (be "nonobvious"), and be capable of industrial application (be "useful"). They are effective for a period of 20 years from the date of application or 17 years from the date when the patent was granted.

Enforcement and Penalties. NAFTA requires that each country enforce its IPR laws, both internally and at the border to prevent smuggling of counterfeit items. IPR owners will be able to protect their rights through administrative action and judicial relief. Courts will have the authority to order seizure and destruction of infringing items, to issue injunctions against their sale, and to permit lawsuits for damages against infringers. The NAFTA countries must provide criminal penalties for cases in which willful trademark counterfeiting or copyright piracy occurs on a commercial scale. Penalties may include imprisonment or monetary fines or both.

Environmental Cooperation and Enforcement

The *North American Agreement on Environmental Cooperation* (NAAEC) does not set environmental or ecological standards, but it does call for the three countries to cooperate in protecting the environment. The countries have promised to enforce their laws more effectively. They also promise to develop environmental emergency procedures and to share information on protecting the environment. They are also working to develop common environmental standards. All countries must notify the others before banning a pesticide or chemical, and afterward, all are urged to prohibit the export of such products to other countries.

The NAAEC created the *North American Commission for Environmental Cooperation* (CEC) to oversee this portion of the agreement. The commission is headed by



a council made up of three cabinet-level officers of the three governments. The commission may convene panels to resolve disputes between countries. The arbitral panels can authorize tariff increases against a country that fails to enforce its environmental laws or is otherwise found in violation of the environmental provisions of the agreement, or can impose a monetary penalty.

One of NAFTA's first environmental cases was reported in *The Journal of Commerce* in 1995. The CEC was called on to investigate the death of 40,000 wild birds in Mexico. The commission acted quickly to determine the cause—apparently the birds died from the industrial dumping of either chromium or red dye—and made recommendations in order to protect other migratory birds that were due to return to the area. Mexico took quick action as a result of the commission's investigation. It was the first time in North America that authorities from other countries investigated an environmental disaster solely within another country. As of 2016, there have been a total of 88 requests for investigation submitted to the CEC. Forty-five of these requests concern environmental injuries alleged in Mexico. Environmental practices in Canada and the United States are the subject matter of 31 and 12 requests, respectively. However, the effectiveness of the CEC investigative process in changing environmental practices among the member states remains an open question.

Labor Cooperation and Worker Rights

Many people worried that NAFTA would cause U.S. companies to move to Mexico to take advantage of cheap labor and weakly enforced labor laws. With this in mind, the United States insisted on a side agreement called the *North American Agreement on Labor Cooperation* (NAALC), intended to make labor policies more uniform by promoting the following basic labor principles in the region:

- Freedom of association and right to organize
- Right to bargain collectively
- Right to strike
- Prohibition of forced labor
- Protection for children and young persons
- Minimum working conditions
- Elimination of employment discrimination
- Equal pay for women and men
- Prevention of accidents and occupational disease and injuries, and compensation to workers
- Protection of migrant workers

NAFTA does not set specific rules or domestic labor standards but requires countries to enforce those

standards that they already have. Indeed, Mexico's labor laws meet all international standards. The problems lie in the enforcement of Mexican laws, notably in the *maquiladoras* and factories along the border region. A North American Commission for Labor Cooperation was created to oversee the agreement and to promote cooperation in labor issues. The commission is headed by a council consisting of the U.S. Secretary of Labor and labor ministers from the other countries. An arbitral panel may be convened to investigate issues involving worker health or safety, child labor, or the failure to enforce minimum wage laws, and it may make recommendations for solutions and impose fines.

There is some criticism of the efficacy of this agreement. One attorney quoted in *The Wall Street Journal* who litigated five cases before the NAO (National Administrative Office) noted:

Technically speaking in all cases we won. But in all cases workers are left with a piece of paper that says "you were right." Not a single worker was ever reinstated, not a single employer was sanctioned, no union was ever recognized.

At best, the agreement provides a forum to discuss disputes.

Rights to Temporary Entry

Unlike the EU, NAFTA does not create a common market in labor. Each country may still determine its own qualifications for employment and its own immigration policies. NAFTA countries, however, have agreed to give businesspeople easy access to their customers, clients, factories, and offices across the borders. NAFTA permits temporary entry in the following cases:

1. Business visitors engaged in international business activities related to research, manufacturing, marketing, sales, and distribution; those who are service providers; and those servicing products after the sale (repair or maintenance of products after the sale must be done pursuant to a warranty or other service contract on the products)
2. Traders employed by a company in a NAFTA country and those who are buying and selling substantial amounts of goods and services
3. Potential investors
4. Management or executive employees transferred to subsidiary companies in another NAFTA country
5. Qualified professionals entering to do business (in professions ranging from teaching and law to hotel management); separate licensing qualifications must also be met if they intend to practice a profession



Mexico requires these travelers to obtain an FMN card (*Formulario Migratorio NAFTA*), which is valid for 30 days. Special visas are available for periods of stay longer than 30 days. Normal tourist cards are still available.

The following case addresses the interaction of NAFTA's temporary entry rules with state regulation of professional licensing.



Kirk v. New York State Department of Education

562 F. Supp.2d 405 (2008) (U.S. District Court, Western District of New York)

BACKGROUND AND FACTS

Simon Kirk, a veterinarian and citizen of Canada, sought to obtain a license to practice veterinary medicine from the State of New York. Kirk was neither a U.S. citizen nor a permanent resident alien. However, he obtained an entry visa pursuant to NAFTA that permitted him to live and work in the United States on a temporary basis. Kirk was granted an entry visa for the specific purpose of allowing him to practice veterinary medicine in the United States. However, New York's education code restricted the issuance of veterinary licenses to U.S. citizens or aliens lawfully admitted for permanent residence in the United States. New York claimed the restriction protected the public as veterinarians routinely deal with issues affecting public health and safety including handling of controlled substances and involvement with the closely regulated horse racing industry. Furthermore, New York claimed temporarily admitted individuals did not have the same incentives to comply with New York law as citizens or permanent residents, and their eventual departure from the United States rendered enforcement difficult if not impossible.

Kirk filed a lawsuit against the New York Department of Education alleging that its restriction upon licensure was inconsistent with federal regulations implementing NAFTA and permitting him to temporarily enter the United States to practice veterinary science.

SIRAGUSA, DISTRICT COURT JUDGE

[T]he relevant regulation provides that "a citizen of Canada or Mexico who seeks temporary entry as a business person to engage in business activities at a professional level may be admitted to the United States in accordance with the North American Free Trade Agreement (NAFTA)." 8 C.F.R. § 214.6(a). The regulation further states:

Temporary entry, as defined in the NAFTA, means entry without the intent to establish permanent residence. The alien must satisfy the inspecting immigration officer that the proposed stay is temporary. A temporary period has a reasonable, finite end that does not equate to permanent residence. In order to establish that the alien's entry will be temporary, the alien must demonstrate to the satisfaction of the inspecting immigration officer that his or her work assignment in the United States will end at a predictable time and that he or she will depart upon completion of the assignment.

8 C.F.R. § 214.6(b).

As mentioned above, the State of New York restricts the issuance of veterinary licenses to United States citizens or aliens lawfully admitted for permanent residence in the United States. In that regard, Education Law § 6704(6) states, in relevant part: "To qualify for a license as a veterinarian, an applicant shall fulfill the following requirements: ... (6) Citizenship or immigration status: be a United States citizen or an alien lawfully admitted for permanent residence in the United States[.]" It is undisputed that, apart from this requirement, Plaintiff meets all the requisites needed to qualify for a veterinarian's license.

Defendants ... deny that the subject statute violates the Supremacy Clause, since "states have the power to administer their professions."

[I]t is undisputed that "the Supremacy Clause requires the invalidation of any state legislation that burdens or conflicts in any manner with any federal laws or treaties." *DeCanas v. Bica*, 424 U.S. 351, 358, 96 S.Ct. 933, 938 n. 5, 47 L.Ed.2d 43 (1976). It is also clear that "[t]he National Government has broad constitutional powers in determining what aliens shall be admitted to the United States, the period they may remain, regulation of their conduct before naturalization, and the terms and conditions of their naturalization," and that "the States can neither add to nor take from the conditions lawfully imposed by Congress upon admission, naturalization and residence of aliens in the United States." *Graham v. Richardson*, 403 U.S. at 377-78, 91 S.Ct. at 1854-55. Consequently, "[s]tate laws which impose discriminatory burdens upon the entrance or residence of aliens lawfully within the United States conflict with this constitutionally derived federal power to regulate immigration, and have accordingly been held invalid." *Id.*, 403 U.S. at 378, 91 S.Ct. at 1855 ... On the other hand, the Supreme Court "has never held that every state enactment which in any way deals with aliens is a regulation of immigration and thus per se pre-empted by [Congress's] constitutional power, whether latent or exercised." *De Canas v. Bica*, 424 U.S. at 355, 96 S.Ct. at 936.

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In the instant case, the Court finds that Education Law § 6704(6) conflicts with NAFTA, and therefore violates the Supremacy Clause. As discussed above, NAFTA provides that Plaintiff may practice veterinary medicine in the United States, as long as he does not intend to permanently reside here. Conversely, Education Law § 6704(6) provides that Plaintiff may obtain a veterinarian's license only if he intends to reside in the United States permanently, as evidenced by U.S. citizenship or green card status. In the Court's view, these statutes are in conflict. Moreover, by requiring Plaintiff to become a U.S. citizen or obtain Permanent Resident Alien status, Education Law § 6704(6) imposes an additional burden on him that apparently was not contemplated by NAFTA. Accordingly, the Court finds that Education Law § 6704(6) violates the Supremacy Clause.

For all of the foregoing reasons, Plaintiff's motion for summary judgment is granted and Defendants' cross-motion for summary judgment is denied.

Decision. The court granted Kirk's motion for summary judgment and ordered New York to grant him a

veterinary license in accordance with his immigration status pursuant to NAFTA.

CASE QUESTIONS

1. On what basis did the court determine that New York's licensing law for veterinarians was unconstitutional?
2. Do you agree with the justifications offered by New York with respect to limiting licensing to U.S. citizens and permanent residents? How much control should states have over licensing issues?
3. Despite striking down the licensing requirement, the court also held that not every state law that addresses aliens is an unconstitutional regulation. Under what circumstances would states be able to constitutionally regulate professional licensing and aliens? Are there other circumstances outside of licensing in which states could regulate aliens without violating the U.S. Constitution?

ADMINISTRATION AND DISPUTE SETTLEMENT

NAFTA does not have the type of lawmaking institutions that the EU has. However, an administrative body oversees implementation of the agreement, and a dispute resolution process is available to NAFTA countries. The dispute resolution process is similar to that of the WTO.

NAFTA Fair Trade Commission

The NAFTA Fair Trade Commission supervises the implementation of the agreement and attempts to resolve disputes that may arise regarding its interpretation or application. One cabinet-level official from each of the three governments, supported by an administrative staff and committees, form the commission.

Arbitral Panels. When one NAFTA country accuses another of violating NAFTA's principles, it must first attempt to negotiate a settlement. If a settlement is not reached, then the countries can seek dispute resolution. When the issue falls under both NAFTA and GATT, the countries must agree on whether it will be heard by the NAFTA Fair Trade Commission or the WTO. If they cannot agree on which forum, the case will normally be heard before the Fair Trade Commission. If a settlement is not reached, the commission may convene an

arbitral panel, which consists of five members who are experts in trade or law. They decide whether one country has violated NAFTA and recommend a solution. If the recommendations of the arbitral panel are not followed and no agreement is reached within 30 days, the complaining country may retaliate by raising tariffs. No arbitral panel has the authority to tell a country to actually change its laws or policies. For example, if a panel rules that a regulation of the U.S. Consumer Product Safety Commission, the National Park Service, or other agency is violating NAFTA, an individual cannot obtain a court order compelling the agency to alter its decision solely on the basis of the panel report.

Antidumping and Countervailing Duty Cases. The Fair Trade Commission also hears cases involving countervailing and antidumping duties. These cases are treated differently from other disputes. Recall that countervailing duties are imposed on imported goods that received an unfair price advantage because a part of their cost of production was subsidized by the exporting country. Antidumping duties are imposed on "dumped" products. Dumping, another unfair trade practice, is the selling of goods in a foreign market for less than the price charged in the country in which they were produced. Antidumping and countervailing duties are only imposed pursuant to an order of an administrative agency in the importing country.



This practice continues under NAFTA; however, the appellate process has been changed greatly. In the United States, an appeal of an agency decision in an international trade case normally goes to the U.S. Court of International Trade, but appeals from administrative orders in NAFTA cases now go to NAFTA **binational panels**, not to courts of law. The role of these panels and their standard of review in reviewing agency decisions are limited. Binational panels apply the same standard of review as would a court of law convened in the country where the case originated. Because it is not an appellate court, a panel does not make law in the traditional sense, but it applies the existing law of the country from which the case was appealed. This legal process is quite unusual and controversial, because private businesses will be bound by the decision of an intergovernmental panel with no recourse to judicial review.

Extraordinary Challenge Committees. Appeals of a binational panel decision may be taken only to a NAFTA Extraordinary Challenge Committee, and not to courts of law. A challenge committee examines a case only to see if a panelist was biased or guilty of misconduct, or whether the panel departed from a fundamental rule of procedure, or exceeded its powers, authority, or jurisdiction. A binational panel must apply the correct standard of review. Under NAFTA, a binational panel that fails to apply the correct standard of review would be considered to have exceeded its powers, authority, or jurisdiction. Panelists for binational panels and extraordinary challenge committees are chosen from a roster of impartial judges or former judges whenever possible.

PRODUCTION SHARING: ASSEMBLY PLANTS AND THE MEXICAN MAQUILADORAS

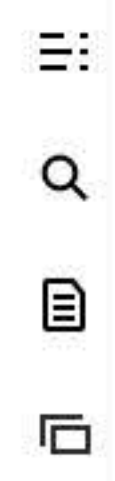
The process of spreading manufacturing and assembly operations across international borders is often called **production sharing**, a term coined by business theorist Peter Drucker. One type of production sharing involves the manufacture or fabrication of articles or component parts in one country and their assembly into finished goods in another. While this is not a part of NAFTA, production sharing is discussed in this chapter because of its importance to industry and trade in North America and the entire Western Hemisphere. Historically, global manufacturing firms have invested

in manufacturing operations in developed countries that offered higher-skilled workers, technology, capital investment, research and development, quality control, and state-of-the-art production and management methods, as well as political and economic stability. The manufactured articles were then shipped to “assembly plants” in lower-wage countries for assembly into the final product.

To economists and management theorists, production sharing makes perfect economic sense. It allows countries to specialize in what they do best, be it research and development, highly skilled manufacturing, or low-wage labor. Production sharing also has been a major force for investment, employment, and the transfer of technology and know-how to developing countries. Today, modern production sharing techniques are integral to efficient global manufacturing operations and supply chain management.

Since the mid-1960s, U.S. legislation has encouraged the manufacture of articles in the United States and their assembly in foreign plants. Section 9802 of the *Harmonized Tariff Schedules of the United States* contains a special provision allowing U.S.-made articles or component parts to be shipped to factories in a foreign country where the articles are assembled or joined to other articles and then returned to the United States with duties assessed only on the value of the newly assembled product less the value of the U.S.-made component parts. In essence, import duties are placed only on the low-wage labor and the relatively inexpensive overhead of the foreign plants. For example, a cellular telephone manufacturer can assemble a telephone in a Mexican assembly plant, using parts sourced from North America and from other countries, and then reexport the finished telephone to the United States. Tariffs on the telephone are based on the value of the phone, less the value of the U.S. component parts.

Foreign assembly operations are common in industries that produce electronic goods, home furnishings and appliances, automobiles and automotive parts, textiles and apparel, and many others. Assembly plants can be locally owned or owned by companies from the United States or other countries. They can be located in countries all over the world, although most are located in low-wage countries. Many are located in Mexico. Some of the largest users of assembly plants are Honeywell, General Electric, Ford, General Motors, Siemens, Sony, Whirlpool, Sanyo, Samsung, Motorola, Hyundai, Bose, Mattel, Fisher Price, Toshiba, and Nokia, to name just a few common brand names among hundreds.



During the 1990s, automobile firms from all over the world invested heavily in assembly plants in Japan, Canada, Sweden, Germany, and Mexico, while the electronics and apparel industries invested heavily in Asia, Mexico, and the Caribbean. Production-sharing plants are also called *offshore assembly plants*, or in the case of Mexico, *border plants*, because of their location along the U.S. border. The Spanish term for these plants is **maquiladora**, derived from the word *maquilar*, meaning “to process.” Production-sharing plants are common not only in Mexico but also throughout the Caribbean and Central America. Plants in Mexico have the advantage of being located close to the U.S. border, accessible by road and rail transportation. Proximity to the United States means faster shipping, lower inventory requirements, and lower transportation costs. This is particularly important for industries assembling products with short shelf lives, for products that can quickly become obsolete, or for managing just-in-time inventory in global manufacturing.

Many Asian firms have taken advantage of assembly operations in Mexico, giving them a platform for shipping throughout North America, as well as to Central and South America.

Assembly Plant Tariff Rules

Under Section 9802, the tariff assessed on an assembled article upon reimportation to the United States is calculated on the value of the newly assembled article less the value of the U.S.-made component parts.

These tariff savings are available only where the imports were assembled in the foreign plant (1) from U.S.-manufactured or fabricated components (2) that had been exported “ready for assembly without further fabrication” and (3) that have not lost their physical identity and have not been advanced in value or improved in condition abroad except by being assembled and except “by operations incidental to the assembly process” such as cleaning, trimming, calibrating, or lubricating.

Examples of fabricated components that would qualify as being ready for assembly without losing their physical identity include circuit boards, machine parts, semiconductors, precut parts of wearing apparel, lug nuts, and automobile engines or tires. Sending bolts of fabric abroad to be cut into parts of shirts does not qualify as assembly, but sewing two sleeves to the body of a shirt does. It is not “assembly” when lumber, leather, or plastic is sent abroad to be formed into new and different articles that will become components of finished goods. Section 9802 applies only to assembly operations, which include any method of joining two or more solid articles, such as welding, screwing, gluing, or sewing. Combining chemicals, liquids, gases, or food ingredients is not considered assembly. In addition to automobiles and clothing, other representative products include telecommunications and electronic equipment, computers, televisions, sausage casings, mini-blinds, stuffed toys, and almost any product capable of assembly. In *Samsonite Corp. v. United States*, the operations of the plant were held to be a fabrication and not a mere assembly.



Samsonite Corp. v. United States

889 F.2d 1074 (1989) (U.S. Court of Appeals, Federal Circuit)

BACKGROUND AND FACTS

Samsonite Corporation assembled luggage in Mexico for import into the United States. Many component parts used in the assembly process were made in the United States. Samsonite shipped steel strips from the United States to Mexico for use as luggage handles. When the strips left the United States, they were five inches long, straight, and bearing a coat of oil. Their value ranged from 95 cents to \$1.26. In Mexico, the strips were bent by machine into a form resembling a square-sided letter C, cleaned, covered with a vinyl sheath, and riveted to plastic frame assemblies. The assemblies were then placed in, and fastened to, bags of vinyl to make soft luggage. On import into the United States, the Customs Service dutied the luggage, including the value of the

steel strips at the rate of 20 percent *ad valorem*. The Court of International Trade upheld the government’s contention that the steel strips had not been “exported in a condition ready for assembly” and that the process in Mexico amounted to a fabrication and more than a mere assembly. Samsonite appealed.

SENIOR CIRCUIT JUDGE FRIEDMAN

To obtain a deduction for American-fabricated articles assembled abroad, the components

- a. must have been exported from the United States “in condition ready for assembly without further fabrication,”
- b. not have lost their physical identity in the articles by change in form, shape, or otherwise, and

continues



continued

c. not have been advanced in value or improved in condition “except by being assembled” and except “by operations incidental to the assembly process such as cleaning, lubricating, and painting.”

As the Court of International Trade correctly pointed out, since the “foregoing three conditions for a deduction are set forth in the conjunctive, ... each must be satisfied before a component can qualify for duty-free treatment.” We agree with that court that the steel strips involved in this case did not meet those conditions.

The critical inquiry is whether the bending and shaping that the strips underwent constituted “fabrication” or mere assembly and operations incidental to the assembly process. We hold that what was done to the strips in Mexico was fabrication and not mere assembly.

When the steel strips were exported from the United States, they were just that: five-inch strips that could not serve as the frame of the luggage without undergoing a complete change in shape. Prior to assembling the luggage, the strips were bent by machine into a carefully and specially configured rectangular shape that was necessary before the original strip would serve its ultimate function as part of the frame of the luggage.

In short, what emerged after the bending operation was a different object from that which left the United States. The latter was a steel strip, the former was a metal frame for a piece of luggage. The transformation of the strip in this manner into a luggage frame was a fabrication. The strips therefore had not been exported from the United States “in condition ready for assembly without further fabrication.”

Samsonite contends, however, that prior decisions of the Court of Customs and Patent Appeals require a contrary conclusion. It relies particularly on *General Instrument Corp. v. United States*, 499 F.2d 1318 (CCPA 1974). That case involved wire wound on spools that had been exported from the United States to Taiwan. There the wire was removed from the spools, formed into a horizontal coil by a winding machine, taped to prevent unraveling, dipped in cement, dried, precision shaped, removed from the spools, and wound around a core. The end product made from the wire was a component of a television set that was imported into the United States.

The Court of Customs and Patent Appeals held that: “The steps performed upon the wire after its exportation to Taiwan are not ‘further fabrication’ steps, but rather assembly steps within the meaning of [the statute].”

Samsonite argues that far more was done to the wire in *General Instrument* than was done to the steel strips in this case. It argues that if the processing the wire underwent in *General Instrument* was not “fabrication,” a fortiori “the one simple-minded act of bending a straight frame into a C was neither a further fabrication nor a non-incidental operation.”

The critical inquiry in determining whether fabrication rather than mere assembly took place here, is not the amount of processing that occurred in the two cases, but its nature. In *General Instrument*, the wire, when it left the United States and when it returned as part of a finished product, was a coil. The wire was taken directly from the supply spool on which it was wound and, after processing, was used in assembling the TV set components. The wire underwent no basic change in connection with its incorporation into the television set component.

In contrast, in the present case the steel strips had to undergo a significant change in shape before the actual assembly of luggage could begin. Until the steel strips had been made into C shapes they could not be used as a part of the luggage. Unlike the “assembly” that the court in *General Instrument* held the processing of the wire involved, here “further fabrication” of the steel strips was required in order to change them into frames for luggage, before the assembly of the luggage could take place.

Decision. The Court of Appeals upheld the decision of the lower court. The bending and processing of the steel strips in Mexico was fabrication and not a mere assembly and therefore did not qualify for duty-free treatment under Section 9802.

Comment. In *United States v. Haggar Apparel Co.*, 526 U.S. 380 (1999), the United States Supreme Court upheld regulations of the U.S. Customs Service that permapressing of men’s pants was an additional step in manufacturing and not a minor operation incidental to assembly.

Case Questions

1. What was the court’s holding with respect to the application of Section 9802 to Samsonite’s steel strips?
2. Samsonite contended that the bending process in Mexico was less significant than the process upheld as mere assembly in the *General Instrument Corp.* case. Do you agree? Was the court correct in this regard, or is the purported difference one without substance?

Mexican Regulation of Maquiladoras. The *maquila* industry is governed by regulations and decrees of the Mexican government. These regulations are intended to promote Mexico’s competitiveness in assembly and manufacturing and to promote exports by giving tariff

and tax incentives to Mexican exporters. *Maquiladoras* are chief beneficiaries of the incentives. The incentives include the elimination or reduction of tariffs on imports of certain component parts or raw materials destined for reexport as finished goods. The duty



reductions apply only to products in select industry sectors. In order to qualify for favorable tariff treatment, a Mexican company must meet complex regulatory and tax law requirements that require companies to rely on sophisticated legal and accounting advice.

Mexico's tariff incentives for exporting firms have changed several times in recent years. In large part, the changes are due to changes in NAFTA rules. In 2007, the Mexican Ministry of the Economy merged the *maquila* program with another government export program into the *Maquiladora Manufacturing Industry and Export Services Program*, or IMMEX. The IMMEX law covers eligibility requirements for IMMEX companies and their certification, operation, taxation, inspection, and reporting requirements.

Issues Related to the Mexican Maquila Industry

Mexico has encouraged development in the *maquila* industry since 1965, offering incentives for investment and favorable tariff and tax treatment for *maquiladoras*. Since then, *maquiladoras* have contributed significantly to Mexico's job growth and to its economy generally. For most of that time, *maquiladoras* were used only for low-wage assembly operations, whereas most capital investment remained in true "manufacturing" plants in the United States. Today, many Mexican plants use state-of-the-art production equipment and techniques and employ many more higher-skilled workers than in the past. Many U.S. businesspeople claim that the quality of workmanship in Mexican plants is on par with that anywhere in the world. Some plants are quality certified by the International Standards Organization (ISO). The average hourly wage for direct labor, however, is still only about \$2.00 an hour, although ahead of average wages elsewhere in the country.

The success of the *maquila* industry has caused a migration of workers from all over Mexico to the border region. This has led to many social problems that are typical of fast-growing migrant areas. These include overcrowded living conditions, pollution, substandard housing, poor health care, inadequate sanitation and public utilities, poor roads and infrastructure, and many other problems. The electrical power and telecommunications industries are encumbered by a history of government protection and monopoly, and electricity and other utilities are often unreliable and inadequate for industry.

One of the most severe problems in the border region is an epidemic of crime that has spread to both sides of the border, including violent crimes such as

kidnapping for ransom, smuggling and drug-related crimes, organized crime, and offenses related to illegal immigration and border crossings. Many foreign companies have to provide personal protective services for their employees.

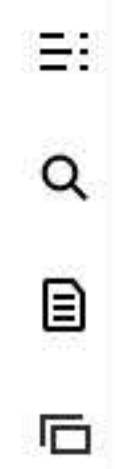
Other political and societal factors have also detracted from the business climate in Mexico. The government bureaucracy is often encumbered by red tape and corruption, and officials at some levels of government maintain an antibusiness attitude.

Still other problems have arisen in the *maquila* workplace. Many accusations of labor abuses have been made by governments, nongovernmental organizations, labor activists, and the popular press. These include unsafe or unhealthy working conditions, excessive working hours, sexual harassment, and violations of the right to organize. Although Mexico has enacted sophisticated labor and employment laws related to wages, working hours, and other areas, these laws are not always adequately enforced. As jobs become harder to find, unskilled workers become more vulnerable to a few unscrupulous supervisors and plant managers who are able to exploit workers desperate for well-paying jobs. Most global brand-name firms that operate *maquiladoras* or that have purchasing and supply arrangements with local plants try to monitor and "police" labor violations, although it is not always an easy task.

No issue is more pressing in the border region than the harm the plants have caused to the environment. In the early 1990s, the governments of the United States and Mexico began negotiations on protecting the Rio Grande and on building municipal sewer systems, water treatment plants, and solid-waste disposal sites. Their greatest concern was how to deal with hazardous waste. The two governments devised methods of tracking hazardous waste and regulating disposal sites. Complicating the problem are the thousands of trucks that cross the border daily, causing severe air pollution and damage to roads and bridges. Both governments have spent hundreds of millions of dollars to deal with these social and environmental problems.

CONCLUSION

The *North American Free Trade Agreement* was approved by the legislatures of Canada, Mexico, and the United States only after heated debate. Proponents saw it as a means of expanding trade opportunities for North American products, spurring cross-border investment,



increasing the number of high-paying jobs in export industries, and bringing greater economic and social stability to Mexico. Opponents argued that it would result in large-scale loss of U.S. and Canadian jobs to low-wage workers in Mexico. Today, the impact of NAFTA is still disputed. NAFTA supporters point to an increase in the volume of trade and investment between the three countries and to an increase in living standards and strengthening of the Mexican middle class. Critics point to an increasing U.S. trade deficit with Mexico, which did not exist in 1993. They argue that NAFTA has caused a loss of U.S. jobs in many industries, particularly manufacturing, and in virtually every

U.S. state. These critics maintain that despite an increase in manufacturing jobs in Mexico, real wages have not increased. Moreover, they point out that many Mexican jobs are in plants along the U.S.–Mexican border, with many people working and living in crowded, slum-like conditions, with inadequate housing, health care, and sanitation. Environmentalists argue that NAFTA and the growth of border factories have created a social and environmental disaster in the region. One thing is certain: arguments over the impact of NAFTA are colored by U.S. attitudes regarding Mexican immigration into the United States. Certainly, the immigration issue has become the hottest topic in U.S.–Mexican relations.

Chapter Summary

1. The economic provisions of the U.S. Constitution constituted an agreement among the states to have their economies managed as a single unit by the federal government. Under the Constitution's economic provisions, Congress had the exclusive power to manage trade between the states and with foreign nations. The federal court system was empowered to strike down any state law that would impede the free interstate movement of goods or people or discriminate against businesses based in other states. The Constitution gave the federal government the sole right to issue currency and determine monetary policy and concentrated all control over commercial policy toward other nations in the federal government.

2. A free trade area (FTA) is created when a group of countries agrees to eliminate or phase out customs duties and other barriers to trade among the member countries as to goods originating in the FTA countries.

3. In a customs union, there is free trade of all goods that come through any of the union's members, even if they entered a member state through importation from outside the customs union. Because of this, a customs union can only function if all of its members agree to a common tariff on imports from outside the union and a common institution to negotiate such tariffs on behalf of the group.

4. A "common market" is a customs union that has reached a further state of integration. In addition to assuring the free movement of goods within the customs union, a common market seeks to further
- facilitate free competition within the union and protect the right of all enterprises and persons within the area to do business, invest capital, and sell their services within the area without discrimination on the basis of national origin. To achieve free economic competition in a common market, the members of the market establish common rules relating to anticompetitive behavior and subsidization of industry. Further, a court with jurisdiction and power to enforce its rulings is necessary to ensure compliance with the market's norms.

5. The provisions of the *WTO Agreement* do not prevent formation of a customs union or FTA. The WTO treats such a grouping as an economic actor and requires that tariffs against those outside the grouping not be increased as a consequence of the group's formation.

6. The *North American Free Trade Agreement* between Canada, Mexico, and the United States went into force in 1994. It created the world's largest free trade area. Today, this market encompasses about 481 million people and a combined gross domestic product of more than \$21 trillion.

7. By 2008, all tariffs on goods originating and traded in Canada, Mexico, and the United States were eliminated.

8. NAFTA tariff rates apply only to articles that originate in Canada, Mexico, or the United States. Only goods that qualify under NAFTA's rules of origin can obtain NAFTA tariff rates. Goods originate in a NAFTA country if they are wholly produced or obtained in Canada, Mexico, or the United States.



- This includes live animals born and raised, minerals mined, and crops grown in these countries. However, if the goods contain non-originating inputs (components or raw materials), they qualify as having originated in a NAFTA country if they meet the regional value content requirements or the tariff shift rules of Annex 401 of NAFTA.
9. NAFTA's national treatment principle is similar to that found in GATT. It states that once goods arrive from another NAFTA country, they must be treated without discrimination and no differently than domestically made goods. Reports of the United States Trade Representative show that Mexico and Canada still maintain many nontariff barriers to U.S. goods and services.
 10. The country-of-origin marking and labeling rules are set out in Annex 311 to NAFTA and are enacted in the national customs regulations of the United States, Canada, and Mexico.
 11. Canada and Mexico are significant purchasers of U.S. agricultural products. NAFTA has boosted U.S. agricultural exports to Canada and Mexico since 1994. The elimination of Mexican tariffs in 2008 on products such as corn and beans has been viewed as a threat by many small Mexican farmers, who fear competition from large-scale American farms. This remains a sensitive political issue in both countries.
 12. NAFTA's side agreements on the protection of labor and the environment are controversial. The *North American Agreement on Environmental Cooperation* does not set environmental or ecological standards, but it does call for the three countries to cooperate in protecting the environment. The *North American Agreement on Labor Cooperation* is intended to make labor policies more uniform by promoting Mexico's enforcement of its labor laws.
 13. The Fair Trade Commission supervises the implementation of the agreement and attempts to resolve disputes that may arise among the three governments. If a settlement is not reached, the commission may convene an arbitral panel that can recommend a solution. Panels do not have the authority to tell a country to actually change its laws or policies.
 14. The Mexican *maquiladora* industry consists of "production-sharing" factories that assemble U.S. components into finished products for return to the United States. Products include electronics, automobiles, and apparel. This industry allows manufacturers to take advantage of low-cost labor that is located close to the United States. The *maquila* industry is attempting to compete with even lower-cost labor from China, as Chinese imports to the United States grow at faster rates than imports from Mexico. Since 2007, the *maquila* industry has been governed by Mexican "IMMEX" regulations.

Key Terms

free trade area (FTA) 365	customs user fees 369	arbitral panel 378
customs union 365	substantial transformation test 370	binational panels 389
common market 366	tariff shift rule 371	production sharing 389
national treatment 369	regional value content 371	<i>maquiladoras</i> 391
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Questions and Case Problems

1. Does the United States have any free trade agreements under negotiation at the present time? If so, what is their status? Are there countries with which the United States should contemplate future free trade agreements?
2. What is the present status of NAFTA in light of the Trump administration's threats to renegotiate or abandon the agreement or impose significant tariffs on goods originating from Mexico? What are the pros and cons of these approaches? Who are the parties likely to benefit or be harmed by these approaches?
3. Consider a study of doing business in Mexico. How do the economic, cultural, social, and political climates affect a business there? Describe Mexico's form of government. How are business relations conducted there? Are they



more or less formal than in other Western countries? Describe how Mexico's policies toward trade and investment have changed over the years. Do you believe that Mexico provides a stable climate for trade and investment? What products or industries would seem to do well in the Mexican market?

4. NAFTA contains provisions regarding the fair treatment of labor and the protection of the environment. Evaluate their potential for success. What labor and environmental issues are addressed in NAFTA? What issues should be addressed?

5. Your company produces "Big Duster" tires. Your most popular styles are the ones with the raised white lettering on the outside of the tire. You would like to export tires to Mexico but cannot pass the Mexican labeling and marking requirements. Among the many other requirements, a required remolding of the tires in Spanish would be costly. You do not think the regulations are fair. Do the requirements violate NAFTA? What course of action should you take?

6. Your company distills Kentucky bourbon. A Canadian competitor is selling "Kentucky bourbon" in Ontario, but its bourbon is made in Canada. Canada's liquor control agency has looked the other way and ignored your

requests to enjoin the sale. Does the sale violate NAFTA or the WTO system? Would this action be heard before the NAFTA Free Trade Commission or the WTO? What steps can be taken to force Canada to enjoin the sale? What remedies are available? If the Canadian products are exported to the United States, can they be stopped at the border?

7. How does the function of a NAFTA arbitral panel differ from that of a binational panel? What is the standard of review in binational panel decisions? Describe the role of an extraordinary challenge committee. Why does NAFTA recommend that panelists on binational panels and extraordinary challenge committees be judges or former judges whenever possible, but allow arbitral panelists to be specialists in international business or trade?

8. What is a rule of origin? Why is it important to the operation of a free trade area?

9. Discuss the social responsibility of a Canadian or U.S. manager working in Mexico. If a certain course of action is illegal in the manager's own country but lawful and accepted in Mexico, which standard should the manager follow? Describe the social responsibility of firms operating in Mexico in regard to environmental protection, worker health and safety, and corrupt practices.

Managerial Implications

Consider the following NAFTA management problem in a global business context.

DownPillow, Inc., a small U.S. manufacturer of down comforters and pillows, sells nationally through high-quality retailers. The company is known for its quality of materials and production. Its raw materials include cotton fabric, unfilled cotton shells, and down fills. These materials are not produced in the United States in sufficient quantities to meet the needs of the U.S. market. The HTS classification for unfilled comforter shells is 6307.90. The classification for finished down comforters is HTS 9404.90.

For many years, DownPillow purchased materials from Europe and paid in foreign currency. Gradually, costs rose because European suppliers faced higher labor and overhead costs. A declining U.S. dollar made goods more costly, but as costs rose, the company could not pass them on in price increases. When the U.S. market became more competitive in the early 1990s, DownPillow looked to China for cheaper materials. China is the world's leading producer of cotton textiles and down fill. Chinese textiles enter the United States under strict quota limits, enforced by U.S. Customs. Quota category 362 includes unfilled shells, comforters, quilts, bedspreads, and other top-of-the-bed products. DownPillow negotiated with a Chinese manufacturer for low-cost

materials priced in dollars. The new products were introduced to U.S. customers in 1993 at competitive prices. The new lower-priced goods quickly became an important part of the company's line.

However, the political situation changed over time. The United States accused China of illegally transshipping textiles through third countries to get around the U.S. quota. In response, the United States reduced the quota on category 362. The annual quota began to close in early fall. Goods anticipated for shipment during the Christmas season sat in a customs-bonded warehouse at the port until released by U.S. Customs the following January. In the following year, the largest U.S. importers of comforters and bedspreads had bought their merchandise early, and the quota closed in March. DownPillow was barely able to obtain sufficient unfilled shells for its production needs. When it tried to switch its customers back to the higher-priced merchandise made from European materials, they balked. Many threatened to take their business elsewhere.

1. Management is desperate for a solution. It has learned that Canada will permit the entry of Chinese textiles. They also know that Canadian trade negotiators put a little-known rule of origin in NAFTA providing that a product that undergoes a change from category

6307.90 to category 9404.90 will become a product of North America. (Tariff shifting is not generally available for textile articles, but widely available for many other manufactured and processed goods.) They would like your opinion on answers to the following questions:

- a. May they bring the Chinese cotton shells into Canada and ship them to the United States despite the quota? What processes would have to take place in Canada to do this? If they did, what would the tariff rate be? Would they see any net tariff savings?
 - b. Production in Canada would give ready access to the Canadian home-fashions market. Should the company explore the possibility of investment in a plant in Canada? What are the pros and cons of such a move? How would they be affected by NAFTA investment provisions?
 - c. Canada is a good supplier of goose down. If DownPillow produces finished comforters in Canada, would it make a difference if it used down from Canada geese, as opposed to down plucked from geese in, say, Poland, and imported into Canada?
 - d. Every state requires that comforters may only be sold if they are manufactured or imported by licensed bedding manufacturers. Bedding manufacturers are subject to state health codes. Does NAFTA prohibit the application of state health codes to Canadian and Mexican companies or to products made by them?
 - e. The company also has had some interest from buyers in Mexico. Would any import duties apply on shipments of either its U.S.- or Canadian-made products to Mexico? What would the tariff rate be? What special textile labeling rules are applicable, and how would they affect the company's ability to market there?
 - f. Management is concerned about meeting foreign health standards applicable to a natural product like down and feathers. Where would they go for information on foreign regulations?
2. Discuss the wisdom of DownPillow's decision to switch its source of supply to China. Describe the impact of customs and tariff law on a North American firm's strategy. Describe how this small company was affected by international political events out of its control. Do you think the company underestimated its customers and its market?

Ethical Considerations

Maquiladoras have been subject to much criticism. Critics contend that the industry is merely an attempt to attract foreign investment by not strictly adhering to environmental and labor standards. As a result, environmental problems especially in border areas have been exacerbated, and social tensions have increased. Wages, while improving, may still be inadequate to meet basic needs, thereby causing workers to live in squalid conditions. The absence of mobility promoted by the low-skill nature of many jobs locks workers into permanent cycles of poverty and dependency on the *maquila* industry. This dependency and the absence of mobility may encourage worker exploitation in the form of excessive work hours, unhealthy and unsafe working conditions, and discriminatory hiring practices. Finally, critics note that, to the extent the health of the *maquila* industry depends on companies and economies of other countries, it does not promote long-term economic stability. Economic stability is also lacking as other low-wage countries, such as China and countries in Southeast Asia, develop their own productive capabilities, thereby causing companies to depart from Mexico and leaving a large pool of unemployed and unskilled workers in their wake.

By contrast, supporters of the *maquiladora* strategy have contended that the factories are a means of integrating Mexico's developing economy and growing labor force into the global economy. *Maquiladoras* are an important source of foreign exchange and constitute a significant portion of Mexico's exports. Given their number and size, *maquiladoras*

are a successful method of domestic job creation, which serves to keep Mexican workers at home. Proponents also note that conditions have improved in most *maquiladoras* since NAFTA's entry into force and effect. Furthermore, the *maquila* industry has evolved from simple assembly activity based on cheap labor with low added value through the adoption of best practices in the productive processes and industrial organization. Examples of such practices include increases and improvements in capabilities, just-in-time, continuous improvement, environmental performance, and occupational safety and health.

These tensions also exist when analyzing the *maquila* industry from an ethical standpoint. Which impact is the most persuasive from an ethical point of view? For example, utilizing a teleological framework, a moral relativist might contend that the *maquila* industry is appropriate given Mexico's status as a developing economy and the level of skill of a significant portion of its workforce. However, a moral relativist could also argue that, although perhaps appropriate at the present time, the *maquila* industry is not a viable long-term strategy for economic prosperity.

A utilitarian point of view may reach similar conclusions. One may contend that the *maquila* industry is ethical given that it results in the greatest overall good for the community by providing economic growth for Mexico and jobs for Mexican workers. However, a utilitarian approach may also conclude that the *maquila* industry will not result in the



greatest overall good for the greatest number in the long term. Furthermore, the tendency to focus on short-term profits and employment may justify many otherwise objectionable behaviors with respect to environmental protection and labor rights.

By contrast, deontological frameworks may provide clearer guidance. Divine command theory, which resolves dilemmas on the basis of tenets of faith within religious beliefs, may find the *maquila* industry objectionable to the extent that it encourages the exploitation or mistreatment of labor contrary to human dignity. *Maquiladoras* may also be subject to condemnation pursuant to the Categorical Imperative as

no one would wish for the practices within the industry to become universal laws with respect to the treatment of laborers engaged in manufacturing. The industry is subject to further condemnation to the extent that it treats workers as a means to an end. Finally, the lack of fairness and equality in the *maquila* industry may subject it to criticism pursuant to contractarianism. Exploitation of labor, to the extent it occurs in the industry, may also be deemed to violate the duties and responsibilities placed on employers with respect to low-skilled workforces in developing economies.

What point of view best represents your thinking with respect to the *maquila* industry? Why?



CHAPTER 15

The European Union

Europe's history is long and tumultuous with alliances formed and dissolved over thousands of years. A significant trend in the post-World War II period has been the development of regional economic alliances to facilitate trade, as well as to maintain peace and security. These regional agreements have had significant impact on the conduct of business.

Historical precedents for European economic integration go back to before the Roman Empire. However, the devastation of Europe caused by World War II and the efforts to rebuild were the major forces in bringing six European countries—Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany (the western portion of modern Germany)—together to form the European Common Market or European Economic Community, now known as the European Union (EU). As of August 2013, the number of member states grew to 28 with the addition of Croatia. The EU is now the largest single market in the world with a population of more than 500 million people and a combined gross domestic product of more than \$16 trillion. The primary focus of this chapter is to examine the structure and operation of the EU to the extent that it is relevant to business. It also examines the process of gradually greater economic integration within the EU and its impact on business.

HISTORY OF THE EUROPEAN UNION

The EU did not spring forth fully developed in its current form. Rather, it developed over a period of years and with successive modifications. Understanding the present issues requires an examination of the EU's history.

Founding Treaties

Winston Churchill, a former prime minister of Great Britain, stated in 1946 that postwar Europe needed a " ... [s]overeign remedy ... to re-create the European

family, or as much of it as we can, and provide it with a structure under which it can dwell in peace and safety and freedom. We must build a kind of United States of Europe." Jean Monnet, a French government official considered the founding father of the EU, said that "the states of Europe must form a federation." They hoped this type of partnership would prevent the development of conditions that might result in a third world war.

Although the EU is a single unit, it actually started as three "communities," each created and operating under a separate treaty. The best known was the European Community (EC), formerly known as the European Economic Community, established under the 1957 *Treaty of Rome*. This treaty, like the U.S. Constitution, created a set of market-wide institutions empowered to develop common policies, but it left the substance of the policies to the new institutions. The second community, the European Coal and Steel Community (ECSC), was established in 1952 under the *Treaty of Paris*, which specifically defined the outlines of an agreed common policy, covering combined price and output controls, investment subsidies, tariff protection, and competition rules with respect to coal and steel. The third community, the European Atomic Energy Community (Euratom), established on the same day as the EC by a second, separate *Treaty of Rome*, focused primarily on creating a market for and distributing atomic energy throughout the European states. It also was responsible for selling excess nuclear energy outside member states. All three of these "communities" existed under the administration of a single institution, the Commission of the European Communities (the Commission).

The **European Union** is a concept added by the *Maastricht Agreement*, also known as the *Treaty on European Union*. The *Maastricht Agreement* did not abolish the Communities, but created the concept of a Union as an expression of the member states' underlying unity, as reflected in the Communities. Maastricht also added goals, to which the member states aspired, that might permit the eventual development of political integration. In practice, the level of political integration was very loose: Member states had very different



positions on political, military, social, and labor questions and made little attempt to coordinate them. Legally, there were three communities. Thus, the somewhat confusing result was that, although the EU was a single set of institutions, each of which we will discuss in depth below, it acted as ECSC on steel and coal matters; it acted as Euratom on atomic energy matters; and when it acted on most other economic matters, it did so as the EC.

Because the general rule is that the EU has only the powers its member states confer on it in treaties, we will review some of the major treaties in more detail.

Treaty of Rome. The *Treaty of Rome* stated the original objectives of the EU (see Exhibit 15.1). The *Treaty of Rome* launched the process of establishing a customs union, gradually turning over international trade policy to the Commission. The *Treaty of Rome* also launched internal multinational regulation, as it contained “competition law” calculated to prevent the creation of market-wide private combinations in restraint of trade. The *Treaty of Rome* is still important in the area of competition law. Notwithstanding the earlier ECSC effort,

the *Treaty of Rome* is commonly regarded as the true beginning of European economic integration.

The Single European Act. Despite the professed goals of the *Treaty of Rome*, progress on economic integration was quite slow. Approaching the thirtieth anniversary of the *Treaty of Rome*, the EU was still more a loose free trade area than a customs union. It posed significant barriers to imports from other member states, and its divergent approaches on trade policy with nonmember states made a customs union untenable. The 12 existing members thus enacted the *Single European Act* (SEA), effective in July 1987. The purpose of the SEA was to strengthen the institutions and enable them to act to further the goals of the *Treaty of Rome*.

The SEA signaled a dramatic move away from the *Treaty of Rome*’s slow, consensus-based system. The members abandoned the requirement of unanimous consent to move forward and instead adopted the concept of **qualified majority voting**. This change meant that not all the member states had to agree on proposals that related to the internal market. This allowed the institutions to make decisions even if there was some objection.

Exhibit 15.1

Treaty of Rome

Article 2

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.

Article 3

For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

- A. the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of the other measures having equivalent effect;
- B. the establishment of a common customs tariff and of a common commercial policy toward third countries;
- C. the abolition, as between Member States, of obstacles to freedom of movement for persons, services, and capital;
- D. the adoption of a common policy in the sphere of agriculture;
- E. the adoption of a common policy in the sphere of transport;
- F. the institution of a system ensuring that competition in the common market is not distorted;
- G. the application of procedures by which the economic policies of Member States can be coordinated and disequilibrium in their balances of payments remedied;
- H. the approximation of the laws of Member States to the extent required for the proper functioning of the common market;
- I. the creation of a European Social Fund in order to improve employment opportunities for workers and to contribute to the raising of their standard of living;
- J. the establishment of a European Investment Bank to facilitate the economic expansion of the Community by opening up fresh resources;
- K. the association of the overseas countries and territories in order to increase trade and to promote jointly economic and social development.



The Maastricht Treaty. After the passage of the SEA, the pace of change quickened. In 1991, EU leaders hammered out an agreement at Maastricht, Netherlands, that advanced economic integration and set the stage for a measure of political integration. The EU concept was established, along with EU “citizenship,” which facilitated movement of labor. It set the stage for a single European currency, the euro, and a European Central Bank to control monetary policy. The agreement also set goals for common policy on internal environmental and other issues important to business. The *Maastricht Treaty* also increased the use of qualified majority voting.

Treaty of Lisbon. The period from 1991 through 2007 was marked by difficulties in furthering economic integration. Attempts to address institutional reform in the *Treaty of Nice* (2003) failed, and the rejection of an attempt to consolidate the EU’s authority in the *Treaty Establishing a Constitution for Europe* by voters in France and the Netherlands in 2005 led to a period of reflection and inaction. The period of reflection ended in 2007, when a new effort was initiated to salvage some of the reforms set forth in the Constitution for Europe. These efforts resulted in the *Treaty of Lisbon*, which was signed in December 2007 and entered force in December 2009. The *Treaty of Lisbon* significantly modified the EU’s existing institutions as well as its underlying structure. The treaty abolished the separation between the policy areas and introduced a single consolidated entity with a legal personality. The word “Community” was removed from the name of all existing institutions.

The *Treaty of Lisbon* redefined the relationship between EU institutions and the national governments of the member states. This relationship has been redefined in three separate principles. First, the *Treaty of Lisbon* distinguishes between exclusive competence, shared competence, and supporting competence. The EU has exclusive competence or power in areas such as the functioning of the customs union, common trade policy, competition law, and monetary policy. The member states share competency with the EU in such areas as the internal market, social policy, agriculture, environmental and consumer protection, transportation, energy, and public health. However, the member states’ power is limited to those areas where the EU has not otherwise acted. The EU may support, coordinate, or supplement actions in fields left primarily to the member states, such as industry, tourism, culture, and education.

The second principle is a greater role for national governments in EU affairs. National parliaments may now object to proposed EU legislation on the basis that it oversteps EU authority. The EU may be forced to reexamine or explain the proposed legislation depending on the number of national parliaments that file objections.

Finally, for the first time, the *Treaty of Lisbon* formalizes a procedure by which member states may withdraw from the EU. This will be discussed shortly in the context of the vote by the United Kingdom to withdraw from the EU in June 2016.

The *Treaty of Lisbon* also redefined the relationship between the EU and citizens of the member states. The treaty creates a new citizens’ initiative that requires the consideration of proposals signed by one million citizens from any number of member states. The treaty also provides that the political, social, and economic rights set forth in the *Charter of Fundamental Rights* are legally binding on the member states.

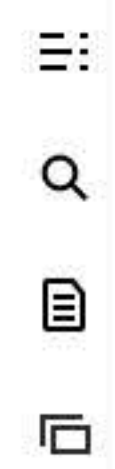
The *Treaty of Lisbon* represents the most significant change to the EU since the beginning of European economic integration as represented by the *Treaty of Rome* (now known as the *Treaty on the Functioning of the European Union*, which for purposes of clarity we will continue to refer to as the *Treaty of Rome*). The structure of the EU is discussed in the next section.

MEMBERSHIP IN THE EUROPEAN UNION

The EU currently consists of 28 states. Table 15.1 lists the current EU member states alphabetically with the year each state applied for and acceded to membership. Membership in the EU has been highly desired by the vast majority of states as noted by the fact that only one state (Norway) has refused an invitation to join, and states are willing to wait for long periods of time while their applications are undergoing review. This long period of time begs the question—how does a state join the EU?

The Accession Process

Becoming a member of the EU is a long and complex process. The *Maastricht Treaty* provides that any European state may apply for membership if it respects democratic values. These values include stable institutions guaranteeing democracy and respect for the rule of law and human rights, a functioning market



economy, and acceptance of EU laws and practices. A state wishing to join must first reach a stabilization and association agreement with the EU whereby the potential candidate state is offered free trade incentives in return for commitments to political and economic

reform. A state may submit an application for membership once such an agreement is completed. At this juncture, an applicant becomes an official candidate. However, this status does not mean that formal membership negotiations have commenced.

Table 15.1 MEMBERSHIP IN THE EUROPEAN UNION AND ITS PREDECESSORS

STATE	DATE OF APPLICATION	ACCESSION
Austria	July 1989	January 1995
Belgium	Founding Member	July 1952
Bulgaria	December 1995	January 2007
Croatia	February 2003	July 2013
Cyprus	July 1990	May 2004
Czech Republic	January 1996	May 2004
Denmark	May 1967	January 1973
Estonia	November 1995	May 2004
Finland	March 1992	January 1995
France	Founding Member	July 1952
Germany, West	Founding Member	July 1952
Greece	June 1975	January 1981
Hungary	March 1994	May 2004
Ireland	May 1967	January 1973
Italy	Founding Member	July 1952
Latvia	September 1995	May 2004
Lithuania	December 1995	May 2004
Luxembourg	Founding Member	July 1952
Malta	July 1990	May 2004
Netherlands	Founding Member	July 1952
Poland	April 1994	May 2004
Portugal	March 1977	January 1986
Romania	June 1995	January 2007
Slovakia	June 1995	May 2004
Slovenia	June 1996	May 2004
Spain	June 1977	January 1986
Sweden	July 1991	January 1995
United Kingdom	May 1967	January 1973 pending withdrawal



Membership negotiations are conducted in chapters relating to specific EU legislation, legal acts, and court decisions otherwise known as the *acquis communautaire* (literally meaning that which has been agreed upon by the community). An accession treaty is only drafted once negotiations are concluded on all chapters and topics. Accession treaties granting new membership must be ratified by all existing members. A date is then set for the commencement of formal membership. Any existing member state may effectively veto a new membership application although such an occurrence would be rare at this stage. Of course, negotiations may take place over such a long period of time as to constitute an effective veto of membership. Such is the case with Turkey, which has been an applicant for membership since 1987 with no end in sight to membership negotiations. Table 15.2 lists the current candidates for EU membership and the status of each application.

The Advantages and Disadvantages of Further Expansion. Expansion of membership slowed considerably after rapid growth in the mid-1990s and from 2004 through 2007. This may be due to several factors, including a declining number of suitable expansion candidates and the financial crisis that has taken some of the luster off of membership (to be discussed later in this chapter). The most recent enlargements have focused on poorer, eastern European states that may pose a threat to western European dominance of EU institutions and a drain on resources. Enlargement to Eastern Europe has resulted in increased development aid to these new and poorer member states. Expansion may also increase migration by Eastern Europeans and exacerbate the unemployment problem facing Western Europe. Expansion has also occurred in a somewhat

undemocratic manner as there has never been an EU-wide referendum on any of the previous additions. Finally, possible future expansion has caused the EU to consider what it means to be European. As noted by German chancellor Angela Merkel in 2006, “[i]f we do not want to stop completely or even reverse integration, we have to say where the borders of Europe are.” For example, should a state like Turkey be admitted given that the majority of its territory is located in Asia and its population is predominantly Muslim? If religion is a determinant, what should be done about a candidate such as Bosnia that is a part of the European continent but a predominantly Muslim country? These are questions which the EU will need to answer as it considers future expansion, perhaps even its continued existence.

There are several benefits of enlargement. Expansion provides greater security for the European continent and minimizes the likelihood of future armed conflict. Democratization, the rule of law, and respect for human rights are promoted through the enlargement process. Expansion to Eastern Europe provides Western European states with access to new markets for goods and services and cheaper labor. The EU must take action to retain its economic clout as regional trading blocs become more commonplace in the absence of progress on greater global integration at the World Trade Organization. The EU cannot afford to be left behind by economic events in the Pacific Rim and on the Indian subcontinent and greater regional integration on a worldwide scale.

Withdrawal from the EU

On June 23, 2016, the United Kingdom voted to invoke Article 50 of the *Treaty of Lisbon* (see Exhibit 15.2) and withdraw from the European Union, the so-called

Table 15.2 CANDIDATES FOR EU MEMBERSHIP AS OF JANUARY 2017

STATE	DATE OF APPLICATION	STATUS
Albania	April 2009	Candidate Country
Bosnia & Herzegovina	-	Potential Candidate
Kosovo	-	Potential Candidate
Macedonia	March 2004	Candidate Country
Montenegro	December 2008	Candidate Country
Serbia	December 2009	Candidate Country
Turkey	April 1987	Candidate Country



Exhibit 15.2

Treaty of Lisbon

Article 1

Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

Article 2

A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

Article 3

The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

Brexit vote. More than 30 million people voted in the referendum, which was more than 71 percent of eligible voters. The vote was close with 52 percent of voters favoring leave and 48 percent voting to remain in the EU. The vote was split between urban and rural areas and between the constituent parts of the United Kingdom. England, other than the London metropolitan area, and Wales strongly endorsed leave while Northern Ireland and Scotland voted to remain. The results of the vote caused Prime Minister David Cameron, a supporter of remaining in the EU, to resign. Prime Minister Cameron was succeeded by Theresa May, the former home secretary, who also opposed leaving the EU but noted that the will of the people should be respected and that “Brexit means Brexit.”

Brexit was the result of growing frustration with the EU. Supporters of Brexit claimed that EU regulations and directives imposed an undue burden on business and that the United Kingdom received little benefit as compared to the large membership fees charged to remain a part of the customs union. Supporters of Brexit also cited the need for the United Kingdom to reclaim its sovereignty and democracy. Border control was another important issue given the EU’s relaxed immigration policies and the flood of refugees arriving from war-torn parts of the world such as Afghanistan, Iraq, Libya, and Syria.

Opponents noted that Brexit could result in loss of access to the integrated EU marketplace. From a financial standpoint, the British pound could be weakened in world currency markets, and London could lose its status as Europe’s financial center. Brexit has created uncertainty in the immigration status of EU nationals working in the United Kingdom and could result in a “brain drain” as such individuals return to their home states. There has been concern expressed about potential disintegration of the United Kingdom given the split between England and Wales on one side of the argument and Northern Ireland and Scotland on the other side.

The path forward for Brexit is unclear as no member state has ever left the EU. The United Kingdom and the EU have two years to negotiate the terms of withdrawal starting on March 29, 2017, the date the United Kingdom triggered Brexit through formal notification to the EU. However, there are significant challenges for both parties. The primary challenge is determination of the terms of Brexit. Future relations between the United Kingdom and the EU may be harmed with possible economic consequences if the terms are too harsh. On the other hand, allowing the United Kingdom to withdraw from the EU without suffering significant consequences may encourage actors within the remaining member states to seek withdrawal. All that can be said at this juncture is that nothing other than the eventual withdrawal of the United Kingdom from the EU is set in stone.



STRUCTURE OF THE EUROPEAN UNION

Power in the EU is allocated by the member states to several institutions. The primary institutions are the European Council, the Council of Ministers of the European Union, the Commission of the European Union, the European Parliament, and the Court of Justice.

The European Council

A potential source of confusion arising from the *Treaty of Lisbon* is the European Council (the Council), which should not be confused with the Council of Ministers, to be discussed shortly. The Council became a full EU institution as a result of the *Treaty of Lisbon*. It is composed of the heads of state or government of the EU's member states along with the president of the European Commission. The Council has jurisdiction over a wide range of areas, including the composition of the Parliament and Commission and law enforcement, foreign policy, and constitutional matters. The Council is headed by a president. The president is elected by the Council to a term of two and one-half years and can be reappointed once. The president's work is largely administrative with responsibility for preparing the Council's work, hosting its meetings, reporting its work to the European Parliament, and working to secure consensus among member states. The president also acts as the EU's external representative on issues concerning common foreign policy and security.

The Council of Ministers of the European Union

The Council of Ministers of the European Union (the Council of Ministers) sits in Brussels, Belgium, the effective "capital" of the EU. It is composed of one representative from each member state. Each member state has several ministers, each specializing in a different area. A member state will designate a different minister to be its representative on the Council of Ministers, depending on the subject on the agenda at a given meeting. Different areas of specialization include international affairs, finance, agriculture, justice, employment, environmental protection, education, and transportation. The position of president of the Council of Ministers is elected by European leaders to chair quarterly summits and

establish the agenda. The purpose of the Council of Ministers is to coordinate economic policies of member states and to make decisions on issues within its jurisdiction, which includes approving legislative directives to the member states and international agreements.

The Council of Ministers reaches decisions through a complex "qualified majority" voting system (unless unanimity or simple majority is otherwise required). A qualified majority is achieved if 55 percent of member states representing at least 65 percent of the total EU population approve a proposal. A proposal may be blocked if it does not achieve these requirements and at least four states object. The *Treaty of Lisbon* also obligates the Council of Ministers to meet in public when it deliberates and votes on legislation.

The European Commission

The European Commission serves as the EU's executive body carrying out the decisions of the Council of Ministers. It also is the only body that can make legislative proposals for the Council of Ministers and European Parliament to consider. As a practical matter, however, the Commission proposes whatever the Parliament or the Council of Ministers requests that it propose. The Commission is headed by the College of Commissioners. It consists of one member appointed by each member state, each of whom is theoretically obligated to represent the interests of the EU as a whole rather than the interest of his or her home state. The Commission is headed by a president who is elected by the European Parliament.

The term *Commission* also refers to the bureaucracy that performs the Commission's day-to-day work: more than 25,000 civil servants who serve in the different Directorates-General, which are specialized areas of interest of the Commission. For example, *DG-IV* is the part of the Commission responsible for development of its competition law. Each commissioner has special responsibilities at a directorate. There is some overlap among directorates, and fierce turf battles often rage among the bureaucrats.

The European Parliament

The European Parliament (the Parliament) is the only EU institution whose members are elected by European citizens. Each member state elects a different number, based on population who are known as Members of the



European Parliament or MEPs. However, no member state can have more than 96 or less than 6 MEPs. The current allocation of MEPs pending Brexit is set forth in the following table.

Austria	18
Belgium	21
Bulgaria	17
Croatia	11
Cyprus	6
Czech Republic	21
Denmark	13
Estonia	6
Finland	13
France	74
Germany	96
Greece	21
Hungary	21
Ireland	11
Italy	73
Latvia	8
Lithuania	11
Luxembourg	6
Malta	6
Netherlands	26
Poland	51
Portugal	21
Romania	32
Slovakia	13
Slovenia	8
Spain	53
Sweden	20
United Kingdom	73
TOTAL	751

The MEPs are elected to five-year terms. Each member state determines the electoral rules for its own candidates. The Parliament comprises members of various political factions that create alliances across national boundaries, including the Socialists, Christian Democrats, European Democrat Alliance, Greens, and other groups.

The power of the European Parliament has progressively grown over time. This expanding power is an attempt to address concerns that the EU relies too heavily on appointed officials and is undemocratic. As a result of the *Treaty of Lisbon*, the Parliament now has the same degree of lawmaking power as the Council of Ministers in some areas where previously it was merely consulted or not involved at all. These areas include immigration, law enforcement and judicial cooperation, and some aspects of trade policy and agriculture. The Parliament must also approve the EU's budget, which is set forth within a multiannual financial framework (unlike the United States). Parliamentary assent is required for many international agreements to which the EU may ascribe. Finally, the Parliament is responsible for the selection of the president of the European Commission.

The Court of Justice of the European Union

The Court of Justice of the European Union (ECJ) in Luxembourg functions as the final arbiter of EU law. For private parties, its main function is to hear appeals from the European trial court, the General Court. It also has original jurisdiction in cases brought by EU institutions to compel member states to comply with their treaty obligations or by member states against EU institutions alleged to have overstepped their powers under the treaties.

One judge is appointed by each of the member states for a renewable term of six years. The judges elect a president of the Court for a renewable term of three years. Unlike most national high courts, the Court may sit as a full court, in a Grand Chamber of 11 judges, or in smaller chambers. The Court only sits as a full court when the judges determine that a case is of unusual importance, when different small chambers are in conflict, or, in rare cases, to remove a commissioner. The Court of Justice sits in a Grand Chamber in important cases or when petitioned by a member state or an EU institution. The Court hears most cases in chambers of three or five judges, much like the Courts of Appeals in the U.S. federal court system.



The General Court (formerly known as the Court of First Instance) is the general trial court of the EU. It has original jurisdiction over lawsuits brought by private parties and member states (other than those assigned to the Court of Justice). Like the Court of Justice, the General Court is comprised of one judge from each member state, who serve renewable six-year terms. A party bringing a suit in the General Court will probably encounter a three-judge chamber. The General Court hears about three-quarters of its cases in this fashion. If it deems a case important enough, the General Court can sit as a Grand Chamber of 13 judges or as a full court.

The EU courts follow the civil law tradition because all but the British and Irish judges come from this tradition. For example, the court itself calls witnesses, demands the production of documents, and hires necessary experts. The court allows limited cross-examination by the parties and permits parties to present their own experts on factual disputes.

Adherence to the civil law tradition is not the only difference between EU and U.S. courts. EU courts often handle cases that are different from their U.S. counterparts. For example, the ECJ may be asked by a national court to issue a preliminary ruling on a point of EU law. Resort to such an advisory opinion is largely absent in the U.S. judicial system. EU courts also decide cases brought against member state governments for failing to fulfill treaty obligations or apply EU law. Additional types of cases include annulment actions to set aside EU laws alleged to violate EU treaties or fundamental rights and direct actions brought by individuals, companies, or organizations challenging EU decisions or actions.

Another distinguishing feature is that decisions are issued without any dissenting opinions. This practice does not indicate total agreement among the judges; however, the public is not privy to their differences. This is in contrast to the U.S. judicial tradition, where the public, press, and legal scholars examine dissenting opinions to divine the philosophical differences among judges and predict future outcomes on different cases. The rationale for this EU practice is to protect the national judges from pressure within their home states.

National courts are obligated to follow EU law and the ECJ's decisions. An English court recognized this authority in a famous opinion that noted the difference between English and EU law, but nonetheless followed the controlling EU law. Lord Denning in *Bulmer v. Bollinger* [1974] stated:

The [EC] Treaty is quite unlike any of the enactments to which we have become accustomed ... It lays down general principles. It expresses its aims and purposes. All in sentences of moderate length and commendable style. But it lacks precision. It uses words and phrases without defining what they mean. An English lawyer would look for an interpretation clause, but he would look in vain. There is none. All the way through the Treaty there are gaps and lacunae. These have to be filled in by the judges, or by the regulations or directives. It is the European way ... Seeing these differences, what are the English courts to do when they are faced with a problem of interpretation? They must follow the European pattern. No longer must they argue about the precise grammatical sense. They must divine the spirit of the Treaty and gain inspiration from it. If they find a gap, they must fill it as best they can ... These are the principles as I understand it, on which the European Court acts.

The Court of Justice must also interpret EU law and is the ultimate authority for these conflicts.

Distinctions among Institutions

Non-Europeans have some difficulty following developments in the EU because of a lack of clarity about the roles of its various institutions. The European Council and the Council of Ministers easily can be confused with the Council of Europe. The Council of Europe comprises all the EU members plus a number of other countries, including Switzerland. The Council of Europe works to support democracy and human rights and to address the issues facing Europe as a whole. The Council of Europe has a European Court of Human Rights that hears complaints about violations of the *European Convention on Human Rights* and the *Anti-Torture Convention*.

Similarly, one should not confuse the EU's Court of Justice, which sits in Luxembourg, with the International Court of Justice, a court of final jurisdiction annexed by statute to the *United Nations Charter*, or the European Court of Human Rights. As discussed earlier in this chapter, the Court of Justice, an EU institution, hears cases dealing with the interpretation of EU treaties and legislation and conflicts between EU and national law.

The EU also should not be confused with the European Free Trade Association (EFTA). EFTA was founded in 1960 for the purposes of promoting free trade and closer economic cooperation among Western European countries. EFTA membership consisted of several countries that are now EU members such as Austria, Denmark, Finland, Portugal, Sweden, and the United Kingdom. These states withdrew from EFTA to



join the EU, leaving the current membership of Iceland, Liechtenstein, Norway, and Switzerland. Despite its small size, EFTA has pursued trade relations around the world and has concluded several free trade agreements, including one with the EU.

Harmonization: Directives and Regulations

One of the principal goals of the EU is to harmonize national laws and create a common legal environment for business. How does the EU accomplish this goal? The Council of Ministers, Commission, and Parliament have several avenues open to them to achieve this objective. Article 189 of the *Treaty of Rome* identifies the four principal means:

- An **EU regulation** shall have general application. It shall be binding in its entirety and directly applicable in all member states.
- An **EU directive** shall be binding as to the result to be achieved on each member state to which it is addressed but shall leave to the national authorities the choice of form and methods.
- A **decision** shall be binding in its entirety on the member state or individual to whom it is addressed. Decisions are commonly used with respect to proposed mergers and agricultural matters.
- Recommendations and opinions shall have no binding force.

Regulations take effect immediately in the states and circumvent the need to pass legislation on the national level. Many *EU regulations* exist in the agriculture and competition law areas. *EU directives*, in contrast to regulations, require that members bring their laws into harmony with the standard stated in the directive within a stated time period, most often three years. The EU has used this approach in the environmental, products liability, and employment arenas. Directives give member states more autonomy to implement legislative programs in ways that are most consistent with local conditions. The problem with local autonomy, however, is that the national legislation may not advance the purposes of the directive. If the Commission believes that has happened, it may initiate action in the EU courts to force the member state to comply. The member state will, of course, try to show that its action adequately complied with the directive.

There are two concepts of primary importance in any discussion of EU law. The first concept is the direct effects doctrine. The direct effects doctrine provides that provisions within EU treaties are applicable to individual businesses and persons and thus these businesses and individuals are empowered to seek enforcement without the necessity of state intervention or participation. The doctrine had its origin in *Van Gend*

en Loos v. Nederlandse Administratie der Belastingen, Case 26/62 [1963] in which a transportation company sought a refund of a tariff from Dutch customs authorities that the company claimed was contrary to the free movement of goods provision of the *Treaty of Rome*. In permitting the transportation company to proceed with its action to enforce the free movement provisions, the ECJ stated:

community law ... not only imposes obligations on individuals but is also intended to confer upon them rights which become part of their legal heritage. These rights arise not only where they are expressly granted by the treaty, but also by reason of obligations which the treaty imposes in a clearly defined way upon individuals as well as upon the member states and upon the institutions of the community.

The direct effects doctrine has thus empowered businesses and individuals to serve as enforcers of obligations imposed by EU treaties.

The second concept is the supremacy doctrine. In a manner similar to the relationship between U.S. federal and state law, EU law is superior to the laws of the member states in areas in which integration has been occurred. Where a conflict arises between EU law and the national law of a member state, the EU law takes precedence. This principle was first announced in *Costa v. ENEL*, Case 6/64 [1964], in which the ECJ stated:

[t]he law stemming from the treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions ... without being deprived of its character as community law and without the legal basis of the community itself being called into question.

The supremacy doctrine has had the effect of overturning numerous national laws regardless of their ancient pedigree. For example, in 1987, the ECJ struck down the *Reinheitsgebot*, the German beer purity law, originally adopted in 1516, which mandated that only four ingredients (water, hops, barley, and yeast) could be contained in any beverage sold to the German public as "beer." The effect of this law was to exclude beer brewed using rice, maize, sorghum, or other raw cereals. The ECJ dismissed Germany's contention that sales of products labeled as "beer" containing other ingredients would deceive German consumers and would imperil public health. The ECJ struck the law down as an artificial and unwarranted barrier to trade. The decision evoked widespread outcry in Germany but nevertheless opened the German market to a wide variety of beverages that could now be labeled as beer. It also demonstrated the ECJ's commitment to the supremacy doctrine.



Another example of the supremacy doctrine in operation may be found in the following case. It is important to note the wide scope of the doctrine in this case, extending all the down to admissions fees to cultural sights and museums operated by local government authorities.

As a result of the supremacy doctrine, the EU has achieved considerable integration in a wide variety of areas. Four of these areas, the so-called **Four Freedoms**, are discussed in the next section. Other areas where significant integration has occurred or been attempted are discussed later in this chapter.



Commission of the European Communities v. Italian Republic

C-388/01 [2003] European Court of Justice

BACKGROUND AND FACTS

Decree No. 507 of the Italian Ministry of Cultural Assets and Natural Sites regulated tickets for admission to monuments, museums, galleries, archaeological digs, parks and gardens classified as "national monuments." Article 4(3) of the Decree provided for free admission to EU citizens under the age of 18 years or over the age of 65 years. However, the Decree was only applicable to national monuments and did not apply to public monuments operated by local government authorities. Examples of public monuments included tourist attractions located in Treviso, Padua, Florence, and Venice. Reduced rates for admission to public monuments were restricted to Italian nationals and persons residing within the territory of the local authority operating such monuments. Favorable admission was denied to tourists who were nationals of other member states who fulfilled the same age requirements.

Italy defended this distinction on the basis that free admission to the sites could not be granted in disregard of economic considerations with respect to the management of local cultural sights and that the national government had no authority with respect to museums and other cultural sites operated by local authorities.

The Commission challenged the distinction between national and public monuments before the European Court of Justice. It claimed that Italy permitted discrimination in violation of its treaty obligations by allowing local governments to grant advantageous conditions for admission to Italian nationals and persons resident within the territory of those authorities running the cultural sites in question and by excluding from such advantages tourists who were nationals of other member states.

FINDINGS OF THE COURT

The Court has already held that national legislation on admission to the museums of one Member State which entails discrimination affecting only foreign tourists is, for nationals of other Member States, prohibited by Articles 7 and 59 of the EEC Treaty (which became Articles 6 and 59 of the EC Treaty, now, after amendment, Articles 12 EC and 49 EC) (Case C-45/93 *Commission v. Spain* [1994] ECR I-911).

It is also clear from the Court's case-law (see, Case C-3/88 *Commission v. Italy* [1989] ECR 4035, paragraph 8) that the principle of equal treatment, of which Article 49 EC embodies a specific instance, prohibits not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.

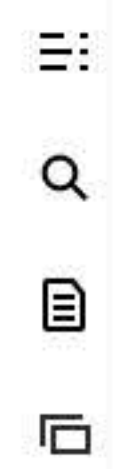
The Italian Republic none the less puts forward various reasons in the general interest in order to justify the advantageous rates at issue. First, in the light of the cost of managing cultural assets, free admission to the sites cannot be granted in disregard of economic considerations.

First of all, to the extent that the advantageous rates at issue provide for a distinction on the basis of nationality, it should be recalled that such advantages are compatible with Community law only if they can be covered by an express derogating provision ... namely public policy, public security or public health. Economic aims cannot constitute grounds of public policy within the meaning of Article 46 EC (see, Case C-484/93 *Svensson and Gustavsson* [1995] ECR I-3955, paragraph 15).... [As] neither the necessity to preserve the cohesion of the tax system nor the economic considerations put forward by the Italian Government come within the exceptions allowed by Article 46 EC, the advantageous rates at issue, in so far as they are allowed only for Italian nationals, are incompatible with Community law.

As regards, the economic grounds put forward by the Italian Government, suffice it to note that they cannot be accepted, since aims of a purely economic nature cannot constitute overriding reasons in the general interest justifying a restriction of a fundamental freedom guaranteed by the Treaty (see, Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 48).

Finally, the Italian Government contends that the regulations which introduced the advantageous

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rates at issue are not within its competence. They concern museums or other exhibition spaces run by local authorities, whereas, in accordance with Article 47 of Presidential Decree No. 616 of 1977, “all services and activities relating to the existence, conservation, functioning, public enjoyment and development of museums, collections of artistic, historic or bibliographic interest ... belonging to the region or to other local authorities including non-territorial authorities subject to its control or, in any event, of local interest” come within the exclusive competence of the regions.

In that regard, suffice it to recall that a Member State cannot plead conditions existing within its own legal system in order to justify its failure to comply with obligations arising under Community law. While each Member State may be free to allocate areas of internal legal competence as it sees fit, the fact still remains that it alone is responsible towards the Community under Article 226 EC for compliance with its obligations (see, Case C-33/90 *Commission v. Italy* [1991] ECR I-5987, paragraph 24).

Costs

Article 69(2) of the Rules of Procedure provides that the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party’s pleadings. Since the Commission has applied for costs and the Italian Republic has been unsuccessful, the latter must be ordered to pay the costs.

On those grounds, THE COURT (Sixth Chamber), hereby:

1. Declares that, by allowing discriminatory, advantageous rates for admission to museums, monuments, galleries, archaeological digs, parks and gardens classified as public monuments, granted

by local or decentralized State authorities only in favor of Italian nationals and persons resident within the territory of those authorities running the cultural sites in question, who are aged over 60 or 65 years, and by excluding from such advantages tourists who are nationals of other Member States and non-residents who fulfill the same objective age requirements, the Italian Republic has failed to fulfill its obligations under Articles 12 EC and 49 EC;

2. Orders the Italian Republic to pay the costs.

Decision. The Court prohibited local governments in Italy from maintaining different fees for Italian nationals and citizens of other EU member states with respect to admission to local museums and cultural attractions. The Court rejected Italy’s contention that it did not possess authority to regulate the fees charged by local governments. Rather, the Court extended the non-discrimination principle from cultural attractions and museums operated by national governments to such sights operated by regional and local governments.

Case Questions

1. What was the ECJ’s holding with respect to Italy’s claims regarding the cost to local governments of maintaining cultural attractions and historic locations?
2. What was the basis for the ECJ’s decision that the Italian national government was responsible for the conduct of local governments with respect to the fees charged for admission to museums and cultural attractions?

THE EUROPEAN UNION AND THE REGULATION OF BUSINESS: THE FOUR FREEDOMS

The Four Freedoms refer to a body of EU law originating with the *Treaty of Rome* in which the EU committed itself to achieving the free movement of goods, services, capital, and people in the common market. The Four Freedoms constitute the very essence of the EU and are at the heart of its substantive law. These freedoms constitute the most important economic factors and are central to the EU’s goals of enhancing continental integration and prosperity. All factors of production are entitled to move freely between the member states. This

guarantee creates a truly free market and permits efficient allocation of factors of production to areas where they are most needed and valued. The following sections briefly describe each of the Four Freedoms.

The Free Movement of Goods

The *Treaty of Rome* provides that the common market “shall cover all trade in goods” and prohibits between member states “customs duties on imports and exports and ... all charges having equivalent effect.” This article also mandates the adoption of a common external tariff with respect to goods entering the member states from nonmember states. Once a good has entered a member state from a nonmember state and the appropriate customs duty has been paid, it must then be permitted to circulate freely between member

states. Exceptions exist for goods that pose risks to consumers or harm the public health or the environment. The free movement of goods prohibits not only customs duties on imports and exports but also charges having the equivalent effect of a customs duty. Charges having equivalent effects include any pecuniary charge, no matter how small or its designation, that are unilaterally imposed on domestic and foreign goods upon crossing a border within the EU. It does not matter if a charge does not benefit the charging state, does not discriminate, and does not attempt to protect a like competitive domestic product. Internal

taxes imposed on products of other member states in excess of those imposed on like domestic products are also prohibited.

In addition to customs duties and taxes, free movement of goods also prohibits quantitative restrictions and nontariff measures having an equivalent effect. This prohibition is applicable to discriminatory rules that expressly distinguish between national and imported goods as well as rules that have the effect of hindering the free movement of imported goods. The following case is an example of a measure that had the effect of hindering the free movement of goods.



Commission of the European Communities v. Portuguese Republic

265/06 [2008] European Court of Justice

BACKGROUND AND FACTS

Article 2(1) of Portuguese Law No. 40/2003 provided that “the affixing of tinted film to the windows of passenger or goods vehicles shall be prohibited with the exception of lawful stickers and dark, non-reflective film to the goods compartment of goods vehicles.”

Portugal acknowledged that its law constituted a restriction on the free movement of goods but contended that it was justified by the objectives of road safety and public safety. Portugal argued that the ban was intended to enable law enforcement authorities to make a rapid external inspection of the interior of motor vehicles in order to ensure that the vehicle’s occupants were wearing seat belts and to identify potential criminals for the purpose of combating crime.

There was no Community legislation on tinted film designed to be affixed to the windows of motor vehicles at the time Portugal adopted its legislation. However, Community legislation existed in relation to safety glazing which was fitted from the outset to motor vehicles. This legislation included Council Directive 92/22/EEC of March 31, 1992 on safety glazing and glazing materials on motor vehicles and their trailers. This legislation provided that with respect to windshields, light transmittance could not be less than 75%. The light transmittance was required to be at least 70% in other areas within the driver’s forward line of sight. Light transmittance could be less than 70% with respect to safety glazing located within the driver’s rearward field of view if the vehicle was fitted with two exterior rear-view mirrors.

The Commission claimed that Portugal failed to fulfill its obligations under Articles 28 and 30 of the EC Treaty by affecting the marketing of almost all colored film, lawfully manufactured and marketed in other

Member States intended to be affixed to the windows of motor vehicles. No potential customers, traders or individuals would purchase such film, since they knew that they could not affix it to the windows of motor vehicles. The Commission also claimed that the ban was excessive and disproportionate with respect to the objectives of combating crime and ensuring road safety. The Commission claimed a visual inspection was only one means among others in order to fight crime and prevent offenses relating to the obligation to wear seat belts, and at least some films, namely those with a sufficient degree of transparency, permitted the desired visual inspection of the interior of motor vehicles. Finally, the Commission noted that glazing of windows was permitted on motor vehicles before they were released into the stream of commerce as provided by Council Directive 92/22/EEC.

FINDINGS OF THE COURT

According to settled case-law, all rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions, prohibited by Article 28 EC. In this case, the Portuguese Republic acknowledges that the ban restricts the marketing of products in Portugal.

It must be held that potential customers, traders or individuals have practically no interest in buying [such products] in the knowledge that affixing such film to the windscreen and windows alongside passenger seats in motor vehicles is prohibited.

The contested provision therefore affects the marketing in Portugal of almost all tinted film legally

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manufactured and sold in other Member States or in States party to the EEA Agreement intended to be affixed to the windows of motor vehicles.

It follows that the ban in Article 2(1) of Law No. 40/2003 constitutes a measure having equivalent effect to quantitative restrictions within the meaning of Article 28 EC. That provision is incompatible with the obligations arising from those provisions, unless it may be objectively justified.

According to settled case-law, a measure having an effect equivalent to a quantitative restriction on imports may be justified only by one of the public-interest reasons laid down in Article 30 EC or by one of the overriding requirements referred to in the judgments of the Court (see, in particular, Case 120/78 *Rewe-Zentral* ('*Cassis de Dijon*') [1979] ECR 649, paragraph 8), provided in each case that that measure is appropriate for securing the attainment of the objective pursued and does not go beyond what is necessary in order to attain it (Case C-14/02 *ATRAL* [2003] ECR I-4431, paragraph 64; Case C-432/03 *Commission v Portugal* [2005] ECR I-9665, paragraph 42; and Case C-254/05 *Commission v. Belgium*, paragraph 33).

In this case, the justifications put forward by the Portuguese Republic relate, first, to the fight against crime in the context of public safety and, second, to ensuring that the obligation to wear seat belts is complied with, which comes within the sphere of road safety. The fight against crime and ensuring road safety may constitute overriding reasons in the public interest capable of justifying a hindrance to the free movement of goods (see, with regard to road safety, Case C-54/05 *Commission v. Finland* [2007] ECR I-2473, paragraph 40).

However, it is for the Member States to show that their legislation is appropriate to ensure the attainment of such objectives and that it is in conformity with the principle of proportionality (see, to that effect, *inter alia*, Case C-297/05 *Commission v. Netherlands* [2007] ECR I-0000, paragraph 76).

In that regard, the Portuguese Republic has produced only one argument in support of the contested measure, namely, that it enables the passenger compartment of motor vehicles to be immediately inspected by means of simple observation from outside the vehicle.

Although the ban in Article 2(1) of Law No. 40/2003 does indeed appear to be likely to facilitate such inspection and, therefore, appropriate to attain the objectives of fighting crime and ensuring road safety, it does not follow that it is necessary to attain those objectives or that there are no other less restrictive means of doing so.

The visual inspection in question is only one means among others available to the competent authorities in

order to fight crime and prevent offences relating to the obligation to wear seat belts.

The claim that the contested measure is necessary was further undermined when the Portuguese Republic admitted at the hearing that it allows the marketing on its territory of motor vehicles fitted from the outset with tinted windows within the limits laid down by Directive 92/22. Tinted windows, like the tinted film at issue, may prevent any external visual inspection of the interior of vehicles.

Therefore, unless it is accepted that, as regards motor vehicles fitted at the outset with tinted windows, the competent authorities have abandoned their campaign to fight crime and their efforts to enforce road safety, it is clear that they must use other methods to identify criminals and persons who may be breaking the rules concerning the wearing of seat belts.

Furthermore, the Portuguese Republic has not shown that the ban, in so far as it concerns all tinted film, is necessary to promote road safety and combat crime.

As stated by the Commission at the hearing, there is a wide range of tinted film, from transparent film to film which is almost opaque. That information, which was not challenged by the Portuguese Republic, means that at least some films, namely those with a sufficient degree of transparency, permit the desired visual inspection of the interior of motor vehicles.

It follows that that ban must be regarded as being excessive and, therefore, disproportionate with respect to the objectives pursued.

Decision. The court struck down Portugal's absolute prohibition upon the tinting of automobile windows after they have been released into the stream of commerce despite the absence of an EU law directly in contravention of the Portuguese law and the concerns regarding public safety and combating crime.

Case Questions

1. What was the ECJ's holding with respect to Portugal's claims that the prohibition upon window tinting was in the interest of public safety and eradication of crime?
2. What was the basis for the ECJ's decision that Portugal's law constituted an obstacle to the free movement of goods?
3. How did the ECJ conclude that the prohibition on window tinting was an obstacle to the free movement of goods when the Portuguese law did not contravene a directly applicable EU law?



The Free Movement of Services

Services have long been recognized as an important part of EU economic activity. Services presently account for approximately 70 percent of all economic activity and employment in the EU. Free movement of services is thus of vital importance to the smooth operation of the internal market. Such free movement allows businesses to pursue continuous economic activities across national borders throughout the EU. Free movement also allows service providers in one member state to offer temporary services in other member states without having to be established already in these states.

The *Treaty of Rome* prohibits restrictions on the freedom to provide services within the EU with respect to nationals in one member state who provide services in another member state. Services are broadly defined

to include any economic activity for remuneration not governed by treaty provisions relating to the free movement of goods, capital, and persons. This includes activities of an industrial or commercial character and activities of craftspeople and of the professions.

Prohibited restrictions on services include those which are directly discriminatory as well as those which are neutral on their face but have a negative impact on the free movement of services. Service providers in one member state offering their services across the border in another member state are entitled to the same treatment as domestic service providers in the same industry, trade, or profession. In the following case, the ECJ was requested to determine whether Italian legislation that imposed different tax burdens on gambling proceeds was inconsistent with the free movement of services.



Blanco and Fabretti v. Agenzia Delle Entrate

C-344/13, C-367/13 [2014] European Court of Justice

BACKGROUND AND FACTS

In Italy, winnings from casinos situated in Italy were exempt from income taxation to the extent that their taxation was included in an entertainment tax. However, winnings from casinos situated outside of Italy were subject to income tax. As a result, only winnings obtained in casinos situated abroad were included in the basis for assessment of income tax for persons residing in Italy.

Two Italian nationals were accused by Italian tax authorities of failing to declare winnings obtained in casinos located abroad. The individuals claimed that the tax assessments discriminated against casinos located abroad as such winnings would have been tax exempt had they occurred in Italy. Italy claimed that the differing treatment was justified by the need to prevent money laundering abroad and limit the arrival in Italy of capital whose origin was uncertain.

The provincial tax court in Rome requested that the European Court of Justice address the consistency of Italy's dual tax treatment of casino winnings with the principle of non-discrimination with respect to service providers and whether such treatment could be justified by reasons of public policy, security or health.

FINDINGS OF THE COURT

In the first place, the referring court asks whether the national legislation at issue in the main proceedings constitutes a restriction on the freedom to provide services.

In that regard, it must be borne in mind that the freedom to provide services under Article 56 TFEU requires not only the elimination of all discrimination on grounds of nationality against providers of services established in other Member States, but also the abolition of any restriction—even if it applies without distinction to national providers of services and to those from other Member States—which is liable to prohibit, impede or render less attractive the activities of a provider of services established in another Member State where he lawfully provides similar services.

As the Court has already held, the provisions of the FEU Treaty on the freedom to provide services apply to an activity which enables people to participate in gambling in return for remuneration.

[A] difference in tax treatment, under which only the winnings from games obtained in another Member State are considered to be taxable income, reduces the attractiveness of going to another Member State with the objective of playing games of chance. In fact, the recipients of the services in question, who reside in the Member State where such a difference in treatment prevails, are dissuaded from participating in such games, the organisers of which are established in another Member State, in view of the importance for them of being able to obtain tax exemptions.

Therefore, national legislation such as that at issue in the main proceedings gives rise to a

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discriminatory restriction on the freedom to provide services as guaranteed by Article 56 TFEU in relation to not only service providers but also the recipients of those services.

In the second place, it must be ascertained whether that discriminatory restriction may be justified. The referring court and the Italian Government observe that the national legislation at issue in the main proceedings has the objective of preventing money laundering and 'self-laundering' of capital abroad and of limiting the flow of capital abroad or the arrival in Italy of capital whose origin is particularly uncertain.

However, although the Court has already recognised a certain number of overriding reasons in the public interest which may justify a restriction on the freedom to provide services, including consumer protection, action against fraud and prevention of social problems linked to gambling, those objectives cannot be relied upon to justify discriminatory restrictions.

[N]ational legislation, such as that at issue in the main proceedings, can be justified only insofar as it pursues objectives corresponding to the grounds of public policy, public security or public health within the meaning of Article 52 TFEU. In addition, the restrictions imposed by the Member States must satisfy the conditions of proportionality. Thus, national legislation is appropriate for guaranteeing attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner.

As regards, first of all, the objectives invoked by the Italian Government relating to the prevention of money laundering and the need to limit the flow of capital abroad or the arrival in Italy of capital whose origin is uncertain, it suffices for the Court, without needing to determine whether those objectives could fall within the definition of public policy, to point out, first of all, that, as is apparent from the Court's case-law, it is not justifiable for the authorities of a Member State to assume, in a general way and without distinction, that bodies and entities established in another Member State are engaging in criminal activity (see, to that effect, judgment in *Commission v Spain*, EU:C:2009:618, paragraph 39 and case-law cited).

Next, it should be noted that ... the Italian Government does not adduce evidence that, even if the proceeds of organised crime in Italy are high, they have been made totally or predominantly outside Italy.

Furthermore, to exclude in a general way the benefit of a tax exemption appears to be disproportionate, as it goes beyond what is necessary to combat money laundering, other methods being available to the Member States in this respect.

Finally, it cannot be excluded that action against compulsive gambling falls within the protection of public health and is capable, as such, of justifying a discriminatory restriction on the freedom to provide services ...

However, ... the taxation by a Member State of winnings from casinos in other Member States and the exemption of such winnings from casinos situated on its territory are not a suitable and coherent means of ensuring the attainment of the objective of combatting compulsive gambling, as such an exemption is in fact likely to encourage consumers to participate in games of chance which allow them to benefit from such an exemption.

Therefore, it follows from all the foregoing that the answer to the question submitted for a preliminary ruling is that Articles 52 and 56 TFEU must be interpreted as precluding legislation of a Member State which subjects winnings from games of chance obtained in casinos in other Member States to income tax and exempts similar income from that tax if it is obtained from casinos in its national territory.

Decision. The ECJ concluded that Italy's differing tax treatment of casino winnings discriminated against casinos located outside of Italy and could not be justified by reasons of public policy.

Case Questions

1. What was the decision of the ECJ with respect to the consistency of Italy's dual tax treatment for casino winnings with the principle of non-discrimination with respect to service providers?
2. What was the ECJ's decision with respect to Italy's justifications for the differing treatment of casino winnings?
3. Attitudes differ among the EU's member states with respect to social issues such as gambling. Nevertheless, the ECJ deprived Italy of a means by which to regulate gambling within its borders by striking down its tax treatment of proceeds. Is this an example of the EU improperly interfering with an area of economic activity that should be left to national governments? Why or why not?

The Free Movement of Capital

The *Treaty of Rome* prohibits all restrictions on the movement of capital between member states. This includes a prohibition on restrictions on payments. Thus, capital may be freely transferred in any amount between member states. All such transfers are deemed domestic payments and can only be subjected to domestic transfer costs if any. Credit and debit card charging and withdrawals from automated teller machines within member states are also deemed domestic transactions.

Efforts to integrate the free flow of capital are best exemplified by two events. The first was the creation of the **European Central Bank**. Located in Frankfurt, Germany, and founded in 1998, the European Central Bank's mission is to "promote price stability" and "to define and implement the monetary policy of the euro zone, conduct foreign exchange operations, issue notes, and promote the smooth operation of payment systems." The European Central Bank is effectively in charge of monetary policy relating to the euro, the common currency within the majority of the EU member states.

There is considerable historical precedent for the euro, including common currencies that were utilized in the Roman Empire, the Holy Roman Empire, the Hanseatic League, the "Latin Monetary Unit" used during the reign of Napoleon III, and the Scandinavian Monetary Unit used from 1872 to 1914. One of the EU's founders, Jean Monnet, advocated creation of a single European currency in the late 1940s. At the time of the creation of the European Coal and Steel Community, French economist Jacques Rueff stated, "Europe will become united through its money or not at all." However, despite these sentiments, early efforts at monetary union failed.

The euro resulted from the Delors Report drafted by a committee of appointed fiscal experts and released in April 1989. After years of legislative wrangling, the euro became fully effective in January 2002, when the national currencies of participating states were retired. They were replaced with 14.25 billion notes (\$577 billion in circulation) and 50 billion coins with \$15.4 billion in value.

Every state that wanted to utilize the euro was permitted to join the monetary union. However, a few states chose to retain their national currencies. Denmark opted out in 2001 and retained the kroner due to concerns about cuts to its health, pension, and education benefits. The United Kingdom opted out in

2003 because of high costs, slower economic growth in the EU, and national pride in the British pound. Sweden opted out in 2003 due to opposition to monetary centralization, faster economic growth, cultural differences, and high social spending. The states listed in Table 15.3 currently utilize the euro as their national currency and are part of the so-called Eurozone. The *Eurozone* encompasses more than 338 million people (66 percent of all people in the EU) and has a gross domestic product of \$14 trillion (more than 70 percent of the EU's gross domestic product). Other than Denmark and the United Kingdom, all other EU member states are required to eventually join the Eurozone.

The euro is revolutionary for many reasons. Monetary union has never been attempted on such a large scale—replacing so many successful currencies, serving millions of people and on a continent-wide basis.

Table 15.3 EUROZONE MEMBER STATES AS OF JANUARY 2017

STATE	DATE OF ADOPTION
Austria	January 1999
Belgium	January 1999
Cyprus	January 2008
Estonia	January 2011
Finland	January 1999
France	January 1999
Germany	January 1999
Greece	January 2001
Ireland	January 1999
Italy	January 1999
Latvia	January 2014
Lithuania	January 2015
Luxembourg	January 1999
Malta	January 2008
Netherlands	January 1999
Portugal	January 1999
Slovakia	January 2009
Slovenia	January 2007
Spain	January 1999



Several replaced currencies had long histories of successful use. For example, the Greek drachma was one of the world's oldest currencies, dating from the fifth century BC. The French franc was first minted in 1360, the Dutch guilder in the fourteenth century, and the Spanish peseta in 1497. The Italian lira was created in the sixteenth century and was used to pay Michelangelo and other Renaissance artists.

The euro was intended to create a currency to challenge the U.S. dollar as the world's preferred reserve currency and standard unit of exchange in international transactions. To its credit, the euro eliminates the cost of currency conversion, specifically, \$15 for every border crossing in Europe with an estimated annual cost of \$10 billion. It also serves to integrate markets, makes comparison shopping easier, leads to price convergence throughout Europe, and eliminates exchange rate risk. However, the viability of the euro was seriously tested in the financial crisis that swept through the EU in wake of the 2008 global recession. The financial crisis and the future of the euro will be discussed later in this chapter.

The Free Movement of People

The final freedom is the free movement of people. All EU residents have the right to travel, live, study, and work in another member state without being subject to nationality-based discrimination. Workers traveling within the EU are to be free from nationality-based discrimination with respect to employment, pay, and all other conditions of work. This freedom entails the rights to accept employment offers in other member states, travel to other member states to engage in such employment, and stay in another member state while performing such employment. This freedom of movement extends to close family members even if they are not citizens of an EU member state. Workers may remain in another member state after completing such employment if they choose to do so. The following case of *Torresi v. Consiglio dell'Ordine degli Avvocati di Macerata* demonstrates the principle of free movement of people in the context of the practice of law.



Torresi v. Consiglio dell'Ordine degli Avvocati di Macerata

C-58/13, C-59/13 [2014] European Court of Justice

BACKGROUND AND FACTS

Two Italian nationals obtained university law degrees in Italy and Spain from Italian and Spanish institutions. Both nationals subsequently registered as attorneys in the Bar of Santa Cruz de Tenerife in Spain. Three months later, they submitted applications to register in the "special section" of the Bar Council of Macerata in Italy. Registration in the special section covers individuals who hold the title of "attorney" issued in a member state other than Italy but who are otherwise established in Italy. The sole requirement for registration in the special section was presentation of a certificate attesting to registration with competent authorities in the individual's home state, in this case, Spain.

The Bar Council of Macerata failed to act on the applications. The Italian nationals subsequently brought an action before the National Bar Council of Italy seeking a determination of their registration applications. The National Bar Council was of the opinion that the applicants registered in Spain in order to circumvent Italian law governing access to the legal profession. The National Bar Council requested that the European Court of Justice address the issue of whether Italy could refuse registration of its nationals who, after obtaining a university degree in Italy, traveled to Spain to acquire the professional qualification of "attorney"

and subsequently returned to Italy with the purpose of practicing law under the title obtained in Spain. At issue was the interpretation of Directive 98/5/EC which was intended to facilitate the free movement of people by making attorney registration requirements uniform across the EU.

FINDINGS OF THE COURT

Article 1(1) of Directive 98/5 provides that the purpose of the directive is to facilitate practice of the profession of lawyer on a permanent basis in a self-employed or salaried capacity in a Member State other than that in which the professional qualification was obtained.

The first paragraph of Article 2 of Directive 98/5, that article being headed 'Right to practise under the home-country professional title', provides: "Any lawyer shall be entitled to pursue on a permanent basis, in any other Member State under his home-country professional title, the activities specified in Article 5."

Article 3(1) and (2) of that directive, that article being headed 'Registration with the competent authority', provide:

1. A lawyer who wishes to practise in a Member State other than that in which he obtained his professional qualification shall register with the competent authority in that State.

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2. The competent authority in the host Member State shall register the lawyer upon presentation of a certificate attesting to his registration with the competent authority in the home Member State. It may require that, when presented by the competent authority of the home Member State, the certificate be not more than three months old. It shall inform the competent authority in the home Member State of the registration.

By its first question, the referring court seeks in essence to ascertain whether Article 3 of Directive 98/5 must be interpreted as precluding the competent authorities of a Member State from refusing, on the ground of a claimed abuse of rights, registration in the register of lawyers qualified abroad to nationals of that Member State who, after obtaining a university degree in that Member State, have travelled to another Member State in order to acquire there the professional qualification of lawyer and have subsequently returned to the former Member State with a view to practising there the profession of lawyer under the professional title obtained in the Member State where the professional qualification was obtained.

It must be recalled at the outset that, under Article 1(1) of Directive 98/5, the purpose of that directive is to facilitate the practice of the profession of lawyer on a permanent basis in a Member State other than that in which the professional qualification was obtained.

Further, as is clear from ... Directive 98/5, the EU legislature sought to put an end to the differences in national rules on the conditions for registration with the competent authorities, which gave rise to inequalities and obstacles to freedom of movement.

In that context, Article 3 of Directive 98/5 undertakes a complete harmonisation of the preliminary conditions required for the exercise of the right of establishment conferred by that directive, providing that a lawyer who wishes to practise in a Member State other than that in which he obtained his professional qualification is obliged to register with the competent authority in that Member State, which must effect that registration 'upon presentation of a certificate attesting to his registration with the competent authority of the home Member State.'

In that regard, the Court has previously ruled that the presentation to the competent authority of the host Member State of a certificate attesting to registration with the competent authority of the home Member State is the only condition to which registration of the person concerned in the host Member State may be subject, enabling him to practise in the latter Member State under his home-country professional title.

Consequently, it must be stated that nationals of a Member State, such as the applicants in the main

proceedings, who present to the competent authority of that Member State a certificate attesting to their registration with the competent authority of another Member State, must, in principle, be regarded as satisfying all the conditions required for their registration, under their professional titles obtained in the latter Member State, in the former Member State's register of lawyers qualified abroad.

However, in the view of the referring court, it was not open to the applicants in the main proceedings, in this case, to rely on Article 3 of Directive 98/5, since the acquisition of the professional qualification of lawyer in a Member State other than the Italian Republic had, it is argued, no other purpose than to evade the application of the law of the Italian Republic governing access to the profession of lawyer and thereby constituted an abuse of the right of establishment, contrary to the objectives of that directive.

In that regard, it must be recalled that, in accordance with settled case-law of the Court, EU law cannot be relied on for abusive or fraudulent ends ... In particular, with regard to combating abuse of freedom of establishment, a Member State is entitled to take measures designed to prevent certain of its nationals from attempting, under cover of the rights created by the FEU Treaty, improperly to circumvent the rules of their national legislation.

A finding of abuse requires a combination of objective and subjective elements. With regard to the objective element, it must be apparent from a combination of objective circumstances that, despite formal observance of the conditions laid down by EU rules, the purpose of those rules has not been achieved. As regards the subjective element, it must be apparent that there is an intention to obtain an improper advantage from the EU rules by artificially creating the conditions laid down for obtaining it.

[T]he purpose of Directive 98/5 is to facilitate the practice of the profession of lawyer on a permanent basis in a Member State other than that in which the professional qualification was obtained. In that regard, it must be held that the right of nationals of a Member State to choose, on the one hand, the Member State in which they wish to acquire their professional qualifications and, on the other, the Member State in which they intend to practise their profession is inherent in the exercise, in a single market, of the fundamental freedoms guaranteed by the Treaties.

Accordingly, the fact that a national of a Member State who has obtained a university degree in that State travels to another Member State, in order to acquire there the professional qualification of lawyer, and subsequently returns to the Member State of which he is a national in order to practise the profession of lawyer under the professional title obtained in the Member State where that qualification was acquired, constitutes one of the possible situations where the objective

continues



continued

of Directive 98/5 is achieved and cannot constitute, in itself, an abuse of the right of establishment stemming from Article 3 of Directive 98/5.

On those grounds, the Court (Grand Chamber) hereby rules:

Article 3 of Directive 98/5/EC of the European Parliament and of the Council of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained must be interpreted as meaning that no abuse can be identified in the fact that a national of a Member State who after successfully obtaining a university degree travels to another Member State in order to acquire there the professional qualification of lawyer and returns to the Member State of which he is a national in order to practise there the profession of lawyer under the professional title obtained in the Member State where that professional qualification was acquired.

Decision. The Court held that Directive 98/5/EC must be interpreted as meaning that no abuse was present as a result of a national of a member state obtaining a university degree, traveling to another member state in order to acquire the professional qualification of a lawyer, and then returning to his or her home state in order to practice law.

Case Questions

1. What was the ECJ's holding with respect to Italy's claims regarding interpretation of Directive 98/5/EC and purported abuse of the registration process?
2. What facts would demonstrate abuse in this case sufficient to invalidate the attorneys' efforts to register in Italy? Did the Court give sufficient weight to the concern about the possibility of evasion of Italy's licensing requirements? Should consumer protection concerns outweigh the need for harmonization of rules relating to attorney registration? Why or why not?

The right to free movement of people is subject to limitations on the grounds of public policy, security, and health, and they do not apply to public employment. Additionally, EU citizens must not become an undue burden on their country of residence. Citizens of member states may reside in another member state for up to three months without being subject to any condition or formalities other than the requirement to hold a valid passport or identity card. After three months, such persons may be required to register with local government authorities. After five years, the right to residence is permanent without any preconditions.

Free movement of people has also resulted in the removal of border controls when traveling by land between 22 of the member states. Border controls remain in place in 6 states and, of course, for travelers entering from outside of the EU. Additionally, several states, including Austria, Denmark, France, Germany, Poland, and Sweden, reimposed border controls in response to the migrant crisis of 2016.

OTHER AREAS OF INTEGRATION: SOME EXAMPLES

It is important to note that the EU's efforts at harmonization and the removal of barriers to free movement of goods, services, capital, and people are comprehensive.

These efforts cut across a wide range of industrial sectors, and they affect every business operating in the EU. Individuals residing in member states are also significantly affected by the EU's efforts at harmonization and removal of barriers—from the products they consume to the energy that they use and the environment in which they live. This next section summarizes developments in some of these areas with respect to industry and individuals.

The Common Agricultural Policy

The EU is committed to the establishment of a **common agricultural policy (CAP)**. First implemented in 1962, the CAP has been central to the EU's mission ever since. Its goals, which are set forth in Article 39 of the *Treaty of Rome*, are as follows:

1. To increase agricultural productivity
2. To ensure a fair standard of living for the agricultural community
3. To stabilize markets
4. To guarantee regular supplies
5. To ensure reasonable prices to consumers

The EU has implemented these objectives through the CAP, which ensures minimum prices to farmers, imposes import tariff barriers and quotas on agricultural products from nonmember states, and pays subsidies to farmers for cultivated land. The CAP effectively



maintains European agricultural firms that otherwise would not be able to withstand competition from lower-cost producers from outside the EU and increases the cost of agricultural products. This does provide the EU with some ability to feed itself in the event of hostilities. However, there is a difference of view between those who benefit from these policies and those who pay for them as to how much protection the EU should provide.

The CAP has been divisive within the EU for many reasons. First, the CAP is extremely expensive. The CAP has traditionally been the largest single item of EU expenditure and accounts for more than 30 percent of the EU's total budget (down from 48 percent in 2006 and 71 percent in 1984). The CAP also involves considerable administrative expenses, which have been subject to allegations of mismanagement and fraud. It has been contended that the primary beneficiaries of the program are not small family farms but rather large producers and agribusinesses that have reaped considerable financial windfalls. Program costs and administrative expenses have been passed on the consumers in the form of artificially high food prices. The CAP is alleged to have contributed to overproduction of certain products (such as cereals, dairy, and alcohol). The production encouraged by the CAP has been criticized as damaging to the environment and contributing to unhealthy diets within the EU. The CAP has also contributed to inequities within the EU as member states with larger agricultural sectors, such as Portugal, Spain, and France (the largest recipient of CAP funds), receive large amounts of money at the expense of states with smaller agricultural sectors. Finally, the CAP has limited the ability of lesser developed states to increase their earnings through agricultural exports to the EU. The EU has attempted to address some of these concerns in recent years and will continue to do so in the future. It is expected that the revisions to the CAP will focus on decreasing direct payments and ensuring viable food production and sustainable use of natural resources and promoting balanced territorial development within the EU.

Consumer Protection

Consumer protection is an important aspect of EU legislation in all relevant policy areas. As the free movement of goods and services as well as the common currency have opened borders and use of the Internet and electronic commerce have expanded, the need for adequate consumer protection has increased.

The EU has adopted numerous measures to safeguard consumer interests with respect to fair business practices, misleading and comparative advertising, labeling, and a host of products including toys, electrical appliances, cosmetics, pharmaceutical products, and machinery. There are also rules that set safety standards across the EU for numerous consumer products including sports equipment, childcare articles, gas appliances, textiles, and household furniture. In December 2007, the EU adopted rules for strengthening the ban on misleading advertising and prohibiting coercive and harassing sales practices. Efforts to strengthen EU-wide rules relating to online business practices and consumer credit and other noncash means of payment are ongoing.

A more recent example of consumer protection measures may be found in Directive 2014/40 relating to the manufacture, promotion, and sale of tobacco products. This directive prohibits the marketing of cigarettes containing menthol that makes tobacco products more attractive to consumers due to its pleasant flavor. The directive also prohibits the inclusion of any element or feature on packets or outside packaging that promotes or encourages tobacco consumption. Packets and packaging must carry health warnings taking the form of a message and color photograph covering 65 percent of the front and back surfaces. Finally, the directive regulates the manufacture, distribution, and marketing of electronic cigarettes. The restrictions contained within the directive were upheld by the ECJ in 2016 in three separate cases encaptioned *Poland v. Parliament and Council, Pillbox 38(UK) v. Secretary of State for Health*, and *Philip Morris Brands SARL v. Secretary of State for Health*.

Energy and the Environment

EU energy policy is based on a number of concerns. There is a recognized need to develop alternative sources of energy in order to lessen dependence on foreign sources of energy, which currently exceeds 50 percent. The reduction of dependence on foreign sources of energy also requires increasing energy efficiency. The EU has undertaken numerous efforts to increase energy efficiency at the macroeconomic level as well as informing consumers of the energy usage of household items. Consumer products sold in the EU now carry energy efficiency ratings and consumption statistics. In July 2007, EU households were free to pick gas and electricity suppliers of their choice and were no longer required to bundle such services through one supplier.



EU environmental legislation is far too comprehensive and detailed for adequate discussion here. Current EU environmental practices are driven by the Environmental Action Program (EAP) that entered into force in January 2014. The EAP has three key objectives, specifically, the protection, conservation, and enhancement of natural capital; the creation of a resource-efficient, green and competitive low-carbon economy; and the safeguarding of EU populations from health risks associated with environmental degradation. Aspects of this plan include approval and enforcement of comprehensive emissions standards for greenhouse gases, increasing the market share of renewable energy sources, and reducing energy consumption.

The Business Implications of the European Union

The main object of the EU is to make it easier to do business within Europe. The elimination of intra-EU tariffs means that, once a product enters the EU, an enterprise need not concern itself further with customs duties. Harmonization of laws and standardization of equipment means that companies can manufacture the same product for the entire European market, creating significant economies of scale and streamlining regulatory compliance costs. Companies can centralize or regionalize corporate offices and distribution centers rather than have a separate office for each country. Firms must still comply with separate national laws, particularly those that regulate health and advertising. However, because such laws must increasingly comply with EU directives, they are less of a hindrance to intermember state commerce. The EU seems relentless in its efforts to impose its economic will on the member states.

These commercial unification developments particularly benefit competitive European businesses that have a larger duty-free market. They harm marginal European businesses that owe their survival to trade barriers against competition from other member states. Economic theory suggests that ultimately, as more efficient and qualified firms vanquish corporate deadwood, the majority of Europeans will benefit. These developments also benefit competitive firms from non-EU countries. While non-EU concerns must still confront the hurdle of EU tariffs and quotas, once they surmount that barrier, the customs union gives them the same advantages as entities in member states. The dynamic of free internal trade was largely responsible for the

economic success of the United States and has had a similar, if less dramatic, effect within the EU.

The EU's treaty-making powers also have a direct effect on businesses from nonmember states. Article 133 of the *Treaty of Rome* gives the EU the exclusive power to conclude trade and tariff agreements with other nations, a necessary precondition to a customs union. Thus, if the EU decides that it needs to protect a particular European industry from nonmember state competition, nonmember state firms will be directly and adversely affected by EU action. In 2014, it was the EU, and not any single member state, that concluded the so-called Canada–EU Comprehensive Economic and Trade Agreement that will eliminate 98 percent of tariffs on goods traded between the two entities. In recent years, the EU negotiated with the United States and litigated against it in the WTO with respect to bananas, commercial aircraft, beef hormones, information technology products, competitive practices, and privacy. The businessperson from a nonmember state must recognize that in modern Europe, the commercial side of foreign policy is largely in the hands of the EU.

THE EUROPEAN ECONOMIC INTEGRATION MODEL AND THE FINANCIAL CRISIS

The financial crisis that continues to confront the EU is complex, multifaceted, and beyond detailed discussion in this book. The following section discusses some aspects of the crisis, the EU's response, and the future of the euro. Predictions regarding the ultimate outcome of the crisis are uncertain. Undoubtedly, circumstances will change over time, and readers will need to update themselves as events warrant.

Causes of the Financial Crisis

The financial crisis in the EU was the result of a convergence of many different factors, including the liberal extension of credit, high-risk lending practices, the global recession starting in 2008, and the collapse of real estate markets in some Eurozone states. There were other factors as well that undoubtedly contributed to the crisis, including unsustainable levels of sovereign debt in some Eurozone states, the inability or lack of willingness to address financial problems within these states, and an



underestimation of the magnitude of the crisis which in turn delayed an effective coordinated response.

The EU itself is also to blame. As previously discussed, the EU created a continental currency without also creating a strong central financial authority. The European Central Bank is significantly limited in its powers with respect to the national budgets and financial affairs of the Eurozone members. The EU was and remains hampered in responding to the crisis due to the absence of full integration of European banking and fiscal management and the continuing responsibility for national budgetary policy at the member state level.

The causes, impacts, and responses to the financial crisis varied widely within the Eurozone members. The bursting of the residential real estate bubble followed by a massive government bailout of negatively impacted banks helped fuel the crisis in Spain. These factors also played a significant role in the crisis as it developed in Ireland. Excessive government debt has been a hallmark of the crisis in Greece and contributed to the worsening of the crisis in Portugal. The collapse of the Greek economy had a significant impact on neighboring Cyprus. It is clear that no member of the Eurozone is immune—the crisis proved contagious and spread to other member states such as Hungary, Latvia, Italy, and Romania.

The EU's Response to the Financial Crisis

It can be concluded from this discussion that there is no one cause of the financial issues currently plaguing the Eurozone and thus no one solution. The EU's response to the financial crisis has been as complex and multifaceted as the crisis itself. EU-sponsored bailouts have proven controversial not only to wealthier member states (such as Germany) that have been asked to assist their poorer neighbors but also in recipient states that have been required to endure significant austerity measures as a condition to receiving assistance. A side effect of these measures was in some cases to deepen the recession with negative economic impacts. For example, Greece's gross domestic product declined by almost 7 percent in 2011, industrial output was more than 28 percent lower than it had been at the height of Greek prosperity in 2005, and unemployment skyrocketed to more than 26 percent by the end of 2012. Self-imposed austerity measures such as were adopted by Spain in 2011 also deepened the recession and contributed to an unemployment rate exceeding 24 percent by the end

of 2012. As in Greece, public frustration boiled over in massive street demonstrations.

Even now, several years later, some member state economies are far from completely recovered. For example, the most recent economic data place the Greek unemployment rate at more than 23 percent, an amount that is more than double the average Eurozone rate. In May 2016, the International Monetary Fund predicted that the Greek unemployment rate would eventually decline to 12 percent by 2040. Spain made progress in reducing its unemployment rate to slightly under 20 percent by the end of 2016, but more than 45 percent of young people remain unemployed. For better or worse, the fates of the strongest and weakest economies within the Eurozone are inextricably linked to one another.

There are two additional responses worthy of separate mention. In September 2012, the Eurozone states launched the European Stability Mechanism (ESM). The ESM is a permanent funding program for the rescue of states experiencing a financial crisis. The ESM is designed to prevent financial contagion within the Eurozone by containing such crises within the borders of an affected state. The containment of such crises is to occur through guarantees of all or a portion of the debts of an affected state.

A second notable response is the creation of the European Fiscal Compact (EFC). The EFC became effective on January 1, 2013 after its ratification by 12 of the 17 Eurozone members. As of the date of preparation of this text, only three member states, Croatia, the Czech Republic, and the United Kingdom, have failed to ratify the EFC. The EFC requires that ratifying states adopt laws within one year of ratification requiring their national budgets be in balance or in a surplus. The EFC defines the term *balanced budget* to mean a general budget deficit of less than 3 percent of gross domestic product. Structural deficits of no more than 1 percent of gross domestic product are also permissible. States not in compliance with these limitations are required to correct the issue within designated timeframes. Ratifying states that were not in compliance at the time that the EFC entered force and effect were provided with state-specific "adjustment paths" for eventually achieving compliance. States failing to implement the EFC may be subject to a compliance action brought in the European Court of Justice at the request of another ratifying state. The EFC also provides for financial penalties for failure to adequately implement its provisions.



The Future of the Euro

The future of the euro in light of the financial crisis remains difficult to predict. Some commentators have suggested that one or more of the most significantly affected states voluntarily leave the Eurozone and return to their former national currencies. This proposal could prove disastrous for creditors, exiting states, and their citizens alike. The political and reputational damage to the EU, should such withdrawals occur, is equally serious and would be difficult, if not impossible, to calculate. Other commentators have discussed the possibility of withdrawal from the Eurozone by economically healthy states (primarily Germany) thereby preserving German fiscal strength, which could in turn be utilized to provide an economic boost to the EU through reintroduction of the deutsche mark. All of these options seem unlikely given the repeated commitments to the euro expressed by national leaders within the Eurozone member states and by representatives of the European Central Bank and the enormous efforts and funds that have been committed to preserving the euro and the Eurozone.

It is much more likely that the efforts to forge closer economic ties among the peoples of Europe as expressed most forcefully in the euro will continue for the foreseeable future. Eurozone members will undoubtedly monitor the EFC to determine its effectiveness as well as proceed with full establishment of the ESM to address future financial problems. It is unlikely that the current crisis

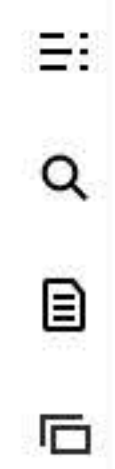
will result in the creation of an EU treasury department empowered to make financial decisions at the regional, national, and continental levels. However, greater integration of the banking and financial sectors and budgetary processes may emerge as a result of the crisis.

CONCLUSION

The development of integrated trade areas reflects an increasing recognition of the accepted economic principle that free trade maximizes benefits to the whole by allowing each country to specialize in its areas of relative competitive advantage. The United States is a successful model of such an effort. Until recently, the EU was also demonstrating the advantages of economic integration. The current challenges facing the EU have severely tested its ability to maintain its current structure let alone move forward with its vision of greater integration and harmonization. As was also discussed in the previous chapter relating to NAFTA, in every context where free trade has been allowed to proceed, the overall economic fortunes of the affected populations have improved. The message is unmistakable: Free trade—or at least enhanced economic cooperation—is the most prosperous path forward. However, it bears noting that this message will undoubtedly be tested and contested in the years to come.

Chapter Summary

1. The European Union (EU) started as a concept that represented three “communities,” each created and operating under a separate treaty: the European Community, formerly known as the European Economic Community; the European Coal and Steel Community; and the European Atomic Energy Community. Today, the EU is a fully integrated single entity.
2. The EU consists of numerous institutions. These institutions include the Council of Ministers of the European Union, the European Council, the Commission, and the Parliament. Broadly speaking, these institutions are responsible for proposing and adopting legislation, enforcing such legislation and the EU treaties against encroachment, attempting to further harmonize national legal and regulatory regimes within the individual member states, and representing the EU to the rest of the world.
3. The Court of Justice and the General Court hold the judicial power of the European Union. The Court of Justice is comprised of one judge from each member state. The judges are appointed by the member states for a renewable term of six years. In cases involving private parties, it generally hears appeals of judgments from the General Court, which is the trial court of the EU.
4. Substantive law in the EU consists of many different types of legislation. Regulations have general application and are binding on the member states without further action. Directives are binding as to the result to be achieved but leave to each member state the means by which they are to be implemented.



Decisions are binding on the parties to whom they are addressed. Recommendations are nonbinding statements of policy.

5. The hallmark of EU regulation is the free movement of goods, services, capital, and people, the so-called

Four Freedoms. Measures by member states that place limitations on these freedoms or directly or indirectly discriminate on the basis of national origin are not tolerated and may be subject to nullification by the ECJ.

Key Terms

European Union 398	EU regulation 407	Four Freedoms 408
qualified majority voting 399	EU directive 407	common agricultural policy (CAP) 417
acquis communautaire 402		

Questions and Case Problems

1. Rewe, a limited liability company with an office in Germany, imported goods from the EU countries. In 1976, Rewe applied to a German agency for permission to import Cassis de Dijon. The agency responded that spirits needed to contain 32 percent alcohol to be marketed in Germany. (The only exception to this rule was beer.) Cassis had only 15–20 percent spirit content, so it could not be imported. The German court referred the case to the ECJ to deal with conflicts between German law and Articles 30 and 37 of the *Treaty of Rome*. The German government argued that it was trying to protect public health and consumers. How did the court rule? Why? Did this settle the issue for the future? See *Rewe-Zentral [Cassis de Dijon]*, C-120/78 [1979].
2. Italy required chocolate products manufactured in other member states that contained vegetable fats other than cocoa butter to be sold in Italy as “chocolate substitutes.” The Commission claimed that Italy had failed to fulfill its obligation under Article 30 of the EC treaty and *Council Directive 73/241/EEC* of July 24, 1973, which permitted the use of vegetable fats other than cocoa butter in chocolate products. The Commission stated that chocolate containing vegetable fats other than cocoa butter up to a maximum of 5 percent of the total weight of the product is manufactured under the name “chocolate” in six member states (Denmark, Ireland, Portugal, Sweden, Finland, and the United Kingdom) and that it is accepted under that name in all member states with the exception of Spain and Italy. The Commission considered that it was not possible to claim that the addition of vegetable fats other than cocoa butter to a chocolate product that contains the minimum contents required under *Directive 73/241* substantially changed the nature of the product to the point where the use of the name “chocolate” would create confusion as regards its basic characteristics. However, the Italian government refused to change its interpretation of the Directive or the Italian law. What should be the ECJ’s holding in this case? Based upon its decision, are the member states required to harmonize their product descriptions regardless of differences between their populations? Why or why not? See *Commission of the European Communities v. Italian Republic*, 14/00 [2003].
3. *Deutsche Parkinson Vereinigung (DPV)* is a German organization devoted to improving the lives of those afflicted with Parkinson’s disease. DPV entered into a relationship with DocMorris, a mail order pharmacy located in the Netherlands, whereby DPV members could benefit from the purchase of DocMorris prescription-only medications for treating Parkinson’s disease. Mail order sales of prescription-only medications are legal in Germany. A German association for protection against unfair competition viewed the arrangement as a violation of Germany’s fixed-price system for the supply of prescription-only medications by pharmacies. The German system requires each manufacturer to establish a price for its medications to which wholesalers and pharmacies add additional charges. The Regional Court for Düsseldorf found a violation of the fixed-price system and ordered DPV to refrain from promoting its relationship with DocMorris to its members. On appeal, the Higher Regional Court of Düsseldorf referred the issue of whether Germany’s fixed-price system was compatible with the free movement of goods to the ECJ. How should the ECJ rule in this case? How should the court address Germany’s claim that its system was essential to the protection of human health and life? See *Deutsche Parkinson Vereinigung v. Zentrale zur Bekämpfung unlauteren Wettbewerbs*, C-148/15 [2016].



4. What is the present status of Brexit? What effect has Brexit had on the United Kingdom and the EU? Are there other member states considering departing from the EU? What states and what reasons have been given for taking such action?
5. Following the discovery of a probable link between a variant of Creutzfeldt–Jakob disease, a disease affecting human beings, and bovine spongiform encephalopathy (BSE), which was widespread in the United Kingdom in the mid-1990s, the Commission adopted *Decision 96/239/EC* of 27 March 1996, which contained emergency measures to protect against BSE. This decision prohibited the United Kingdom from exporting certain products, in particular live bovine animals, meat of bovine animals, and products obtained from bovine animals, from its territory to the other member states and third countries. In 1998, the ban was lifted but not all countries felt comfortable about British meat exports. France continued to refuse to accept meat imported from the United Kingdom on the grounds of public safety. The case was heard by the ECJ. What should be the ECJ's holding in this case? May member states prevent the importation of products they believe are harmful to the health of their citizens in disregard of EU policies? Why or why not? See *National Farmers' Union v. Secrétariat Général du Gouvernement*, C-241/01 [2002].
6. The EU sought a declaration that, because of the way in which long-standing Italian law permitted extrajudicial debt recovery by creditors against entities established in other member states, Italy had failed to fulfill its treaty obligations. The EU had not passed directly applicable legislation in the area of extrajudicial debt recovery.

Italian law provided that, in order to recover debts extrajudicially, a creditor needed to obtain a license from the *Questore* (the local police authority). This license permitted action only in the Italian province where it was issued. Further, the *Questore* could place such conditions on the grant of a license as it thought appropriate. The license holder needed to display a list of all services provided and their cost on its business premises so that the *Questore* could confirm that prices for the services did not vary significantly. Further, license holders could not provide banking or credit services. Only banks and financial institutions listed with the ministry of the treasury could provide these services. The Commission brought an action against Italy, as it considered these requirements to be in restraint of commerce among the member states. The Commission asked the Court of Justice to clarify the degree of discretion that member states retain vis-à-vis the European Commission in intermember state economic matters. Are Italy's licensing requirements an interference with the free movement of services? What impediments do they pose to such free movement? How should the ECJ decide this case? See *Commission of the European Communities v. Italian Republic*, C-134/05 [2006].

7. How do a directive, a regulation, and a recommendation differ? Why would the EU choose one over the other? Give examples. What impact does this decision have on businesses?
8. The financial crisis in the Eurozone has led to considerable debate about the future of not only the euro but also the EU. What is your prediction regarding the future of the euro? What is your prediction regarding the future of the EU?

Managerial Implications

1. Your company has an office in Spain. You have hired a worker, Ms. Jimenez, for a float term and have renewed her contract twice. Shortly after renewing it for the second time, you discover that she will be giving birth within three months. You send her a notice stating that she is terminated effective in one month (which is two months before her due date). You believe that since she was only on a limited-term contract she cannot expect to be treated like a more permanent employee and given all maternity benefits. Are there any legal concerns here? What impact might this decision have on the advancement of women in employment? How will this affect your hiring practices?
2. Your company is expanding into Europe. You must pick a location for your office and have two locations to consider.
 - a. How will you make this decision?
 - b. Will whether the country has adopted the euro have an impact on your decision?
 - c. Would you be discouraged from locating to a country that has had a poor record of implementing EU directives?
 - d. Would you consider locating an office in one of the countries that plans to join but has not done so yet?
3. Labco is a small manufacturing company that wants to do more exporting to the EU. It discovers that the Commission is considering a directive that might limit its ability to do business in those countries.
 - a. What can it do? The president of the company has asked you to research this matter and outline a plan of action.
 - b. What difference does it make if Labco is a very large, publicly traded corporation?
 - c. What are your options if the EU implements a directive or regulation that you believe discriminates against you as a foreign business?



4. Imagine that you are a student intern and will be spending this semester on assignment to the vice president of international sales at a toy firm. Up until now, the firm's primary markets have been in the United States and Canada. The toys are designed in the United States and manufactured by vendor firms in China. At a meeting with the vice president's design and marketing staff, he asks about opening new markets in Europe. He explains that in the United States, the design and sale of children's toys are highly regulated by the U.S. Consumer Products Safety Commission. Indeed, some other companies have had their toys removed from store shelves for noncompliance with federal regulations. He feels there must be some consumer safety regulations in effect in Europe that will act as a barrier to his firm's access to European markets. After all, if the regulations are very different from those in the United States, it may be costly to redesign the toys to comply with European standards. After the meeting, the vice president asks you to find answers to the following questions:
- a. Are there any standards or technical regulations in effect in Europe that govern the sale of toys? Where can he locate the regulations on the design, manufacture, and marketing of children's toys in Europe? Can you give a specific Web address so that he can look at them himself?
 - b. Do the toys have to meet different requirements in every European country, or is there a single standard that covers all of Europe?
 - c. To which toys do the standards apply, and what toys, if any, are exempt?
 - d. What are the design and manufacturing standards for toys covered by the regulations, and what is the standard for safety? Are there any specific provisions covering the toys' physical or mechanical properties?
 - e. Do the toys have to be tested in advance for compliance with safety regulations?
 - f. What are the toy labeling requirements? Is there a certain label or mark that will let consumers know that the toy has been tested for safety?

Ethical Considerations

Despite its relative success in building a common market for European goods, services, and capital, the EU faces many difficult challenges in the coming years. Concerns include the growing bureaucracy necessary to govern the EU, increasing cultural and social diversity, and the accession of national interests over greater integration as most vividly demonstrated by Brexit. The EU also faces serious economic challenges. The financial meltdown in some member states and its effect across the continent is only one of many challenges confronting the EU.

These concerns also raise the issue of the extent to which the interests of citizens of member states are best served by the present state of integration and possible closer integration in the future. Citizens of wealthier states have justifiable concerns about subsidizing poorer states and the fact that these wealthier states receive less money from the EU than they contribute. Smaller states worry that they will be overpowered in the EU's institutions by larger, more populous states. Less developed states may also be concerned about dominance of important areas such as media and technological innovation by more developed states such as France, Germany, and Italy. States with liberal social policies may be concerned that such policies will come under attack by states with more conservative social views. Conversely, more conservative states may be concerned that socially liberal policies will be imposed on them.

Citizens of all member states worry about the surrender of sovereignty to "Eurocrats" in Brussels and resultant loss of concern about local issues. In particular, the EU has been criticized in the past for a "democratic deficit." This deficit arises from the fact that the EU's institutions (other than the Parliament)

are not directly elected by European citizens. Furthermore, the operations of these institutions are so complex as to be inaccessible to ordinary citizens. The *Treaty of Lisbon* was, in part, an effort to address these concerns primarily through the expansion of the role of the Parliament in the EU's governance structure. It also provided dissatisfied member states with an escape hatch by which to leave the EU. The vote in favor of Brexit in June 2016 served as a wake-up call to factions advocating withdrawal in other member states as well as to EU advocates who have come to realize the fragility of the institutions that have been painstakingly constructed in the past seven decades.

Utilitarianism focuses on whether a given action adds to the overall utility of the community. Ethical conduct is that which is likely to produce the greatest overall good not just for the decider but for all persons who will be affected by the decision. Based on the above-referenced concerns, is the current state of integration in Europe consistent with principles of utilitarianism? Is greater integration, which may occur in the future, consistent with the greatest overall good of European citizens? Is the success of greater economic integration an adequate measure of the utilitarian nature of the EU? Who should determine the course of future integration in the EU—its citizens or its institutions? What local concerns and individual well-being of European citizens are sacrificed as a result of the current state of integration? What local concerns and individual well-being of European citizens will be sacrificed as a result of greater future integration? Are such individual and national sacrifices worth the price of greater European prosperity and global influence? Why or why not?