TOWARD DEEPER NORTH AMERICAN INTEGRATION: A CUSTOMS UNION?[1]

AXEL HUELSEMEYER

I. INTRODUCTION

In the last few years, a public as well as an academic debate has surfaced primarily, but by no means exclusively in Canada, about the desirability of deeper North American integration. A number of officials, among them former Finance Minister John Manley (Beauchesne, 2003), former International Trade Minister Pierre Pettigrew (Pettigrew, 2003), President and CE Thomas D'Aquino of the Canadian Council of Chief Executives (D'Aquino, 2003), and Bank of Canada Governor David Dodge (Dodge, 2003), have publicly spoken in favor of deeper North American integration. In addition, the House of Commons Standing Committee on Foreign Affairs and International Trade in December, 2002 (Canada, 2002), as well as its equivalent in the Senate six months later (Canada, 2003), produced comprehensive reports on both the current state and the

*A list of acronyms used in this article is provided on page 30.

prospects of Canada's relations within NAFTA. Mexican President Vicente Fox issued the boldest proposal soon after his inauguration in the summer of 2000, calling for the establishment of a North American Common Market (Pastor, 2002: 92). In the United States, deeper NAFTA integration has so far not achieved any noticeable public interest.

The recent attention the topic receives among Canadian public and private decision makers is fueled largely by arguments and counter-arguments advanced by Canadian and American scholars through academic think tanks, particularly the C. D. Howe Institute.[2] Much of the literature deals with the desirability and feasibility of a North American Monetary Union (NAMU); less consideration has so far been devoted to a North American Customs Union (NACU), let alone to a Common Market.[3]

This debate takes place simultaneous to, but is often seen as separate from, efforts to establish a Free Trade Area of the Americas (FTAA). Contrary to the extant literature (*e.g.*, Dobson, 2002: 7; Hufbauer and Schott, 2004: 7), I hold that the two projects are closely interrelated. The reason is that the hemispheric project is the first instance in which four pre-existing integration schemes (NAFTA; Mercosur; the Andean Community; and CARICOM)[4] would effectively be merged rather than geographically widening and institutionally deepening the same agreement over time (as in European

Axel Huelsemeyer teaches political science at Concordia University, Montreal. He has published Globalization and Institutional Adjustment: Federalism as an Obstacle? *(UK, 2004);* Introduction to International Relations: A Reader *(with Julian Schofield: Boston, 2004); "Die (In) signifikanz der Krak-Krise: Gedanken zu Thomas Risses Beitrag [the Insignificance of the Iraq Crisis: Thoughts on the Contribution by Thomas Risse],* WeltTrends *40: 36-9 (2003); "Changing 'Political Economies of Scale' and Public Sector Adjustment: Insights from Fiscal Federalism,"* Review of International Political Economy 7 *(1): 72-100 (2000); "Subnational Units go International: Anmerkungen zu einem Forschungfeld" ["Subnational units Go International: Remarks on a Field of Study"]* WeltTrends *11: 167-75 (1996); "The Political Economy of Canada's Relations with the European Union," in Patrick James and Marc O'Reilly (eds.),* Canadian Foreign Policy: A Reader *(forthcoming), and is editor of* Globalization in the Twenty-First Century: Convergence or Divergence? *(UK, 2003). E-mail: huelse67@hotmail.com*

integration). I suggest that this fact has to date been grossly underestimated in the United States where the conception of the FTAA is a NAFTA writ large, although the three "preferential trading arrangements" (PTAs) (Mansfield and Milner, 1999) in the south are customs unions, *i.e.* they already exhibit a deeper level of integration than the NAFTA.[5] Consequently, the concrete form of deeper NAFTA integration, including its potential absence, has a profound influence on whether or not and, if so, with what institutional structure the FTAA is likely to materialize.[6] Put differently, *if* a NACU were negotiated, it would make hemispheric integration more easily attainable because of greater institutional compatibility with the three PTAs in the south.

I will argue in this paper that the Canadian debate needs to concentrate on customs union proposals if it is to have any practical relevance; a limited, *i.e.* sectoral, NACU is both economically prudent and politically feasible. Given both the selective level of economic integration within NAFTA as well as the asymmetric relationship among its member states, I maintain that this, however, cannot be said of either a common market or a monetary union. In pursuing this claim, I endeavor to strip a thus far still largely technical debate to its main points.

The analysis proceeds as follows: the first section begins with a general discussion of the various levels of regional economic integration, interspersed with empirical illustrations. Its purpose is threefold: to serve as the reference point for the relationship among the different proposals put forth for deeper North American integration; to clarify the often explicit location of the arguments *vis-à-vis* the European Union (EU); and to demonstrate how the latter stages of European integration already have had very practical implications for Canada, the U.S., and Mexico.[7] The higher the degree of institutional density (*i.e.* the deeper regional integration), the greater the loss of independent national policymaking capacity. Then the second section explains why, and under which circumstances, politicians are both willing and able to limit national sovereignty in order to pursue regional integration. The third section explores the feasibility of a North American Customs Union, and the fourth one deals with the economic and political conditions for a single currency between the NAFTA members, as well as a common market. I conclude with theoretical and practical implications of this Canadian debate on both aspects of North American integration.

II. GENERALIZING ABOUT REGIONAL INTEGRATION

NAFTA, Mercosur, and the EU are instances of regional integration that vary considerably in their institutional density, *i.e.*, the extent to which the respective member states voluntarily transfer national policy domains to supranational institutions.[8] To understand the different proposals about deeper North American integration and their practical implications, it is imperative to distinguish between five categories of commitment among the countries aligned in a PTA. This is an analytical construct which does not imply a deterministic process through all stages. In other words, a free trade area like NAFTA does not by some inner logic of regional integration ultimately have to evolve into an economic, let alone political, union. What this delineation does stand for, however, is that there is an economic, and often concomitant political, logic behind the sequence of integration steps. Put differently, a free trade area does not progress to an economic union directly, by-passing the intermediate stages of a customs union and a common market. This would neither make economic sense nor would it be politically feasible. Furthermore, as we will see with the proposition for a NACU, individual stages of institutional density can take on varying degrees themselves.

Preferential trading arrangements, as the name suggests, appear to violate the commitment of the World Trade Organization (WTO) to the principle of nondiscrimination. This principle is embodied in the so-called most-favored nation (MFN) status, which means that any tariff concession granted by a member state to any one country ought to be granted to all WTO members. The exception specifically allowed for in Article XXIV is the conclusion of PTAs, provided that they do not, as a group, increase their level of protection *vis-à-vis* non-members of the regional integration scheme. Consequently, if the signatories of a preferential trading arrangement decided to establish a common external tariff structure, the joint adoption of the customs code of the member state with the highest duties would not be permissible.

The lowest level of regional integration is a free trade area (FTA) in which tariffs and other barriers between its members are largely abolished, while they all retain different customs duties toward third countries. The consequence is that outsiders have an incentive to export their goods via the PTA member state with the lowest tariff for a given product and then transship freely within the free trade area to the countries with a higher external tariff structure, particularly if like the United States they comprise large markets. To prevent this from happening, FTAs necessitate the development of elaborate, so-called "rules of origin" (ROOs) that specify for every product group the content requirements that allow it to qualify as an FTA product. If such a prerequisite is met, then the product moves freely within the free trade area. Conversely, in case this condition is not fulfilled, as in the case of products that are entirely or substantially produced in outsider countries, they are still subject to customs duties within the FTA.

Canada has experience with two free trade areas: the bilateral Canada-United States Free Trade Agreement (CUSFTA) of 1988 and NAFTA. The goal for Canadian foreign economic policy with CUSFTA was not free trade in the traditional sense (in fact, prior to the agreement, 80 percent of Canadian exports to the U.S. were already duty free); instead, Canadian negotiators sought more secure access to the American market through the incorporation of the bilateral dispute settlement mechanism of Chapter XIX.[9] Through it, trade disputes between the two countries are no longer a matter of national law; instead, the CUSFTA replaces domestic judicial review procedures with a bilateral one. This means that Canadians sit on panels that ascertain whether or not U.S. law was properly followed when imposing protectionist measures against Canadian products.[10]

CUSFTA became the blueprint for the North American Free Trade Agreement. The primary concern of the Canadian trade representatives in these negotiations was defensive, *i.e.*, to avert a scenario in which Mexico obtained better access to the American market than Canada had achieved under CUSFTA (Cameron and Tomlin, 2000: chapter 4).[11] Yet, European integration again served as the instigator for the NAFTA talks to occur in the first place. There were two reasons why: first, the Mexican government had unsuccessfully sought to solicit funds for its market reforms because the opening of Eastern Europe meant that then European Community (EC) member states directed all their financial attention to the countries that joined the in 2004. Like Canada since CUSFTA, Mexico now concentrated on the U.S. economy. Second, both Canadian and American foreign policy makers were deeply concerned with the signing of the Maastricht Treaty which, among other aspects, established the timetable for introduction of a single European currency.[12] In the eyes of one participant in the NAFTA negotiations, "[a]rguably we would not have a NAFTA (and before that a Canada-U.S. free trade agreement [CUFTA]) had the Europeans not moved to create the European Union (EU)." (Mayer, 1998: 39).

In the North American Free Trade Agreement, which is the most prominent FTA, the rules of origin encompass about 200 pages. For instance, the content requirement for motor vehicles is set at 62.5 percent to qualify as a NAFTA product, while the garment industry is based on a so-called "thread-forward" rule: only textiles made from NAFTA-produced thread are not subject to duties among its members. These ROOs are different for each sector because domestic producers in the member states lobbied their respective trade representatives in that respect. They are very detailed and impose costs, both administratively in terms of their negotiation and enforcement as well as on businesses, to provide formal evidence to customs authorities that a given product meets the "NAFTA test."

Regulations do not merely vary according to the sector or product group concerned, and the North American Free Trade Agreement has numerous exceptions to internal free trade between its three member countries. Several sectors are subject to transition periods of between five and fifteen years. Also, separate from the main text but nonetheless part of the NAFTA are seven annexes that declare exemptions from the treaty as a whole; this includes the nationalized oil industry in Mexico and Canadian print media, the latter to limit the amount of American content and advertisement in Canadian magazines. In addition, "[s]tates and provinces have up to two years after the agreement's entry into force to identify any other reservation they wish to add to Annex I" (Lipsey *et al.*, 1994: 66).[13] This does not qualify the fact that future policy options of component governments are severely constrained, as any changes in subnational legislation after the NAFTA came into force on 1 January 1994 must comply with NAFTA regulations.[14]

The second stage in the degree of regional integration is a Customs Union (CU). In contrast to an FTA, members also adopt common external tariffs toward the outside world. Since there no longer is an incentive for transshipment, a CU does not need rules of origin. This requires a higher degree of policy coordination among the PTA's member states than is the case in an FTA. Specifically, setting a common external tariff demands consensus in two areas: first, the exact level at which the common customs duty should be set. This task becomes easier the closer the tariff rates among the member states concerned already are before taking this step. Second, the apportionment of the now commonly collected customs revenue among the PTA countries needs to be agreed upon. In an FTA with different external tariffs, each member individually gathers these revenues, but a CU by definition removes the incentive for non-members to seek entry via a particular country into the PTA. Thus, given the extent of policy coordination required to move from an FTA to a customs union, CUs themselves can vary from common external tariffs only for particular sectors to a full-fledged joint customs structure. Mercosur, the Andean Community, and CARICOM are current examples of limited customs unions, while European integration as commenced in the late 1950s already had a broader scope.

The third step of regional integration is a Common Market which includes not only the free movement of goods but also of services, financial capital, and labor within the PTA. Collectively, these are the so-called "four freedoms." A Common Market is based on a high degree of coordination among its member countries, since it is almost a *de facto* extension of domestic economies to the regional level, absent a common currency and joint taxation. This means that customs procedures within the common market become superfluous. The Single European Act (SEA), concluded by the EC member states in 1986 to establish a common market by the end of 1992, is to date the only empirical example of this degree of integration.[15] By its very nature, a common market favors all goods, services, and financial capital originating within the members, since all third country products are made relatively more expensive by being subject to tariffs erected by the common market.[16]

There appears to be some confusion in the literature as to what exactly a common market entails. Harris (2003: 5) contends that "[t]he three important characteristics of a common market like the European Union that go beyond free trade are 1) labour mobility, 2) a common external trade policy, and 3) monetary integration or a common currency." Such a demarcation is both conceptually problematic and empirically incorrect on several accounts. First, while labor mobility, *i.e.*, the entitlement to seek employment in any other member state, is one of the four freedoms of a common market, a joint trade policy is part of a full-fledged customs union that precedes a common market. It becomes necessary if and when PTA members adopt a common external tariff (CET) *vis-à-vis* third countries. Yet a joint trade policy relates to the economic exchange of goods and services; it does not depend upon, or have anything to do with, labor mobility and/or a common currency. Empirically, in this vein the European Community had a common trade policy well before it became a common market with the SEA. Conversely, the WTO defines the minimum requirement of a customs union having a CET, *i.e.*, a joint trade policy need not be adopted. Mercosur, the Andean Community, and CARICOM are CUs in which only specific sectors have a common tariff structure. Second, the free movement of goods, services, financial capital, and labor within a regional integration scheme has nothing to do with a common currency. Monetary integration can be an economically preferable consequence, if and when a common market, *i.e.*, the institutionalization of the four freedoms, is fully attained, but it is analytically and empirically different from it. The EU only established a timetable for the introduction of a single currency as part of the Treaty on European Union, commonly known as the Maastricht Treaty, in 1991. Third, the successful implementation of a common market necessitates an array of enforceable supranational regulations from competition policy to joint technical standards, food safety and labor laws.

The European Commission, which was charged by the then twelve member states of the EC to institute the regulatory changes for the completion of the common market, determined that 279 directives (regulations that are binding on the member states) needed to be put in place by the end of 1992 (Hülsemeyer, 2000). This was accomplished primarily through the principle of "mutual recognition," whereby products approved in one of the member states were automatically deemed acceptable for consumption throughout what was then still the European Community. For instance, in the field of services, government procurement procedures varied tremendously and required harmonization. Also, the free movement of labor demanded that academic and non-academic qualifications, as well as minimum labor standards (*e.g*,. working hours and social security) had to be standardized. In this vein, member state and EU redistributive policies, social and environmental regulations have grown as well (Rhodes, 1992; Majone, 1993). Once the four freedoms are in place, businesses and travelers alike nonetheless still have to deal with different currencies in cross-border exchange. These involve a certain amount of risk for the former due to exchange rate fluctuations, and they are costly for the latter because of the bank fees incurred for currency conversions.

Against this backdrop, the degree of market and policy coordination embodied in a common market provides the *raison d'être* for the fourth step in deepening regional integration, namely an economic union. Monetary autonomy of the member states is transferred to a common central bank. The economic rationale for this move is based on the so-called Mundell-Fleming theorem. It stipulates that a country can maximally achieve two of the three following goals at the same time: exchange rate stability; monetary autonomy; and capital mobility. Since the mobility of financial capital nowadays is given, countries face a trade-off between exchange rate stability and monetary autonomy (Frieden, 1991). Which of the two goals takes precedence is a political decision and crucially depends upon the socio-economic benefactors and losers of either one. A single currency signifies a decision for exchange rate stability, since abandoning the very existence of different currencies altogether leads to the highest degree of exchange rate "stability" possible. Monetary autonomy is therefore lost at the national level but regained collectively for members of the PTA through a supranational central bank.

The only empirical example of this is the European Union when it embraced the goal of a single currency with the so-called Maastricht Treaty that came into effect in 1993. The new European Central Bank (ECB) began operating by the end of the last century, and in 2002 the euro became legal tender in twelve of the currently 15 EU member states.[17] The ECB's Governing Council, which includes the presidents of the twelve national central banks, must adopt the policies set by the ECB. A single currency not only deprives a country of the symbolic value of its own legal tender (which might be important to citizens, as the British public's resistance to a euro accession demonstrates), results in the loss of seigneurage revenues, and leads to the abolition of autonomous national monetary policies. But it also demands increasing *de facto* convergence of fiscal policies among the member governments of the PTA because achieving the goal of monetary stability, as manifested in the ECB's mandate, depends upon the prevention of longstanding budgetary deficits among the member states. Hence, monetary and fiscal policies need to be complementary in a monetary union. While the former is centralized, the latter still belongs to the portfolio of the individual PTA signatories. The ideal, therefore, would be the adoption of a monetary and fiscal union where the latter policies are set centrally by an EU body. Attempts to do this failed because of resistance among the member states who jealously regard fiscal policy as one of their important prerogatives. This being said, the member states' finance ministers are moving *de facto* toward similar tax rates so that any national tax policy independent from the policies in the other EU countries is merely symbolic. A single currency makes the economic union so integrated that only a common government is missing to make the regional integration scheme look like a "normal" country.

The fifth and last step of PTA integration is a political union in which macro-regional governmental institutions fully, or at least partially, replace the individual member governments. The European Union comprises several institutional as well as symbolic aspects of a political union; among the former are the European Commission, the European Court of Justice (through which supranational law overrides national law, and in which individual citizens are permitted to litigate against their own governments), and the European Parliament. The latter entail a European flag and anthem that is intended to lead to a gradual identity shift among the populations. In addition, a constitution foreseeing, among other aspects, the creation of an EU president and a European foreign minister was adopted by the heads of state and government at their summit under the Irish presidency in June, 2004.

In other words, as the degree of economic integration within a PTA increases with every stage outlined above, so does the extent of national sovereignty to be relinquished to macro-regional bodies. Why are certain governments more willing than others to give up national sovereignty? What are the conditions under which they are prepared to do so, given that they are ultimately still held accountable in domestic elections?

III. NATIONAL GOVERNMENTS AND THE SUCCESS OF REGIONAL INTEGRATION

The first systematic comparative investigation of the conditions under which PTAs are negotiated and which actors play a role in their adoption has been undertaken by Walter Mattli in *The Logic of Regional Integration: Europe and Beyond* (1999). The purpose of Mattli's work is to explain the variation of regional integration schemes, understood as voluntary agreements between formerly independent states "to the extent that authority over key areas of national policy is shifted towards the supranational level" (Mattli 1999: 1). He proposes that a general logic of macro-regional integration exists so that the proliferation of integration schemes can be organized in an orderly fashion. Two puzzles arise which Mattli sets out to analyze. First, what accounts for the ultimate success or failure of different PTAs? He operationalizes "success" as the degree to which treaty provisions are actually implemented into rules and regulations, since at this stage several integration schemes have failed. Second, under which conditions do "outsiders" who encounter negative economic effects either join (*i.e.*, become belated "insiders") or attempt to form a counter-union?

After reviewing the relevant literature, Mattli concludes that most "classical" theoretical approaches to regional integration in both political science (neofunctionalism, intergovernmentalism) and economics (customs union theory, optimal currency area theory) are insufficient to capture the *problématique* contained in the two puzzles. Instead, Mattli proposes that certain demand and supply conditions must be fulfilled in order for a regional integration scheme to have a high likelihood of successful implementation. In terms of the demand side, he extrapolates from the contributions of property rights theory, economic history and new institutional economics for the process of macro-regional integration. A combination of these three theories suggests that "as new technologies increase the scope of markets beyond the boundaries of a single state, actors who stand to gain from wider markets will seek to change an existing structure in order to realize these gains to the fullest extent." (Mattli 1999: 46) Consequently, regional institution-building can be understood as an attempt to internalize within a group of countries the externalities accruing from cross-border economic exchange.[18]

The potential economic costs of relying on foreign markets range from differing rates of inflation and currency devaluation to non-tariff barriers like distinct technical standards.[19] This has two implications: first, it raises the rationale for a macro-regional governance structure, that is, a framework that actually captures the geographically extended market it is supposed to manage. Second, the pressure for the supra-nationalization of rules and regulations governing economic exchange will come from the market actors that stand to benefit from the reduced risks associated with it.[20]

Yet Mattli also stresses that the demand by business alone is not sufficient for the successful completion of such a scheme; instead, three supply conditions must also be met. First, political leaders in the countries involved must have the willingness to surrender part of their national powers to a supranational governance structure. Politicians are conceptualized as preferring national autonomy and the will to stay in power, with the latter aspect seen as a function of their ability to manage the domestic economy. Hence, they are facing a potential trade-off between these two goals if a prolonged recession is threatening their re-election chances. Only then are they likely to consider giving up competencies to the supranational level in order to enhance national economic performance and thereby attempt to stay in office.

Even if politicians are willing to shift formerly domestic regulatory powers to the macro-regional level, they may not have the ability to do so because of two collective action problems. These are the so-called Prisoners' Dilemma, the standard case of externalities, and coordination games. The conceptual problem of the Prisoners' Dilemma is the difference between individual and collective rationality. Although two or more states would jointly benefit from the establishment of common rules and regulations, each of them has an incentive to defect, assuming that the other partners comply. Since the problem of achieving the collectively favorable outcome is largely one of communication (that is, information about the others' willingness to obey), this difficulty can be overcome through so-called commitment institutions that oversee and enforce rule adherence. This is the second, albeit weak, supply condition. Although it facilitates compliance, cooperation might nonetheless occur even without such institutions, as the absence of equivalents to the European Commission and the European Court of Justice elsewhere demonstrates.

More important for macro-regional integration is the third and strong supply condition which is a consequence of so-called coordination games. In contrast to the Prisoners' Dilemma, the question here is not how a collectively favorable outcome can be achieved but which of different possible alternatives will be attained. Since the latter vary in the relative distribution of the benefits among participants, states have opposing preferences on these results. On this basis, Mattli holds, successful regional integration projects require the presence of a benevolent hegemon for two reasons. First, it serves as the focus for the standardization of rules and regulations because the aggregate regional costs of converging around the regional leader are lower than adopting the standards of any economically less significant member state. Second, given that any of the various possible cooperative outcomes raise distributional issues, the economic hegemon can ease them by virtue of its financial capabilities, serving as the regional "paymaster."

The above demand and supply conditions, although developed to resolve the first puzzle, *i.e.*, the variation of successful and failed PTAs, also have a bearing on the second puzzle. If "outsiders" face negative externalities from an existing macro-region, among them the relative loss of market access and investment diversion, they can either attempt to join the union and provoke the negative externalities or, in case the application for membership is rejected, form a counter-union. Mattli calls these options respectively the first and second integrative responses.[21] He tests the framework by examining several integration projects during the nineteenth and twentieth century. As the most recent successful macro-regions he considers both the EU since the signing of the Single European Act in 1986, and NAFTA.

This assessment actually creates a new puzzle, namely that of institutional disparity. Categorizing the EU and NAFTA in the same way clouds their substantial difference in the governance structures established to integrate their regional markets. The current Canadian debate about the advantages and disadvantages of deeper North American integration speaks precisely to the considerable differences in institutional density between the EU and NAFTA. Proposals for a North American "catching up" through deepened NAFTA integration focus on either a customs union or a single currency.[22] Given the logic implied by the five stages of regional economic integration, I begin with a discussion of the former.

IV. NORTH AMERICAN CUSTOMS UNION: A Realistic Way Forward?

How economically desirable is a North American customs union? If it were, how politically feasible is it, *i.e.*, would there be the will and ability of policymakers to embark on a NACU? Unlike the other four stages of regional economic integration, customs unions themselves can vary in the extent of their institutional reach. The minimum requirement defined by the WTO is the imposition of a common external tariff for the member states of a CU.

Indeed, the elimination of rules of origin is the economic benefit of a customs union over an FTA, for the maintenance of ROOs is costly to enforce for governments as well as expensive to prove for businesses within the NAFTA region. These costs are estimated to range between two percent and three percent of NAFTA GDP (Goldfarb 2003a: 2).[23] Exporters have to provide a so-called "certificate of origin" which the importer must provide to customs officials to qualify for NAFTA preferential treatment. Parallel to the preferential tariffs under NAFTA, Canada and the United States also apply MFN tariffs *vis-à-vis* third countries with which they maintain normal trading relations. For roughly 40 percent of goods traded under MFN status, the tariff is *nil*. This has the unintended consequence of being cheaper for companies to pay the MFN rate rather than bear the administrative costs of proving NAFTA rules of origin. In short, businesses deliberately forego preferential treatment. Hence a North American customs union is desirable for all corporations with trading relations throughout the PTA, especially since most economic exchange within NAFTA is intra-firm or intra-industry trade. (Pastor, 2002: 92) The more crucial question then relates to the practical and political challenges to realizing NACU.

First, the tariff structures for some sectors differ widely between the three countries and would have to be brought into conformity. Since the WTO also demands that PTAs are a permissible exception to the MFN rule as long as tariffs within a regional integration scheme are not raised relative to the individual customs duties before its conclusion, the NAFTA alignment of different tariff structures in the member states would always necessitate convergence on the respective lower tariff for any product group. With a few exceptions, this means the adoption of the American customs code; hence, Canada and Mexico inevitably would lose tax revenue. Second, the creation of a uniform customs code necessitates devising a procedure whereby the joint tariff revenues are shared. This problem could principally be addressed in a rather straightforward manner by computing the value of goods and services from non-NAFTA countries that clear customs in Canada, the United States, or Mexico, and then dividing up their relative shares. Since foreigners in a NACU would no longer have any incentive for transshipment within North America, one could assume that the goods and services arriving at each country's entry point were actually destined for the domestic market.

Third, all three NAFTA members have signed numerous bilateral FTAs, partly with the same, partly with different countries. (Pastor, 2002; Goldfarb, 2004) The preferential tariffs granted in these agreements vary even in cases where Canada, the U.S. and Mexico signed FTAs with the same countries. For the common external tariff structure of a customs union, the NAFTA members would have to bring their differing agreements with third parties in line. It immediately follows that the more bilateral FTAs they sign with "outsiders," and the more that the concrete obligations established under them vary, the more challenging it becomes to negotiate a North American customs union. In this vein, the FTAA talks are currently stalled because of differences between the U.S. and Brazilian delegations over its institutional density.[24] The American administration seeks to sidestep Brazil's position by concluding new bilateral free trade agreements with Colombia, Peru, Panama, Ecuador, and Bolivia (Goldfarb, 2004: 3). This tactic further exacerbates the institutional difficulties in negotiating a NACU.

Beyond the minimum requirement of a CET as stipulated by the WTO, the member states in a full-fledged customs union would have to coordinate their future trade policy within multilateral fora. While the European Union negotiates within the WTO as a bloc, this approach is foreign to North America.[25] The cause for the institutional variation between the EU and NAFTA may lie partly in generally different traditions about the degree of state involvement in the economy in the respective member states which translated into a mirroring institutional set-up in both macro-regions. In other words, the distinction is between the night-watchman Anglo-Saxon and the more interventionist Rhenish forms of capitalism. This difference is not easily overcome but instead is reflective of a "cultural" norm (see Hülsemeyer, 2004).[26]

Therefore, while a NACU is economically desirable, the institutional constraints to arrive at a joint NAFTA commercial policy make it more politically feasible to embark on a piecemeal approach to a North American customs union (Goldfarb, 2003a). In the short term, a common external tariff seems realistic only in a few sectors. For instance, a *de facto* sectoral North American CU already exists for computer equipment. This could be enhanced by incorporating those sectors in which tariffs *vis-à-vis* third parties are similar between the two, or three, countries (*i.e.*, within one or two percentage points of each other), and in which the ROO costs are high (*i.e.*, the "competing" MFN rate is very low or *nil*). Once achieved, the sectoral CU could be extended to all goods, thereby eliminating rules of origin requirements in their entirety from the bilateral (or even trilateral) trading relationship. Both the sectoral and the general CET approach fulfill the criterion for a customs union as defined by the World Trade Organization.

The third step in such an "evolutionary" (Dobson, 2002) undertaking is a customs union in which the general CET is complemented by common trade and commercial policies between Canada and the United States at least. This would be similar to the arrangement in the EU, which to date is the only empirical example of such a "deep" (Goldfarb, 2003a) customs union. Although the level of coordination required makes this last step of a NACU attainable in the long term at best, the added benefit for Canada (and Mexico) would be significant. A joint commercial policy would incorporate the elimination of so-called trade remedy penalties between the countries, which in the Canadian case pertain especially to softwood lumber and durum wheat. Although these primary commodities make up only a fraction of cross-border trade, the general elimination of anti-dumping measures and countervailing duties would enhance the security of access to the U.S. market by Canadian business.[27] Precisely this had already been the motivation in Canada's negotiation of the CUSFTA, although it was only partially attained via the dispute settlement procedure. Hufbauer and Schott (2004) stress that the U.S. still does not consider trade remedy law negotiable, and that Canadians should simply drop the topic.

Irrespective of the long time horizon, it follows from the asymmetry of the economic relationship between the three countries that "common" rules and regulations for trade and commerce *de facto* would mean the Canadian and Mexican adoption of American standards, rather than a mutual agreement among the partners.[28]

Since a common trade policy and the associated institutions are unlikely to emerge in the foreseeable future, trying to remove irritants and barriers to trade at the Canada-U.S. border without necessitating any formalized customs union seems more realistic, both in attracting a positive U.S. response (Hart, 2003) and in maintaining a measure of Canadian "sovereignty" (Dobson, 2002). Among the measures that could be undertaken are common standards for product and process regulation, a national treatment approach[29] to government procurement, as well as common goals and enforcement procedures in competition policy (Hart, 2003: 427-8). Several commentators call for a "bold" and broad initiative (Hart, 2003) or a "strategic bargain"(Dobson, 2002) to overcome sectoral interests in the United States that would likely derail any narrowly focused initiative, although Goldfarb (2003b) maintains that the distinction between "incremental" measures for deeper North American integration is somewhat blurred. In keeping with "big" ideas, many envision an even more ambitious project than what a common trade policy among the NAFTA members could deliver: a North American Monetary Union.

V. A SINGLE CURRENCY-- PUTTING THE CART BEFORE THE HORSE

Prior to EU enlargement in May, 2004, its 15 member states traded on average 62.9 percent of their overall economic exchange with each other (*i.e.*, 16 percent of GDP), whereas Canada's trade with its southern neighbor amounts to 82.0 percent of overall exports (30 percent of GDP). Thus Harris (2001: 21) concludes that Canada has even more economic reason to pursue monetary integration with the United States than the EU 15 did when twelve of its members adopted the euro. Parallel to the previous section, is there indeed an economic case for a North American Monetary Union, and would it be politically feasible?[30]

The economic part of the question arises from the floating exchange rate with the U.S. dollar and whether or not this has been a positive arrangement for Canada. The main purpose of flexible exchange rates is to act as buffers against external shocks. The argument holds that floating currencies in the short term react primarily to capital movements, the latter in turn being caused by shocks in financial markets or "real" economies. A floating exchange rate is intended to prevent a spillover into the domestic economy, and its importance increases as national economies become integrated. If, however, for extended periods of time these shocks delink the exchange rate from the economic fundamentals of the countries concerned, a so-called "misalignment" occurs.

Courchene and Harris (1999) hold that this is precisely what happened in Canada when the Canadian dollar relative to the U.S. dollar fluctuated between 89¢ in the early 1980s to a low of 63¢ in the early 1990s, followed by a rise to 77¢ by the end of 2003. The problem of prolonged misalignment is that a depreciated Canadian dollar discourages productivity improvements since imports are expensive and exports relatively cheap, thereby insulating domestic producers somewhat from international price signals. Generally, a volatile exchange rate results in higher foreign investment in the United States (with its far larger market) rather than in Canada.

Given Canada's overwhelming dependence upon the U.S. market, this misalignment has made some form of fixed currency arrangement more attractive. It would not only make Canadian companies more aware of their American competitors and thereby introduce productivity improvements and/or higher wage flexibility, but also it would reduce the costs of currency conversion for both business and consumers.[31] There are various options for greater exchange rate fixity, from pegging and "dollarization" to the adoption of a single currency (Smith, 2002). The latter is the most far-reaching option and the one that is economically preferred by several Canadian commentators (Courchene and Harris, 1999; Robson and Laidler, 2002). However, contrary to the European experience, it would amount to unilaterally accepting the U.S. dollar.

If this were to be accomplished, various transitory problems would arise: the pace of conversion; the actual conversion rate at which Canadian dollars would be replaced by U.S. dollars; and the question of whether or not macro indicators, such as a maximum permissible budget deficit relative to the GDP, should be put in place. These are the questions that were settled for the twelve members of the Euro zone with the three convergence criteria, known as the "Maastricht Criteria;" they required an inflation rate of no more than 1.5 percent above the inflation rate of the three most stable economies; a national debt of no higher than 60 percent of GDP, and a budget deficit no higher than 3 percent of GDP.[32]

Even more fundamental in a NAMU would be the role of the Bank of Canada in a single currency arrangement. With reference to the European Central Bank (ECB), could the Bank of Canada not simply become the 13th district of the U.S. Federal Reserve System, as Courchene and Harris (1999) suggest? This would also very closely reflect Canada's share of the overall binational GDP. A resolution of this question depends upon two factors: (1) whether or not the institutional structures of the Canadian and U.S. central banks are compatible; and (2) whether or not the United States was willing to consider such an arrangement.

To begin, a comparison of the U.S. Federal Reserve System with the European Central Bank does not hold, and being part of the former can neither be in the interest of the Bank of Canada itself nor of Canadians. In particular, the twelve districts of the U.S. Federal

Reserve participate in the ownership of commercial banks within these districts, *i.e.*, they are not designed to represent the public interest. Conversely, the Bank of Canada is a public institution whose governor is nominated by the minister of finance. Its mandate, therefore, is a very different one and would not match with the representation of business interests in the "other" twelve districts. Further, the European Central Bank, as well as the national central banks of the euro zone which are represented on the ECB's Governing Council, are all public institutions. The ECB also must consult with other EU institutions on certain issues, among them the European Parliament. In other words, neither in institutional structure nor mandate does it lend itself as a blueprint for the potential future role of the Bank of Canada within the U.S. Federal Reserve System (see Helleiner, 2003).

What are the implications of this institutional difference between the Bank of Canada and its American counterpart? It is preposterous to expect that the nature of the U.S. Federal Reserve System would be altered merely to accommodate a junior partner. Alternatively, a change in the Bank of Canada's mandate to become a representative of commercial banks appears equally inconceivable; certainly, it would be hard to imagine public support for such a move. However, the point here is that in either case the structure of the American central bank and that of the ECB are so distinct that advancing a NAMU with reference to the European Central Bank does not stand empirical scrutiny. Ironically, although entirely unsupported by the extent of economic integration, the mandates of the Bank of Canada and the ECB would be highly compatible.

Regardless of institutional aspects, would the United States be willing to consider any type of formal role for the Bank of Canada? The stark economic asymmetry within North America, to which there is no equivalent in the EU, does not give the United States the slightest reason to share influence on its monetary policy,even if Canada and Mexico were unilaterally adopting the U.S. dollar (Hufbauer and Schott, 2004). Yet, even then, the U.S. Federal Reserve is unlikely to offer financial assistance with obtaining U.S. currency or liquidity to Canadian commercial banks after the adoption of a NAMU (Robson and Laidler, 2002).

Lastly, the level of economic integration in North America is quite low (irrespective of the largest bilateral trading relationship in the world) in comparison to the European Union. It pertains primarily to goods and services (and these with the numerous caveats and exemptions specified in the NAFTA), whereas labor and regulatory integration are almost non-existent (see McKinney, 2000). Against this backdrop, pursuing a single currency is unconvincing, both theoretically and practically. Instead, Canada should focus on getting more secure access to the U.S. market through a customs union.

VI. CONCLUSION

Among Canadian scholars the dominant view is pursuing deeper bilateral integration with its southern neighbor to cement access to the U.S. market while not jeopardizing the negotiations over immigration issues between the United States and Mexico. By contrast, American observers stress that Latinos are the fastest growing linguistic group within the United States, and electoral arithmetic ensures that any form of deeper North American integration must include Mexico (Hufbauer and Schott, 2004).[33] Canadian public opinion is favorably predisposed to closer ties with the United States, a viewpoint unchanged by the events of 11 September 2001, nor by the differences over the wisdom of U.S. military engagement in Iraq. Yet Canadians are uncertain, if not confused, about what precisely deeper "integration" means and which tangible economic benefits they can expect from it (Alexandroff and Guy, 2003). As for the meaning of deeper integration, proposals in principle advocate either a customs union or a single currency in North America. Both, but particularly the latter, tend to be too technical in nature to capture the public imagination.

I have argued in this paper that a North American Monetary Union is unrealistic for three reasons: first, the trade and investment integration within NAFTA is replete with exempted sectors, and its institutional underpinnings are inconsequential. Hence the intermediate steps of a full-fledged customs union or a common market are not remotely attainable on this basis. Second, the representation of U.S. commercial interests in the twelve districts of the U.S. Federal Reserve System is irreconcilable with the public mandate of the Bank of Canada (Helleiner, 2003) and, for that matter, the *Banco de México*. Any suggestion to incorporate the central banks of the two peripheral countries into additional districts of the U.S. Federal Reserve (Courchene and Harris, 1999) is ignoring this fact. Third, given the economic asymmetry among the NAFTA members, a monetary union would not lead to the creation of a new currency reminiscent of the euro (Pastor (2002) recommends the "Amero") but rather would amount to the unilateral adoption of the U.S. dollar by Canada and Mexico. Irrespective of central bank incompatibility, the United States still does not have the slightest interest in sharing control over its monetary policy (Hufbauer and Schott, 2004), and expending energy and resources on continuously pursuing a NAMU does not seem fruitful at this stage.

By contrast, I suggested that the assessment of a North American customs union is economically and politically feasible as well as clearly in the Canadian interest. A CU would be the second stage of regional economic integration after an FTA. Its minimum requirement is a common external tariff, whereas a mature customs union encompasses a common trade policy and the institutions to administer it. European integration began with the Treaty of Rome in 1957 from the outset at this "deep" CU level, but the United States is neither willing to consider "commitment institutions" (Mattli, 1999) like a permanent trade court, or a joint competition policy, nor is it prepared to discuss a CET for agriculture or textiles (Hufbauer and Schott, 2004). However, a "sectoral" (Goldfarb, 2003a) or "evolutionary" (Dobson, 2002) NACU is feasible; only those sectors are initially included for which the individual external tariffs under NAFTA are already very similar, and/or the MFN rates are close to *nil*. A sectoral approach makes it easier to include Mexico, *i.e.,* to cater to the American interest of not merely embarking on a deepened Canada-U.S. agreement. Related, a sectoral NACU would facilitate the negotiation of the FTAA because the four extant PTAs in the Western hemisphere would then display the same level of economic integration. In turn, it would curb the current policy of all three NAFTA members to negotiate separate bilateral FTAs with several Latin and South American countries (Goldfarb, 2004: 2-3). They do so to circumvent the stalled FTAA talks, but I maintain that they are far behind the envisioned January, 2005, schedule precisely because the conception of a NAFTA-writ large ignores the higher level of economic integration in the three "other" PTAs in the hemisphere.

Is the prospect of a sectoral North American customs union sufficient to get serious U.S. attention? Although it certainly is not as visionary as the "North American community" that Pastor (2001) has in mind, a customs union is a realistic prospect, and negotiations might commence in 2005 following the U.S. presidential election (Hufbauer and Schott, 2004). It would offer measurable advantages for American companies with respect to the abolition of rules of origin, while the contentious sectors of agriculture and textiles (U.S.), media (Canada), and crude oil (Mexico) would not derail the first step to deeper North American integration. By contrast, the United States has nothing to gain from a single North American currency. While it would not be opposed to extending the circulation of the U.S. dollar to curb the "threat" of the euro to its reserve currency status, it would certainly not concede any influence on its monetary policy to Canada and / or Mexico if one or both decided unilaterally to adopt the American currency.

The "lessons" from the different stages of regional integration are clear both in theoretical and practical terms, and Canada and the U.S. would be far from agreeing on what Goldfarb (2003a) terms a "basic" CU, let alone a "deep" one with its requirement for trade policy coordination. It is revealing that the third stage, a Common Market, which crucially would have to entail Mexican labor mobility, is only mentioned by one observer (Dobson, 2002). As Bank of Canada Governor David Dodge put it: "...let me stress that monetary union is an issue that should be considered once we have made more progress towards establishing a *single* market for goods and services, capital and labour (Dodge, 2003, 6; emphasis in original)." Anything else amounts to putting the cart before the horse.

REFERENCES

Alexandroff, Alan S. and Guy, Don (2003), *What Canadians Have to Say About Relations With the United States* (Backgrounder No. 73), Toronto: C. D. Howe Institute.

Arndt, Steven W. (2003), "The Pros and Cons of North American Monetary Integration," in *North American Linkages: Opportunities and Challenges for Canada* (Industry Canada Research Series v. XI), edited by Richard G. Harris, Calgary: University of Calgary Press, pp. 391-418.

Beauchesne, Eric (2003), "It's Not a Matter of Choice, We're Tied to U.S. Economy: Manley," *Ottawa Citizen* 26 June: A1/A2.

Bornschier, Volker (ed.) (2000), *State-Building in Europe: The Revitalization of Western European Integration*, Cambridge: Cambridge University Press.

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

Canada (2002), *Partners in North America: Advancing Canada's Relations with the United States and Mexico* (Report of the House of Commons Standing Committee on Foreign Affairs and International Trade), Ottawa: Public Works and Government Services.

Canada (2003), *Uncertain Access: The Consequences of U.S. Security and Trade Actions for Canadian Trade Policy* (Report of the Senate Standing Committee on Foreign Affairs and International Trade), Ottawa: Public Works and Government Services.

Clarkson, Stephen (2002), *Uncle Sam and US: Globalization, Neoconservatism, and the Canadian State*, Toronto: University of Toronto Press.

Courchene, Thomas J. and Harris, Richard G. (1999), *From Fixing to Monetary Union: Options for North American Currency Integration* (Commentary No. 127), Toronto: C. D. Howe Institute.

D'Aquino, Thomas (2003), *Security and Prosperity: The Dynamics of a New Canada-United States Partnership for North America*. Presentation to the Annual General Meeting of the Canadian Council of Chief Executives, Toronto, 14 January <http://www.ceocouncil.ca/English/Publications/reports/jan14-03.pdf> (accessed 12 August 2003)

Dobson, Wendy (2002), *Shaping the Future of the North American Economic Space: A Framework for Action* (Commentary No. 162), Toronto: C. D. Howe Institute.

Dodge, David (2003), *Check against Delivery*. Remarks by David Dodge, Governor of the Bank of Canada, to the Couchiching Institute on Public Affairs, Geneva Park, ON, 7 August <http://www.bankofcanada.ca/en/speeches/2003/sp03-11.htm> (accessed 8 August 2003).

Doern, Bruce G. and Tomlin, Brian W. (1991), *Faith and Fear: The Free Trade Story*, Toronto: Stoddart.

Dupras, Daniel (1993), *NAFTA: Implementation and Participation of the Provinces* (Background Paper BP-324E), Ottawa: Library of Parliament, Research Branch.

Frieden Jeffry A. (1991), "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45(1): 425-51.

Goldfarb, Danielle (2003a), *The Road to a Canada-U.S. Customs Union: Step by Step or in a Single Bound?* (Commentary No. 184), Toronto: C. D. Howe Institute.

——— (2003b), *Beyond Labels: Comparing Proposals for Deeper Canada-U.S. Economic Relations* (Backgrounder No. 76), Toronto: C. D. Howe Institute.

——— (coordinator) (2004), *The FTAA Bulletin: Analysts Comment on Their Country and the Free Trade Area of the Americas*, Toronto: C.D. Howe Institute.

Hanson, Brian T. (1998), "What Happened to Fortress Europe? External Trade Liberalization in the European Union," *International Organization* 52(1): 55-85.

Harris, Richard G. (2001), *North American Economic Integration: Issues and Research Agenda* (Industry Canada Research Publications Program, Discussion Paper Number 10), Ottawa: Industry Canada.

——— (2003), "Introduction," in *North American Linkages: Opportunities and Challenges for Canada* (Industry Canada Research Series v. XI), edited by Richard G. Harris, Calgary: University of Calgary Press, pp. 1-10.

Hart, Michael (2003), "Canada, the United States, and Deepening Economic Integration: Next Steps," in *North American Linkages: Opportunities and Challenges for Canada* (Industry Canada Research Series v. XI), edited by Richard G. Harris, Calgary: University of Calgary Press, pp. 419-45.

Helleiner, Eric (2003), "What Political Architecture for North American Monetary Union? The Canadian Debate," Paper presented at the 44th Annual Meeting of the International Studies Association, Portland, OR, 25 February – 1 March.

Hülsemeyer, Axel (2000), "Changing 'Political Economies of Scale' and Public Sector Adjustment: Insights from Fiscal Federalism," *Review of International Political Economy* 7(1): 72-100.

——— (ed.) (2003), *Globalization in the Twenty-First Century: Convergence or Divergence*? Basingstoke, UK: Palgrave Macmillan.

——— (2004), *Globalization and Institutional Adjustment: Federalism as an Obstacle*? Aldershot, UK: Ashgate.

——— (forthcoming), "The Political Economy of Canada's Relations with the European Union," in Patrick James and Marc O'Reilly (eds) *Canadian Foreign Policy: A Reader*, Lanham, MD: Lexington.

Hufbauer, Gary C. and Schott, Jeffrey J. (2004), *The Prospects of Deeper North American Economic Integration: A U.S. Perspective* (Commentary No. 195), Toronto: C. D. Howe Institute.

Jackson, Andrew (2003), *Why the "Big Idea" is a Bad Idea: A Critical Perspective on Deeper Economic Integration with the United States*, Ottawa: Canadian Centre for Policy Alternatives.

Laursen, Finn (ed.) (2003), *Comparative Regional Integration: Theoretical Perspectives*, Aldershot, UK: Ashgate.

Lee, Marc (2003), "Indecent Proposal: The Case against a Canada-US Customs Union." Paper presented at the conference "Canada, Free Trade and Deep Integration in North America: Revitalizing Democracy, Upholding the Public Good," Toronto: York University, 14-16 October.

Lipsey, Richard G., Schwanen, Daniel, and Wonnacott, Ronald J. (1994), *The NAFTA: What's In, What's Out, What's Next*, Toronto: C. D. Howe Institute.

Majone, Giandomenico (1993), "The European Community between Social Policy and Social Regulation," *Journal of Common Market Studies* 31(2): 153-70.

Mansfield, Edward D. and Milner, Helen V. (1999), "The New Wave of Regionalism," *International Organization* 53(3): 589-627.

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

Mayer, Frederik W. (1998), *Interpreting NAFTA: The Science and Art of Political Analysis*, New York: Columbia University Press.

McKinney, Joseph A. (2000), *Created from NAFTA: The Structure, Function, and Significance of the Treaty's Related Institutions*, Amonk, NY: M. E. Sharpe.

Mirus, Rolf and Rylska, Nataliya (2002), "Should NAFTA Become a Customs Union?" in *NAFTA in the New Millennium*, edited by

Edward D. Chambers and Peter H. Smith, Edmonton, AB: The University of Alberta Press, pp. 359-76.

Pastor, Robert A. (2001), *Toward a North American Community: Lessons from the Old World for the New*, Washington, D.C.: Institute for International Economics.

——— (2002), "NAFTA Is Not Enough: Steps toward a North American Community," in *The Future of North American Integration: Beyond NAFTA*, edited by Peter Hakim and Robert E. Litan, Washington, D.C.: Brookings Institution Press, pp. 87-117.

Pettigrew, Pierre (2003), *Dancing with the Elephant: Contending with an Assertive Super Power in Trade and Global Diplomacy*. Address to the Empire Club, Toronto, 25 September <http://webapps.dfait-maeci.gc.ca/minpub/Publication.asp?FileSpec=/Min_Pub_Docs/106485.htm&bPrint=False&Year= 2003&ID= 3&Language=E> (accessed 12 November 2003)

Phillips, Nicola (2004), *The Southern Cone Model: The Political Economy of Regional Capitalist Development in Latin America*, London: Routledge.

Ritchie, Gordon (1997), *Wrestling with the Elephant: The Inside Story of the Canada-US Trade Wars*, Toronto: Macfarlane Walter & Ross.

Rhodes, Martin (1992), "The Future of the 'Social Dimension:' Labour Market Regulation in Post-1992 Europe," *Journal of Common Market Studies* 30(1): 23-51.

Robinson, Ian (1993), "The NAFTA, The Side-Deals, and Canadian Federalism: Constitutional Reform by Other Means?" in *Canada: The State of the Federation 1993*, edited by Ronald L. Watts and Douglas M. Brown, Kingston, ON: Institute of Intergovernmental Relations, Queen's University.

Robson, William B. P. and Laidler, David (2002), *No Small Change: The Awkward Economics and Politics of North American Monetary Integration* (Commentary No. 167), Toronto: C. D. Howe Institute.

Seccareccia, Mario (2003), "Some Critical Macroeconomic Aspects of Deepening North American Economic Integration." Paper presented at the conference "Canada, Free Trade and Deep Integration in North America: Revitalizing Democracy, Upholding the Public Good," Toronto: York University, 14-16 October.

Smith, Constance (2002), "Dollarization and Its Alternatives: Currency Arrangements under NAFTA," in *NAFTA in the New Millennium*, edited by Edward D. Chambers and Peter H. Smith, Edmonton, AB: The University of Alberta Press, pp. 377-96.

Sprout, Hendrik (1994), *The Sovereign State and Its Competitors: An Analysis of Systems Change*, Princeton, NJ: Princeton University Press.

ACRONYMS

CARICOM	Carribbean Community and Common Market
CET	common external tariff
CUSFTA	Canada-United States Free Trade Agreement
CU	Customs union
ECB	European Central Bank
EU	European Union
FTA	free trade area
FTAA	Free kTrade Area of the Americas
GDP	gross domestic product
MERCOSUR	economic region of Brazil, Argentina, Uruguay and Paraguay
MFN	most-favored-nation status
NACU	North American Customs Union
NAFTA	North American Free Trade Agreement
NAMU	North American Monetary Union
PTAs	preferential trading arrangements

NOTES

[1] An earlier version of this paper was presented under the title "Toward Deeper North American Integration? The Canadian Debate" at the 17th Biennial Conference of the Association for Canadian Studies in the United States (ACSUS) in Portland, OR, 19 – 23 November 2003. I am indebted to the three reviewers of CAPP and to Robert Babcock for their most helpful comments, as well as to Sarah Tarry for her assistance in revising the manuscript.

[2] For an overview of the various proposals for deeper North American integration that have recently been advanced, see Goldfarb (2003b).

[3] It is important to note that Canadian scholars concentrate on the economic relationship between Canada and the United States, *i.e.*, the designation "North American" covers the *bilateral* free trade agreement (CUSFTA) signed in 1988, rather than the NAFTA. Conversely, U.S. academics regard the inclusion of Mexico as crucial.

[4] For recent work on how regional integration in the south came about and what factors can explain it, see Phillips (2004), and various chapters in Laursen (2003).

[5] The NAFTA writ large-approach has, therefore, now run into serious problems, prompting Canada, Mexico, and the U.S. to circumvent them by signing numerous bilateral trade agreements with Latin American countries.

[6] I am currently engaged in a three-year research program that investigates the prospects and likely shape of integration in the western hemisphere. It draws on the institutional structure of the four PTAs, as well as interviews with stakeholders in the crucial member states of the respective integration schemes.

[7] The implications of European integration specifically for Canadian foreign policy, including the Canadian initiative to negotiate the CUSFTA, are discussed in Hülsemeyer (forthcoming).

[8] It is as yet unclear what factors explain this institutional variation. For an overview of international and domestic approaches, see Mansfield and Milner (1999).

[9] For a detailed account of how the CUSFTA negotiations developed from the Canadian perspective, see Doern and Tomlin (1991) and Ritchie (1997).

[10] This was seen as important because in 1986 the twelve member states of the then European Community had concluded the Common Market initiative. Subsequent fears of a "fortress Europe" (see Hanson, 1998) prompted the Canadian government to concentrate on better access to the U.S. economy. Further, sporadic tendencies of American protectionism have a ripple effect for Canadian trade and investment.

[11] As a result, *two* chapters in the NAFTA explicitly deal with this issue. The dispute settlement proper is outlined in chapters XIX and XX. The latter applies to the NAFTA as a whole, sets up a system of panels with national nominees, a NAFTA secretariat as well as a Free Trade Commission comprised of cabinet ministers, as an oversight body. Chapter XIX mainly mirrors its CUSFTA predecessor, having binational panels determine on a binding basis whether the imposition of trade remedy measures correctly apply the domestic law of the country in question, and whether legislative changes are consistent with NAFTA provisions (see McKinney, 2000).

[12] The Maastricht Treaty is officially called Treaty on European Union (TEU). With it, the European Community became, as the name suggests, the European Union.

[13] This amounted to an exemption of *all* existing subnational legislation that was in clear or potential violation of the NAFTA at the time – provided they were identified by the respective component government. The provinces had prior notice of this measure through their constant consultation with the Canadian negotiators; thus, they were able to complete their lists well ahead of the deadline. Yet, the U.S. states had not received early information and subsequently informed the federal government that they were unable to sift through their state laws to identify non-conforming state legislation, demanding the U.S. government do it for them. As a result, the three contracting parties agreed upon American request that all existing subnational legislation not consistent with the NAFTA be *automatically* exempted (correspondence with Helmut Mach, Executive Director for Trade

Policy, Alberta Department of International and Intergovernmental Relations, June 2002).

[14] The impact of the NAFTA on the Canadian provinces is detailed in Dupras (1993); Robinson (1993) gives particular attention to the effect of the side agreement's on labor and the environment.

[15] For a detailed analysis of how the SEA came about, see Bornschier (2000).

[16] This is typically referred to as a "trade diversion," *i.e,.* goods and services from third countries are made artificially more expensive through the joint tariffs to insulate more expensive producers within the common market against foreign competition.

[17] The three member states currently not part of the Euro zone are the United Kingdom, Denmark, and Sweden. In the latter two, referenda on accession to the single currency failed in 2002 and 2003, respectively.

[18] This emphasis on technological innovations corresponds to Spruyt's (1994) treatment of "exogenous change" in bringing about the end of feudalism in Europe. In both cases, they are seen as the driving force in establishing new governance structures by enhancing the possibility for economic exchange to a larger geographical area.

[19] Mattli also mentions political risks, such as the nationalization of foreign assets (1999: 47). For the E.U. and NAFTA, however, this can be neglected.

[20] This is in contrast to standard economic theories that tend to take the political framework within which market actors find themselves as given, rather than to conceptualize these market actors as being actively engaged in driving political-institutional change.

[21] Mattli considers the SEA a response to the competitive pressure of Japan and the United States, and NAFTA a reply to fears of a "fortress Europe," hence an example of the second integrative response.

[22] Not all observers are favorably disposed toward deeper North American integration. For critical assessments, see Jackson (2003; Lee (2003); and Seccareccia (2003).

[23] Lee (2003) charges that the reduction of costs expected from eliminating the rules of origin (2-3 percent of NAFTA GDP) seems overstated. If they were indeed that high, he finds it is surprising that the emphasis on them did not surface much earlier. Had businesses identified them as a major trade impediment, the NAFTA would have given an opportunity to correct this regulatory oversight from the CUSFTA. Instead, NAFTA even strengthened the rules of origin requirements.

[24] For this reason, it was decided at the Miami ministerial meeting in 2003 that all subsequent FTAA discussions will be chaired by the United States and Brazil together (Goldfarb, 2004: 3).

[25] Also, given the uneven economic clout of the two countries, it is conceivable that Canada's trade policy would have to converge on the American one far more than is the case in the absence of the coordination imperative of a CU. Clarkson (2002: chapters 3 and 4) charges that the effect of NAFTA is to have *formalized* this asymmetry into U.S. economic hegemony *vis-à-vis* Canada.

[26] Putting the term in quotation marks signifies that the intention is *not* to pitch rational choice and cultural studies in the traditional sense against each other.

[27] Anti-dumping refers to the imposition of additional duties on an imported product that is sold at a price lower than the domestic price of a similar good. Countervailing duties are put in place to compensate for subsidies provided by a foreign government to its producers. In the case of the "current" softwood lumber dispute, which has been lingering since 1982, the bone of contention is the so-called "stumpage fees" which Canadian companies pay for logging on Crown-owned land. U.S. competitors maintain that the low level of these stumpage fees amounts to an unfair subsidy to Canadian companies.

[28] There is disagreement whether Canadian standards, therefore, never could surpass American ones (Lee, 2003), or whether there need not be a difference between an FTA and a CU in negotiating these policy areas separately, therefore preventing a race to the bottom (Mirus and Rylska, 2002: 369-70).

[29] National Treatment is the second principle, apart from the Most-Favored Nation status, upon which the WTO, and its predecessor,

the General Agreement on Tariffs and Trade, is based. National treatment requires that a good or service, once it entered the domestic market, must not be discriminated against through any regulations that do not apply to local products. Just as PTAs are a permissible exception under the MFN rules, the agricultural sector has been, and still is, at least partially immune to national treatment. This second WTO principle is particularly relevant with respect to government procurement, i.e. the procedure by which such contracts are awarded, sincemost governments tend to bias in favor of domestic providers.

[30] For an overview of the arguments made in favor and against a NAMU, see Arndt (2003).

[31] This pertains almost exclusively to Canadians traveling to the United States, since Americans can usually pay in their own currency in Canada. The relationship is similar to Britain's with the Euro. Although the U.K. is not part of the single currency, tourists from continental Europe no longer exchange Euro for Pounds. This has led to what in Britain is referred to as "Euro creep," *i.e.*, British retailers are forced to hold Euros and price their products in both currencies.

[32] These convergence criteria were supposed to be enforced through the so-called "Growth and Stability Pact," which was meant to levy financial penalties against members of the Euro zone that consistently violate anyone of them. However, since several member states have repeatedly failed to fulfill the 3 percent deficit criterion, the E.U. Commission has, as of September 2004, effectively abandoned the Growth and Stability Pact as having set arbitrary fiscal standards.

[33] This population factor conceivably added to President Vicente Fox's impetus in 2000 to propose a North American Common Market, as this would include the free movement of (Mexican) labor.