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THE U.S.-MEXICO TRADE RELATIONSHIP UNDER AMLO: CHALLENGES AND OPPORTUNITIES

David A. Gantz, J.D.
Will Clayton Fellow in Trade and International Economics

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I. Introduction

Andres Manuel Lopez Obrador (AMLO) became Mexico's president on December 1, 2018. Arguably, this is the most important *sexenio* (presidency) for Mexico since Lazaro Cardenas (1934-1940) who, among other actions, nationalized Mexico's oil industry.[1] Mexico today, with AMLO as president, faces enormous challenges. The most important of these includes helping millions of Mexican citizens out of poverty through offering higher wages and better education, health care, and economic growth; reducing a high level of corruption; and dealing with violence (drug-related, oil and mineral theft, kidnappings, extortion, homicide, and others) that is endemic in much of the nation.[2] Also vitally important is maintaining a strong trade relationship with the United States under President Donald Trump, a relationship on which nearly 80% of Mexico's exports depends,[3] and addressing a petroleum sector in which oil production has been declining by about 6-7% per year, from about 3.5 million barrels per day in 2004 to around 2 million barrels per day in 2018.[4]

However, many opportunities also exist. First, Mexico, Canada, and the United States signed a revised trade agreement, designed to replace the North American Free Trade Agreement (NAFTA)[5] that bound the three countries, on November 30, 2018. Approval of the United States-Mexico-Canada Agreement (USMCA)[6] by the Mexican and U.S. congresses and the Canadian Parliament by the end of 2019 is possible but by no means certain in the United States due to the Democratic Party recently taking control of the House of Representatives.

The successful trade negotiations and the possibility of the USMCA going into effect on January 1, 2020, or soon thereafter should greatly reduce uncertainties about the future North American trade relationship that have chilled new investment and hiring in all three NAFTA countries since Trump was elected in November 2016. But the United States' potentially disruptive trade war with China continues and deepens. As of March 2019,

[1] See "Mexican Expropriation of Foreign Oil, 1938," Office of the Historian, U.S. Department of State, available at https://history.state.gov/milestones/1937-1945/mexican-oil (last visited Oct. 8, 2018).
[2] Vanda Felbab-Brown, "Andres Manuel Lopez Obrador and a New Ear of Politics in Mexico," *Brookings Institution* (blog), July 3, 2018, https://www.brookings.edu/blog/order-from-chaos/2018/07/03/andres-manuel-lopez-obrador-and-a-new-era-of-politics-in-mexico/.
[3] Daniel Workman, "Mexico's Top Trading Partners", *WTEx* (blog), March 5, 2018, http://www.worldstopexports.com/mexicos-top-import-partners/.
[4] See "Mexico's Declining Oil Production," *Seeking Alpha*, August 27, 2017, https://seekingalpha.com/article/4102171-mexicos-declining-oil-production.
[5] North American Free Trade Agreement (U.S.-Mex.-Can.), December 8, 1993, https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement.
[6] Agreement between the United States of America, the United Mexican States, and Canada, November 30, 2018 (not yet in force), https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between. The name was changed at the demand of President Trump, even though many of the changes are minor, since Trump has frequently referred to NAFTA as "the worst trade deal ever." See Parker Schorr, "Is NAFTA the 'Worst Trade Deal Ever?' Panelists say No," *The Badger Herald*, September 26, 2018, https://badgerherald.com/news/2018/09/26/is-nafta-the-worst-trade-deal-ever-panelists-say-no/.

$250 billion worth of Chinese goods were subject to penalty tariffs of 10-25%,[7] and many observers expect that at least some of these tariffs—and retaliatory tariffs by China—may last for months and perhaps longer unless the negotiations that are currently under way are successful.[8] Consequently, the international supply chains American manufacturers have relied on for low cost parts and components for nearly two decades may at least in part be restructured. Such changes mean shifting production of many parts and components from China to Vietnam, Taiwan, South Korea, and Mexico, among others, likely over a period of several years and at significant cost to American importers and manufacturers.[9]

When NAFTA's future was uncertain, Mexico was not an attractive investment option. With the new relationship likely to be formalized, albeit perhaps not in 2019, Mexico will once again become a prime source country for lower cost manufacturing of both automobiles and parts to be exported to the United States, despite the somewhat less favorable automotive rules of origin in the USMCA and other disadvantages. Moreover, while the USMCA makes many changes for the automotive production industry, rules of origin for most other manufacturing sectors except textiles are largely unchanged, keeping Mexico an attractive country for the export of goods to the United States. Moreover, if the Trump administration follows through on its plans to impose "national security"-based tariffs of 20-25% on imports of all automobiles and auto parts[10] (with Mexico and Canada both enjoying exemptions under the USMCA), such tariffs could indirectly have a significant positive impact on auto and auto part production in Mexico (although the impacts would largely be negative for many North American auto producers).

Separately, the statutory and constitutional energy reforms engineered by outgoing Mexico President Enrique Peña-Nieto,[11] if they are supported by AMLO, offer Mexico an opportunity to re-energize the declining petroleum sector by encouraging foreign oil companies, including but not limited to those located in the United States, to proceed with investments and exploration activities, which have repeatedly been postponed since many hydrocarbons exploration leases were awarded in 2017[12] due to both low global oil prices as

[7] The tariffs were initially set at 10% and to be increased to 25% beginning January 1, 2019. See Jim Tankersley and Keith Bradsher, "Trump Hits China with Tariffs on $200 Billion in Goods, Escalating Trade War," *The New York Times*, September 17, 2018, https://www.nytimes.com/2018/09/17/us/politics/trump-china-tariffs-trade.html.
[8] Everett Rosenfeld, "Beijing Says Latest US-China Trade Talks were Extensive, Made Progress on Forced Tech Transfers," *CNBC*, January 9, 2019, https://www.cnbc.com/2019/01/10/beijing-issues-statement-on-us-china-trade-talks.html.
[9] Supply chain shifts away from China are difficult to predict and will depend in part on available alternative production venues, the costs for enterprises of moving manufacturing facilities to other countries, and the ability of enterprises that sell finished goods or parts and components in the United States to pass along cost increases stemming from higher tariffs to consumers in the United States.
[10] See U.S. Department of Commerce, "U.S. Department of Commerce Initiates Section 232 Investigation into Auto Imports," May 23, 2018, https://www.commerce.gov/news/press-releases/2018/05/us-department-commerce-initiates-section-232-investigation-auto-imports..
[11] USMCA, Appendix to Annex 4-B.
[12] "Ten Blocks Awarded under Mexico's Round 2.1 Lease Sale," *Offshore*, June 20, 2017, https://www.offshore-mag.com/articles/2017/06/ten-blocks-awarded-under-mexico-second-round-lease-sale.html.

well as uncertainty as to what AMLO's energy policies may entail. This could encourage investment in Mexico's oil sector to go forward, despite the fact that world oil prices have fluctuated recently from more than $70 per barrel to as low as $41 per barrel.[13] That being said, the USMCA on its face maintains the sovereignty of Mexico's existing legislation and constitutional provisions related to hydrocarbons,[14] although other provisions of the agreement indicate that a rollback of the energy reforms would be a violation of the USMCA.[15] It is still possible that AMLO, who has a supermajority in the Mexican Congress, could seek to roll back the Peña-Nieto administration's energy policies, though leases previously awarded to U.S. or Canadian enterprises would be subject to challenges under the dispute settlement provisions of NAFTA's Chapter 11 for up to three years after the USMCA goes into effect.

While this article does not discuss in any detail the domestic promises AMLO made during his campaign and is now seeking to implement, including those related to improving education and combatting endemic corruption and violence, their success all largely depends on AMLO's ability to encourage investment in the hydrocarbons sector, which would permit Mexico to increase its oil and gas exports—and thus revenue—in the future. Even though the major impact of such investment is not likely to be felt directly during AMLO's presidency, income from the new leases alone could soon provide some of the funding for AMLO's promised reforms. Thus, if the AMLO administration fails to encourage and protect new investment in the petroleum sector, in my view his *sexenio* will be a failure, and will probably result in a level of social and political instability that Mexico has not seen in many decades.

The remaining sections of this paper are organized as follows. Part II presents a brief overview of the USMCA, with a focus on the aspects most likely to affect Mexico and limited attention to contentious issues such as dispute settlement (or the absence thereof) and the "sunset" clause, as well as brief coverage of matters important to Canada. Given the length and breadth of the USMCA, Part III focuses on four key sectors modified under the agreement: automotive, energy, agriculture, and labor. This part seeks to relate the USMCA's provisions to AMLO's policies, since Mexico will require wise legal and economic policies throughout its core industries (not only the petroleum sector) to maximize the benefits and minimize the disadvantages of a revised NAFTA.

Part IV addresses several important uncertainties that will affect the U.S.-Mexico trade relationship, including the approval or rejection of the USMCA by the U.S. Congress; AMLO's domestic policies, which may affect investor confidence in Mexico; and the impact of Trump's trade policies on both U.S-Mexico trade and unrelated issues such as

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[13] See Statista, "Average Annual OPEC Crude Oil Price from 1960 to 2019," https://www.statista.com/statistics/262858/change-in-opec-crude-oil-prices-since-1960/.
[14] USMCA, art. 8.2.
[15] USMCA, art. 32.11 effectively provides most-favored-nation treatment for energy. Given that Mexico's Annex I in the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) effectively locks in the Pena-Nieto reforms, the United States must also receive treatment in the energy sector that is no less favorable than that afforded by Mexico to its CPTPP partners.

immigration and the "wall," which could have spillover effects on trade. Part IV also includes a list of policy recommendations.

II. The United States-Mexico-Canada Agreement: An Overview

AMLO generally endorsed the Peña-Nieto administration's negotiating strategies and conclusions on the USMCA. Close AMLO advisors participated in all bilateral negotiations that occurred after AMLO won a landslide election on July 1, 2018,[16] including those that resulted in a joint U.S.-Mexico announcement of the agreement in principle on August 28, 2018.[17] AMLO's support for the agreement, which was concluded with both the United States and Canada on September 30, 2018, was reiterated by AMLO's then-foreign minister designate Marcelo Ebrard, who stated that "The culmination of this negotiation process promotes certainty in the financial markets and investment and job creation in our country."[18] (The Pena-Nieto administration signed the agreement on behalf of Mexico on November 30.) According to some observers, this reflected a degree of pragmatism on AMLO's part—previously exhibited during his term as mayor of Mexico City[19]—rather than the populism present in many of his earlier campaign statements, including a denunciation of NAFTA and assertions that, with its natural resources, Mexico can become self-sufficient, a view that many observers dispute.[20]

President Trump hailed the USMCA as:

> [A] great deal for all three countries, solves the many deficiencies and mistakes in NAFTA, greatly opens markets to our Farmers and Manufacturers, reduces Trade Barriers to the U.S. and will bring all three Great Nations together in competition with the rest of the world. The USMCA is a historic transaction![21] (sic)

Canadian Prime Minister Justin Trudeau, after Canada reached consensus on a trilateral agreement literally at the last minute on September 30, termed the USMCA an "agreement that, when enacted, will be good for Canadian workers, good for Canadian business, and good for Canadian families. It's an agreement that

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[16] Azam Ahmed and Paulina Villegas, "Lopez Obrador, an Atypical Leftist, Wins Mexico Presidency in a Landslide," *The New York Times*, July 1, 2018, https://www.nytimes.com/2018/07/01/world/americas/mexico-election-andres-manuel-lopez-obrador.html.
[17] Ana Swanson, Katie Rogers, and Alan Rappeport, "Trump Reaches Revised Trade Deal with Mexico, Threatening to Leave Out Canada," *The New York Times*, August 27, 2018, https://www.nytimes.com/2018/08/27/us/politics/us-mexico-nafta-deal.html.
[18] Elizabeth Malkin, "Mexico's New Leader, Once a NAFTA Foe, Welcomes New Deal," *The New York Times*, October 1, 2018, https://www.nytimes.com/2018/10/01/world/americas/nafta-mexico.html.
[19] Ibid.
[20] Sean Higgins, "NAFTA Critic Andres Manuel Lopez Obrador Holds Big Lead on Eve of Mexican Election," *Washington Examiner*, June 29, 2018, https://www.washingtonexaminer.com/policy/economy/nafta-critic-andres-manuel-lopez-obrador-holds-big-lead-on-eve-of-mexican-election.
[21] See "US-Mexico-Canada Trade Deal Draws Scrutiny as Partners Prep for Signature, Ratification Processes," *Bridges* 22, no. 32 (October 2018), https://www.ictsd.org/bridges-news/bridges/news/us-mexico-canada-trade-deal-draws-scrutiny-as-partners-prep-for-signature.

removes uncertainty for our manufacturers and investors and improves labour rights for all North Americans."[22]

For Canada and Mexico, the USMCA represents the least bad alternative to NAFTA, far superior to the termination of NAFTA repeatedly threatened by the Trump administration, which would have led to a further period of uncertainty that would have jeopardized new investment and job creation in all three countries. The major objective for both was to preserve relatively unhampered access to the U.S. market, which traditionally receives more than 75% of total exports from Mexico and Canada each. Both Canada and Mexico are likely to be slightly less well-off economically than they were under NAFTA, as explained below, but this is by no means certain. Neither country desired the 16-year sunset clause,[23] but it was far better than the five year sunset initially demanded by the Trump administration, and presumably neither wished to accept a prohibition on bilateral free trade agreements with "non-market economies" (i.e., China),[24] a prohibition that if it were imposed on (rather than demanded by) the United States would likely have been denounced as a flagrant violation of U.S. sovereignty. Most significantly, and in a radical departure from a so-called free trade agreement, neither country was exempted from the 25% tariffs on U.S. imports of steel and 10% on imports of aluminum (nor was the U.S. exempted from retaliatory tariffs imposed by Mexico and Canada on agricultural and other products)[25] although those tariffs will probably have to be lifted by the administration before the U.S. Congress agrees to approve the USMCA.[26]

Still, few would argue against the suggestion that after 25 years, the original NAFTA was seriously in need of updating; in my view, most objective observers will recognize that the modernized agreement holds the potential for significant benefits for all three parties. If the advantages of renewing the North American cooperation established under NAFTA through this new agreement can be realized—and that is a big "if"—North America will be in a position to continue to compete effectively with its challengers from China, Europe, and elsewhere, establishing a "comprehensive North American strategy in which the U.S., Mexico, and Canada act in concert to become the global superpower of the 21st century."[27] Partly because it is both a modernization and expansion of NAFTA, the USMCA consists of 34 chapters, 12 more than NAFTA. The areas that are new or significantly updated

[22] Office of Justin Trudeau, Prime Minister of Canada, "Prime Minister Trudeau and Minister Freeland Deliver Remarks on the USMCA," October 1, 2018, https://pm.gc.ca/eng/video/2018/10/01/prime-minister-trudeau-and-minister-freeland-deliver-remarks-usmca.
[23] USMCA, art. 34.7.
[24] USMCA, art. 32.10.
[25] Jeffrey J. Schott, "For Mexico, Canada and the United States, a Step Backward on Trade and Investment," *Peterson Institute for International Economics* (blog), October 2, 2018, https://piie.com/blogs/trade-investment-policy-watch/mexico-canada-and-united-states-step-backwards-trade-and.
[26] See "Brady: Congress not Willing to Consider USMCA until Steel, Aluminum Issues Resolved," *World Trade Online*, January 29, 2019, https://insidetrade.com/daily-news/brady-congress-not-willing-consider-usmca-until-steel-aluminum-issues-resolved.
[27] Edward P, Djerejian, *The North American Nexus*, Policy Brief: Recommendations for the New Administration, Rice University's Baker Institute for Public Policy, Houston, Texas, https://www.bakerinstitute.org/files/11250/.

compared to NAFTA include e-commerce and digital trade, treatment of data, treatment of state-owned enterprises, small and medium-sized enterprises, competition law, corruption, currency manipulation, intellectual property, the environment, and labor rights.[28] Many of these additions have been adapted with only minor modifications from the Trans-Pacific Partnership (TPP),[29] of which all NAFTA members were also parties until Trump withdrew the U.S. from the TPP on January 23, 2017.[30] In time, some of these changes could prove significant both in trilateral North American trade and as a model for other trade agreements if and when the Trump administration is able to conclude them.[31] However, this discussion is limited to USMCA provisions relevant to certain key areas, with particular attention to automotive rules of origin, hydrocarbons, investment, and labor rights.

For Mexico, the most significant risks in the USMCA are changes in North American trade patterns resulting from new automotive rules of origin and related provisions.[32] These changes are designed to encourage enterprises that sell automobiles in the United States to assemble more vehicles and source more parts in the U.S. rather than in Mexico (and to a lesser extent Canada), as discussed in detail below in Part III. However, the economic costs for Mexico will probably be relatively minor, due to a variety of other factors. Mexico also loses the broad protections for U.S. investors in Mexico previously established in NAFTA's Chapter 11 on investor-state dispute settlement,[33] which some observers believe encouraged investment in Mexico. In addition, the increased protection period for biologic drugs to 10 years could raise the cost of such drugs in Mexico (and Canada), most of which are provided to consumers by government health services.[34] Other changes in patent and

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[28] The USMCA chapters include initial provisions; national treatment and market access; agriculture; rules of origin and origin procedures; textiles and apparel; customs and trade facilitation; Mexican ownership of hydrocarbons; sanitary and phytosanitary measures; trade remedies technical barriers to trade; sectoral annexes; government procurement; investment cross-border trade in services; temporary entry; financial services telecommunications; digital trade; intellectual property; competition policy; state-owned enterprises; labor; environment; small and medium-sized enterprises; competitiveness; anticorruption good regulatory practices; publication and administration; administration and institutional provisions; dispute settlement; exceptions; exchange rate matters; and final provisions.

[29] Trans-Pacific Partnership, (Australia, Bahrain, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam), February 4, 2016 (superseded), https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text. The TPP has been replaced (for all parties other than the United States) by the Comprehensive and Progressive Trans-Pacific Partnership, March 8, 2018, https://www.mfat.govt.nz/assets/CPTPP/Comprehensive-and-Progressive-Agreement-for-Trans-Pacific-Partnership-CPTPP-English.pdf. (The TPP and CPTPP must be read together.)

[30] See The White House, "Presidential Memorandum Regarding Withdrawal of the United States from the Trans-Pacific Partnership Negotiations and Agreement," January 23, 2017, https://www.whitehouse.gov/presidential-actions/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific-partnership-negotiations-agreement/.

[31] See letters the U.S. trade representative sent to congressional leaders pursuant to Trade Promotion Authority, notifying Congress of the administration's intent to negotiate trade agreements with the EU, Japan, and the United Kingdom, October 16, 2018, available at https://ustr.gov/sites/default/files/20181017004930805-3.pdf.

[32] See Part III-A, infra.

[33] See USMCA, ch. 14, annex 14-D.

[34] USMCA, art. 20.F.14.

trademark protection, while different from NAFTA, are within the scope of provisions agreed to by all three parties under the TPP.

For Canada, the impact is somewhat different. The new auto rules of origin are not likely to adversely affect Canada (since it already meets the $16 per hour minimum wage requirement for 40-45% of autos and auto parts produced in North America).[35] Canada's concessions are relatively minor: it was forced to open approximately 3.5% of its market for milk proteins to imports from the United States and make some modifications to its milk supply management system[36]; provide protections for biologic drugs (as noted above); and increase the *de minimis* level for small imported packages from about $15 to roughly $115.[37] These latter two changes will likely be welcomed by Canadian consumers. However, both Canada and Mexico were forced to accept language that may prevent either country from concluding a trade agreement with China in the future.[38] Still, Canada preserved the "cultural industries" exception from NAFTA[39] and, most importantly, the Chapter 19 dispute settlement mechanism, a nonnegotiable "red line" for Canada since 1987.[40] While Canada did not obtain broad language on indigenous rights, it was able to include a provision protecting Canadian measures deemed necessary to fulfill the country's legal obligation to indigenous peoples.[41]

For the discussion of more specific aspects of the USMCA in Part III, it helps to understand the significant motivations behind the Trump administration's desire to reform or dispense with NAFTA, as well as its broader trade policies designed to strongly encourage enterprises that sell goods to U.S. businesses and consumers to manufacture those goods in the U.S. using domestically sourced raw materials, parts, and components[42] (hence the high tariffs on most products now being imported into the United States from China). Perhaps most significantly, the administration has sought to discourage enterprises, whether U.S.-owned or foreign, from moving U.S. manufacturing jobs to Mexico or expanding existing production facilities and employment there, particularly in the auto and auto parts sector. This is expected to be accomplished primarily through changes in automotive rules of origin, as discussed in the next section, but also through reduced protections for investor-state dispute settlement under the USMCA compared to NAFTA's Chapter 11. Initial efforts to further discourage investment in Mexico by implementing a five-year sunset clause were largely unsuccessful.

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[35] See Part III-A, infra.
[36] USMCA, ch. 3, annex 3-B.
[37] USMCA, art. 7.8
[38] USMCA, art. 32.19.
[39] USMCA, art. 32.6.
[40] USMCA, ch. 10, sec. D, art. 4. Chapter 19 was critical to Canada's acceptance of the United States-Canada Free Trade Agreement in 1987. See Alexander Panetta, "NAFTA's Third-Party Arbitration System was Canada's Big Prize . . . Is it worth Fighting For?" *The Star,* August 23, 2017, https://www.thestar.com/news/canada/2017/08/23/naftas-chapter-19-was-canadas-big-prize-but-is-it-still-worth-fighting-for.html.
[41] USMCA, art. 32.6.
[42] See USTR, "U.S.-Mexico Trade Facts," https://ustr.gov/countries-regions/americas/mexico; and USTR, "U.S.-Canada Trade Facts," https://ustr.gov/countries-regions/americas/canada.

III. Key USMCA Sectors for AMLO and Mexico

While many areas of the USMCA will have an impact on Mexico, four of the most significant ones concern the automotive sector, energy, agriculture, and labor. This section explores each of these in detail, addressing related economic and policy challenges where appropriate.

A. The Automotive Sector

Autos and auto parts account for more than 20% of total NAFTA trade and for about 950,000 jobs in the United States,[43] in part because some automotive components cross the Canadian and/or Mexican borders as many as eight times before they are assembled into a finished automobile in one of the three NAFTA countries.[44] It is thus not surprising that this was the focus of the NAFTA renegotiations. The elements of the USMCA that directly address the auto industry include: 1) modifications to the NAFTA rules of origin; 2) protections for Mexico and Canada in the event the Trump administration imposes tariffs of 20-25% on U.S. auto and auto part imports generally (presumably on "national security" grounds under Section 232 of the Trade Expansion Act of 1962[45]); 3) an effective ban preventing Mexico or Canada from negotiating a free trade agreement with China; and 4) reduced protections for U.S. and Canadian investors in the automotive and most other sectors.

1. Rules of Origin

The significant changes for autos include an increase in the amount of regional value content (RVC) required for automobiles and light trucks from 62.5% under NAFTA to 75% for the USMCA, to be phased in over three years from the date the USMCA goes into effect.[46] In addition, 70% of the steel used in the manufacture of autos and small trucks must be sourced in USMCA nations.[47] Most significantly for Mexico, 40% of the content of autos and 45% of the content of light trucks must be produced by entities that pay workers at least $16 per hour.[48] Companies that conduct research and development and/or assembly of advanced components such as batteries, engines, and transmissions can count for up to 15% of these thresholds. The calculations are subject to complex tracing rules,[49] which likely will add to auto manufacturing costs in North America.

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[43] See Bureau of Labor Statistics, "Automotive Industry: Employment, Earnings and Hours," October 2018, https://www.bls.gov/iag/tgs/iagauto.htm. Another 3.3 million are employed in vehicle and parts dealerships.
[44] See Kristin Dziczek, Bernard Swiecki, Yen Chen, Valerie Brugeman, Michael Schultz, and David Andrea, *NAFTA Briefing: Trade benefits to the automotive industry and potential consequences of withdrawal from the agreement* (Ann Arbor, MI: Center for Automotive Research, January 2017), http://www.cargroup.org/wp-content/uploads/2017/01/nafta_briefing_january_2017_public_version-final.pdf.
[45] 19 U.S. Code § 1862 – Safeguarding National Security.
[46] USMCA, app. to annex 4-B, art. 4-B.3.
[47] USMCA, app. to annex 4-B, art. 4-B.6.
[48] USMCA, app. to annex 4-B, art 4-B.7.
[49] See., e.g., app. to annex 4-B, arts. 4-B.7, 4-B.8.

Since typical auto industry wages in Mexico are approximately $3.60-$3.90 per hour (which some studies attribute in part to a lack of union support for workers),[50] this means that most of the auto content must be produced in the United States or Canada. Still, some high wage workers in Mexico, such as engineers and R&D and management personnel, are paid between $10 and $22 per hour and may be counted toward the total, which could perhaps encourage auto manufacturers to conduct more R&D in Mexico.[51] It is possible that wages in Mexico eventually will increase to the $16/hour level, given that AMLO is expected to implement policies encouraging higher wages for Mexican workers. Moreover, at least at present, the $16/hour rate is not indexed to inflation, although with inflation in the United States averaging about 2% per year ($0.32), indexing would probably not significantly help Mexico.

Mexico officials estimate that about 70% of the country's current auto production already would meet the 75% RVC requirements.[52] Those vehicles and auto parts that do not meet the USMCA rules of origin would be eligible for the current most-favored-nation (MFN) duty of 2.5%, if the applied MFN rate remains at that level. If the rate increases, for example to 20-25% on the basis of "national security" concerns under Section 232 of the Trade Expansion Act, up to 1.6 million vehicles that met the NAFTA rules of origin would continue to benefit from the current MFN duties.[53] Since small trucks are dutiable at 25%, as a practical matter they cannot be exported to the United States unless they meet the USMCA rules of origin, which will become more difficult to satisfy because of the $16/hour labor rules. Thus, current Fiat-Chrysler and General Motors truck production in Mexico may decrease or cease altogether after the USMCA rules are fully implemented, possibly being replaced by other vehicle production at their existing facilities in Mexico.

Estimating the additional North American production costs due to the more restrictive rules of origin is almost impossible, in part because they likely will vary company by company and vehicle model by vehicle model. The $16/hour requirement will impose a significant tracing and record-keeping burden on enterprises that produce finished passenger vehicles or light trucks.[54] At the same time, existing rules that require companies to trace the origin of parts and components instead of only the major subassemblies of components such as transmissions have been relaxed, which may save the auto industry some administrative costs.[55] Overall, the changes will add to the administrative costs of producing vehicles in North America (compared to in the European Union and Asia), most significantly in the first few years of the USMCA when the industry is adjusting to the changes. The rules of origin for autos under NAFTA have been a significant burden

[50] "Study Points to Large Wage Gaps for Mexican Auto Workers," *Mexico News Daily*, July 2, 2014, https://mexiconewsdaily.com/news/study-points-large-wage-gaps-mexican-auto-workers/.
[51] Rossella Brevetti, "Tough NAFTA Auto Rules Will Help Spur Investment in Mexico," *Bloomberg Law,* October 12, 2018, https://news.bloomberglaw.com/international-trade/tough-nafta-auto-rules-will-help-spur-investment-in-mexico-1.
[52] Sharay Angulo, "Most Mexican Auto Exports Can Meet New NAFTA Rules, Says Minister," *Reuters*, August 27, 2018, https://www.reuters.com/article/us-trade-nafta-mexico-autos/most-mexican-auto-exports-can-meet-new-nafta-rules-says-minister-idUSKCN1LC2HC.
[53] USMCA, Annex 2-C, para. 5.
[54] USMCA, appendix to annex 4-B, art. 4-B.7.
[55] USMCA, ch. 4, annex B, appendix.

because of the requirement to trace not only major components but also parts of major components.[56] However, auto manufacturing companies in North America appear to have learned to minimize the administrative costs of compliance and, as noted above, will escape many of these requirements under the USMCA.

The overall economic impact depends on several other factors, including the increased cost of steel and aluminum due to U.S. tariffs and quotas on imports of these materials from most countries other than Australia, enacted allegedly on Section 232 national security grounds.[57] If these increased costs are added to the costs of complying with the USMCA rules of origin and minimum hourly labor costs, vehicle costs will also increase. This could result in a decrease in sales volumes as well as exports, although predicting the magnitude of the decrease, and the resulting job losses, is difficult. In addition, the retaliatory tariffs from China on imports of American-made autos, initially set at 25% in addition to the standard MFN tariff of 15% (a hike that was to go into effect on Jan. 1 but was later suspended for 90 days),[58] may also have an impact on U.S. auto production and employment because of a decrease in U.S. (mostly BMW and Mercedes) exports.[59]

Another uncertainty for the auto industry more generally will also affect production in North America (as well as other regions). By the time the new USMCA rules of origin have been fully phased in some four years after the agreement goes into effect (i.e., 2024 or later), many observers expect that a significant percentage of the autos sold in the United States will be electric vehicles. Such vehicles rely heavily on electric motors and batteries, and many of the thousands of components required for production of an internal combustion engine will no longer be required. The potential effect of this transition on the auto parts industry worldwide will be significant.

It is virtually impossible (as of the time of this writing) to determine the impact of the new rules of origin on future Mexican auto parts production. Presumably, some of the current auto parts production in Mexico will move to the United States or Canada because of the $16/hour labor rule. (The extent to which this change will create additional U.S. positions depends in part on the extent to which manufacturers invest in robots and other labor-saving equipment.) At the same time, while the RVC requirement for manufactured goods is being increased from 62.5% to 75%, 25% of the total content may still be sourced from non-North American sources. For auto manufacturers in Mexico, sourcing from China, elsewhere in Asia, and the EU will still be feasible, even if the Trump administration

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[56] See NAFTA, annex 300-A.

[57] Australia is the only country among those originally exempted who remains so as of December 2018. See Michael Cowden, "Australia Joins 232 Tariff Exemption Parade," *Fastmarkets AMM*, March 12, 2018, https://www.amm.com/Article/3793254/Australia-joins-232-tariff-exemption-parade.html.

[58] See Trefor Moss, "U.S. Car Makers Left in the Dust as China's Tariff Cut Boosts Europe, Japan," *The Wall Street Journal,* August 10, 2018, https://www.wsj.com/articles/u-s-car-makers-left-in-the-dust-as-chinas-tariff-cuts-boost-europe-japan-1533901068; and "China Suspends Tariffs on U.S. Auto Imports for 90 Days," *KTLA 5*, December 14, 2018, https://ktla.com/2018/12/14/china-to-suspend-tariffs-on-u-s-auto-imports-in-hopes-of-negotiating-new-trade-deal/.

[59] For example, BMW is preparing to shift some auto production now manufactured in the United States for export to China to a different country. See Gabrielle Coppola, "BMW May Shift Production to China from U.S. as Trade War Bites," *Bloomberg Law,* November 8, 2018, http://bit.ly/2N5uOxy.

ultimately imposes 20-25% tariffs on auto parts imported into the United States from those countries under Section 232. Also, with the increase in North American content required in automobiles and auto parts, inexpensive parts currently made in Asia will likely be replaced by parts production in Mexico. For some producers, this many encourage a shift in auto parts production for USMCA markets from China to Mexico rather than to Malaysia, Vietnam, South Korea, or elsewhere, assuming Mexico's investment climate remains favorable. This could further increase the cost advantage of producing autos and some parts in Mexico.

The rules discussed above do not affect shipments of autos from Mexico or Canada to third-market countries. Moreover, Canada and Mexico are protected to a significant extent from the possible impact of high U.S. tariffs on autos and auto parts. Side letters effectively establish a tariff/rate quota for both Mexico- and Canada-made vehicles, whereby up to 2.6 million passenger vehicles per year and a set quantity of auto parts (valued at up to $32.4 billion for Canada and up to $108 billion from Mexico), as well as light trucks from both countries would be excluded from the Section 232 tariffs if applied elsewhere.[60] All such figures are well above current Canadian and Mexican auto and auto part exports to the United States.

Future exchange rates will also play a role in the overall cost analysis, to the extent permitted under the quota limitations noted below. For example, the strong U.S. dollar means that the value of the Mexican peso has declined over the last several years even with the conclusion of the USMCA, reaching a rate of about 19.1 pesos to US$1 as of January 2019.[61] Similarly, the Canadian dollar is only worth about US$0.75.[62] Mexico is probably less susceptible to price increases driving down demand for autos and light trucks, since production in Mexico for the domestic market (or third-country markets) should not be directly affected by USMCA rules of origin. Still, to the extent that prices for vehicles imported from the United States have increased, even if they enter Mexico (and Canada) duty-free, one may reasonably expect a decrease in overall sales, which again may have a potentially negative impact on U.S. production volumes and employment. Given that total U.S. auto and light truck exports to Mexico and Canada in 2017 amounted to nearly 1.1 million vehicles,[63] this could have more than a negligible effect. All of these changes come at a time when U.S. auto sales have been holding steady despite minor price increases for raw materials,[64] although a modest decline is predicted in 2019.[65]

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[60] USMCA, U.S.-Canada 232 side letter, U.S.-Mexico 232 side letter.
[61] See "Mexican Pesos (MXN) per U.S. Dollar (USD)," *Exchange-Rates.org*, retrieved on January 11, 2019.
[62] "XE Currency Converter," *XE*, retrieved on January 12, 2019.
[63] See "U.S. exports of New Passenger Vehicles and Light Trucks," U.S. Department of Commerce, International Trade Administration ,https://www.trade.gov/td/otm/autostats.asp.
[64] U.S. light vehicle production declined by 4.3% in 2017 from the record year, 2016. See Sarah Petit, "North America Production Down 4.3% in 2017," *Wards Intelligence*, January 19, 2018, http://subscribers.wardsintelligence.com/analysis/north-america-production-down-43-2017.
[65] Ben Klayman and Shravanth Wijayakumar, "U.S. Auto Sales Expected to dip in 2019, NADA Says," *Automotive News,* December 13, 2018, https://www.autonews.com/sales/us-auto-sales-expected-dip-2019-nada-says.

In the absence of a threat of extraordinary tariffs on U.S. imports of autos and auto parts, a passenger vehicle produced in Mexico that did not qualify for NAFTA treatment because it did not meet the 62.5% RVC standard would simply be exported to the United States under the 2.5% U.S. MFN tariff. Factors such as the low MFN rate, a variety of production cost savings in Mexico, the declining peso value, and fewer restrictions on the use of less expensive parts from Asia could more than counteract the tariff. However, as indicated below, this is no longer necessarily the case under the USMCA.

<u>2. Possible Future U.S. Tariff Increases</u>

Some assurances exist for Mexico that passenger vehicles that do not meet the 75% RVC standard can be exported to the United States at the current 2.5% MFN rate. The 2.5% rate for these nonconforming vehicles is protected even if the United States invokes the national security provisions, as long as a) those vehicles would have met the 62.5% RVC under the 1994 NAFTA, and b) the number of vehicles exported by Mexico to the U.S. each year under this exception does not exceed 1.6 million vehicles.[66] In other words, Mexico obtains a guaranteed quantity of exports to the United States of vehicles that meet the old (NAFTA) but not the new (USMCA) rules, even if the United States raises its import duties on autos to 25% in the future.

A side letter to the USMCA provides additional protection for Mexico against the potential Section 232 tariffs on automobiles in the form of what is effectively a tariff/rate quota. It stipulates that Mexico can export up to 2.6 million passenger vehicles and an unlimited number of light trucks that meet USMCA standards, along with up to $108 billion worth of auto parts, without incurring additional tariffs.[67] In this instance, a similar side letter applies to Canada.[68] To reiterate, in the case of Mexico, it appears that the 2.6 million quota under the side letter is intended to apply to autos that meet the USMCA requirements, while the 1.6 million quota under Annex 2-C of the agreement itself applies to vehicles that do not meet the USMCA standards. Assuming this is the case, current auto and parts production volumes in Canada and Mexico would be protected, albeit in a rather complex manner.

Unless and until the United States decides not to impose high tariffs on imports of autos and auto parts from third-market countries, along with tariff/rate quotas on imports from Mexico and Canada, the USMCA will probably have a chilling effect on any additional auto investment and production in Mexico. Without this threat, the alternative to meeting the USCMA rules of origin would simply be exporting vehicles to the United States subject to the 2.5% MFN tariff and auto parts subject to MFN tariffs in the 3.5% range.[69] Auto production in Mexico, particularly of small cars, would remain a more desirable option over China (because of bilateral retaliatory tariffs, originally enacted under Section 301 of

[66] USMCA, annex 2-C, paras. 5(a) and 5(b).
[67] U.S.-Canada side letter, September 30, 2018, https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/Side_Letter_Text_on_232_CA-US_Response.pdf.
[68] Ibid.
[69] See USMCA, annex 2-C, pars. 2-4.

the Trade Act of 1974[70]) and probably other countries in Asia. For example, one can assume that the new version of the Focus—which originally was to be produced by Ford in Mexico until Trump objected and later in China before the Section 301 tariffs and retaliatory tariffs were imposed—might still be manufactured in Mexico if the MFN rate were an option (it now appears that the Focus will not be available at all in the United States[71]).

3. Ban on a Free Trade Agreement With China

As noted earlier, the USCMA effectively bans Mexico and Canada each from negotiating a free trade agreement with China (or another nonmarket economy such as North Korea) unless the United States concurs; should either country decide to enter such an agreement, the United States reserves the right to terminate the USMCA with six months' notice.[72] While this is probably not a significant limitation on Mexico and Canada's ability to conclude new free trade agreements, it is somewhat troubling to advocates of freer trade through regional trade agreements. As with other provisions of the USMCA, it reflects the United States' overwhelming concern over China's economic rise and the probability that it will eclipse the United States not only in gross GDP but in specific sectors targeted by the "Made in China 2025" policies.[73]

Mexico (and Canada) would encounter substantial risks should either seek a free trade agreement with China, given that a reduction of Mexican tariffs on most or all products manufactured in China could risk causing balance of payments problems. However, it can be argued that Mexico could benefit from a Chinese market that is more open to Mexican agricultural exports. In addition, a reduction or elimination of tariffs on vehicles exported from Mexico to China, currently set at 15%, could provide a significant boon for auto producers in Mexico, at least of specific models that are not already manufactured in China or other countries in Asia, or of models currently made in the United States destined for China. Also, should Mexico lower its tariffs on auto parts from China (or elsewhere) to zero, this would decrease auto production costs in Mexico, particularly with Mexican production for third-country markets that are not subject to the USMCA's RVC requirements.

4. Reduced Protections for Investors

It is unclear whether the reduced protections for investors in most sectors once the USMCA goes into effect will have a significant impact on new investment in the auto and auto parts sectors. Other factors, discussed earlier in this section, are likely far more important; the full range of changes to investor protections is discussed in Part III-B. Still, it is significant that Chapter 14 of the USMCA, except for "legacy" claims under NAFTA's

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[70] See USTR, "Section 301 Report into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation," March 27, 2018, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/march/section-301-report-chinas-acts.
[71] Patti Waldmeir, "Ford Scraps Plan for U.S. Imports of New Focus From China," *Financial Times*, August 31, 2018, https://www.ft.com/content/67e707be-ad3a-11e8-94bd-cba20d67390c.
[72] USMCA, art. 32.10.
[73] See Kristen Hopewell, "What is 'Made in China 2025'—and Why is it a Threat to Trump's Trade Goals," *Washington Post*, May 3, 2018, https://www.washingtonpost.com/news/monkey-cage/wp/2018/05/03/what-is-made-in-china-2025-and-why-is-it-a-threat-to-trumps-trade-goals/?utm_term=.22a90abcdc89.

Chapter 11,[74] reduces protections for most investors in Mexico, primarily by depriving them of the right to pursue actions against the Mexican government in investor-state dispute settlement (ISDS) for denial of "fair and equitable treatment" or indirect expropriation.[75] In addition, the new provisions do not apply to establishment claims (prior to the actual investment) and impose a 30-month period for exhaustion of local remedies before international arbitration can be sought.[76] (The situation with Canada is different; ISDS claims will not be permitted at all between the United States and Canada after the legacy period.[77]) Disputes between Canadian investors and the Mexican government and vice-versa would be covered by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which includes Canada, Mexico, and other partners in the Asia-Pacific region and went into effect on December 30, 2018.[78]

This is a significant departure for the United States, both from NAFTA and from the more than a dozen investment chapters in free trade agreements concluded by the United States since 2002, although presumably the most egregious claims for denial of national treatment and direct expropriation would be pursued by injured investors once the exhaustion of local remedies requirement is met.

The reduction of investment protections was one of the Trump administration's policy objectives in the NAFTA renegotiations. U.S. officials appear to believe that without such protections, investors are less likely to move manufacturing and goods production to Mexico (or elsewhere outside of the United States). The U.S. had originally proposed that NAFTA parties would be able to opt out of the investment protection chapter in a revised NAFTA, despite opposition from members of Congress and the business community.[79] However, the result was somewhat different, with ISDS disappearing from U.S.-Canada disputes entirely and being limited for most sectors with respect to Mexico.

Still, in my view these changes will have little or no measurable effect on Mexico's auto industry unless the Mexican government under AMLO takes actions that investors in Mexico may consider generally more unfair or discriminatory to foreign investment. Since most of the investment in the Mexico's auto industry is foreign (e.g., by companies in the U.S., Canada, European Union, Japan, and Korea, among others), and since the industry accounts for an estimated 840,000 jobs in Mexico,[80] it is extremely unlikely in my view that members of the industry should have any serious concerns. Moreover, any prospective investors who have reservations can protect themselves by investing in Mexico

[74] USMCA, annex 14-C.
[75] USCMA, annex 14-D.
[76] Ibid.
[77] See USMCA, annexes 14-D and 14-E (not applicable to Canada).
[78] CPTPP, ch. 9; but see CPTPP text, annex, para. 2 (related to the suspension of certain investment-related provisions of the TPP).
[79] "USTR Sticks to ISDS Opt-In Proposal while Stakeholders Eye Other Options," *World Trade Online*, May 3, 2018, https://insidetrade.com/daily-news/ustr-sticks-isds-opt-proposal-while-stakeholders-eye-other-options.
[80] See "Employment in Mexico's Automotive Industry Reached Record High in 2017," *Mexico Now,* March 26, 2018, https://mexico-now.com/index.php/article/3831-employment-in-mexico-s-automotive-industry-reached-record-high-in-2017.

through an enterprise established in Canada, Japan, Korea, or other CPTPP member countries.[81] A U.S.-owned enterprise could invest in Mexico via a Canadian (or other CPTPP) subsidiary, if the subsidiary maintains substantial business activities in Canada.[82]

B. Energy

Since the Mexican oil industry—previously dominated by British and U.S. enterprises—was expropriated by President Lázaro Cárdenas in 1938 as "the apogee of Mexican resource nationalism" and a "patriotic triumph,"[83] hydrocarbons have been the most politically sensitive economic sector in Mexico, with its ownership of the sector largely untouchable for political reasons until NAFTA went into effect in 1994, and well after in most respects. The state oil company Pemex, a symbol of national pride,[84] has effectively enjoyed a monopoly for some 78 years. The sector's relationship to North American trade, first under NAFTA and now under the USMCA, remains tenuous. It was only in 2013 during the Peña-Nieto administration that changes made in Mexican law and to the Mexican Constitution have permitted private foreign investment in petroleum.

Understanding the transition, and the possibility of further changes under AMLO, requires a brief discussion of the history of Mexico's oil sector since 1938.

<u>1. 1938 to NAFTA (1994) to USMCA</u>

NAFTA did little to open petroleum (or electricity generation) to private investment (foreign or domestic). First and foremost, the government monopoly over oil and gas was explicitly preserved:

1. The Mexican State reserves to itself the following strategic activities, including investment in such activities and the provision of services in such activities:

    a) exploration and exploitation of crude oil and natural gas; refining or processing of crude oil and natural gas; and production of artificial gas, basic petrochemicals, and their feedstocks and pipelines;
    b) foreign trade, transportation, storage, and distribution, up to and including the first hand sales of the following goods:
        (i) crude oil,
        (ii) natural and artificial gas,

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[81] See CPTPP, art. 9.1, which states that "investor of a Party means a Party, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of another Party."
[82] See CPTPP, art. 9.15.
[83] See Noel Maurer, "The Empire Struck Back: Sanctions and Compensation in the Mexican Oil Expropriation of 1938," *Journal of Economic History* 71 (2011): 590-615, http://www.hbs.edu/businesshistory/Documents/maurer-article-mexican-oil.pdf. For an overview of Mexico's oil industry from 1901 to 1972, see George Grayson, *The Politics of Mexican Oil* (Pittsburgh, PA; University of Pittsburgh Press, 1980).
[84] Clare Ribando Seelke, Michael Ratner, M. Angeles Villarreal, and Phillip Brown, *Mexico's Oil and Gas Sector: Background, Reform Efforts, and Implications for the United States,* R43313 (Washington, D.C.: Congressional Research Service, September 2015), https://fas.org/sgp/crs/row/R43313.pdf.

(iii) goods covered by this Chapter obtained from the refining or processing of crude oil and natural gas, and
(iv) basic petrochemicals;[85]

c) the supply of electricity as a public service in Mexico, including, except as provided in paragraph 5, the generation, transmission, transformation, distribution, and sale of electricity; and
d) exploration, exploitation, and processing of radioactive minerals, the nuclear fuel cycle, the generation of nuclear energy, the transportation and storage of nuclear waste, the use and reprocessing of nuclear fuel, and the regulation of their applications for other purposes and the production of heavy water.

In the event of an inconsistency between this paragraph and another provision of this agreement, this paragraph shall prevail to the extent of that inconsistency.

2. Pursuant to Article 1101(2), (Investment-Scope and Coverage), private investment is not permitted in the activities listed in paragraph 1…[86]

This broad exception, widely regarded in the United States as one the great failures of the NAFTA negotiations, meant that private investment in the sector was permitted only in non-basic petrochemicals. Petroleum activities, from exploration to production to retail distribution, were the exclusive province of the state under Pemex. I am among the analysts who believe that Mexico's refusal to permit even limited foreign investment in the sector was more responsible than any other single factor for the fact that Mexico's GDP, which in 1994 was equivalent to countries such as South Korea, represents less than half of South Korea's GDP 25 years later.[87] The funds that could have been generated by increasing Mexico's oil and gas production over the past several decades could have permitted the Mexican government to build the safety nets that are now among the major objectives of AMLO's administration.

The most significant liberalization of the Mexican petroleum and electricity sectors took place in 2013-14, with a series of more than 21 legislative changes and three amendments to the Mexican Constitution.[88] Led by the Peña-Nieto administration but also supported by the National Action Party (PAN) and the Party of the Democratic Revolution (PRD, which

[85] Other petrochemicals are governed in part by Annex 603.6, which grants the Mexican government the authority to restrict import and export licenses, but does not require it to do so.
[86] NAFTA, annex 602.3.
[87] In 2017, South Korea's per capita GDP was $39,400; Mexico's was $19,900. Central Intelligence Agency, "World Factbook, Country Comparison GDP Per Capita (PPP)," 2017, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html.
[88] See Diana Villiers Negroponte, "Mexico's Energy Reforms Become Law," August 14, 2018, *Brookings*, https://www.brookings.edu/articles/mexicos-energy-reforms-become-law/.

was AMLO's former political party), the reforms were intended in significant part to support the enactment of financial, education, telecommunications, and fiscal reforms.[89]

Key elements of the reforms overwhelmingly approved by Mexico's Congress included:

- Maintaining state ownership of subsoil hydrocarbons resources, but allowing companies to take ownership of those resources once they are extracted and to book reserves for accounting purposes;
- Creating four types of contracts for exploration and production: service contracts (companies are paid for activities done on behalf of the state), profit-sharing contracts, production-sharing contracts, and licenses (enabling a company to obtain ownership of the oil or gas at the wellhead after it has paid taxes);
- Opening refining, transport, storage, natural gas processing, and the petrochemicals sectors to private investment;
- Transforming Pemex into a productive state enterprise with an autonomous budget and a board of directors that does not include union representatives;
- Strengthening four federal entities with regulatory roles in the hydrocarbons industry (the Ministries of Energy and Finance, the National Hydrocarbons Commission, and the Energy Regulatory Commission) and creating a National Agency for Industrial Safety and Environmental Protection; and
- Establishing a sovereign wealth fund, the Mexican Petroleum Fund for Stabilization and Development, to be managed by the central bank. [90]

While actual exploration and development has been hampered by low oil prices,[91] the prospects are generally bright. Only two of the original 14 blocs found bidders in 2015.[92] Less than three years later, in January and March 2018, more than 70 different firms made over $100 billion in new oil investment commitments, important revenue for a government that seeks to enact sweeping social changes.[93]

2. Treatment of the Hydrocarbons Sector Under the USMCA

Despite the liberalization of Mexico's petroleum sector since 2013, the USMCA's hydrocarbons chapter does not grant the United States or Canada any rights for their citizens to participate in the development of the sector. Rather, USMCA Chapter 8 specifies that:

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[89] See Manuel Rueda, "Peña Nieto Makes Big Promises to Mexico," *ABC News*, December 1, 2012, https://abcnews.go.com/ABC_Univision/News/pea-nieto-makes-big-promises-mexico/story?id=17857633.

[90] Approved by the Mexican Senate on December 11, 2013 (95-28) and by the Chamber of Deputies on December 12, 2013 (354-134). See also Seelke et al., *Mexico's Oil and Gas Sector*, 4.

[91] See "Mexico Energy Outlook," *International Energy Agency*, 2016, https://www.iea.org/publications/freepublications/publication/MexicoEnergyOutlookExecutivesummary_WEB_UK.pdf.

[92] Seelke et al., "Mexico's Oil and Gas Sector," 7.

[93] See Craig Guthrie, "Amlo and the Realities of Mexico's Oil Reform," *Petroleum Economist*, July 9, 2018, http://www.petroleum-economist.com/articles/politics-economics/south-central-america/2018/amlo-and-the-realities-of-mexicos-oil-reform.

2. In the case of Mexico, and without prejudice to their rights and remedies available under this agreement, the United States and Canada recognize that:
    a) Mexico reserves its sovereign right to reform its Constitution and its domestic legislation; and
    b) The Mexican State has the direct, inalienable, and imprescriptible ownership of all hydrocarbons in the subsoil of the national territory, including the continental shelf and the exclusive economic zone located outside the territorial sea and adjacent thereto, in strata or deposits, regardless of their physical conditions, pursuant to Mexico's Constitution.[94]

Does this mean that the Lopez Obrador administration could choose to roll back the 2013 reforms to Mexico's energy law that permit U.S. and other foreign investment in the sector? Legally, the answer is "no," even though the legal structure that underlies Mexico's obligation under the USMCA is complex.

Mexico agrees in the USMCA to a type of most-favored-nation clause, which affords other USMCA parties treatment regarding energy (as well as services and state-owned enterprises) that is no more restrictive than treatment given by Mexico to parties in other trade agreements Mexico has concluded. Thus,

> With respect to the obligations in Chapter 14 (Investment), Chapter 15 (Cross-Border Trade in Services), and Chapter 22 (State-Owned Enterprises and Designated Monopolies), Mexico reserves the right to adopt or maintain a measure with respect to a sector or subsector 32-12 for which Mexico has not taken a specific reservation in its schedules to annexes I, II, and IV of this agreement, *only to the extent consistent with the least restrictive measures that Mexico may adopt or maintain under the terms of applicable reservations and exceptions to parallel obligations in other trade and investment agreements that Mexico has ratified prior to entry into force of this agreement,* including the WTO agreement, without regard to whether those other agreements have entered into force.[95] (emphasis added)

Mexico did not make any specific reservations regarding investment in the energy sector in its USMCA obligations, beyond the stating-the-obvious language in Chapter 8, as noted above. However, in the CPTPP, Mexico listed several specific energy-related reservations.[96] The "least restrictive" reservations authorize foreign investment in the sector under the conditions set out in the 2013 legislation enacted by the Pena-Nieto administration (which apply directly to Canada since Canada is a CPTPP party). Thus, under the proviso quoted above, along with the energy reservations Mexico agreed to in the CPTPP, the Lopez-Obrador administration (and any subsequent Mexican governments) may not impose rules on foreign

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[94] USMCA, ch. 8.2.
[95] USMCA, art. 32.11. This is an obvious reference to TPP/CPTPP, since Mexico had ratified that agreement at the time the USMCA negotiations were concluded, but it had not yet entered into force.
[96] TPP, Annex I-Mexico-17 to 26.

investment in the energy sector that are any more restrictive than those set out in the CPTPP reservations without violating the terms of the USMCA.

Given that AMLO in 2018 backed away from his previous radicalism and threats to re-nationalize Mexico's oil sector,[97] it may not matter to his administration that under the above analysis (which to the best of my knowledge has not been publicized in Mexico) exists to preclude backsliding. AMLO's colleagues participated in the finalization of the USMCA negotiations beginning immediately after the July 1 election, presumably including in the discussions for the energy chapter. At the end of August 2018, AMLO indicated that Trump "understood our position" and accepted his administration's proposals on energy: "We put the emphasis on defending national sovereignty on the energy issue and it was achieved."[98] AMLO's administration has promised to review the more than 100 oil exploration and production contracts awarded by the Peña-Nieto administration, but to revise them only if the review discovered evidence of corruption.[99]

Observers differ on how AMLO's petroleum policies will develop in the first several years of his presidency. One expert suggested the following in July:

> AMLO will likely enjoy the benefits from the existing contracts that have been awarded, especially in terms of oil barrels produced, fiscal revenue received, and jobs created. By the third year of his administration he can claim that Mexico is producing more oil under his presidency . . . But he will be reluctant to continue the bidding rounds.[100]

Given the AMLO administration's need for revenue in order to meet campaign promises to address issues such as corruption, drug violence, unequal economic growth, the difficulties faced by Mexico's poorest citizens, and the country's weak rule of law,[101] I initially believed it to be highly unlikely that these objectives could be accomplished without massive funding, funding that realistically can come only from the income received from the sale of oil leases and ultimately the export of petroleum products. Under that hypothesis, Mexico would have continued to auction oil and gas leases. However, it appears that I was mistaken; Mexico announced in late November that the government would suspend further bidding for oil and gas exploration leases until 2021.[102]

3. Protecting Foreign Investment in Petroleum

Investment protection in the petroleum sector was not a major factor in NAFTA, given the Chapter 6 prohibition on private investment (which was reflected in provisions of

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[97] Felbab-Brown, "Andres Manuel Lopez-Obrador and a New Era of Politics."
[98] Diego Oré, "Mexico's next Leader Says NAFTA Deal Preserves Energy 'sovereignty,'" *Reuters*, August 27, 2018, https://www.reuters.com/article/us-trade-nafta-mexico/mexicos-next-leader-says-nafta-deal-preserves-energy-sovereignty-idUSKCN1LC2BP.
[99] Ibid.
[100] Guthrie, "Amlo and the Realities."
[101] Felbab-Brown, "Andres Manuel Lopez-Obrador and a New Era of Politics."
[102] "Mexico E&P Auctions on Hold until 2021: report," *The Oil & Gas Year*, November 21, 2018, https://www.theoilandgasyear.com/news/mexico-ep-auctions-on-hold-until-2021-report/.

Mexico's Constitution until 2013-14) and the fact that little actual investment and exploration occurred after some hydrocarbons leases were sold between 2014 and 2018. NAFTA's Chapter 11 by its broad terms would apply to investments in the petroleum sector to the extent they are made while NAFTA remains in force, but no incidents have apparently arisen.

It is unnecessary to discuss the protections of NAFTA's Chapter 11 in this article in any detail, given the enormous volume of literature addressing the subject.[103] Suffice it to note here that investors who are nationals of one NAFTA party are protected when they invest[104] in another NAFTA party, most significantly against violations of national treatment, most-favored nation treatment, fair and equitable treatment, and expropriation, both direct and indirect. Investors also are protected against the imposition of performance requirements, enjoy the right to choose their own management, and may repatriate capital and profits.[105] In the event of a dispute, investors may demand that the host country settle investment disputes through international arbitration.[106] In the 25 years of NAFTA, more than 55 notices of arbitration have been lodged against the three member countries, and several dozen awards have been rendered.[107] Mexico and Canada each have lost five to six actions, with each country paying awards totaling several hundred million dollars. The United States is the only party yet to lose a dispute under Chapter 11.[108]

As noted above, USMCA's Chapter 14 reduces protections for investors in most sectors, eliminating claims for violations of fair and equitable treatment and for pre-investment discrimination while also imposing an exhaustion of local remedies requirement. However, Chapter 11-like protection[109] is fully maintained for several sectors that were apparently deemed sensitive, where Mexico as well as the United States government and U.S. stakeholders wished to assure investor protections.

The covered sectors are oil and gas, power generation, telecommunications, transportation, and ownership or management of infrastructure.[110] Actions by investors can be brought against a "national authority" of the party "at the central level of government."[111] This is further clarified in a footnote, which states that the "central level of government includes

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[103] See, for example, Emmanuel Gallard and Frederic Bachand, eds., *Fifteen Years of NAFTA Chapter 11 Arbitration* (Huntington, N.Y.: Juris Publishing Inc., 2011); Andrea Bjorklund, "NAFTA Chapter 11," in *Commentaries on Selected Model Investment Treaties,* edited by Chester Brown (Oxford University Press, 2013); and Meg Kinnear, Andrea Bjorklund and John. F.G. Hannaford, *Investment Disputes Under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Zuidpoolsingel, Netherlands: Kluwer Law International, 2006).
[104] With "investment" defined broadly in art. 39.
[105] NAFTA, section B.
[106] NAFTA, ch. 11, section B.
[107] "NAFTA Research: Investor-State Ch. 11 disputes," LibGuides, New York University Law Library, accessed October 10, 2018, http://nyulaw.libguides.com/c.php?g=773833&p=5551688.
[108] Ibid.
[109] Subject to certain updates between 1994 and 2017 in U.S. investment chapter practice, reflecting inter alia Chapter 9 of the TPP.
[110] USMCA, ch. 14, annex 14-E. Coverage of infrastructure initially included airports and ports, but the signed version provides coverage only for roads, bridges, or canals. See Annex 14-E, para. 6(v).
[111] USMCA, ch. 14, Annex 14-E, para. 6(c).

any person, including a state enterprise or another body, when it exercises governmental authority delegated to it by an authority at the central level of government."[112] Presumably, this language is intended to ensure availability of the full ISDS provisions for state entities such as Pemex and the Comisión Federal de Electricidad. One might have hoped, however, that the annex would define the term "government contract" as including contracts with state-owned enterprises.

It is evident that the major purpose of this coverage, accepted by the incoming AMLO administration as well as the Trump and Peña-Nieto administrations, is to give American petroleum and natural gas investors a strong sense of confidence in Mexico, with the assurance that should a dispute arise, e.g., between the investor and Pemex under an exploration contract or lease, the investor would have the recourse normally expected under investment chapters such as NAFTA Chapter 11 and the 35 bilateral investment treaties Mexico has concluded with third parties ranging from the United Kingdom to China.[113]

For Canadian investment in Mexico's oil (or other) sectors, the two countries and their affected stakeholders would rely on Chapter 9 of the CPTPP, with certain limitations on the scope of coverage of the investment agreements under the original article 9.1 of the CPTPP.[114] According to my reading of these provisions, ISDS under Chapter 9 of the CPTPP would *not* be available to Canadian investors that had concluded "investment agreements" with Mexican entities such as Pemex unless those agreements specifically provided for ISDS. (Subsidiaries of Canadian energy firms operating in the United States, or in third countries where bilateral investment treaties with Mexico were in force, would be protected.)

One other area of the USMCA could give U.S. oil, gas, and gasoline exporters some protection against an arbitrary change in the regulatory environment in Mexico. A decision by Mexico's government to roll back the 2013 energy reforms would not in itself be a violation of the USMCA's technical barriers to trade (TBT) provisions, which by their nature are procedural rather than substantive. Chapter 11 "applies to the preparation, adoption, and application of standards, technical regulations, and conformity assessment procedures, including any amendments, of central level of government bodies, which may affect trade in goods between the parties."[115] Changes in technical regulations require that preference be given to international standards, with a written explanation of any other standard used that includes the obligatory exchange of information, consultation with the other party (e.g., the United States), and a high level of transparency.[116] The preference is always for conformity with international standards and avoidance of regulations that

[112] Ibid., fn. 32.
[113] See "Mexico: Bilateral Investment Treaties," and "Ecuador: Bilateral Investment Treaties," International Investment Agreements Navigator, Investment Policy Hub, https://investmentpolicyhub.unctad.org/IIA/CountryBits/136.
[114] CPTPP, art. 2, annex, para. 2, which deletes the definition of "investment agreement" from the revised CPTPP.
[115] USMCA, article 11.2.
[116] USMCA, arts. 11.5(3), (6), 11.7. This discussion benefits from a telephone discussion on or about January 7, 2019 with a USTR expert on TBT issues, who prefers to remain anonymous.

unduly restrict trade, with the other parties having the right to seek a less trade-restrictive method to fulfill the regulation's objective, including one based on an international standard.[117] For example, if Mexico (or the United States) proposed a regulation requiring that gasoline contain 15% ethanol (instead of the current 10% standard), the other party to the agreement could invoke the TBT procedures. TBT's most valuable provisions are thus those related to consultation and transparency, giving each member country the opportunity to discourage another party from issuing regulations that restrict trade.

The energy sector is also complicated by uncertainties surrounding AMLO's policies, such as the administration's apparent commitment to spend large sums on a gasoline refinery, along with its plan to reduce gasoline imports from the United States by about 28% compared to a year ago.[118] Most importantly, AMLO has taken steps to reduce chronic theft of petroleum products from pipelines, estimated at more than $3 billion in 2018, which are mostly committed by criminal gangs (a problem ignored by Pemex under previous administrations).[119] By shutting down the pipelines and endeavoring to deliver gasoline to filling stations by tanker trucks, the administration has caused long lines in several parts of the country and unhappiness among citizens who need fuel for business purposes in particular.[120] However, to date the crisis shows no signs of abating, and it does not appear to have adversely affected AMLO's popularity in Mexico.[121]

C. Agriculture

For Mexico, and those in the United States who are dependent on agricultural trade with Mexico, one of the more positive aspects of the USMCA is the fact that it did not make major changes that would have disturbed agricultural trade between the United States and Mexico. Previous efforts by Florida tomato and other U.S. crop growers to convince the United States to demand stronger protections against the alleged dumping of winter fruits and vegetables were abandoned by the United States, and such provisions were not included in the agreement.[122] Separately, however, the Trump administration, under pressure from the Florida congressional delegation, has announced its intent to withdraw from a long-standing anti-dumping suspension agreement applicable to fresh tomato imports from Mexico, an action that if implemented could be similarly damaging to cross-

[117] USMCA, art. 11.5(2)(b)(ii).
[118] Robbie Whelan and Rebecca Elliott, "Mexico Reduces U.S. Gasoline Imports," *The Wall Street Journal*, January 11, 2019, https://www.wsj.com/articles/mexico-reduces-u-s-gasoline-imports-11547249440.
[119] Megan Specia, "Long Lines and Guarded Fuel: Mexico's Gas Crisis, Explained," *The New York Times*, January 11, 2019, https://www.nytimes.com/2019/01/11/world/americas/mexico-gas-crisis.html.
[120] Ibid.
[121] Dave Graham, "Popularity Sky-High, Mexico's President Runs a One-Man Show," *Reuters,* March 10, 2019, https://www.reuters.com/article/us-mexico-president/popularity-sky-high-mexicos-president-runs-a-one-man-show-idUSKBN1QR0KL.
[122] "Mexico to Target U.S. Grains, Meats If Seasonal Proposal Added to NAFTA," *InsideTrade.com*, October 19, 2017, https://insidetrade.com/inside-us-trade/mexico-target-us-grains-meats-if-seasonal-proposal-added-nafta.

border agricultural trade.[123] Agricultural disputes with Canada were even more serious, where a dispute over U.S. dairy market access to Canada almost derailed negotiations. In the USMCA, Canada relaxed its dairy market restrictions, primarily in its market for milk solids, to a limited degree—about 3.6% of total Canadian demand.[124] The inclusion of standards for agricultural biotechnology and increased consultation on agricultural matters is useful, but does not change the basic agricultural trade relationship.

With regard to U.S.-Canada dairy trade, other changes may be more important than the limited increased access for milk solids. First, Canada is required to immediately notify the United States of any proposal introduced to increase customs duties on dairy, poultry, or egg products imported into Canada from the United States, in time to provide the United States "a sufficient opportunity to review the proposal prior to its implementation." The United States accepts a similar obligation with regard to imports of sugar, sugar-containing products, or dairy products imported into the United States.[125] Also, Canada is obligated to eliminate milk class 6 and class 7 pricing schemes within six months of the USMCA going into effect.[126] (It was the class 7 system that had suddenly increased tariffs and reduced U.S. exports of milk powder and milk protein several years ago, causing great unhappiness among U.S. dairy farmers.)

Agricultural trade within North America is also indirectly affected by the Section 232 national security action imposing 25% tariffs on Canadian and Mexican steel imports and 10% tariffs on aluminum exports. One study suggests that the USMCA would provide about $450 million in export gains to the U.S., primarily in milk product exports to Canada. However, retaliatory tariffs from Mexico and Canada in response to the Section 232 tariffs could cause up to a $1.8 billion decline in U.S. farm exports, particularly to Mexico, given Mexico's more aggressive tariffs.[127]

Preservation of the status quo in agricultural trade was important for both the U.S. and Mexico, the United States because of grain and meat exports and Mexico due to the importance of agricultural workers in Mexico to the AMLO administration.[128] U.S. agricultural exports to Mexico, the third largest after Canada and China (the latter before the recent trade war), are worth about $19 billion annually and include products such as wheat, hops, corn, soy, and other grains; beef; chicken parts; and pork. Agricultural imports from Mexico totaled $25 billion in 2017, including mostly fresh vegetables and fruit but

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[123] "Lawmakers, Industry Push Back Against Tomato Agreement Withdrawal," *World Trade Online*, March 8, 2019, https://insidetrade.com/daily-news/lawmakers-industry-push-back-against-tomato-agreement-withdrawal.
[124] Katie Lobosco, "Canada Opened Its Dairy Market. But by How Much?" *CNN*, October 2, 2018, https://www.cnn.com/2018/10/02/politics/usmca-canada-dairy/index.html.
[125] USMCA, Annex 3-A, art. 3.A.1(1) and (2).
[126] USMCA, Annex 3-A, art. 3.A.3(3), (4).
[127] "Analysis: 'Modest' USMCA Gains for U.S. Agriculture Would Be Undone by Tariffs," July 2018 Congressional Research Service Report on Escalating Tariffs: Timeline and Potential Impact, *InsideTrade.com*, November 1, 2018, https://insidetrade.com/daily-news/analysis-modest-usmca-gains-us-agriculture-would-be-undone-tariffs.
[128] This section is based in part on David A. Gantz, "The Risks and Rewards of Negotiating the North American Trade Relationship," Maryland Journal of International Law 33, no. 1 (2018): 127, 153-55.

also wine and beer, processed foods, and processed fruits and vegetables.[129] It is thus obvious that Mexico is importing farm products that benefit from a high level of mechanization and processing, while U.S. imports from Mexico are mostly fruits and vegetables that require extensive hand labor.

Many U.S. agricultural export goods are fungible, with Brazil, Argentina, Canada, and Australia all interested in exporting more grain and meat to Mexico. During initial discussions in the NAFTA renegotiations, Mexico, with the support of several of its senators, made initial inquiries on potentially shifting some grain and corn purchases from U.S. exporters to Brazil and Argentina, even though transport costs would be higher because of the greater distances from the export market. In the short term, Mexican consumers could be negatively impacted by higher food prices, partly as a result of peso devaluation but also through increases in animal feed costs, harm the government likely would to try to avoid until new agricultural supply chains could be established over a period of several years. Recent developments in the reduction of U.S. soybean exports to China because of the trade war over intellectual property[130] has raised the price of soybeans from Brazil and Argentina[131] while lowering the price of U.S. soy. That factor alone is likely to convince Mexican importers to rely on traditional American sources in the foreseeable future.

U.S. exports of farm products to Mexico also have a significant tariff advantage. Under WTO rules, which currently apply to Argentina and Brazil as well as other competing source countries and would apply to U.S. exports post-NAFTA if it is not replaced by the USMCA, wheat is subject to a 15% tariff, beef 25% percent, and chicken 75%.[132] Mexico exports labor-intensive farm produce to the United States (e.g., tomatoes, avocados, peppers, grapes, cucumbers, melons, berries, onions, cantaloupes, and other fruits/vegetables), which account for 44% of total U.S. imports.[133] Most such fruits and vegetables currently enter duty free and will continue to do so under the USMCA.[134]

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[129] USTR, "U.S.-Mexico Trade Facts."
[130] Bill Perry, "U.S. China Trade War Update – 301 Case $50 Billion Tariffs Imports from China — China Retaliates," U*S China Trade War* (blog), June 15, 2018, https://uschinatradewar.com/us-china-trade-war-update-301-case-50-billion-tarifffs-imports-from-china/.
[131] Emiko Terazono, "Brazil's Big Soyabean Win Turns Painful," *Financial Times*, October 10, 2018, https://www.ft.com/content/0c608ae6-cbe9-11e8-b276-b9069bde0956.
[132] Ana Swanson and Kevin Granville, "What Would Happen If the U.S. Withdrew From Nafta," *The New York Times*, October 12, 2017, https://www.nytimes.com/2017/10/12/business/economy/what-would-happen-if-the-us-withdrew-from-nafta.html.
[133] Renee Johnson, *The U.S. Trade Situation for Fruit and Vegetable Products* (Washington, D.C.: Congressional Research Service, December 2016), Table 1, https://fas.org/sgp/crs/misc/RL34468.pdf
[134] U.S. MFN tariffs can be prohibitively high, for example, ranging 12.8%-29.8% for cantaloupes depending on the season, but much less for tomatoes (2.8-3.9 cents/kg) and in between for avocados (11.2 cents/kg). For specific tariff rates, see "Harmonized Tariff Schedules of the United States," headings 0702 (tomatoes); 0804.40 (avocadoes); and 0807.19 (cantaloupes). Such tariffs would presumably have been passed on to consumers and thus impact supermarket prices soon, or consumers would simply have fewer choices, particularly in the offseason. Sufficient alternative sources probably do not exist in the United States, particularly in the winter, due to a (worsening) shortage of legal farm workers and water shortages in Arizona and California, among other factors.

The USMCA makes other relatively minor changes affecting agriculture. Intellectual property protection for R&D, patents, and trademarks is enhanced, including coverage of agricultural biotechnology.[135] The agreement also provides for a review of geographical indications. These are particularly important to American cheese and wine exporters who fear that pressure from the European Union will restrict the Mexican market for products such as feta cheese, which the U.S. believes is generic rather than specific to Greece. Among other protections, the USMCA requires government analysis before Mexico imposes any new restrictions on the use of such names as feta cheese (for example, by limiting that term to cheese from Greece), with criteria for determining when a product is specific to a particular region or generic.[136] This language was probably included because the E.U. and Mexico are currently in negotiations for a revised free trade agreement, and the E.U. and Canada concluded the Comprehensive Economic and Trade Agreement (CETA) in September 2017; both agreements enhanced geographical indication protection for exported E.U. products. The USMCA provisions also explicitly protect a list of U.S. cheeses marketed in Mexico.[137] The availability of seasonal workers to provide agricultural labor in the United States is not addressed in the USMCA.

During his presidential campaign, AMLO spoke of the desire to make Mexico self-sufficient in foodstuffs, a proposal that seems unrealistic given Mexico's heavy dependence on grain and meat imports, primarily from the United States. Other limiting factors on self-sufficiency include water shortages in the lower Colorado River and in the Rio Grande,[138] as well as Mexican grain farmers' inability to compete with American farm technology and limited access to low-cost credit. The bargain reached between the United States and Mexico during the original NAFTA negotiations in 1991-92, whereby Mexico would import the products of mechanized farms—grain and meat—from the United States and export labor-intensive fruits and vegetables to the United States, has worked reasonably well for 25 years; it seems unlikely that AMLO will seek to change it, particularly after Mexico prevailed in preserving the status quo with regard to U.S. trade restrictions on tomatoes and other winter vegetables.

D. Labor Rights and Obligations

Several of the USMCA changes related to labor in Mexico could support one of AMLO's major campaign promises—reducing income inequality in Mexico—as well as the Trump administration's desire to make production of goods in Mexico relatively less attractive. The first, discussed in Part A above, is the requirement that a significant percentage of automobile and light truck content be produced in facilities where workers are paid at least $16 per hour. The second, discussed in this section, is a series of Mexico-specific

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[135] USTR, "US-Mexico Trade Agreement, Report of the Agricultural Policy Advisory Committee," September 27, 2018, https://ustr.gov/sites/default/files/files/agreements/FTA/AdvisoryCommitteeReports/Agriculture%20Policy%20Advisory%20Committee.pdf.

[136] Ibid.

[137] Ibid.

[138] Nicole T. Carter, Stephen P. Mulligan, and Clare Ribando Seekle, *U.S. Mexican Water Sharing: Background and Recent Developments* (Washington, D.C.: Congressional Research Service, March 2, 2017), https://fas.org/sgp/crs/row/R43312.pdf.

requirements in the USMCA's labor rights chapter that aim to facilitate the development of independent unions and collective bargaining.[139] If AMLO is serious about improving conditions for Mexican workers, his administration will commit itself to faithful implementation of the USMCA's labor provisions.

Many observers believe the very limited labor rights protections in the original NAFTA was one of the agreement's most glaring weaknesses. NAFTA itself incorporates little coverage of labor issues (except for references in the Preamble to creating new employment opportunities, improving working conditions, and enhancing and enforcing basic workers' rights). NAFTA also provides for visas for temporary visitors for business purposes,[140] but does not further deal with immigration-related matters.

The evolution of labor and environmental rights in U.S. free trade agreements has unfolded in a non-linear manner over a 28-year period since the beginning of the NAFTA negotiations in 1991.[141] The inclusion of labor and environmental provisions in U.S. free trade agreements was not a foregone conclusion; it was mostly an afterthought in relation to NAFTA, as explained below. Pre-NAFTA agreements with Israel and Canada do not include such provisions, for example. However, the relationship between trade and labor in the United States was well established prior to NAFTA through non-reciprocal programs such as the Generalized System of Preferences (GSP),[142] the Caribbean Basin Initiative (CBI),[143] and the African Growth and Opportunity Act (AGOA).[144]

The NAFTA "side" agreements were considered necessary when President Bill Clinton succeeded President George H.W. Bush in January 1993—after NAFTA had been negotiated and signed by the Bush administration but before it had been submitted to Congress for approval. As a presidential candidate, Clinton boldly endorsed NAFTA in October 1992, but only on the condition that NAFTA's environmental and labor provisions be strengthened.[145] Clinton's decision was driven in part by concerns from members of Congress and other U.S. elected officials that without attention to potential labor (and environmental) problems, working and living conditions on both sides of the U.S.-Mexico border would deteriorate.[146]

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[139] USMCA, annex 23-A.
[140] NAFTA, ch. 16.
[141] The first U.S. free trade agreement, negotiated with Israel in 1985, was a relatively short document and contained no labor or environmental provisions. See David A. Gantz, *Regional Trade Agreements: Law Policy and Practice* (Durham, N.C.: Carolina Academic Press, 2009), 208-18.
[142] See, for example, U.S. legislation authorizing the GSP program, 19 U.S.C. §§ 2461 et seq.
[143] 19 U.S.C. §§ 2701-2707.
[144] 19 U.S.C. §§ 3701-3739 (2006).
[145] Gerald F. Seib, "Clinton Backs the North American Trade Pact, But Candidates' Stances on the Issue Aren't Clear," *The Wall Street Journal,* October 5, 2002, A14.
[146] Mark Spalding and Marc Stern, *NAFTA Effects: Claims and Arguments 1991-1994, 1996* (Ottawa, CA: Commission for Environmental Cooperation, 1996), http://www3.cec.org/islandora/en/item/1692-nafta-effects-potential-nafta-effects-claims-and-arguments-1991-1994-en.pdf.

This realization resulted in the North American Agreement on Labor Cooperation (NAALC).[147] Given the timing, and the reluctance of all parties to reopen discussions on a highly complex agreement that had already been negotiated and signed, the most practical solution was to negotiate parallel agreements to address NAFTA's perceived environmental and labor shortcomings.

Under the NAALC, each member country retains the right to set and apply its own labor standards. Each party is also required to provide in its laws unspecified "high labor standards"[148] and to enforce labor rights through specified procedures, including opportunities for citizen access to administrative or labor tribunals to protect their legal interests under labor and employment laws.[149] The NAALC parties committed themselves to encouraging such labor standards, including freedom of association, protection of the right to organize, the right to collective bargaining and to strike, prohibition of forced labor, protections for child laborers, minimum employment standards, elimination of discrimination in employment, equal pay for men and women, prevention of and compensation for occupational injuries and illnesses, and protections for migrant workers.[150]

The NAALC initially provided for a Commission for Labor Cooperation (CLC), consisting of a Council of Ministers and a secretariat.[151] Each NAFTA member nation established its own National Administrative Office (now the Office of Trade and Labor Affairs in the United States), which monitors labor rights issues in North America. The NAO/OTLA's principle functions include "receiving complaints about non-enforcement of labor laws" by any of the NAFTA governments.[152]

The formal dispute settlement mechanism, which is solely available to the governments, may be utilized only where there is a "persistent pattern of failure . . . to effectively enforce enumerated labor standards." Standards enforceable by arbitration are limited to occupational safety and health, child labor, or minimum wage technical labor standards[153] (in other words, a denial of the right to organize a union alone would not be subject to arbitration). After inter-governmental consultations, fact-finding and/or mediation by the CLC may follow. If issues are not resolved at this point, a party may request arbitration, a step requiring a two-thirds vote of the CLC for approval;[154] because of the two-thirds requirement, no arbitration ever took place under the NAALC. Moreover, the secretariat that was originally intended to investigate citizen complaints (which had some success in

[147] U.S. Department of Labor, "North American Agreement on Labor Cooperation," September 14, 1993, https://www.dol.gov/ilab/reports/pdf/naalc.htm.
[148] NAALC, art. 2.
[149] Id., art. 4.
[150] Id., annex 1.
[151] Id., arts. 8-14.
[152] NAALC, arts. 15-16, esp. 16.3.
[153] Id., art. 27.1.
[154] Id., arts. 28-29.

the early years), had for all practical purposes disappeared entirely by 2009, with its responsibilities absorbed by the three national labor offices that were largely useless.[155]

Labor provisions in U.S. trade agreements, including the USMCA, evolved considerably after NAFTA due to strong congressional pressure, particularly with the inclusion of labor provisions in the body of the agreements and a requirement that disputes be submitted to the same state-to-state mechanisms utilized in trade disputes.[156] Other major innovations in the years since NAFTA include the acceptance of the ILO Declaration on Fundamental Principles and Rights at Work,[157] elimination of sex-based discrimination,[158] and a mechanism for accepting citizen submissions regarding labor complaints through the establishment of contact points, all of which are included in the USMCA.[159]

However, the key innovation in the USMCA is an annex titled "Worker Representation in Collective Bargaining in Mexico." It is evident from the language that AMLO endorsed this set of obligations during the negotiations:

> Mexico shall adopt and maintain the following provisions covered in this Annex, necessary for the effective recognition of the right to collective bargaining, given that *the incoming Mexican government has confirmed that each of these provisions is within the scope of the mandate provided to the incoming government by the people of Mexico in the recent elections.*[160] (emphasis added)

The key obligation for Mexico is to guarantee in Mexican labor laws the:

> right of workers to engage in concerted activities for collective bargaining or protection and to organize, form, and join the union of their choice, and prohibit employer domination or interference in union activities, discrimination or coercion against workers for union activity or support, and refusal to bargain collectively with the duly recognized union.[161]

Under the USMCA, Mexico's labor laws are to be changed to assure *inter alia* implementation of the rights of unionization through independent administrative bodies for conciliation and for registration of unions (as well as labor courts) and to register union elections and resolve disputes. The requirements include a variety of safeguards for union

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[155] Ruth Buchanan and Rusby Chaparro, "International Institutions and Transnational Advocacy: The Case of the North American Agreement on Labor Cooperation," *UCLA Journal of International Law and Foreign Affairs* 13 (2008): 129, 157.
[156] David A. Gantz, "Labor Rights and Environmental Protection Under NAFTA and Other U.S. Free Trade Agreements," University of Miami Inter-American Law Review, 2011, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1791839.
[157] USMCA, art. 23.3; such rights include freedom of association and the right to collective bargaining; elimination of forced or compulsory labor; abolition of child labor; and elimination of discrimination in employment. The declaration is referenced in place of the various ILO agreements since the United States is not a party to any of them.
[158] USMCA, art. 23.9.
[159] USMCA, arts. 23.11, 23.15; see TPP, ch. 19.
[160] USMCA, annex 23-A, para. 1 (emphasis added.)
[161] USMCA, annex 23-A, para. 2(a).

organizing such as the use of secret ballot votes, with elections subject to clear time limits and independent verification. Transparency obligations also exist, including a requirement that collective bargaining agreements be made available to affected workers prior to the vote.[162] Further, the legislation must require that all existing collective bargaining agreements in Mexico be revised at least once every four years after the new legislation goes into effect and be deposited with and verified by the responsible independent entity.[163] Finally, collective bargaining agreements and related governing documents must be made available to all affected workers and to the public.[164]

Significantly, the USMCA member countries recorded their "expectation" that Mexico would adopt implementing legislation by January 1, 2019, with the option for the other countries that the USMCA's entry into force "may be delayed until such legislation becomes effective."[165] This deadline was not met. Rather, as of the time of this writing, it was anticipated the necessary legislation would be enacted by the Mexican Congress before the end of April 2019.[166]

While the effectiveness of these provisions will depend on implementation by Mexico, and possibly on ongoing pressure from the United States, there is little doubt that such provisions can significantly improve the observance of labor rights in Mexico and other developing countries, while their absence would have negative implications. For example, the United States during the Obama administration brought an action against Guatemala under the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR)[167] in 2014, charging that Guatemala failed to comply with its obligations under the agreement.[168] While the dispute settlement panel ultimately ruled in favor of Guatemala (for lack of evidence of a "sustained or recurring course of action" by Guatemala in failing to enforce its labor laws), similar actions are possible under CAFTA-DR and other agreements such as the USMCA in the future should the U.S. government be interested in pursuing them.

Conversely, the absence of such provisions may also result in a continuing or worsening of labor standard violations. Under the TPP, Brunei, Malaysia, and Vietnam all concluded bilateral labor rights agreements with the United States, each of which provided specific obligations regarding the provision of labor rights, with the potential for trade sanctions if

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[162] USMCA, annex 23-A, paras. 2(b-e).
[163] USMCA, annex 23-A, para. 2(f).
[164] USMCA, annex 23-A, para 2(g).
[165] USMCA, annex 23-A, para. 3.
[166] "Mexican Official: Labor Reform Legislation Slated to Pass by the End of April," *World Trade Online*, February 19, 2019, https://insidetrade.com/trade/mexican-official-labor-reform-legislation-slated-pass-end-april.
[167] Central America-Dominican Republic-United States Free Trade Agreement (DR-CAFTA) (Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua, and the United States), http://www.sice.oas.org/Trade/CAFTA/CAFTADR_e/CAFTADRin_e.asp.
[168] Kevin Banks, Theodore R. Posner, and Ricardo Ramírez Hernández, "Dominican Republic–Central America–United States Free Trade Agreement (final report of the panel)," https://www.trade.gov/industry/tas/Guatemala – Obligations Under Article 16-2-1(a) of the CAFTA-DR June 14 2017.pdf.

the agreements were breached.[169] However, after Trump withdrew from the TPP in January 2017, it has been reported that

> Freed from conditions imposed by the Obama administration to join the trade pact, Vietnam's Communist government has scrapped plans to allow independent trade unions and unleashed its most severe clampdown on dissent in decades. Authorities have arrested scores of social activists, bloggers and democracy advocates, sentencing many to jail terms of 10 to 20 years.[170]

Attention on improved labor rights in Mexico demonstrates a confluence of interests among AMLO, Trump, and U.S. labor unions. AMLO supports such enhanced labor rights to form independent unions as part of his objectives to improve workers' economic conditions, while Trump, his advisors, and U.S. labor unions appear to believe that strict enforcement of worker's rights will help reduce the labor cost gap between the United States and Mexico. The Guatemalan and Vietnam experiences discussed above in my view confirm the wisdom of including strong labor provisions in the USMCA, which if fully implemented have a reasonable likelihood of improving labor rights and collective bargaining in Mexico.

The USMCA also addresses discrimination in the workplace. In language apparently advocated by Canada, it requires that

> each party shall implement policies that it considers appropriate to protect workers against employment discrimination on the basis of sex (including with regard to sexual harassment), pregnancy, *sexual orientation, gender identity*, and caregiving responsibilities; provide job-protected leave for birth or adoption of a child and care of family members; and protect against wage discrimination.[171] (emphasis added)

However, due to opposition from conservative members of the U.S. Congress on eliminating discrimination on the basis of sexual orientation and gender identity (which some U.S. states have laws prohibiting), a clause was added to the signed version of the USMCA stating that federal agency policies on the hiring of federal workers were sufficient to put the U.S. in compliance with these policy obligations.[172]

Some hoped the USMCA could have addressed agriculture-related immigration issues. As the advisory committee report indicated, "American agriculture is disappointed that this negotiating opportunity did not achieve consensus on facilitating the cross-border flow of

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[169] USTR, "TPP, US-Vietnam Plan for Enhancement of Trade and Labour Relations," February 4, 2016. https://ustr.gov/sites/default/files/TPP-Final-Text-Labour-US-VN-Plan-for-Enhancement-of-Trade-and-Labour-Relations.pdf.

[170] Simon Denyer and David Nakamura, "How a Trump Decision on Trade Became a Setback for Democracy in Vietnam," *The Washington Post*, October 11, 2018, https://www.washingtonpost.com/graphics/2018/world/how-a-trump-decision-on-trade-became-a-setback-for-democracy-in-vietnam/?utm_term=.3a44dc808788.

[171] USMCA, art. 23.9.

[172] USMCA, art. 23.9, fn. 13.

seasonal and select year-long workers."[173] Given that the USMCA includes only one immigration-related chapter governing temporary entry for business visitors[174] and the enormous sensitivity over immigration issues in the United States at present, it was unrealistic to expect that USMCA negotiators would have tried to address agricultural labor or other broader immigration issues.

IV. The Future

As of April 2019, various uncertainties make the future of the USMCA difficult to chart. These include, in addition to enactment of new labor legislation in Mexico as discussed above, the approval (or ultimate rejection) of the agreement by members of Congress in the U.S. and Mexico (although approval in Mexico is likely to be more straightforward despite some opposition in AMLO's MORENA Party); AMLO's ability to take advantage of the USMCA, including but not limited to encouraging further development of the hydrocarbons sector and new investment in Mexico more generally; and the possibility of other disruptions in U.S.-Mexico relations, such as those relating to immigration or the "Wall."

A. Questions Regarding U.S. Congressional Approval

Given that the USMCA was signed by the three heads of government on November 30, 2018, the next major step toward its entry into force is submission of the agreement to the U.S. Congress under applicable provisions of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA). While there was some speculation that the Trump administration would attempt to do this during the "lame duck" legislative session after the November 2018 U.S. midterm elections,[175] such aspirations were never realistic, as Senate Leader Mitch McConnell immediately confirmed.[176] Under the TPA, the administration is required to submit the final signed agreement along with a draft of the implementing legislation and a statement of administrative action setting out the nature of the legislative changes required,[177] which are impossible to complete in a short time.

Moreover, under the TPA, the U.S. International Trade Commission is required to investigate the likely economic impacts of the agreement and issue a report within 105 days

[173] USTR, "US – Mexico Trade Agreement Report of the Agricultural Policy Advisory Committee," September 27, 2018, https://ustr.gov/sites/default/files/files/agreements/FTA/AdvisoryCommitteeReports/Agriculture Policy Advisory Committee.pdf.
[174] USMCA, ch. 18.
[175] Klimasinska Kasia,"Navarro Expects Vote on Final NAFTA Deal After Midterm Elections," *Bloomberg BNA News*, September 25, 2018, https://news.bloomberglaw.com/international-trade/navarro-expects-vote-on-final-nafta-deal-after-midterm-elections.
[176] Jenny Leonard, "McConnell Rules Out Vote on New NAFTA Trade Deal Before 2019," *Bloomberg Law*, October 16, 2018, https://www.bloomberg.com/news/articles/2018-10-16/mcconnell-says-senate-vote-on-new-nafta-deal-to-wait-until-2019.
[177] Sec. 106 (a)(1)(E)(ii) of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA).

of the signing of the agreement.[178] That report was not originally due until mid-March 2019. However, the report was delayed for at least 35 days, until late April, by the federal government shutdown when USITC staff members were furloughed. Thus, the end of April is the earliest realistic date that the USMCA package could be submitted to Congress, assuming that the Mexican Congress meets its end of April deadline to enact legislation to implement obligations in the labor chapter that would *inter alia* make the formation of independent unions with collective bargaining power feasible in Mexico for the first time.[179] Another potential delay could result from the administration's failure to lift the Section 232 tariffs (25% on steel and 10% on aluminum) on imports from Canada and Mexico. Ranking House Ways and Means Committee member Kevin Brady has asserted that U.S. lawmakers are "not really willing to consider this agreement until the steel and aluminum tariffs are assured of being lifted…including quotas" on the two countries. [180] The Canadian United Steelworkers Union is also pressuring the Canadian government to not approve the USMCA until the Section 232 restraints on Canadian exports are lifted.[181]

The continued imposition of such trade restraints may also affect the willingness of Canada and Mexico to proceed with USMCA ratification. The risk of delays is significant because of the political calendar, with the Iowa presidential caucuses scheduled for early February 2020, suggesting to many that failure to obtain U.S. congressional approval during 2019 may mean delaying the process until 2021.[182]

In my view, the prospects for congressional approval in the medium term, if not the short term, are not significantly dimmed by the Democratic Party's achievement of a majority (approximately 235-197)[183] in the House of Representatives. Trade agreements historically are supported by a significant majority in the Senate, even though under the TPA only 51 votes are needed for passage and no amendment is permitted; the 60-vote filibuster rule in the Senate is not applicable.[184] The approval process for trade agreements has never been the province of one party—even if more Republicans traditionally have supported trade

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[178] "United States-Mexico-Canada Agreement: Likely Impact on the U.S. Economy and on Specific Industry
Sectors," U.S. International Trade Commission, October 12, 2018, https://usitc.gov/secretary/fed_reg_notices/332/105_003_notice10122018sgl.pdf, referencing TPA, 19 U.S.C. §4204(c) (2015).

[179] USMCA, Annex 23-A. The USMCA explicitly recognizes that "entry into force of this agreement may be delayed until such legislation becomes effective. USMCA, Annex 23-A, para. 3.

[180] "Brady: Congress Not Willing to Consider USMCA Until Steel, Aluminum Issues Resolved," World Trade Online, January 29, 2019, https://insidetrade.com/daily-news/brady-congress-not-willing-consider-usmca-until-steel-aluminum-issues-resolved.

[181] "USW: Reject USMCA until Section 232 Tariffs and Quotation not in 'Equation,'" *World Trade Online*, March 22, 2019, https://insidetrade.com/daily-news/usw-reject-usmca-until-section-232-tariffs-and-quotas-not-equation.

[182] See "Brady, Congress not Willing to Consider USMCA" (quoting a former deputy USTR as noting that "It's also important to get it through the U.S. this year [2019] because our presidential election is virtually starting the day after our midterm election in November").

[183] "Party Breakdown: 116th Congress House Lineup," *U.S. House of Representatives Press Gallery*, March 2019, https://pressgallery.house.gov/member-data/party-breakdown. Three seats are currently vacant.

[184] (19 U.S.C. § 2191(d),(f)-(g) (2015).

agreements than Democrats, approval of a modernized NAFTA would likely require the concurrence of some 35-40 Democrats, particularly in the House. Most trade agreements have passed the Senate by significant margins. For example, the TPA was approved in June 2015 by a Republican-controlled House of Representatives; 24 Democrats voted in favor of it, and about the same number of Republicans voted against it.[185]

The USMCA seems likely to attract more votes from Democrats than has historically been the case. For one, the new automotive rules of origin discussed earlier are expected to create jobs in the United States. In addition, stronger provisions protecting independent unions in Mexico will likely be supported by some Democrats for the same reasons they were sought by the Trump administration, as discussed above. Moreover, Democrats who have historically opposed the inclusion of investor-state dispute settlement in U.S. trade agreements are likely to welcome the elimination of ISDS entirely with Canada and its significant narrowing for Mexico.[186] For example, Democratic Senate Minority Leader Chuck Schumer said, "The president deserves praise for taking large steps to improve it [NAFTA]."[187] As one expert suggested upon the release of the USMCA, the agreement is a "significant accomplishment" for Trump and much more than a minor update of NAFTA:

> The unions have opposed every major trade deal for the last 40 years, except the 2000 deal with tiny Jordan that set a new benchmark on labor standards and most Democrats have followed their lead . . . but with the new NAFTA President Trump has done more to address their concerns than any Democratic president ever achieved.[188]

Thus, some Democratic members who steadfastly opposed NAFTA in the past may be encouraged by labor representatives to support the new agreement. This does not mean there will be no significant opposition from Democrats or labor unions; far from it. For example, the AFL-CIO, which in my recollection has never supported any regional trade agreement negotiated by the United States, has indicated that it has "serious doubts" about the effectiveness of the new labor rules in the USMCA, while conceding that the changes are an improvement over NAFTA.[189] Similarly, officials from the United Auto Workers

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[185] See "How Congress Voted on Trade," *GovTrack.us,* June 23, 2015, https://govtrackinsider.com/how-congress-voted-on-trade-afb8b4438823 (showing a House vote of 218-208 in favor of TPA).
[186] Public Citizen, in a sample letter for supporters to send to Congress, welcomed the ISDS changes while asserting that "more work is needed" on the USMCA: "The use of the Investor-State Dispute Settlement (ISDS) system is significantly cut back. This would end most of the egregious ISDS attacks on environmental and health policies that have led to $392 million in taxpayer payouts to multinational corporations. This progress should be preserved, and future deals should eliminate ISDS altogether." See "Renegotiated NAFTA Text is Out," October 2018, https://action.citizen.org/p/dia/action4/common/public/?action_KEY=13896.
[187] See Robert Schroeder, "Trump Gets Rare Praise from Schumer after Deal to Replace NAFTA," *MarketWatch,* October 1, 2018, https://www.marketwatch.com/story/trump-gets-rare-praise-from-schumer-after-deal-to-replace-nafta-2018-10-01.
[188] See Emel Akan, "USMCA Pact Wins Praise for Boosting Workers Rights," *The Epoch Times*, October 12, 2018, https://www.theepochtimes.com/revamped-nafta-will-boost-workers-rights_2684102.html.
[189] "AFL-CIO has 'serious doubts' that Labor rules in USMCA will be Effective," *World Trade Online*, November 1, 2018, https://insidetrade.com/daily-news/afl-cio-has-%E2%80%98serious-doubts%E2%80%99-labor-rules-usmca-will-be-effective.

stated that "While some progress has been made, it is clear from current auto company investments abroad that more work needs to be done to make this agreement enforceable and meaningful to our members and their job security."[190]

It is of course possible that Democrats with their majority in the House will take a totally obstructionist position on all Trump objectives, but House Speaker Nancy Pelosi in January 2019 suggested that Democrats could find "common ground" on a few issues.[191] In addition, prior to the November election when she served as House minority leader, Pelosi indicated that if Democrats took control of the House, they would look for areas where they could cooperate with the Republicans.[192] USMCA approval could well be one of those areas. However, it appears that some Democrats will oppose the USMCA unless the 10-year protection for biologic drugs is modified since they fear the clause would make it impossible in the future to reduce the period of protection in the United States (currently 12 years).[193]

Still, other priorities for a Democratic House, such as multiple investigations of Trump administration officials as well as policy debates over issues like health care and immigration, could at minimum delay consideration of the USMCA well beyond mid-2019.[194] It is also reasonably likely that Democrats in the House, including some of the 90 or so new members who are likely to be unfamiliar with U.S. trade policies, would condition their support of the USMCA on certain changes to the text, particularly to strengthen the enforceability of the labor and environmental provisions. Congressional consideration of the USMCA also could be delayed by other pressing House business.[195] A similar situation occurred in 2011, when the new Republican-majority House supported the passage of free trade agreements with Colombia, Panama, and South Korea five years after their conclusion by the George W. Bush administration, once the

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[190] "After Meeting with Lighthizer, UAW Still not Sold on USMCA," *World Trade Online*, March 5, 2019, https://insidetrade.com/trade/after-meeting-lighthizer-uaw-still-not-sold-usmca.

[191] See Mike Debonis, "Pelosi Says Democrats Could Find 'Common Ground' with Trump—To a Point," *The Washington Post*, October 16, 2018, https://www.washingtonpost.com/powerpost/pelosi-amid-lengthy-campaign-swing-announces-34-million-haul-for-democrats/2018/10/16/8748556c-d162-11e8-83d6-291fcead2ab1_story.html?utm_term=.d41de607094e.

[192] Seung Min Kim, "House Democrats Consider How They Would Balance Investigating and Cooperating with Trump," *The Washington Post*, October 23, 2018, https://www.washingtonpost.com/politics/house-democrats-consider-how-they-would-balance-investigating-and-cooperating-with-trump/2018/10/22/e1608982-d3df-11e8-a275-81c671a50422_story.html?utm_term=.5a55be640e74.

[193] Ana Swanson, "Drug Company Protections are Latest Stumbling Block for NAFTA Rewrite," *The New York Times*, March 21, 2019, https://www.nytimes.com/2019/03/21/us/politics/nafta-drug-prices.html.

[194] See "Midterm Elections Could Realign USAMCA, Other Trade Priorities," *World Trade Online*, November 5, 2018, https://insidetrade.com/daily-news/midterm-elections-could-realign-usmca-other-trade-priorities.

[195] "Analysts: Post-Election USMCA Outlook is Still Good, Though the Road May be Rocky," *World Trade Online*, November 7, 2018, https://insidetrade.com/daily-news/analysts-post-election-usmca-outlook-still-good-though-road-may-be-rocky.

Obama administration reopened negotiations with those countries to make changes sought by industry and labor groups.[196]

While many Republicans may have balked or even opposed the president's will if Canada had been excluded from the agreement—given the extensive bilateral trade between the states they represent and Canada, the presence of thousands of American company affiliates in Canada, and the critical importance of Canadian manufacturers in supply chains for U.S. manufactured goods, particularly autos and auto parts—that problem has disappeared. Also, business groups have expressed dissatisfaction, *inter alia*, with the USMCA's investment and government procurement provisions as well as the more restrictive automotive rules of origin.[197] Still, one can expect groups like the U.S. Chamber of Commerce, the National Association of Manufacturers, auto industry groups such as the Alliance of Automobile Manufacturers (which represents most U.S. auto manufacturers), and major auto producers that make vehicles in both the United States and Canada (including General Motors, Fiat-Chrysler, Ford, and Honda) to strongly support the USMCA.

<u>Recommendations:</u> Members of Congress should review the USMCA objectively to be sure they understand both its risks and benefits, and vote in accordance with their conclusions as to whether approval or disapproval of the USMCA is better for the economic future of the United States. In my view, this is not a difficult question to answer, particularly given the likelihood that if the House refuses to consider the USMCA, the president will attempt to terminate NAFTA, creating both chaos for business and a constitutional crisis. For its part, the Trump administration should do its best to avoid incendiary rhetoric, and work toward building a coalition in favor of the USMCA. U.S. Trade Representative Robert Lighthizer and his colleagues at USTR have the necessary skills to do this if the president and his White House staffers avoid making the process more difficult. The administration should also take immediate steps to rescind the tariffs on steel and aluminum.

B. AMLO's Sexenio

As discussed earlier, the question for many observers regarding AMLO's presidency is whether he will act as a pragmatist as he did when he was mayor of Mexico City some years ago, or as the populist who is unpredictable and makes impulsive decisions in matters affecting foreign policy, petroleum policy, and other areas. While AMLO supported the conclusion of the USMCA and its signing a day before he became president, his past unpredictability worries many observers, particularly regarding foreign investment in the hydrocarbons sector. One of the first tests for AMLO has been his opposition to a new Mexico City airport, a controversial project that was well under way. His decision to hold a bogus referendum among his supporters to provide a basis for cancelling the project

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[196] Binyamin Appelbaum and Jennifer Steinhauer, "Congress Ends 5-Year Standoff on Trade Deals in Rare Accord," *The New York Times*, October 12, 2011, https://www.nytimes.com/2011/10/13/business/trade-bills-near-final-chapter.html.
[197] "Chamber: Elements of USMCA Should not be Viewed as Model for New FTAs," *World Trade Online*, November 5, 2018, https://insidetrade.com/daily-news/chamber-elements-usmca-should-not-be-viewed-model-new-ftas.

suggests to many observers that his administration will not be friendly to investors and will return to statist policies.[198] In the short term, the referendum caused the Mexican peso to fall by about 5% despite assurances that project investors will be protected.[199] It remains uncertain at the publication of this paper how investors in the project will be compensated; Mexico made an offer to bondholders in December that was not accepted by many. Additional compensation may or may not be offered by the administration,[200] which may result in a series of investor claims against Mexico under NAFTA's Chapter 11, which effectively remains in force until three years after the USMCA goes into effect. The filing of such claims, if it occurs soon, is likely to raise further questions among foreign investors about Mexico's foreign investment climate under AMLO.

While AMLO's support of the USMCA generally has been seen as positive, other early actions of his administration raise questions. For example, AMLO has promised to reduce his own salary as well as salaries of about 35,000 other government officials, including Supreme Court justices, by 40%.[201] Should this policy be implemented (it is currently subject to litigation), it likely will prompt some skilled government bureaucrats to leave the government, as many have already done in the period between July and November.[202] The question is not whether replacements can be found, but whether those replacements will have equal skill and, perhaps equally important, whether they will assure themselves a living wage in the time-honored Mexican way—by accepting illegal bribes.[203]

AMLO has also indicated that he plans to fire three-quarters of the Mexican team that negotiated past trade agreements, including those responsible for the USMCA, as a push to cut government spending.[204] Terming this action unwise is a gross understatement. First, many trade experts will be needed to complete the USMCA process, including but not limited to explaining various provisions of the USMCA to members of the Mexican Congress and to stakeholders in Mexico. Second, a wise Mexican trade policy would be to conclude new or revised trade agreements with significant trading partners such as

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[198] See Eduardo Arcos, "AMLO's Move to Scrap an Airport Raises Fears of a Return to Mexico's Statist Past," *World Politics Review*, November 7, 2018, https://www.worldpoliticsreview.com/articles/26684/amlo-s-move-to-scrap-an-airport-raises-fears-of-a-return-to-mexico-s-statist-past.
[199] "AMLO Transition Report," *Monarch Global Strategies*, October 2018.
[200] Jude Webber, "Mexico Has no Plan to Sweeten Airport Bond Offer," *Financial Times*, December 16, 2018, https://www.ft.com/content/f09ee38c-0196-11e9-99df-6183d3002ee1.
[201] "Mexico President-Elect Hails Passage of Public Sector Pay Cuts," *Reuters*, September 14, 2018, https://www.reuters.com/article/us-mexico-politics/mexico-president-elect-hails-passage-of-public-sector-pay-cuts-idUSKCN1LU2KW.
[202] Anecdotal evidence suggests that many technocrats, including those in the Finance Ministry and the Central Bank, have been busy circulating their resumes, and making it clear to prospective new employers that they are ready to depart the government—now.
[203] Transparency International's "Corruptions Perception Index" ranks Mexico 135th out of 180 countries analyzed, among the four worst in Latin America (with only Paraguay, Guatemala, and Nicaragua ranked as more corrupt). See Transparency International "Corruption Perceptions Index 2017" February 21, 2018, https://www.transparency.org/news/feature/corruption_perceptions_index_2017.
[204] Eric Martin, "AMLO is Said Planning to Gut Trade Team that Renegotiated NAFTA," *Bloomberg Law*, October 19, 2018, https://news.bloomberglaw.com/international-trade/amlo-is-said-planning-to-gut-trade-team-that-renegotiated-nafta.

the European Union, or potentially significant trade partners such as MERCOSUR (the Southern Common Market made up of Argentina, Brazil, Paraguay, and Uruguay). In addition to its declining petroleum production, Mexico's most significant economic problem is its dependence on the United States, which purchases more than 75% of Mexico's exports. Thus, Mexico's medium- and long-term strategy should be to reduce that dependence so that the Mexican economy will not be in thrall to the United States in the future.

Petroleum policy is another major risk. As noted earlier, although revenues from hydrocarbons leases could have provided desperately needed funds for the economic reforms AMLO seeks for Mexico's poorest residents, a moratorium on new leases has been imposed for the next three years.[205] At the same time, AMLO is a strong supporter of Pemex. Pemex must be encouraged to use its limited funds wisely. For example, it makes little sense for Mexico to invest $8 billion in a new oil refinery simply to reduce gasoline imports from the United States.[206] Gasoline refineries generally are not highly profitable, as exemplified by the fact that no new gasoline refinery has been built in the United States in several decades.[207] In the view of many experts, Mexico and Pemex would be better off repairing existing refineries that are operating at about 40% of their full capacity and investing in the more profitable hydrocarbons sector. Moreover, given Pemex' current $108 billion debt load and various financial problems, strong financial support for the national oil company by the administration could threaten other high priority objectives.[208]

Several positive steps have also been taken in the early days of the AMLO administration. His initial budget is a responsible one, calling for a 1% surplus,[209] although this may be difficult to achieve unless oil prices continue to increase. In addition, although the terms are not clear, it appears that the AMLO administration is at least implicitly permitting the Trump administration to allow U.S. asylum seekers to remain in Mexico pending a decision by U.S. authorities on their applications.[210] This policy poses risks for AMLO, as large numbers of refugees in cities such as Tijuana are likely to be unpopular, but it clearly offers a route to good relations with the Trump administration.

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[205] I spoke with one Mexican trade lawyer in March who suggested that the moratorium might well be modified before 2021.

[206] "Mexico's President-Elect Sets Out Plan for New $8 billion Oil Refinery," *Reuters,* September 4, 2018, https://www.reuters.com/article/us-mexico-refinery/mexicos-president-elect-sets-out-plan-for-new-8-billion-oil-refinery-idUSKCN1LK2V0.

[207] The newest major refinery in the United States was completed in 1977. See "When Was the Last Refinery Built in the United States?," *U.S. Energy Information Administration*, June 29, 2018, https://www.eia.gov/tools/faqs/faq.php?id=29&t=6.

[208] See Eric Martin and Justin Villamil, "AMLO Risks His Own Fall as He Tries to Pull Pemex Back from the Brink," *Bloomberg News*, March 20, 2019, https://www.bloomberg.com/news/articles/2019-03-20/amlo-risks-a-fall-as-he-tries-to-pull-pemex-back-from-the-brink.

[209] "Mexico's New President Presents a Sober Budget," *The Economist*, December 18, 2018, https://www.economist.com/the-americas/2018/12/18/mexicos-new-president-presents-a-sober-budget.

[210] Azam Ahmed and Mike Tackett, "U.S. Will Send Migrants Back to Mexico as the Wait on Asylum Claims," *New York Times*, December 20, 1918, https://www.nytimes.com/2018/12/20/world/americas/us-mexico-asylum-migrants.html.

Also, the AMLO administration encouraged the Trump administration to join its pledge to provide billions of dollars in development funds for Central America.[211] This initiative was publicly welcomed by the U.S. State Department: "The U.S. . . welcomes the historic commitment by the government of Mexico to development in southern Mexico and to promote our shared goals with the countries of El Salvador, Guatemala, and Honduras."[212]

Recommendations: AMLO and his colleagues should avoid any further statements or actions that are likely to discourage investment in Mexico's hydrocarbons sector or, to the extent feasible, spook potential investors in any sector. AMLO should endeavor to convince the best and brightest experts, regardless of political affiliation, to join his government, and pay them a decent living wage so that no government officials will feel it necessary to accept corrupt payments. Overall, he should seek to manage an administration that is fiscally responsible so that it will be able to borrow credit on international markets when necessary at reasonable rates.

Finally, AMLO becomes president at a time when, despite some improvements, Mexico still ranks poorly on the World Bank's annual report on the ease of doing business; it is currently ranked 54th overall, down from 50th a year earlier.[213] Although Mexico appears above most other Latin American jurisdictions, it ranks well below competing Asian countries such as South Korea, Taiwan, Malaysia, and Thailand.[214] Improving the ease of doing business in Mexico would potentially increase investment and job creation—the latter one of AMLO's key objectives—and assist Mexico in minimizing the disruptive effects of the USMCA. Overall, in my view, a statist, populist sexenio for AMLO is a greater risk to Mexico's future economic well-being than any changes associated with NAFTA.

C. President Trump's Frustration With Illegal Immigration and Other Bilateral Issues

A major factor in the upcoming trade relationships between the Trump and AMLO administrations is potential disruption from non-trade disputes, particularly over immigration and asylum. Trump remains committed to building a border wall (just as the Democrats, who now control the House of Representatives, vehemently oppose it), and willingly shut down much of the U.S. federal government for more than three weeks in December 2018 and January 2019 to (unsuccessfully) seek funding for it from Congress.[215] While he no longer insists that Mexico will pay for the wall directly, he suggests that

[211] Jude Webber, "US and Mexico Pledge Development Funds for Central America," *Financial Times*, December 18, 2019, https://www.ft.com/content/90a953d4-0300-11e9-99df-6183d3002ee1.
[212] Ibid.
[213] The World Bank Group, *Doing Business 2019* (Washington, D.C., 2018), http://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf.
[214] Ibid.
[215] Michael Collins, John Fritze, and David Jackson, "Government Shutdown Sets Record as Longest in U.S. History. When will it Finally End?" *USA Today*, January 12, 2019, https://www.usatoday.com/story/news/politics/2019/01/12/government-shutdown-standoff-now-longest-ever-when-end/2546949002/.

revenue will come from the benefits of the USMCA, a dubious assertion with no evident economic justification.[216]

Other immigration issues also run the risk of disruptive action by the Trump administration, including a seemingly intractable problem of migrants from the Northern Triangle countries in Central America (Guatemala, El Salvador, and Honduras) seeking passage through Mexico so that they can enter and seek asylum in the United States. The sheer numbers of such migrants provide a major challenge for U.S. Immigration and Customs Enforcement. At the same time, Mexican authorities face a difficult situation in seeking to control the mass migration from the Northern Triangle. These difficulties have caused Trump to lash out not only at the source countries of these migrants by cutting off foreign assistance to the three Northern Triangle countries, but also at Mexico if it permits the migrants to cross Mexico and reach the United States. For example, on several occasions in 2019, Trump threatened to close the U.S.-Mexico border entirely, including shutting legal points of entry, blocking all trade flows (worth about $600 billion per year), and halting all travel.[217] Large numbers of migrants heading north in mid-October became an issue in the November elections, and resulted in reiterated threats to close the U.S.-Mexico border.[218]

In the longer term, the only likely means of mitigating the migration would be massive inflows of wisely structured foreign assistance to these countries in return for better control of corruption and violence. In an ideal world, for example, some of the enterprises that are relocating away from China would take advantage of the low labor costs and proximity to the United States to produce lower tech goods such as auto parts. Presumably, Mexican officials would be willing to trade some industrial production for a reduction of the headaches of mass illegal migration into and through Mexico.

Immigration has never been a significant part of NAFTA,[219] but a relationship between immigration and trade has always existed. Many hoped that the enactment of NAFTA would lead to improvements in Mexico's economy, including wage levels, and to reduce the incentives for undocumented migration to the United States, but in 25 years this has not occurred. It is obvious that closing the border would be a disaster for both the United States and Mexico (suggesting that despite the threats it will not happen for any length of time), but it seems clear that the immigration problems faced by the United States will continue to threaten the stability of the U.S.-Mexico relationship with or without the ratification and entry into force of the USMCA.

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[216] Robert Farley, "Is Mexico Paying for the Wall Through USMCA?" *FactCcheck.org*, December 14, 2019, https://www.factcheck.org/2018/12/is-mexico-paying-for-the-wall-through-usmca/.
[217] See David Nakamura, Josh Dawsey and Nick Miroff, "'Close the Whole thing!': Border Tensions Boil Over as Trump's Frustrations Grow," *The Washington Post*, October 19, 2018, https://www.washingtonpost.com/politics/close-the-whole-thing-border-tensions-boil-over-as-trumps-frustrations-grow/2018/10/19/afe45462-d3a6-11e8-8c22-fa2ef74bd6d6_story.html?utm_term=.3947511945e6.
[218] Delphine Schrank, "U.S.-Bound Migrant Caravan Stuck on Guatemalan Border with Mexico," *Reuters*, October 20, 2018, http://news.trust.org//item/20181020165252-ccbx7/.
[219] NAFTA Chapter 16 provides only for temporary entry for business persons; it does not address immigrant visas at all.

Another trade-related issue that could undermine Mexico's support for the USMCA is the decision by the U.S. Department Commerce to terminate the current (2013) suspension agreement of the anti-dumping case against Mexico-grown tomatoes.[220] (The agreement sets a floor price for tomatoes but permitted their importation without anti-dumping duties, resulting in relative peace for the past six years in a trade dispute with Mexico that dates back to the mid-1970s.[221]) The resurrection of the anti-dumping case, long sought by the Florida Tomato Exchange and other Florida growers, could occur as soon as May 7 and would probably result in the imposition of new duties on imports of tomatoes from Mexico (currently at zero under NAFTA and the suspension agreement), raising prices for importers and consumers and threatening the livelihood of hundreds of workers in Nogales, Arizona, the port of entry for most of the tomatoes imported into the Untied States. The Trump administration had sought greater flexibility in the NAFTA renegotiation to impose anti-dumping duties on seasonal tomato imports, but Mexico refused to agree and the administration ultimately eliminated the request.[222] It is too soon to tell whether this action, if implemented, will affect the willingness of the AMLO administration and the Mexican Congress to approve the USMCA.

Recommendations: Difficult as it would be for the Trump administration, both the U.S. and Mexico would benefit from a ratcheting down of the Trump administration's rhetoric on illegal immigration to the United States. The United States needs Mexico's ongoing assistance in interdicting North Triangle migrants who seek to cross through Mexico to the U.S., a collaboration that would be jeopardized if U.S. public statements are unduly critical of Mexico's cooperation. While illegal immigration likely will not be de-emphasized as a political issue before the November 2020 presidential election, it can be hoped that reducing the recriminations between the countries will be possible. Otherwise, not only trade but other aspects of the future Trump-AMLO relationship will suffer. In the longer term, all three North American countries would benefit from a coordinated effort to reduce corruption and violence in the Central American nations of the Northern Triangle. AMLO's development funding proposal noted above could be a valuable first step if it is ultimately supported by the United States. Also, despite the temptation to give in to an important agricultural constituency in what could be a swing state in the November 2020 elections, the Trump administration should resist pandering to the Florida producers and their supporters.

220 International Trade Administration, "Fresh Tomatoes From Mexico: Intent To Terminate Suspension Agreement, Rescind the Sunset and Administrative Reviews, and Resume the Antidumping Duty Investigation," March 5, 2019, https://www.federalregister.gov/documents/2019/03/05/2019-03928/fresh-tomatoes-from-mexico-intent-to-terminate-suspension-agreement-rescind-the-sunset-and#footnote-22%E2%80%8923-p7874.
221 The author spoke recently with a lawyer who served in the Treasury Department in the mid-1970s, who reminded him that dumping disputes between the United States and Mexico over tomato imports are more than 40 years old.
222 David Shepardson and David Lawder, "U.S. to End Tomato Trade Pact with Mexico, Threatening Duties," *Reuters*, February 2, 2019, https://www.reuters.com/article/us-usa-tomatoes-mexico/u-s-to-end-tomato-trade-pact-with-mexico-threatening-duties-idUSKCN1PW27Y.