

From NAFTA to USMCA: Two's Company, Three's a Crowd

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Abstract

The renegotiation of NAFTA was surrounded by a dramatic atmosphere, just as Canadian Minister of Foreign Affairs Chrystia Freeland predicted. The negotiations took place against a backdrop of unilateral trade measures, President Trump's mercantilist approach to trade policy, and the United States' specified preference for bilateral trade deals. This article argues that, for the most part, economic, political and cultural relations in the NAFTA countries are bilateral in nature, but with important trilateral production chains in specific sectors, most notably in the automotive sector. Beyond these trilateral sectors, the relationship between Canada and Mexico plays a relatively minor role. However, replacing NAFTA with bilateral agreements would have placed Canada and Mexico at a disadvantage, relative to the United States, in terms of attracting foreign direct investment. Nevertheless, Canadian and Mexican interests do not always coincide, nor do their negotiating positions. For example, Mexico was willing to give up Chapter 19 dispute settlement for trade remedies, whereas Canada insisted on keeping it in place. In end, USMCA Chapter 10 preserves this dispute settlement mechanism for all three parties. Canada was willing to give up NAFTA Chapter 11 on foreign investment disputes, whereas Mexico accepted a modified version. The result is a trilateral agreement with significant bilateral elements, as well as global elements that will serve as a possible model in future megaregional and multilateral negotiations.

Keywords: USMCA, NAFTA, negotiations, United States, Mexico, Canada, renegotiations.

Resumen

La renegociación del TLCAN estuvo rodeada por una atmósfera dramática, tal como lo predijo la Ministra de Asuntos Exteriores de Canadá, Chrystia Freeland. Las negociaciones tuvieron lugar en un contexto de medidas comerciales unilaterales, el enfoque mercantilista del presidente Trump hacia la política comercial, y la preferencia especificada de los Estados Unidos por los acuerdos comerciales bilaterales. Este artículo sostiene que, en su mayor parte, las relaciones económicas, políticas y culturales en los países del TLCAN son de naturaleza bilateral, pero con importantes cadenas de producción trilateral en sectores específicos, especialmente en el sector automotriz. Más allá de estos sectores trilaterales, la relación entre Canadá y México juega un papel relativamente menor. Sin embargo, reemplazar el TLCAN con acuerdos bilaterales habría colocado a Canadá y México en desventaja, en relación con los Estados Unidos, en términos de atraer inversión extranjera directa. Sin embargo, los intereses canadienses y mexicanos no siempre coinciden, ni tampoco sus posiciones al negociar. Por ejemplo, México estaba dispuesto a renunciar al Capítulo 19 de solución de controversias para diferencias comerciales, mientras que Canadá insistió en mantenerlo en su lugar. Finalmente, el Capítulo 10 de la USMCA preserva este mecanismo de solución de controversias para las tres partes. Canadá estaba dispuesto a renunciar al Capítulo 11 del TLCAN sobre disputas de inversiones extranjeras, mientras que México aceptó una versión modificada. El resultado es un acuerdo trilateral con elementos bilaterales significativos, así como elementos globales que servirán como un posible modelo en futuras negociaciones megaregionales y multilaterales.

Palabras claves: USMCA, TLCAN, negociaciones, Estados Unidos, México, Canadá, renegociaciones.

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Introduction

Twenty-five years after the North American Free Trade Agreement (NAFTA) was signed, the regional relationship consists of two bilateral interactions on two very different borders, with the exception of those sectors in which supply chains have become integrated on a trilateral basis and beyond. Initially, Mexico proposed a bilateral Free Trade Agreement (FTA) with the United States, which is what Canada already had. It was Canada that proposed a trilateral FTA, in order to avoid the possibility of Mexico getting a better deal, and to avoid a hub-and-spoke pattern of investment, with the United States as the hub. Inspired by this hub-and-spoke concept, Mexico went on to sign several FTAs and investment agreements, in order to make Mexico the center of a hub-and-spoke network. The strategy has met with some success, with Mexico serving as a manufacturing platform for European and Asian manufacturers in North America. It appeared that the Trump administration wanted to adopt a hub-and-spoke model for itself, by replacing NAFTA with bilateral trade agreements. However, that would have disrupted regional supply chains, most notably in the automotive sector, and reduced jobs and competitiveness in North American manufacturers.

On 18 May 2017, pursuant to the Trade Priorities and Accountability Act (TPA), the United States Trade Representative (USTR) notified Congress of its intention to initiate negotiations with Canada and Mexico to modernize NAFTA. On 31 August 2018, President Trump notified Congress of his intent “to enter into a trade agreement with Mexico—and with Canada if it is willing, in a timely manner”. Arguably, the 2017 notification does not cover a bilateral trade agreement with Mexico, which would not meet the TPA requirements. The Democrats, who won control of the House of Representatives in the mid-term elections in November 2018, could have used this as a reason to reject a bilateral agreement with Mexico. Moreover, even many Republicans insisted that any new agreement must include Canada, and the Republicans maintained control of the Senate in the mid-term elections in November 2018.

The result is a trilateral agreement, the United States-Mexico-Canada Agreement (USMCA). However, the USMCA has more bilateral elements than the original NAFTA, which adapt the agreement to the primarily bilateral nature of the relationship between the three countries. This article will approach the new agreement from this perspective. It is organized as follows. Part II examines the bilateral nature of relationships among the NAFTA countries, in an historical, political and economic context. Part III focuses on the automotive sector as the best example of trilateral production chains and it examines the new rules for this sector in the USMCA. Part IV examines the new dispute settlement mechanisms in the USMCA.

It is worth noting that some reforms are neither bilateral nor trilateral, but rather global in nature, and will serve as a model for future megaregional and multilateral trade negotiations. A notable example is big data, where the USMCA makes it virtually impossible to restrict data flows across borders. Another example is pharmaceuticals, such as biologics, for which the USMCA expands intellectual property rights protection.

The USMCA adds to the spaghetti bowl of regional trade agreements involving the USMCA parties, most notably the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) (the Trans-Pacific Partnership minus the United States), the EU-Canada Comprehensive Economic and Trade Agreement (CETA), the Mexico-EU Free Trade Agreement, the Korea-U.S. Free Trade

Agreement, the Japan-Mexico Free Trade Agreement, the Canada-Korea Free Trade Agreement, and others that are in the works, notably a Mexico-Korea Free Trade Agreement and a new trade agreement being negotiated between Japan and the United States. With the conclusion of the USMCA, the Canadian government noted that Canada is the only G7 country with free trade agreements with all the other G7 countries. However, this situation is likely to evolve into the United States rejoining the CPTPP and concluding a megaregional trade agreement with the European Union. These mega-regional FTAs are likely to serve as springboards for future multilateral trade negotiations. However, the USMCA contains a surprising provision in Chapter 32, which effectively gives the three parties a role in determining whether any of them negotiate a trade agreement with a non-market economy (i.e. China).

The bilateral natures of North American political economy

NAFTA has created a trilateral economic structure, but it sits on top of two very different bilateral relationships. The dominant position of the United States in the world—in terms of its military might, the size of its economy, and its political influence—is magnified on the North American continent. Not surprisingly, this results in many parallels in the two bilateral relationships, despite the marked differences between Canada and Mexico.

As Table 1 and Table 2 show, Canada and Mexico both depend more on trade than the United States, and both depend overwhelmingly on trade with the United States.

Table 1: Trade and GDP of NAFTA Countries 2017 (rounded to billions of USD)

Country	GDP	Export	Import	Trade/GDP ¹
Canada	1,764	443	444	50%
Mexico	1,142	407	417	72%
USA	19,360	1,576	2,352	20%

Source: CIA Factbook (2017b)

Table 2: Percentage of trade with NAFTA partners (Exports/Imports), 2017

	Canada	Mexico	USA
Canada	--	1.4/6.2**	76.4/51.5*
Mexico	2.8/2.3***	--	79.9/46.4*
USA	18.3/12.8*	15.7/13.4*	--

Source: * CIA Factbook (2017a); ** Statistics Canada (2017); *** Secretaría de Economía (2017)

As Table 3 shows, U.S. merchandise trade with Mexico has almost caught up with U.S. merchandise trade with Canada. In 1995, trade with Mexico was only 41% of trade with Canada. By 2017, trade with Mexico was 96% of trade with Canada. In the first six months of 2018, this rose to 97%.

¹ Trade/GDP is the value of total exports plus total imports as a percentage of GDP. International shipment of non-U.S. goods through the United States can make standard measures of bilateral trade balances potentially misleading.

Table 3: Value of U.S. Merchandise Trade with Canada and Mexico (rounded to billions of USD)

Year	Imports from Canada	Exports to Canada	Imports from Mexico	Exports to Mexico	Total Trade with Canada	Total Trade with Mexico
1995	144	127	62	46	243	100
1996	156	134	74	57	290	131
1997	168	150	86	71	318	157
1998	175	154	95	79	329	174
1999	198	164	110	87	362	197
2000	229	176	136	112	406	248
2001	216	163	131	101	380	233
2002	209	161	135	97	370	232
2003	222	170	138	97	392	235
2004	256	190	156	111	446	267
2005	290	212	170	120	502	390
2006	302	231	198	134	533	332
2007	317	249	211	136	566	347
2008	339	261	216	151	601	367
2009	226	205	177	129	431	306
2010	278	249	230	164	527	394
2011	315	281	263	198	597	461
2012	324	293	278	216	617	493
2013	333	301	281	226	633	507
2014	349	313	296	241	662	537
2015	296	281	296	236	577	533
2016	278	267	294	230	545	524
2017	299	282	314	243	582	558
2018 (Jan-June)	160	152	169	131	312	301

Source: Condon and Sinha (2003); U.S. Census Bureau (1995-2018)

There are parallels in the economic histories of Canada and Mexico. At the turn of the twentieth century, both Canadians and Mexicans first pursued, then rejected, closer economic ties with the United States. Canada's rejection came in the form of a democratic vote; while Mexico's rejection took shape as a violent revolution.

Under President Porfirio Diaz, from the 1880s to 1910 Mexico opened up to foreign investment and deepened its economic ties with the United States. However, Diaz's presidency—and his policy of closer economic ties—ended with the revolution of 1910. After the revolution, under the Partido Revolucionario Institucional (PRI), suspicion of foreign interests was a hallmark of Mexico's economic policy for decades. Economic nationalism with respect to foreign investors hit high points in 1938, with the nationalization of the oil industry, and in 1982, with the nationalization of the banks. More generally, Mexico's foreign investment law discouraged foreign investment (Condon & Sinha, 2003).

In 1911, the United States and Canada negotiated a free trade agreement. The Liberal federal government of Canada under Sir Wilfrid Laurier championed the agreement in a federal election. The Liberals lost the election to the Conservatives and the free trade agreement was never implemented. Curiously, in 1891, the Liberals and the Conservatives had taken exactly the opposite positions on free trade (Condon & Sinha, 2003).

For most of the twentieth century, Canada has followed a different course of national policies compared to the United States, creating a national health care system and government-owned broadcasting, railroad lines, and airlines, among other industries. Canada believed that, if such institutions were left to the private sector, they would be overwhelmed by larger private counterparts from the south. Thus, Canada's ever present fear of cultural, social and economic invasion also resulted in foreign investment restrictions and government ownership of industry. Canada complemented its foreign investment restrictions with trade policies designed to create manufacturing jobs in the country, leading American firms to establish "branch plants" in Canada to gain market access (Condon & Sinha, 2003).

In 1947, Canada, the United States and 21 other countries signed the General Agreement on Tariffs and Trade (GATT).² Over the years, GATT significantly reduced barriers to trade in goods between Canada and the United States, as well as other members (Mexico did not join the GATT until 1986) (Hudec, 1990). However, GATT was not reducing trade barriers quickly enough for the auto industry, so Canada and the United States negotiated the "Autopact" of 1965, creating free trade in this sector. This led to an increasingly integrated auto industry straddling the two sides of the border (Doern & Tomlin, 1991).

Like Canada, for most of the twentieth century Mexico resisted greater economic integration with the United States. Mexico adopted a trade policy based on "import substitution". The aim of this policy was to promote the industrialization of Mexico through barriers to imports and foreign investment. The policy worked well initially and Mexico experienced sustained economic growth. However, over time Mexico's protected industry became highly inefficient, producing inferior quality goods and falling behind technologically. In 1965, the same year of the Canada-United States Autopact, Mexico started the "maquiladora" program. Foreign companies established assembly plants along the northern border that used Mexican labor to assemble imported components, which were then exported as finished goods. In the 1980s, the Mexican government realized that its policy of economic self-sufficiency was no longer working and began to open its economy, first under President Miguel de la Madrid (under whom Mexico joined the GATT in 1986) (Condon & Sinha, 2003).

In the 1980s, almost a century after the idea of free trade was rejected, the Conservatives championed the negotiation of a bilateral free trade agreement between Canada and the United States. The government of Canada sought the negotiations in response to rising protectionist pressures in the U.S. congress. For many years, the Canadian government, led by Liberal Prime Minister Pierre Trudeau, had tried to lessen Canada's economic dependence on the United States through efforts to diversify its trade relations, during that time the percentage of Canada's exports that went to the United States continued to rise. In the 1980s, the government of Conservative Prime Minister Brian Mulroney recognized that

² China was an original GATT signatory, but withdrew in 1950 after the Nationalist Government moved to Taiwan.

geography was working against those efforts and decided that secure access to the U.S. market was an essential element of Canada's trade policy (Doern & Tomlin, 1991).

The proposed free trade agreement generated heated political debate in Canada and became the central issue in the national election of 1988. The incumbent Conservative government negotiated the agreement, while the Liberal and New Democratic opposition parties disapproved vehemently. The opposition parties split the anti-free-trade vote between them, allowing the Conservatives to win re-election and proceed with the implementation of the Canada-United States Free Trade Agreement (CUSFTA), which came into effect in January 1, 1989 (Doern & Tomlin, 1991).

While the CUSFTA debate made for high drama in Canada, the negotiation and passage of the agreement was barely noticed in the United States. The same cannot be said for the NAFTA debate in the United States, where opponents took up the same arguments the Canadian anti-free-trade forces had used five years earlier. The Canadian fear that lower environmental and labor standards in the United States would lead to a "race to the bottom" and compromise Canada's higher standards, became a central issue in the U.S. debate. However, it was now the higher standards in the United States that would be threatened by the Mexico's lower standards. The Canadian fear of job losses and wage depression was translated into the same fear in the United States, expressed by independent presidential candidate Ross Perot as the "giant sucking sound" Americans would hear as manufacturing jobs were moved to lower-wage Mexico (Condon & Sinha, 2003).

In Canada, as in the United States, the NAFTA debate coincided with an election year. In both countries, NAFTA became an election issue, and the government that negotiated the agreement lost to the governments that would implement NAFTA. In Mexico, President Carlos Salinas was there for both the negotiations and the implementation of the agreement (Condon & Sinha, 2003).

For Canada, the CUSFTA was proof of the special relationship that enjoyed with the United States. The CUSFTA gave Canadian business preferential access to the U.S. market and an advantage over other countries' firms. When Mexico entered free trade negotiations with the United States, Canada pushed to be involved in the negotiations and to negotiate a trilateral agreement, rather than two bilateral agreements. As much as possible, Canada wanted to preserve its CUSFTA gains and to make sure Mexico did not get a better deal than Canada. Moreover, to be able to influence the negotiations Canada had to be at the table. As almost an afterthought, Canada sought to enhance its access to the Mexican market (the destination of about one percent of Canadian exports) and to promote Mexico as gateway to Latin America for Canadian business (Lipsey, 1994; Riggs & Velk, 1993).

However, the most important reason Canada had to push for a trilateral agreement was to avoid a hub-and-spoke situation that could have a negative impact on Canada's ability to attract foreign direct investment. With two bilateral agreements, the United States would become the hub and Mexico and Canada the spokes. The United States, as the only one enjoying free trade with everyone involved, would be a more attractive location for foreign direct investment because firms located in the United States would have equal access to the entire market. This would have put Canada, and Mexico, at a disadvantage in attracting foreign direct investment (Lipsey, 1994).

In 1988, Carlos Salinas de Gortari had succeeded de la Madrid as President and had begun a radical transformation of Mexico's economy. Perhaps, his most radical move was to initiate free trade

negotiations with the United States, a move that would have been unthinkable even a few years earlier. Mexico's motives for seeking a free trade agreement were similar to those that motivated Canada to negotiate the CUSFTA: increased access to U.S. market, more secure access to U.S. market, a larger market that would allow Mexico-based firms to expand production and achieve economies of scale, greater competition to enhance productivity and efficiency, and a trade relationship based on rules, not power (Condon & Sinha, 2003).

President Salinas' slogan was that Mexico wanted to export goods, not people. Free trade would promote economic growth, modernize Mexican industry, and attract more foreign direct investment, creating more and higher paying jobs. With better jobs at home, fewer Mexicans would have to risk illegal migration to the United States in search of work. Finally, NAFTA would entrench the series of economic reforms put in place by Salinas, reducing the risk that later governments might roll back the clock on what became known as "Salinastroika" (Condon & Sinha, 2003).

The immigration issue was also a major motivation for the United States, as were the economic and political stability of its southern neighbor. A prosperous, free-trading Mexico would be less likely to erupt in political violence or suffer economic disintegration, both of which could send a flood of economic and political refugees fleeing north. In terms of its economic interests, the United States wanted to enhance its access to Mexican market, use Mexico as gateway to Latin America, and protect U.S. foreign direct investment in Mexico (Condon & Sinha, 2003).

As members of GATT, all three countries were simultaneously involved in the Uruguay Round negotiations. NAFTA negotiations could move quicker than GATT negotiations because fewer countries were involved. At the time the NAFTA was negotiated, it was by no means certain that the Uruguay Round would reach a successful conclusion. NAFTA would provide insurance against a failed Uruguay Round, creating a "fortress North America" that could compete against a "fortress Europe" (Condon & Sinha, 2003).

In terms of economic and business trends, NAFTA has led to deeper integration. In terms of political trends, the picture is more mixed. Despite historical parallels in their relationship with the United States, the Canada-Mexico relationship remained remarkably undeveloped before NAFTA. The two countries have pursued closer political ties in the NAFTA era, recognizing the value of teaming up when their interests in relation to the United States coincided. It should come as no surprise that both Canada and Mexico coincide in the view that a multilateral approach based on the rules of international law is the course to take. Given the asymmetries of power that exist in the NAFTA region, both countries are better off with a rules-based approach to international relations than one based on the unilateral exercise of power, be it military or economic. Indeed, a central motivation for both countries to sign free trade agreements with the United States was to impose a rules-based regime on the relationship.

However, Canadian and Mexican interests do not always coincide. The reality is that they are competitors in the trilateral arena, both economically and politically. Economically, they compete for foreign investment and trade. Each country sells itself to multinational firms as the best base from which to serve the North American market. Politically, they compete for the attention of the U.S. government on bilateral issues when their interests differ. For example, the issue of cross-border labor movement is a problem for Mexico, not Canada.

Canada and the United States have a long history of military and security cooperation, most recently including World Wars I and II, the Korean War, the Cold War, the Gulf War, and Afghanistan. The two continue this tradition through the North American Aerospace Defense Command (NORAD) and the North Atlantic Treaty Organization (NATO). The Canada-U.S. Joint Defense Board, which reports to the Prime Minister and the president, has existed for over seventy-five years. There is a high level of trust between these culturally close countries (Condon & Sinha, 2003).

Many border issues are handled on a bilateral basis rather than on a trilateral basis, and that trend is likely to continue. For example, Canada and the United States formalized cooperation under a 1995 bilateral border accord that was further enhanced by several bilateral initiatives prior to September 11. These include the Canada-United States Partnership (CUSP), USINC-CIC Border Vision (a strategic planning initiative of the immigration authorities to deal with illegal immigration), and the Cross-Border Crime Forum (cooperation and information sharing on transnational crime). In November 2001, Canada passed the first anti-terrorism law in its history. On December 13, 2001 Canada and the United States signed a new bilateral "anti-terror action plan" to further integrate border security and immigration. That same month, Canada passed a five-year budget plan for border infrastructure and security measures worth \$7.7 billion Canadian dollars. The FBI gave the RCMP access to its fingerprint database, the first foreign police force to be granted such access. These initiatives were designed to help the two countries improve the passage of commercial traffic on the border while facing the common external threats of international terrorism, transnational crime, and drug and people smuggling (Condon & Sinha, 2003).

Mexico does not have the financial resources or institutional structure to match Canada's efforts. Bilateral border initiatives take longer to negotiate given Mexico's division of legislative powers between the president and the congress, and a political climate that makes cooperation difficult to achieve between the two. Nevertheless, many U.S. border initiatives with Mexico mirror those taken with Canada, such as the so-called "Smart Border" plans. Moreover, most of Mexico's exports to the United States originate with some fifty companies, making pre-clearance for electronically sealed containers feasible. In August of 2018, the U.S. Drug Enforcement Administration and Mexico will set up a joint team based in Chicago to target Mexican drug cartels, their leaders, and finances, an area of particular interest in their bilateral relationship.

Despite the baggage of history and politics, the process of economic integration in the NAFTA region has moved forward at an increasingly rapid pace in recent years. Heightened awareness of the need to balance economic integration and security needs has sparked even closer cooperation between the three governments. For example, the United States has financed Mexican efforts to stem the flow of migrants across Mexico's southern border. Demographic and economic trends has led to a net outflow of Mexican migrants from the United States, but migrants from further south transit Mexico to get to the United States (González-Barrera, 2015).

Public opinion has come to favor NAFTA, although more so in Canada (74%) and Mexico (60%) than in the United States (51%), where there is a large partisan gap between Republicans (30%) and Democrats (68%). There are also U.S. demographic divides on who favors NAFTA, by sex, age, and race: women (55%); men (46%); 18-29 (62%); 30-49 (53%); 50+ (44%); whites (46%); blacks (59%); hispanics (66%) (Stokes, 2017). Moreover, the Trump administration's visceral attacks on Mexicans has led to the majority

of Mexicans having a negative view of the United States (66%), a dramatic reversal from the Obama administration, under which most Mexicans held a positive view (65%) of their northern neighbor (Vice & Chwe, 2017).

Capital flows in the form of foreign direct investment have had a major impact on merchandise trade by stimulating intra-firm trade. In the NAFTA region, foreign direct investment in the maquiladoras has stimulated considerable growth in cross-border flows of goods across the Mexico-U.S. border. Similarly, the regional integration of the automotive sector has sparked considerable foreign direct investment and merchandise trade between the NAFTA countries. With greater foreign direct investment in Mexico's manufacturing sector, there are more jobs to keep Mexican workers at home. Export-led growth has the potential to reduce the wage gap between Mexico and the United States, reducing incentives for Mexicans to seek work in the northern neighbor.

Mexico's strategy of pursuing free trade agreements around the world is designed to enhance its attractiveness to multinational investors compared to the other two countries; this strategy hub-and-spoke has worked. Mexico has become a manufacturing platform for Japan, EU, and Korea. However, the new USMCA requirements for the automotive sector will have an impact on Japanese, EU, and Korean automobile manufacturers in all three USMCA parties.

Mexico embarked on an ambitious round of trade negotiations in 2017, aimed at diversifying trade and updating existing agreements. In addition to the NAFTA re-negotiation, these include: adding New Zealand, Australia, and Canada to the Pacific Alliance (Mexico, Colombia, Peru, and Chile) as associates via bilateral agreements; deepening FTAs with Japan, EU, and EFTA; negotiating the CPTPP; and negotiating FTAs with Argentina, Brazil, Turkey, and Jordan. The CPTPP's economic impact has been estimated to be more positive for Mexico than the TPP, because it avoids the erosion of preferential access to USA under NAFTA and avoids competition with the United States in CPTPP markets (Dade, Ciuriak, Dadkhah, & Xiao, 2017). However, any impact of this kind is likely to be temporary, with the re-entry of the United States into the TPP as a likely prospect.

Similarly, in 2017 Canada saw the entry into force of the Canada-European Union Trade Agreement, continued to participate in CPTPP negotiations, and came close to launching negotiations for a free trade agreement with China (which would have made Canada the first G7 country to do so).

Canada and Mexico's enthusiasm for trade negotiations stands in sharp contrast to the United States, which pulled out of TTIP, TPP, and threatened to pull out of KORUS and NAFTA. However, at the time of writing, Korea and the United States had reached an agreement, the United States had signaled an interest in rejoining the TPP (now CPTPP), the United States and Japan agreed to negotiate a trade deal that would have similar content to the CPTPP, and the renegotiation of NAFTA produced the USMCA. Perhaps the most accurate description of current U.S. trade policy is that it is erratic. As Petros Mavroidis (2018) puts it:

President Trump's trade policy is a decisive turn towards unilateralism followed by bilateral deals. This combination is a blow to the multilateral edifice the US has helped establish. Only time will tell how serious this turn to unilateralism is. This Administration has accustomed the world to

an erratic behavior, so a turn in the opposite direction — a lifting of tariffs and respect for multilateral treaties — cannot be excluded out of hand.

All of these trade negotiations have implications for the multilateral trading system. CUSFTA and NAFTA negotiations were motivated in part by the risk of multilateral trade negotiation failure. Today's flurry of free trade negotiations is similarly motivated by the inability of WTO negotiations to make any headway. However, as with NAFTA negotiations, between a major power, middle power, and a middle-income developing country, today's free trade negotiations will provide models for a future multilateral negotiation. If enough countries can agree to modernize their FTAs, those advances could make their way into the WTO regime.

In 1992, NAFTA added Mexico to the existing Canada-United States Free Trade Agreement. In 2018, the USMCA added Canada to the bilateral agreement between Mexico and the United States. This reversal of roles is a reflection of the relative bargaining power of Canada and Mexico, since Mexico depends more than Canada on its trade relationship with the United States. However, it also reflects the extent to which Mexico's trade with the United States has grown, to the point at which Mexico is poised to overtake Canada's trade with the United States. Moreover, it shows that, in these trade negotiations, trade flows mattered, perhaps more than the traditional historical, cultural and security ties. In particular, the negotiations demonstrated the importance of Mexico's market for U.S. farmers and other key sectors of importance for President Trump's political fortunes. However, Canada's strategic lobbying of Congress and U.S. governors payed off as well, in the support that Canada received after the bilateral agreement between Mexico and the United States.

The trilateral automotive sector has new bilateral approaches

The USMCA preserves the trilateral nature of the automotive industry, but gradually raises North American content for passenger vehicles and light trucks from 62.5% to 75%, it also requires producers to source 70% of aluminum and steel in North America, and introduces the concept of "Labor Value Content" to require that a percentage of production come from high-wage manufacturing. Automotive tariff rate quotas also reflect the trilateral nature of that sector, setting tariff rate quota levels far higher than current trade flows, to prevent tariffs such as the 25% national security tariffs President Trump threatened to impose on automotive imports. However, the "Labor Value Content" requirement is aimed squarely at Mexico.

The "Labor Value Content" requirement is the result of a proposal from Canada, in response to the U.S. proposal that 50 percent of regional content originates in the United States. Canada proposed incorporating a content requirement for higher wages, which gives Canada an advantage over Mexico. Both this Canadian proposal and the resulting treaty text are evidence of the limits of cooperation between Mexico and Canada on trade issues, even in a sector that is integrated trilaterally.

As Table 4 shows, just two HS sections make up almost two-thirds of Canada-Mexico trade. Vehicles and equipment alone account for 32.4%.

Table 4: Five largest sectors in Canada-Mexico trade, 2017, rounded to CAD millions

HS Section	Exports from Canada	Imports from Mexico	Total trade	% of bilateral trade
02 Veg. Prod.	\$1,391	\$2,016	\$3,407	7.9%
05 Mineral Prod.	\$586	\$753	\$1,339	3.1%
15 Base Metal Prod.	\$1,244	\$1,013	\$2,257	5.2%
16 Mach. Mech. Elec. Prod.	\$1,207	\$12,059	\$13,266	30.6%
17 Vehicles and Equip.	\$1,412	\$12,618	\$14,030	32.4%

Source: Government of Canada (2017)

As Table 5 shows, Motor Vehicles and parts make up 20% of Canada-U.S. trade and 22.7% of Mexico-U.S. trade. In 2016, the U.S. trade deficit on vehicle trade with Canada was \$20.4 billion, and with Mexico was \$45.3 billion (Canis, Villarreal, & Jones, 2017). Fossil fuels and their products make up 10.7% of Canada-U.S. trade, but a much smaller percentage of Mexico-U.S. trade. However, Canada is the largest energy trading partner of the United States, with total energy trade accounting for about 5% of the value of all U.S. exports to Canada and more than 19% of the value of all U.S. imports from Canada in 2016 (U.S. Energy Information Administration, 2017).

Table 5: Largest sectors in USA- Canada and USA -Mexico trade, 2016, USD billions

NAFTA partner/Product	U.S. Exports	U.S. Imports	Total	% of total bilateral trade
Can, Motor Vehicles	25.9	46.3	72.2	13.3%
Can, M.V. Parts	21.0	13.8	34.8	6.4%
Can, Oil & Gas	2.0	43.2	45.2	8.3%
Can, Petroleum & Coal Products	8.9	4.0	12.9	2.4%
Mex, Motor Vehicles	4.0	49.3	53.3	10.2%
Mex, M.V. Parts	19.8	46.0	65.8	12.6%
Mex, Computer Equip	16.5	18.2	34.7	6.6%
Mex, Oil & Gas	0.2	0.8	1.0	.19%
Mex, Petroleum & Coal Products	16.7	2.0	18.7	3.6%

Source: (Canis et al., 2017; U.S. Census Bureau, 1995-2018; U.S. Energy Information Administration, 2017, 2018)

For passenger vehicles and light trucks, as well as for some of the parts used in their production, North American content will gradually increase from 62.5% to 75% by 1 January 2023, using the net cost method of calculating content. Some other parts such as passenger vehicles and light trucks will rise to

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From NAFTA to USMCA: Two's Company, Three's a Crowd

65% or to 70%, depending on the part. For heavy trucks, North American content will gradually increase to 70% on 1 January 2027, while the content requirements for their parts will be 60% or 70%, depending on the part.

In addition to the foregoing content requirements, a passenger vehicle producer must certify annually that it meets the Labor Value Content requirements, which will increase gradually from 30% on 1 January 2020 to 40% on 1 January 2023. For light trucks or heavy trucks, the figure will be 30%. For passenger vehicles, the 40% Labor Value Content must consist of at least 25% high wage material and manufacturing expenditures, no more than 10% technology expenditures, and no more than 5% assembly expenditures. For light trucks or heavy trucks, the requirement is at least 15% high wage material and manufacturing expenditures, no more than 10% technology expenditures, and no more than 5% assembly expenditures.

The definitions of these terms are very important. "High wage material and manufacturing expenditures" requires parts manufacturing and vehicle assembly located in North America with a production wage rate that is at least US\$16 per hour. The production wage rate is the average hourly base wage rate, not including benefits, of employees directly involved in the production of the part or component used to calculate R&D, and does not include salaries of management, R&D, engineering, or other workers who are not involved in the direct production of the parts or in the operation of production lines. This definition excludes the possibility that automation in Mexican plants could get around the minimum wage rate by basing the calculation on management, R&D, engineering, or other workers who essentially oversee the operation of production lines by robots. This rule could have the effect of delaying such automation of automobile production, which has implications for the competitiveness of the North American automotive sector outside the region as such automation advances elsewhere in the world.

Furthermore, "assembly expenditures" requires the vehicle producer to demonstrate that it has an engine assembly, transmission assembly, or an advanced battery assembly plant, or has long term contracts with such a plant, located in North America with an average production wage of at least US\$16 per hour. In the case of a passenger vehicle or light truck, a high wage engine assembly or transmission assembly plant must have a production capacity of at least 100,000 originating engines or transmissions and an advanced battery assembly plant must have a production capacity of at least 25,000 originating assembled advanced battery packs. In the case of a heavy truck a high wage engine, transmission, or battery assembly plant must have a production capacity of at least 20,000 originating engines, transmission, or assembled advanced battery packs.

Another concept, "technology expenditures" means the annual vehicle producer expenditures in North America on wages for research and development (R&D) or information technology (IT) as a percentage of total annual vehicle producer expenditures on production wages in North America. R&D expenditures include expenditures on research and development including prototype development, design, engineering, testing, or certifying operations. IT expenditures include expenditures on software development, technology integration, vehicle communications, and information technology support operations.

Lower barriers to trade and low wages are not the only competitive advantages that Mexico offers as a manufacturing platform. Mexico's network of free trade agreements, particularly with the European

Union, Japan, and Korea, lowers the costs of inputs from those countries (Welch & Merrill, 2017). Canada may be in a similar position, particularly with the US withdrawal from the TPP (Dade et al., 2017; Office of the Chief Economist, 2016). Technological disruption will play a role, with advances in artificial intelligence and robotics continuing to increase automation in manufacturing. With so many variables, it is difficult to estimate the economic impact of the USMCA, but the impact is likely to vary across industries. In the automotive sector, the Labor Value Content rules will affect the pace of technological disruption and the location of investment in production facilities.

The new rules of origin for the automotive sector are likely to increase investment in the North American automotive sector, particularly for car parts for European and Asian manufacturers in the region. The Labor Value Content rules may steer more of that investment to Canada and the United States. However, these protectionist rules will reduce the efficiency of the industry in North America, which will raise prices and diminish demand. It is beyond the scope of this article to speculate on the precise economic impact of the new rules for the automotive sector. Moreover, that economic impact could be moderated through trade negotiations in other forums.

Dispute Settlement

In recent years, the United States has begun to retreat from binding dispute settlement in regional trade agreements and at the WTO. Binding dispute settlement mechanisms in the NAFTA and the WTO were created in the 1990s and have been very successful, for the most part. However, their very success has motivated some governments to modify or retreat from such mechanisms. The United States is the most prominent example, particularly with its blocking of WTO Appellate Body appointments (Condon, 2018). However, the European Union has long preferred to use the diplomatic dispute settlement mechanisms in its RTAs, rather than the arbitration mechanisms. Moreover, countries such as Canada have begun to limit the scope of bilateral investment treaties, in order to preserve more regulatory autonomy. These trends raise the issue of whether we are past the era of “peak judicialization” of international dispute settlement, at least in international economic law, and why that might be the case. The dispute settlement reforms in the USMCA are consistent with this retreat from judicialization of trade and investment disputes³.

The USMCA dispute settlement reforms reflect the bilateral nature of North American relations. The USMCA will eliminate the application of NAFTA Chapter 11 to foreign investment between Canada and the United States, but retains a modified investment dispute settlement system for Mexico. Investment dispute settlement is more important for Mexico, where political risk is a bigger issue than in Canada. In Canada and the United States, the similarity in their legal systems and a more solidly entrenched rule of law make investment dispute settlement less important for attracting foreign investment. Moreover, both Canada and the United States faced investor claims regarding public interest regulation that left them dissatisfied with the way that NAFTA Chapter 11 was used, for example to challenge environmental laws and policies.

³ Of course, even with binding arbitration, the disputing parties are always free to reach a negotiated settlement of the dispute, which would then bind the parties to the terms of the settlement. Here, I am referring to third-party dispute settlement by WTO panels or the WTO Appellate Body, for example, which becomes binding on the parties to the dispute upon (virtually automatic) adoption by the WTO Dispute Settlement Body. This stands in contrast to the GATT dispute settlement system, in which the requirement for positive consensus meant that even a party to the dispute could block the adoption of the panel report.

The content of the obligations in NAFTA Chapter 11, and USMCA, Chapter 14 is very similar, but the dispute settlement mechanism has been altered drastically. Compared to NAFTA Chapter 11, USMCA Chapter 14 restricts the scope of investor-to-state international investment dispute settlement, by phasing out investor-to-state dispute settlement involving Canada and reducing the scope of investor-to-state dispute settlement between Mexico and the United States. The State-to-State dispute settlement under USMCA Chapter 31 will serve as the dispute settlement mechanism to a much greater extent than the State-to-State dispute settlement under Chapter 20 of the NAFTA did for NAFTA Chapter 11. For investment disputes involving Canada, this means that investors will not have direct recourse to dispute settlement. This is likely to limit disputes over public interest regulation between Canada and the United States, since the governments are less likely to challenge public interest regulation than private investors would be.

The USMCA now refers to NAFTA as “NAFTA 1994” (since there is only one NAFTA, the addition of 1994 seems superfluous, but this is now the term that is used). Chapter 14 establishes four categories of international investment dispute settlement (USMCA, 2018):

- (1) Annex 14-C: legacy investment claims by investors (investments established or acquired between January 1, 1994 and the date of termination of NAFTA 1994 and claims made prior to three years after the termination of NAFTA 1994)⁴ and pending claims by investors (arbitrations initiated pursuant to the submission of a claim in accordance with Section B of Chapter 11 of NAFTA 1994)⁵;
- (2) Annex 14-D: Mexico-United States investment disputes, for which sectors are not limited, but for which investors can claim only limited violations (national treatment and most-favored-nation treatment, except with respect to the establishment or acquisition of an investment); expropriation and compensation, except with respect to indirect expropriations); and claims for loss or damage arising out of such breaches)⁶;
- (3) Annex 14-E: Mexico-United States investment disputes, for which sectors are limited, but for which investors are not limited in the obligations that can serve as the basis for a claim;
- (4) State-to-State dispute settlement under Chapter 31 for violations of any obligation⁷.

In addition, a Party of an investor can seek State-to-State dispute settlement under Chapter 31 for non-compliance with an arbitral award under Annex 14-D⁸. The same holds true for State-to-State dispute settlement under NAFTA 1994, Chapter 20 for non-compliance with an arbitral award under NAFTA 1994, Chapter 11. However, NAFTA 1994, Chapter 20 ceased to be used due the blocking of panelist nominations, so it is unclear whether this would have any practical effect in the circumstances. Three

⁴ Annex 14-C, Art. 1, 3, and 6.

⁵ Annex 14-C, Art. 1, 3, and 4.

⁶ Annex 14-D, Art. 3.1.

⁷ Art. 31.2(b).

⁸ Annex 14-D, Art. 11.

years after the termination of NAFTA 1994, there will be no possibility of investor-to-State dispute settlement involving Canada.

There was a time when governments sought to expand investor-to-state international investment dispute settlement. The OECD oversaw the negotiation of a Multilateral Investment Agreement, which ultimately failed to gain sufficient political support in countries such as France. Some commentators proposed the establishment of a permanent appeal body for investor-to-state international investment dispute settlement (López, 2012). However, the USMCA signals a retreat from these ambitions.

In the sugar dispute with Mexico, the United States blocked panel selection under NAFTA Chapter 20 in the early 2000s, effectively ending the viability of this dispute settlement venue. No NAFTA Chapter 20 panel has been established since then. In the NAFTA renegotiation, the USTR proposed changing Chapter 20 to an advisory function, rather than binding dispute settlement (Lester, 2017; Pauwelyn, 2006); Mexico sought to strengthen Chapter 20. The USMCA has modified NAFTA Chapter 20 in order to clarify that the parties in a dispute will agree on how to implement any panel rulings. However, in the absence of such an implementation agreement, the USMCA still provides for the suspension of trade benefits in order to induce a settlement of the dispute. The CUSFTA experience, together with the fate of NAFTA Chapter 20, demonstrates that a more advisory dispute settlement system is likely to work as well as, if not better than, the binding system of NAFTA Chapter 20, at least between Canada and the United States.

US Trade Representative Robert Lighthizer has criticized the WTO dispute settlement system as “deficient”, made positive remarks on the GATT system “where you would bring panels and then you would have a negotiation”, and commented on the need to find a way to make “this binding dispute-settlement process” work (Condon, 2018; Lighthizer, 2017). The USMCA replacement for NAFTA Chapter 20 for resolving government-to-government trade disputes takes a step towards a softer advisory system (Lester, 2017). It is worth noting that this type of system worked reasonably well in Chapter 18 of the Canada- United States Free Trade Agreement⁹. Moreover, the European Union uses a negotiation model in the dispute settlement systems of its free trade agreements (Ramírez, 2006). Indeed, the move to “binding” dispute settlement is a relatively recent development in trade agreements.

NAFTA Chapter 19 was also a target in the NAFTA renegotiation. The United States wanted to eliminate this dispute settlement mechanism, having been the target of 43 of the 71 matters brought before Chapter 19 panels (Dattu, Sathananthan, & Schappert, 2017; USTR, 2017). Chapter 19 is unique to NAFTA; it originated in the Canada-United States FTA as a substitute for substantive rules on trade remedy laws, and later expanded to include Mexico. There were three reasons for its creation, to replace judicial review by the US judiciary with binational panel review: (1) with no appeals and time limits, it would provide speedier resolution of trade remedy disputes; (2) the panelists would have greater expertise than judges in a highly technical area of law, resulting in less deference to government investigating agencies; and (3) binational panels would have less bias against foreign companies than domestic courts. Initially, there was resistance on the part of the US judiciary to have foreign lawyers interpreting and applying US law,

⁹ See for example CUSFTA Panel Report, Canada's Landing Requirement for Pacific Coast Salmon and Herring (16 October 1989) CDA-USA-1989-1807-01, in which Canada and the United States used the CUSFTA panel decision as a basis for a negotiated solution that addressed both trade concerns and conservation objectives: : <https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Decisions-and-Reports>

particularly with the expansion of Chapter 19 to include Mexico under NAFTA¹⁰. Mexico agreed to give up on Chapter 19, but Canada insisted on keeping it in place. In the end, this strategy allowed negotiations to progress to a successful conclusion, one that preserves Chapter 19 for all parties (now USMCA Chapter 10).

Some argued that this system is no longer necessary, because domestic judicial review of trade remedy measures has improved in the United States, and Chapter 19 suffers from defects, such as a shortage of expert panelists (Miranda, 2018). However, it has played a key role in Canada-United States disputes over Canadian softwood lumber exports, and permits duties to be refunded when Canada succeeds in overturning U.S. antidumping and countervailing duties, something that the WTO dispute settlement system does not provide.

No other US free trade agreement has incorporated a system like Chapter 19, which means that only Canada and Mexico have been able to use this system with respect to US trade remedies. The original rationale that Chapter 19 would serve as a substitute for substantive rules on trade remedy laws, ceased to exist with the advent of the WTO Agreement on Subsidies and Countervailing Measures and WTO Antidumping Agreement, which did achieve that objective. Canada and Mexico have been subject to much less AD and CVD investigations and orders by the United States than other countries, proportionate to trade volume (Macrory, 2002). However, it is not clear whether Chapter 19 is the cause. Some FTAs have eliminated the use of antidumping duties¹¹; although, that always seemed to be an unlikely outcome in the NAFTA renegotiation (Lighthizer, 2017)¹².

NAFTA Chapter 11 dispute settlement for foreign investors was always more important for Mexico than for Canada. For Mexico, NAFTA's primary importance was not in providing market access to the United States, which already applied low tariff rates under GATT. NAFTA's primary importance was in providing investor protections to foreign direct investment, with the possibility of using NAFTA Chapter 20 to enforce arbitral awards against governments under Chapter 11 of NAFTA. In this regard, NAFTA was instrumental in increasing foreign direct investment in Mexican manufacturing, by lowering political risk (Maurer, 2006). In Canada, which has relatively low political risk, eliminating NAFTA Chapter 11 should not make much difference in its attractiveness to foreign investment. However, it will allow Canadian governments to regulate in the public interest without running the risk that the messiness of modern democratic politics might lead to compensation for foreign investors.

Conclusion

There are several other elements of the USMCA that reflect the bilateral nature of North American relations. In addition to labor value content, the corruption chapter is clearly aimed at Mexico. Moreover, the USMCA incorporates a series of bilateral agreements set out in side letters and annexes. Like the

¹⁰ See for example Extraordinary Challenge Committee, United States-Canada Free Trade Agreement, Certain Softwood Lumber Products from Canada (USA-CDA-1994-1904-01ECC), 3 August 1994, Dissenting Opinion of Malcolm Wilkey (p. 90), and critique of Mexican participation in NAFTA Chapter 19 (p. 69–70): <https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Decisions-and-Reports>.

¹¹ See for example Canada-Chile Free Trade Agreement, Chapter M: <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/chile-chili/fta-ale/index.aspx?lang=en>

¹² See <https://www.chambersandpartners.com/USA/person/223024/robert-e-lighthizer>

CPTPP, the USMCA makes labor and environmental cooperation part of the main agreement, whereas these were set out in separate agreements for NAFTA. Again, these provisions, while trilateral, had their genesis in concerns over Mexico's labor and environmental standards during the original NAFTA negotiations in the early 1990s.

There is evidence that the dispute settlement systems in NAFTA Chapter 19 and Chapter 11 have been beneficial for trade and investment. NAFTA Chapter 20 is no longer in use; it was never used much and the WTO dispute settlement system largely replaced it as a venue for disputes involving trade rules that are duplicated in NAFTA and WTO Agreements. Chapter 19 appears to have reduced the use of trade remedies against Canada and Mexico, but that could also be due to the integration of supply chains across the three countries, which would reduce incentives to use trade remedy laws in those industries. Moreover, the WTO dispute settlement also serves as an important venue for trade remedy disputes, particularly since it has substantive rules on trade remedies, whereas NAFTA does not. NAFTA Chapter 11 has been beneficial for foreign direct investment in Mexico, by reducing political risk and institutionalizing the opening of the Mexican economy to foreign direct investment. However, the recent opening of the Mexican economy to foreign direct investment in the energy sector shows that there is much that Mexico can do unilaterally to attract foreign direct investment, in addition to minimizing political risk overall. Mexico's network of free trade agreements with other parts of the world, which did not yet exist when NAFTA was negotiated, is another factor that maintains Mexico's attractiveness as a destination for foreign direct investment.

The new rules of origin in the automotive sector will have a negative impact on Mexico. They will influence investment patterns in the sector and also influence the pace of technological transformation. Overall, this is likely to have a negative impact on the competitiveness of the North American automotive sector, but it is likely to delay the loss of more manufacturing jobs in the sector in Canada and the United States from automation. This is a particularly interesting development, since it provides an example of how trade policy might generally respond to the rise of artificial intelligence and robotics in manufacturing. It is also of great interest to developing countries that rely on low wages to sustain their competitive advantage as a manufacturing platform for export to developed countries.

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