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Dear Readers,

For many years, I had heard that NAFTA was the product of numerous factors occurring at the right time and place. This notion that the "stars were aligned" for NAFTA prevented the parties from making any changes to the agreement for over two decades (except to its rules of origin which are too technical to be publicly controversial). It was widely believed that modifying NAFTA would carry the risk of breaking the balance of concessions that had been carefully assembled in the original negotiation. How would the original winners and losers react? Touching NAFTA was unthinkable. When I served as General Counsel of Mexico's Ministry of the Economy ("Economía"), NAFTA turned fifteen years. I had the opportunity of participating in various conferences, particularly in Canada and Mexico, and do not recall anyone suggesting that the agreement be renegotiated. With all its flaws and virtues, we used NAFTA as the standard for Mexico's other free trade negotiations and we even had ideas to enhance it. Some of the commercial disputes that we litigated had the potential of seriously questioning NAFTA. But the followers of the NAFTA constellation theory were successful in preserving it for 23 years.

A few weeks ago, the US, Canada and Mexico initiated talks to renegotiate NAFTA. During the 23 years in which it has been in effect, trade in goods among the NAFTA parties has quadrupled. US firms have invested more than $450 billion dollars in Canada and Mexico. The NAFTA region has created numerous global value chains in which exported goods contain a significant percentage of US, Canadian and Mexican intermediate materials. As the renegotiation process is showing, the NAFTA parties' economies are so integrated that the renegotiation discussions are covering not only typical market access matters such as rules of origin or technical barriers to trade but also internal policies regarding wages and workers' compensation, monetary policies, immigration and internal taxes as opposed to simply tariffs.

Another interesting feature of the current NAFTA talks is that the threat of the agreement being terminated by the US will be present throughout the renegotiation process. Given that NAFTA and the WTO agreements entered into effect at similar times, it is difficult to determine which effects on the trilateral market can be attributed to NAFTA, WTO, global market conditions or technology or consumer preferences and trends. What is clear is that regional trade in North America will occur whether or not there is a trade agreement in place among the NAFTA parties. The only question is whether trade will occur in an organized or disorganized manner. "The US is not going anywhere and we sure do not have plans to move Mexico to anywhere else in the planet", Mexico's Undersecretary of Economía said during a presentation. As supply and demand forces in the US and Mexican labor markets have shown, the fact that negotiators elect to ignore some matters and leave them out of the renegotiation agenda does not mean they will not have an effect on the economies of the NAFTA countries. This is the case for trade in labor and unresolved trade disputes among NAFTA parties in softwood lumber, sugar, cross-border trucking services and, ironically, the US-Mexico dispute over the dispute resolution mechanism. In this edition of the newsletter, we have included three articles that address some of these issues primarily from Mexico's perspective - although as NAFTA has shown in its 23 years, there is no longer an issue that is purely a Mexico, US or Canada issue.

We hope you enjoy this special edition of our newsletter.

Yours sincerely,

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NAFTA: Renegation or Renegotiation? Advancing Mexico's Agenda

Álvaro Santos and Mariano Gomezperalta C.

The renegotiation of NAFTA has begun. Since he was on the campaign trail, President Trump has openly criticized the agreement calling it the “single worst trade deal ever” signed by the US and one through which the US has been ripped off by Mexico. A few months ago, the press reported that President Trump even considered withdrawing from NAFTA by invoking article 2205 of the agreement. After the first round of negotiations, President Trump stated in Arizona that he personally does not think NAFTA can be renegotiated and that he may need to “kill” the agreement.

The Mexican government was initially in a state of negation about renegotiating NAFTA but now declares that NAFTA needs to be “modernized” and proposes that all issues of the bilateral agenda be put on the table. Mexico has been active in explaining to the US government why NAFTA is good for the US. It has also reached out to inform US producers that benefit from NAFTA of the costs of terminating the agreement. In short, Mexico is working with its allies in the US to put pressure on the Trump administration to preserve NAFTA.

In addition to emphasizing NAFTA's benefits for the US, Mexico needs to determine what its agenda for the renegotiation process should be. To determine what to renegotiate, Mexico first needs an assessment of the positive and negative effects of NAFTA. While it is true that NAFTA can be modernized, since new commercial practices have emerged since it was signed over 23 years ago, updating NAFTA cannot constitute “the” agenda for Mexico. By relying on the premise that leaving NAFTA essentially unchanged is preferable to an unfavorable renegotiation, Mexico would give up the possibility of improving the agreement and its trade position with the US.

Mexico should take advantage of President Trump's initiative to reopen the agreement to act firmly and address two substantive issues. The first one is a matter of principle: a country that accepts the other country's breach of an agreement is bound to suffer new breaches. Mexico should request that unresolved disputes, particularly sugar and trucking, be resolved and that Chapter 20 on State to State disputes be improved. The second is to incorporate trade in labor which, remarkably, was left out of the original agreement.

Who has taken advantage of whom? Sugar and Cross-border Trucking Services

Disputes about sugar and trucking services constitute two of the most frustrating episodes of the trade relationship between Mexico and the US under NAFTA. The sugar dispute arose in 2000 when the US

blocked Mexican exports of excess sugar inventories despite the provisions of NAFTA Annex 7 which allowed Mexico to export them to the US in accordance with an agreed formula. This caused one of the most serious crises that the Mexican sugar industry (or any other Mexican industry) has suffered. When Mexico requested the establishment of a NAFTA Chapter 20 panel to resolve its claim, the US utilized the deficiencies of the dispute settlement provisions to block the selection of panelists and avoid the establishment of a panel and review of its measures. In an attempt to alleviate the Mexican sugar industry's plight and increase its domestic sales, Mexico adopted an ill-advised tax against US high-fructose corn syrup. US companies challenged the Mexican tax under NAFTA's Chapter 11 investment dispute settlement provisions and obtained multi-million dollar awards in their favor. It was disconcerting to Mexico that investors of the original breaching party (the US) could obtain multi-million-dollar award payments while the initially affected party (Mexico) had no access to an effective remedy. As a result, Mexico had to pay the awards and deal with a resulting sugar industry crisis, which had harmful effects on numerous communities of impoverished sugar producers. Had Chapter 20 worked properly, the outcome of this episode would have very likely been different.

The story in the trucking case is equally sad for Mexico. NAFTA provides that Mexican trucking companies are allowed to carry cargo, point-to-point, from Mexico to the US and back to Mexico. Given the Mexican truckers' cost structure, this represented a real opportunity to assume an important part of the North American market of cross-border trucking services. Despite the NAFTA provisions and a panel ruling confirming Mexico's rights, Mexican trucking companies have not been able to access the US market yet as the Department of Transportation will not grant them the required operating authority. For 20 years, they have been deprived of a US$400 million-a-year market which they were legally entitled to access. Despite the favorable general export terms that NAFTA countries enjoy vis-à-vis the rest of the world, this trade barrier deprives Mexico of that important competitive advantage.

Prospective Agenda: Trade in Labor

Although in the original negotiations the Mexican government stated that NAFTA would reduce the flow of Mexican workers to the US due to job creation, the number of people migrating to the US substantially increased during the first years of NAFTA. As with trade in goods, the expanded North American market altered labor demand and supply patterns. As one would expect in an integrated market, Mexican workers who lost their jobs (notably those in the agricultural sector) migrated to the US to work in farms (many of which export products to Mexico) and other sectors. Since this migration dynamic was not anticipated in the original agreement and there was later no political will to regulate it, this trade in labor occurred in an undocumented and disorganized manner with the acquiescence of US companies and of both governments.

Today, almost 5.6 million undocumented, immigrant Mexicans live in the United States. Mexico should include trade in labor as part of its NAFTA renegotiation agenda to ensure that Mexican labor receives non-discriminatory treatment consistent with the national treatment principles that apply to investors and trade in all other matters under NAFTA. An ambitious agenda would include an agreement for seasonal

and temporary migration, broadening the existing visa programs to sectors in which there is a high demand for labor in the US. Incorporating it into NAFTA would allow parties to agree to mutually acceptable commitments on cooperation, monitoring and repatriation. It would help reduce the illegal trafficking of persons at the border and the human rights violations associated with it. It would also allow US enforcement agencies to register, monitor and better control border crossings. It would eliminate the need for a new border wall and would remove this issue from the political swings and the offensive rhetoric that is so damaging to the US-Mexico relationship.

NAFTA Renegotiation Timeline

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NAFTA's Dispute Resolution Mechanisms: Should They Stay or Should They Go?

Carlos Véjar

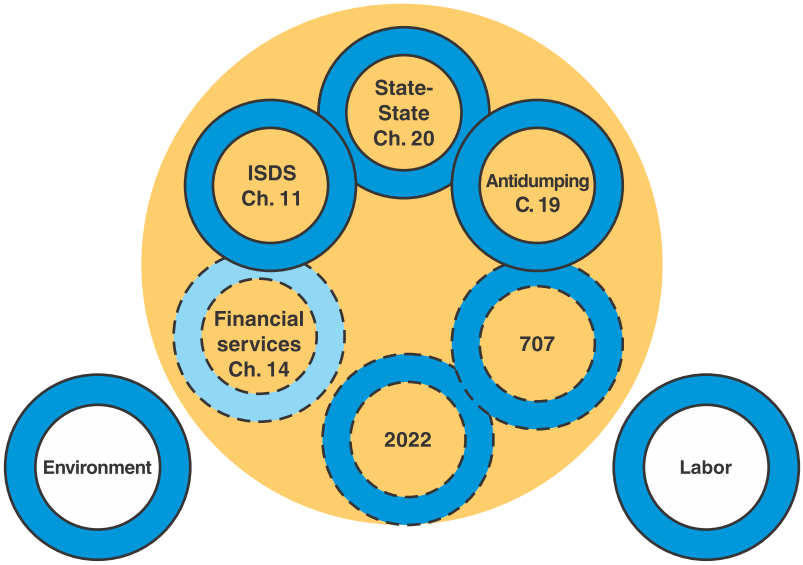
The US Government announced recently that one of its objectives in the renegotiation of NAFTA is the elimination of NAFTA's dispute settlement chapter dealing with administrative determinations on unfair trade practices (anti-dumping and countervailing duties). This mechanism, which is unique in the world, is contained in NAFTA Chapter 19. The US position generated concern and confusion among industry players and made it evident that there is a significant lack of knowledge with respect to the different dispute settlement procedures in NAFTA and their operation. By way of example, the Mexican Senate formally asked Mexican government negotiators to reject the elimination of Chapter 19 as this would result in anti-dumping disputes being resolved in accordance with US laws rather than NAFTA rules. It escaped their attention that the laws of the jurisdiction that issued the anti-dumping measure are always used in the review process in Chapter 19 cases and that, in any event, Chapter 19 has always been an alternative voluntary and optional review mechanism.

The US negotiating objectives omit any reference to the investor-state dispute settlement mechanism ("ISDS") contained in Chapter 11. USTR's statements that the "*dispute settlement provisions should be designed to respect our national sovereignty and our democratic processes*" seem to suggest that there is a chance that the US could also seek to eliminate Chapter 11. The only express reference to dispute settlement mechanisms in the US negotiating objectives seems to apply to the general dispute settlement proceedings regarding the application or interpretation of the agreement (i.e., Chapter 20) where the US mentioned its desire to improve the transparency of such proceedings.

Canada and Mexico have expressly referred to the dispute settlement mechanisms in their respective negotiating objectives. Both governments want Chapter 19 to stay and have observations regarding Chapter 11. For example, Canada has stated that "*Just as good fences make good neighbors, strong dispute settlement systems make good trading partners*" and that Canada's objectives include "*reforming the Investor-State Dispute Settlement process, to ensure that governments have an unassailable right to regulate in the public interest*". Mexico has said that it wants to keep and modernize all of the dispute settlement mechanisms, including Chapters 11 and 19 and the dispute settlement mechanisms for financial services, to make them more efficient and transparent.

The center of the debate so far has been Chapters 11 and 19. These are the chapters that are in full operation. Interestingly, there has been very little polemic with respect to Chapter 20 despite the fact that it has a deficiency of such a magnitude that it renders the mechanism inoperable (e.g., the lack of an agreed roster of arbitrators to solve disputes when parties are unable to agree on the composition of the panel).

Other dispute settlement mechanisms in NAFTA such as the mechanisms for financial services, labor and environment and the limited references for private commercial disputes regarding agricultural goods (Article 707) and alternative dispute procedures (Article 2022) have received almost no coverage.



When one looks at NAFTA carefully, it is clear that even after two decades NAFTA continues to appear as a "modern" and "innovative" agreement with respect to dispute resolution proceedings. It has specialized rules for different types of disputes and it even has institutional structures such as the NAFTA Secretariat and the Free Trade Commission which have an important role in the dispute resolution process. This reflects the importance that dispute resolution had over twenty years ago. Today there is substantial debate on whether these mechanisms should stay or go or be "harmonized" into one single mechanism that would cover all types of disputes, including labor, environment and others that apply to potential new disciplines such as e-commerce, state-owned enterprises, intellectual property or anti-corruption matters.

It is also clear that often institutional structures start to be a problem when ideas change. When this happens, the only way of addressing this issue is apparently to either change the structures or abandon new ideas. In the NAFTA context, there seem to be two ideas or propositions: (1) NAFTA has been the worst trade deal ever and it needs to be renegotiated or (2) NAFTA has been a good deal but it needs to be "modernized". Which of these ideas will prevail? Can they co-exist? How will these ideas impact NAFTA's institutions and rules? (As a side note, it should be clarified that the correct term for updating NAFTA is "renegotiation" rather that the widely used term "modernization". Whether NAFTA is "modernized" or not will depend on the outcome of the renegotiation. A more trade restrictive agreement with tougher rules of origin and fewer avenues for resolving disputes seems hard to reconcile with a "modern" deal).

The above propositions which apply to NAFTA generally are also present in the dispute resolution arena. Many still consider treaty arbitration as the most civilized means of solving disputes and believe it is a *sine qua non* for free trade agreements i.e., NAFTA dispute resolution proceedings are good and could be improved. Other voices (which were silent for a long period of time and are often based on a poor

understanding on how the mechanisms work) believe that the settlement mechanisms constitute a loss of sovereignty and a threat to democracy and the right to regulate in the public interest i.e., NAFTA dispute resolution proceedings are bad and need to be changed or disappear.

Before answering whether the mechanisms are good or bad and whether they need to be renegotiated or eliminated, perhaps the discussion should center on why the mechanisms were created and candidly respond whether such goals have been achieved and, if not, what needs to be done to achieve them. Without entering into too much detail on the specific objectives of each dispute settlement mechanism, NAFTA provides in Article 102.1(e) that one of the purposes of the agreement is to *create effective procedures for the implementation and application of [the] agreement, for its joint administration and for the resolution of disputes*. What can we say about this goal today? Has it been achieved? In my view, NAFTA has had mixed results in this respect (often poor results). Some mechanisms work, others work with some deficiencies and others frankly do not work at all. It would be hard to say that all of them are "effective" to resolve disputes. To illustrate this point, it is useful to highlight the following:

Chapter 20 has solved disputes such as cross-border trucking services, broom corn brooms and agricultural goods but has been ineffective in solving disputes such as sugar, tuna and country of origin labeling for meat products. These disputes had to be solved in the WTO rather than NAFTA, in part because Chapter 20 lacked a list of arbitrators to resolve panel formation issues. This affected the certainty and operation of the mechanism.

Chapter 19 has several deficiencies but despite that, numerous cases are resolved through this mechanism (approximately 146 so far according to the NAFTA Secretariat). To name just a couple of problems with Chapter 19, there have been substantial delays in the formation of binational panels (in some cases over a year to get the agreement of both governments involved) and the standards of review vary from country to country, which has not permitted the creation of a consistent Chapter 19 jurisprudence. There are also claims that the arbitrators' fees are too low (which affects the quality of the decisions) and that there are limited experts available to participate as panelists.

Chapter 11 has had the best results in terms of operation. This is due in large part to the fact that the establishment and operation of tribunals are left to institutions, such as ICSID, that are independent from NAFTA. Some decisions issued by the Chapter 11 tribunals, however, have required NAFTA countries to intervene and issue binding notes of interpretation. This means that arbitral tribunals under Chapter 11 may not be interpreting NAFTA correctly or consistently all the time. Some critics of the mechanism pointed to similar issues in connection with the negotiation of the Transpacific Partnership Agreement (TPP) and attempted to address them in such agreement. There is definitely room to improve this chapter.

The mechanisms under the **Labor and Environment** chapters are limited to consulting and follow up efforts on outstanding issues relating to labor and environmental policies and measures. Claims stay at the consultation phase because it is virtually impossible to establish a panel that can issue a final and binding award as the defendant's consent is required to establish the panel. No panel has ever been formed to resolve disputes under these Agreements.

In short, there are enough issues with the dispute settlement mechanisms under NAFTA to justify their renegotiation. The main question is which ones will disappear, remain or change and whether some of them will be replaced by new mechanisms. In any event, the mechanisms should be evaluated based on their operation on a case by case basis considering their specific purpose and effectiveness, the parties' political and commercial interests and the cost and benefits of maintaining them. The discussion so far has been too general to be useful.

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Can the Proposed NAFTA Reforms Stop Labor Dumping?

Fernando González-Rojas

Some defenders of the recently launched NAFTA renegotiation process believe that the prevalence of low wages in Mexico has 'stolen' jobs from United States, diverted direct investment towards Mexico and rendered made-in-the-U.S.A. goods uncompetitive in terms of price vis-à-vis Mexican products. Therefore, in their view, NAFTA should be modified to force the Mexican Government and entrepreneurs to increase salaries in their territory in order to stop a practice commonly known as 'labor-dumping', i.e. gaining a larger share of the market by reducing their labor costs.

Most trade experts would agree that forcing Mexico to increase its minimum-wage level through the insertion of an express obligation in NAFTA would be unfeasible. First of all, Mexico's economy would most likely be unprepared to resist such a drastic adjustment. In addition, the Mexican Government would certainly face fierce opposition to the acceptance of that obligation from very influential sectors of its economy. It is perhaps for this reason that none of the delegations has formally advanced this proposal.

However, the unfeasibility of reforming NAFTA to impose a direct obligation on Mexico to increase its minimum-wage levels does not mean that other changes to NAFTA proposed by the Parties may not have the same effect in the long term. In my view, some of the labor-related reforms that have already been suggested by the United States and Mexico may actually result in minimum wage increases in Mexico in the long run.

In July, the United States Trade Representative (USTR) announced that one of the United States' primary objectives for this renegotiation process is "that NAFTA countries […] adopt and maintain in their laws and practices the […] core labor standards as recognized by the [International Labor Organization, ILO] Declaration", including "[f]reedom of association and the effective recognition of the right to collective bargaining". Mexico's list of objectives for the renegotiation of NAFTA also includes "strengthening compliance with domestic laws and international commitments on labor matters". Thus, both countries have expressed their desire to adopt and comply with international labor standards, which include the protection of freedom of association and collective bargaining. Interestingly, for more than half a century all three NAFTA Parties refused to adopt the 1949 ILO Convention on the Right to Organize and Collective Bargaining (ILO Convention 98), which was only recently ratified by Canada.

The ILO Convention 98 imposes few yet very important obligations. One of those obligations is ensuring that employers cannot dismiss their workers, if they abandon their unions. For many decades, union-employer contracts in key sectors of Mexico's economy included these so-called 'exclusion clauses', which impose an obligation on employers to discharge those workers who have been separated from their

unions. This practice gave enormous power to union leaders who often colluded with the employers to accept very precarious working conditions for their members. Furthermore, exclusion clauses also cancel the possibility for independent workers' organizations to negotiate separate deals with their employers.

In 2012, Mexico reformed its labor laws and eliminated the provision that expressly authorized the use of exclusion clauses in collective agreements. However, Mexico did not complement the removal of this authorization with an express prohibition of such practice. Consequently, the use of exclusion clauses in Mexico has not been entirely eradicated.

An important obligation contained in the ILO Convention 98 is the elimination of any "acts which are designed to promote the establishment of workers' organizations under the domination of employers or employers' organizations". Another practice that has also been widely denounced in Mexico is the adoption of 'protection contracts', i.e. collective agreements between employers and fictitious or unrepresentative unions. This practice has also hampered the workers' ability to see their interests reflected in their contracts.

The recurrence of both practices in Mexico, i.e. the use of 'exclusion clauses' and 'protection contracts', is demonstrated by the statistics on the application of the public communication mechanism (PCM) established under Article 16 of North American Agreement on Labor Cooperation (NAALC). The PCM allows workers' organizations, NGOs and individuals to submit complaints before the national authorities of one of the NAFTA Parties about another Party's alleged failure to enforce its labor laws. More than half of the submissions claiming Mexico's failure to apply its laws precisely refer to violations of the workers' freedom of association and right to bargain collectively.

Impeding workers' ability to directly negotiate the terms of their contracts with their employers may be one of the reasons that salaries in Mexico have remained low. Thus, finally eradicating the use of exclusion clauses and protection contracts may significantly contribute to raising salaries in Mexico.

In 2015, the Mexican Government submitted the ILO Convention 98 for approval to Mexico's Senate. However, this approval-evaluation process has not yet been finalized. Despite internal pressure exerted by some Senators and Congressmen who are members of left-wing parties in Mexico, the Mexican Senate has not issued a final decision on this matter.

As mentioned above, all three NAFTA Parties refused to adopt the ILO Convention 98 for decades. However, on 14 June 2017 Canada deposited the instrument of ratification of the ILO Convention 98 with the ILO Director General. During that act, Canada's Minister of Employment, Workforce Development and Labour, The Honourable Patty Hajdu declared that "Canada looks forward to working with the ILO and [their] international partners towards ensuring that the rights of workers are respected both at home, and abroad" (emphasis added).

Consequently, there seems to be consensus among the NAFTA negotiators as to the convenience of strengthening the protection of the workers' freedom of association and right to collective bargaining. This agreement may put pressure on Mexico's Senate to finally approve the adoption of the ILO Convention 98. Ratifying this international instrument may provide an effective legal incentive to eradicating the use of exclusion clauses and protection contracts in Mexico. Rather than attempting to establish a novel regulatory scheme in NAFTA which may have an uncertain market effect in the region, the adoption of the ILO Convention 98 by the NAFTA Parties may be a more practical means of increasing salaries in Mexico and offsetting the phenomenon known as labor-dumping which concerns US negotiators.

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