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Twenty Years of Progress at Risk

Labor and Environmental Protections in Trade Agreements

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OVERVIEW

The renegotiation of the North American Free Trade Agreement (NAFTA) that is currently underway will shine a bright light on the agreement's impact on jobs and wages and on the environment. The negotiators will grapple with NAFTA's side agreements on labor and the environment, that were widely seen as weak, and twenty subsequent years of progress toward making trade deals more effective for protecting workers and the environment. These later agreements made commitments enforceable through arbitration and potential sanctions against the violating parties. However the first arbitration ever brought under these clauses was recently decided and, to the shock of most observers, the US lost its case against Guatemala for repeated violation of labor rights and labor laws in that Central American country. Negotiators now appear to be advancing the very language that eviscerated labor commitments in the US-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) and would do the same with regard to environmental obligations. This policy brief outlines how two limiting clauses in the labor template torpedoed the effort to protect workers in Guatemala and draws lessons for the renegotiation of NAFTA and changing the template for global trade policy more broadly. It concludes that if a renegotiated NAFTA is to protect workers and the environment more effectively than trade agreements have done to date, negotiators will need a much bolder approach on labor and environmental clauses.

Background

Over the last two decades, many governments have incorporated clauses in free trade agreements that commit the countries party to the agreements to promote good labor and environmental laws and outcomes. The logic is that countries should not gain competitive advantage in trade by undermining or failing to protect workers' rights and the environment. The commitments typically require adherence to national and/or international labor and environmental standards, laws or conventions.

Beginning with the North American Agreement on Labour Cooperation (NAALC)[1], the labour side agreement of the North American Free Trade Agreement, and the parallel North American Agreement on Environmental Cooperation (NAAEC)[2], these commitments have been made subject to review by arbitral panels and have created the possibility that sanctions could be levied on a party that fails to live up to its commitments. The initial template for this approach in the NAALC and NAAEC was weak in many respects and was widely criticized by labor and environmental advocates. It has since been changed in a series of subsequent trade agreements negotiated by the US with various trading partners and in the negotiated text of the most recent effort, the Transpacific Partnership (TPP). In that draft agreement the parties—which include the US, Canada and Mexico—agreed to the following language:

> "No Party shall fail to effectively enforce its [labour] [environmental] laws through a sustained or recurring course of action or inaction in a manner affecting trade or investment between the Parties, after the date of entry into force of this Agreement for that Party."[3]

They agreed that such a failure could result in an arbitral review and sanctions against the offending party. Although the US has now withdrawn from the TPP and its future status is unknown, there have been indications that the TPP text may be tabled by one or more of the NAFTA parties as a basis for the renegotiation of the latter agreement, now underway.

In a case filed by the US claiming that Guatemala had failed to effectively enforce its labor laws, the arbitral panel concluded that "the United States has not proven that Guatemala failed to conform to its obligations."

In the 25 years since the establishment of the first labor and environmental clauses, only one case alleging a party's failure to comply with these obligations has gone to arbitration. That was a case filed in 2011 by the US against Guatemala under the US-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR), claiming that Guatemala had failed to effectively enforce its labor laws across a range of issues, sectors and enterprises. In June 2017 the panel issued its decision: it concluded that "the United States has not proven that Guatemala failed to conform to its obligations under Article 16.2.1(a) of the CAFTA-DR."[4]

Given the breadth and detail of the allegations in the complaint, coupled with the widespread documentation of a culture of non-compliance with labor laws and labor rights in Guatemala[5], the decision came as a shock to most observers.

The arbitral panel was composed of one arbitrator selected by the US, one Guatemalan-selected arbitrator and a Canadian chair. The panel reached its decision that Guatemala had not breached its

1 Available at: https://www.dol.gov/ilab/reports/pdf/naalc.htm.

2 Available at: www.cec.org/about-us/NAAEC.

3 Article 19.5 (1) regarding labor and Article 20.3 (4) regarding environment, available at: https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text

4 The final report of the panel is available at: http://trade.gov/industry/tas/Guatemala%20%20%E2%80%93%20Obligations%20Under%20Article%2016-2-1(a)%20of%20the%20CAFTA-DR%20%20June%2014%202017.pdf.

5 See for example the discussion of the situation in Guatemala by the Governing Body of the International Labor Organization, available at http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_457557.pdf; US Department of State Human Rights Report for 2016, available at: https://www.state.gov/documents/organization/265802.pdf.

obligations under the DR-CAFTA because the violations had not occurred "in a manner affecting trade" between the parties. This limiting phrase, which first appeared in the US-Jordan Free Trade Agreement in 2000, has been included in all subsequent US-negotiated labor and environmental chapters, and is included in the draft TPP, as noted above. The panel chose to establish a demanding standard in its interpretation of that phrase, requiring that a complaining country would have to prove that there were cost savings from specific labor rights violations and that the savings were of sufficient scale to confer a material competitive advantage in trade between the parties.[6] This threshold is unprecedented in any analogous applications: WTO panels have interpreted similar language much more narrowly, as affecting conditions of competition, without requiring demonstration of costs and their effects. Demonstrating changes in costs at this level would require access to sensitive internal company accounts (at a minimum), and the perpetrators of labor violations would likely have hidden them in any case. This standard could not be met without subpoena power, which does not exist under the trade agreements.

Since this was the first labor-related trade arbitration, the language requiring that violations occur "in a manner affecting trade" had never been tested before. In addition, although the panel did not offer a final interpretation on the other limiting phrase in the labor and environmental chapter obligations (that violations occur as part of "a sustained or recurring course of action or inaction"), they pointed toward an equally demanding approach.

The decision is disturbing for multiple reasons: because of the injustice toward the affected Guatemalan workers; because it invalidated the parties' explicit commitment to broad enforcement of labor rights contained both in the obligatory commitments and the overall stated purposes of the agreement; and because as the first and as of now only arbitration arising from a labor clause (or environmental clause) it set a precedent for future cases.

Renegotiation of NAFTA labor and environmental commitments

As the US, Canada and Mexico now renegotiate NAFTA, this decision has made clear that the current US template for labor and environmental clauses is profoundly flawed by these two limiting phrases. Nonetheless, the US has included in its published objectives for the negotiations labor and environmental chapters based on the TPP language. After the decision and precedent of the Guatemala case, this would result in a de facto evisceration of the labor and environment commitments. Twenty years of negotiated progress regarding other aspects of the substance, scope and rigor of these commitments would be for naught.

The Guatemala case has proven that the easily exploited loopholes in the labor and environment obligations amount to lesser protection for those rights than for intellectual property or, for that matter, for investment or other rights.

Future trade agreements should eliminate both of these limiting phrases that can render countries' obligations to protect labor and environmental rights meaningless. The analogy should be made to other commitments to protect basic rights that the US and many other countries demand of their trading partners. For example, there are no such limits to the obligations to protect intellectual property rights in US trade agreements. Arbitration can be sought regardless of whether alleged violations of such rights affected trade or were part of a sustained or recurring course of action or inaction. The lack of limiting conditions follows the logic that protection of core rights is necessary to level the playing field among trading partners and to ensure that countries cannot gain unfair competitive advantages through their violation. The fact that the US has avoided limiting such obligations with respect to intellectual property rights suggests that those rights have been given a higher priority and greater care in negotiations than have labor and environment rights. The Guatemala case has proven that the eas-

6 The panel's discussion of this and other issues is confusing and often internally contradictory.

ily exploited loopholes in the labor and environment obligations amount to lesser protection for those rights than for intellectual property or, for that matter, for investment or other rights. The stated US approach—that for trade to benefit all partners there must be convergence on the basic rules of competition and protection for essential rights and public policies—has been shown to have glaring gaps.

The renegotiation of the NAFTA agreement presents an urgent, immediate opportunity to eliminate these gaps. The best solution will be to eliminate the two limiting provisions ("through a sustained or recurring course of action or inaction in a manner affecting trade or investment between the Parties") entirely, and allow enforcement of the labor and environmental obligations on par with those protecting intellectual property and other rights.

At a minimum, the parties should be pressed to include definitional footnotes that would constrain overly broad interpretations of the limiting phrases. For example, "in a manner affecting trade" could be defined by a footnote such as:

> For greater certainty, the parties understand "in a manner affecting trade" to mean trade related or occurring in a tradable sector.

Similarly, "a sustained or recurring course of action or inaction" could be defined as:

> For greater certainty, the parties understand "a sustained or recurring course of action or inaction" to mean more than one instance of action or inaction.

It is interesting to note that the NAALC requires an arbitral panel to determine "whether there has been a persistent pattern of failure by the Party complained against to effectively enforce its occupational safety and health, child labor or minimum wage technical labor standards in a matter that is trade-related [emphasis added] and covered by mutually recognized labor laws, or any other determination requested in the terms of reference . . .". The NAAEC requires an arbitral panel to "consider the matter where the alleged persistent pattern of failure by the Party complained against to effectively enforce its environmental law relates to a situation involving workplaces, firms, companies or sectors that produce goods or provide services: 1. traded between the territories of the Parties; or 2. that compete, in the territory of the Party complained against, with goods or services produced or provided by persons of another Party" [emphasis added]. In both cases, the limiting language is less constraining than the current US template. There has never been an arbitration under either of these agreements and so the scope of those definitions has not been tested.

Advocates of labor and environmental rights should insist that in the current renegotiation of NAFTA, there cannot be limitations on enforcement of labor and environmental commitments that in effect negate the commitments.

Qualification of arbitral panelists

A final point to take into account in considering a response to the decision in the Guatemala case is the qualification of arbitral panelists. Under CAFTA-DR, panelists in labor disputes are required "to have expertise or experience in labor law or [emphasis added] its enforcement, international trade, or [emphasis added] the resolution of disputes arising under international agreements."[7] The actual panel included one member with expertise in labor law and two with expertise in trade but none in labor law or enforcement. Arguably that panel's demanding requirements for proof of the cost and trade impact of labor law violations would not have found majority support among three panelists with knowledge

7 CAFTA-DR Article 16.7.2 (a), available at: https://ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file320_3936.pdf. Panelists in disputes over compliance with the obligations on environment are similarly required to "have expertise in environmental law or its enforcement have expertise or experience in environmental law or its enforcement, international trade, or the resolution of disputes arising under international trade or environmental agreements" (Article 17.11.2 (a).

of labor law and enforcement. In any event, the existing template allows creation of a panel in which none of the panelists have expertise in labor issues. The approach agreed in the TPP makes a step in the right direction, by requiring that panelists other than the chair have expertise or experience in labour law or practice[8], although the logic of excluding the requirement of relevant expertise for the chair is not evident. A renegotiated NAFTA should require relevant expertise among all members of panels that will decide cases related to labor and environmental obligations.

Conclusion

Trade cannot be a win-win endeavor when trading partners can gain competitive advantage by violating labor rights, repressing wages and despoiling their environments. The Guatemala case proves that US and other negotiators have not eliminated this possibility to date. The renegotiated NAFTA must do the following:

- Eliminate loopholes that require complaining parties to prove that another party's failure to effectively enforce its labor or environmental laws occurred "through a sustained or recurring course of action or inaction" and "in a manner affecting trade or investment between the Parties".
- Require that all arbitral panelists in disputes over enforcement of labor or environmental laws and obligations must have relevant expertise in those laws and their effective enforcement.

The outcome will demonstrate whether lessons have been learned from the stunning failure of the Guatemala labor case and whether the NAFTA governments have the will to ensure that their trade agreements protect labor and environmental rights as vigorously as they protect intellectual property rights, investment and other interests.

8 TPP Article 28.9.5 (a), available at: https://ustr.gov/sites/default/files/TPP-Final-Text-Dispute-Settlement.pdf. An equivalent approach is taken with respect to environmental dispute panelists.

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