

**STATEMENT SUBMITTED TO THE U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON WAYS AND MEANS  
SUBCOMMITTEE ON TRADE**

**BY SANDRA POLASKI<sup>1</sup>**  
[sandrapolaski@gmail.com](mailto:sandrapolaski@gmail.com)

**ENFORCEMENT OF LABOR OBLIGATIONS IN THE USMCA**

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***Key Points***

- Official estimates of the impact of the U.S. Mexico Canada Trade Agreement (USMCA) suggest that its overall effects on GDP, employment and wages will be negligible. Based on experience with NAFTA and other trade agreements the main effect of USMCA is likely to be redistribution rather than growth. Given increasing inequality, stagnant wages and the highly uneven impacts of trade on different U.S. regions, localities and types of workers, the agreement should be evaluated with a view to its redistributive effects.
- When the original NAFTA was negotiated it was recognized that low wages in Mexico were likely to encourage U.S. factories to relocate to Mexico and to push down wages for U.S. workers. A labor side agreement was negotiated that was claimed to support upward convergence of labor standards and wages in Mexico. That has not happened, in part because of active wage repression in Mexico. The new agreement requires reform of Mexican labor law and institutions.
- While the USMCA appears to strengthen labor obligations in general and Mexico's commitments in particular, it perpetuates the weak and ineffective enforcement mechanisms of NAFTA and all subsequent U.S. free trade agreements. The inadequacy of the current approach was forcefully demonstrated when the U.S. lost the only case it had ever taken to dispute settlement. More generally, existing labor chapters have had at best marginal effects on wages and labor rights. Because they are not enforced effectively they do not create deterrent effects.
- The USMCA must be amended to correct the failings of the existing enforcement mechanism. Several avenues for improvement are explored in this statement, with a particularly promising approach that builds on a proposal from Senators Sherrod Brown and Ron Wyden. Congress should create an ongoing role for itself in ensuring compliance

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<sup>1</sup> Independent expert. Former Deputy Director-General for Policy, International Labor Organization (ILO) and former Deputy Undersecretary, U.S. Department of Labor, in charge of the International Labor Affairs Bureau (ILAB). Affiliated with the Global Economic Governance Initiative (GEGI) at Boston University's Global Development Policy Center as a senior research fellow and with the International Institute for Sustainable Development (IISD) as a senior fellow.

with the labor provisions. Lessons learned from experience with existing labor chapters are drawn upon to suggest other key improvements, including how to target specific violators of labor rights rather than whole sectors or economies.

## ***Introduction***

Official estimates of the impact of the U.S. Mexico Canada Trade Agreement (USMCA) on U.S. employment and wages suggest that there will be only a trivial impact after the agreement is fully implemented. For example, the US International Trade Commission (ITC) projects a one-time addition of 176,000 jobs, an increase to total employment of 0.12%—a small fraction of one percent—after six years.<sup>2</sup> This one-time addition is about the same as the number of jobs that are created by the US economy in a typical single month. According to the ITC, about 70 per cent of the new jobs would be in the service sector and would go to workers with less than college education--meaning that most of the new jobs are likely to be low paid. The report estimates that U.S. wages would increase on average by about a quarter of one percent (0.27%) after six years—an almost imperceptibly small seven cents per hour based on the current average hourly wage of \$27.70. Slightly larger wage increases would go to higher educated workers than to workers without college degrees, increasing inequality. A study of USMCA published by the International Monetary Fund (IMF) using a somewhat different model estimates that Canada and Mexico would each have a very slight welfare gain while the U.S. would have a slight decline and that the overall effects on the three countries' GDP would be negligible.<sup>3</sup>

These modest estimates are credible, given that the overall, economy-wide impact of NAFTA has been similarly small to date. Studies by U.S. congressional researchers have concluded that the effect of the agreement on overall U.S. gross domestic product (GDP) was “probably no more than a few billion dollars, or a few hundredths of a percent”—according to a 2003 report by the Congressional Budget Office.<sup>4</sup> A study prepared by the Congressional Research Service as the U.S. began to re-negotiate NAFTA in 2017 concluded that the “net overall effect of NAFTA on the U.S. economy appears to have been relatively modest, primarily because trade with Canada and Mexico accounts for a small percentage of U.S. GDP. However, there were worker and firm adjustment costs as the three countries adjusted to more open trade and investment.”<sup>5</sup>

It is precisely because trade creates winners and losers, something long recognized by trade economists, that the original NAFTA remains so controversial. NAFTA was the first trade agreement that eliminated tariffs between relatively high wage economies (the U.S. and Canada)

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<sup>2</sup> United States International Trade Commission, *U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors*, Publication Number 4889, April 2019. Available at: <https://www.usitc.gov/publications/332/pub4889.pdf>

<sup>3</sup> Burfisher, Mary E., Frederic Lambert, and Troy Matheson, “NAFTA to USMCA: What is Gained?” International Monetary Fund Working Paper WP/19/73, March 2019. Available at: <https://www.imf.org/en/Publications/.../NAFTA-to-USMCA-What-is-Gained-46680>

<sup>4</sup> Congressional Budget Office of the United States, “The Effects of NAFTA on U.S.-Mexican Trade and GDP,” A CBO Paper, May 2003.

<sup>5</sup> Congressional Research Service, “The North American Free Trade Agreement (NAFTA),” M. Angeles Villarreal and Ian F. Fergusson, May 24, 2017.

and a low wage developing country (Mexico). Mainstream trade theory predicts that in such a situation the wages of workers in the higher wage countries will decline while those for similarly skilled workers in the lower wage country will increase.<sup>6</sup> Further, NAFTA and subsequent U.S. free trade agreements created new protections for cross-border investment, along with robust mechanisms for investors to assert claims against governments. Combined with guaranteed access back into the lucrative U.S. market for the goods produced by those investments these protections created strong incentives for firms to move their operations to low-wage countries. Thus, beyond the winners and losers among sectors and workers directly affected by adjustment to trade, these agreements created a shift in the broader bargaining power of investors (capital) compared to labor's bargaining power. Investors moved production to Mexico and other low wage countries or threatened to leave in order to depress wage demands by workers in the U.S.<sup>7</sup>

While it has traditionally been difficult to measure the actual impact of trade agreements on employment and wages due to the multiple factors affecting labor markets, new research methods and better data have more recently produced robust estimates of these effects. For example, a study that looks at the regional and local wage effects of NAFTA in the U.S. by measuring each industry's vulnerability to Mexican imports and each locality's dependence on vulnerable industries finds that wage growth was dramatically lower for blue collar workers in the most affected industries and localities, with spillover negative effects on service sector workers in those localities as well.<sup>8</sup> At a time of increasing inequality in the US, with particularly harsh effects in some regions, the impact of NAFTA continues to be felt and raises important questions about the potential effects of the USMCA.

### *The labor chapter of USMCA*

As a result of the negative distributive effects of NAFTA and other trade agreements, there has been ongoing pressure from some members of Congress, trade unions and civil society to include strong protections for labor rights in all trade agreements. In this respect, the USMCA labor chapter continues the trend in U.S. trade negotiations over the last 25 years to expand the scope of the parties' commitments to protect labor rights. The chapter includes some welcome added protections for labor rights, including the commitment that "no Party shall fail to address cases of violence or threats of violence against workers, directly related to exercising or attempting to exercise the rights set out in Article 23.3 (Labor Rights)".<sup>9</sup>

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<sup>6</sup> This is a key element of the Stolper–Samuelson theorem, which is closely linked to the factor price equalization theorem. The latter states that, regardless of international factor mobility, factor prices will tend to equalize across countries that do not differ in technology. See for example Neary, J. Peter, "The Stolper-Samuelson Theorem", prepared for the Encyclopedia of World Trade Since 1450, ed. J.J. McCusker et al., New York: Macmillan Reference. Available at: <http://users.ox.ac.uk/~econ0211/papers/pdf/stolpers.pdf>

<sup>7</sup> Bronfenbrenner, Kate, 1997. "We'll Close! Plant Closings, Plant-closing Threats, Union Organizing and NAFTA," *Multinational Monitor* 18(3).

<sup>8</sup> McLaren, John and Hakobyan, Shushanik, "Looking for Local Labor-Market Effects of NAFTA," *Review of Economics and Statistics*, Vol. 98, No. 4, 2016. Available at SSRN: <https://ssrn.com/abstract=2861511>.

<sup>9</sup> However the USMCA continues to limit the definition of the rights to those stated in the International Labor Organization (ILO) Declaration on Rights at Work (Article 23.3: 1). While the Declaration covers the core rights, labor advocates have long argued that labor obligations in free trade agreements should explicitly include the underlying ILO conventions and recommendations that further specify the nature of those rights.

Despite the modest expansion of commitments, the agreement does nothing to strengthen the *enforcement* of labor rights obligations, meaning that even seemingly robust protections have little impact in practice. This has been a long-standing critique of the labor chapters. The weakness of enforcement mechanisms is found both in (i) the mechanisms incorporated within trade agreements themselves to hold parties to their labor commitments and (ii) the observable reluctance of the U.S. and other governments to pursue enforcement of labor obligations. Both of those shortcomings were strikingly demonstrated by the failure of the U.S. to prevail in the only labor case it has ever taken to arbitration, one that addressed egregious and widespread violations of labor rights in Guatemala.<sup>10</sup> Despite acknowledging that violations occurred, the arbitrators declined to hold Guatemala responsible for violating its labor obligations under the trade agreement and did not impose any sanctions.

The USMCA enforcement procedure replicates the flaws in earlier U.S. labor chapters. The dispute settlement mechanism continues to include loopholes such as requiring that violations of the labor commitments must occur through “a sustained or recurring course of action or inaction”. (It is worth noting that no such limitation is applied to enforcement of violations of corporate investment or intellectual property rights.) The process for initiating arbitration under the dispute settlement mechanism appears to allow any one country to stall the establishment of a panel indefinitely (USMCA Article 31.5, 31.6). These shortcomings should be corrected and in addition affected parties such as workers and trade unions should be given stronger standing to participate in any arbitral proceeding and the process should be public and transparent. Given that violations of the labor commitments constitute violations of human rights and inflict economic damage on the weaker party (labor), the agreement should establish an appeal body that has a public interest mandate and qualifications, rather than allowing flawed private arbitral decisions to stand, as happened in the case of U.S. versus Guatemala. However even if these changes are made to the dispute settlement mechanism, it is unlikely to provide timely relief for workers whose rights have been violated.

### ***Annex 23-A: Collective bargaining and union representation in Mexico***

The USMCA also includes an annex to the labor chapter that commits the Mexican government to a series of reforms that would strengthen Mexican workers’ rights to union representation and collective bargaining. These commitments are appropriate and welcome, given that previous Mexican governments had for decades pursued an aggressive strategy of wage repression. They did this both by keeping the minimum wage extremely low and through a system of trade union administration that was ineffective at best and corrupt at worst. It is worth noting that the trade theory predictions discussed above, that wages of workers in the lower-wage country would increase, were negated in practice by Mexican wage repression. To appreciate the extent of the

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<sup>10</sup> See for example Sandra Polaski, “Twenty Years of Progress at Risk: Labor and Environmental Protections in Trade Agreements,” Boston University Global Development Policy Center, GEGI Policy Brief 004, October 2017. Available at: [https://www.bu.edu/gdp/files/2017/10/Polaski.10-2017.Final\\_.pdf](https://www.bu.edu/gdp/files/2017/10/Polaski.10-2017.Final_.pdf)

negative effects of this policy, it is worth noting that average unit labor costs in manufacturing in Mexico today are 30 per cent lower than in China.<sup>11</sup>

The Mexican legislature recently adopted a major reform that appears to be consistent with the commitments in the annex, although apparently the Mexican Senate will still entertain amendments that could weaken the reform. However even if a robust reform survives, its implementation will require dismantling the current flawed system and creating an entirely new system of administrative bodies and labor courts, which will be time consuming and costly to establish and staff. Success will depend on continued political will and allocation of sufficient resources. The current Mexican government is supportive of workers' interests, as demonstrated by the legal reform and by its substantial increase of minimum wages (a 16 per cent national increase and a doubling of the minimum wage in the higher cost-of-living border region) as one of its first acts. However even with a continued pro-worker policy orientation, the damage of the previous low-wage strategy will take years to reverse, as acknowledged by Mexican officials.

### ***A stronger approach to enforcement of labor obligations***

Given the weakness and flaws of the dispute settlement mechanism in the USMCA, along with the uncertainty about the future of Mexican reforms, a more robust approach to enforcement should be added to the agreement. Senators Sherrod Brown and Ron Wyden have put forward a promising concept for such an approach. They propose a bilateral agreement between the U.S. and Mexico that would allow the two governments to audit and inspect facilities suspected of violating labor standards.<sup>12</sup> If violations were found, the government of the importing country would have the right to deny entry under the preferential terms of USMCA to the goods or services produced in that establishment. This is a more direct and timely approach to enforcement and focuses on the firms that engage in violations. The ability to investigate and sanction only violators rather than a whole sector or entire economy is a strong advantage of the approach. In addition to its targeted efficiency it has the potential to create substantial deterrent effects, as other firms observe that the labor chapter is being effectively enforced. Such an approach has precedents. For example the U.S.-Peru free trade agreement allows the U.S. to block imports of illegally logged timber because they violate that agreement's obligations to ensure sound forestry practices; and the World Trade Organization allows member state governments to deny entry of goods made with prison labor. The labor chapter of USMCA itself includes a requirement that "each Party shall prohibit, through measures it considers appropriate, the importation of goods into its territory from other sources produced in whole or in part by forced or compulsory labor, including forced or compulsory child labor" (Article 23:6). This is a small step in the right direction although it does not extend this obligation to other core labor rights and to goods produced by the parties to the agreement. The Mexican ambassador to the US recently said that Mexico could agree to a cross-border inspection arrangement if it were

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<sup>11</sup> See for example North American Production Sharing, Inc. (NAPS), "Mexico vs. China Manufacturing: How the Two Countries Compare" Available at: <https://napsintl.com/manufacturing-in-mexico/mexico-vs-china-manufacturing-comparison/>; China Economic Review, "Chinese wages higher than Brazil, Mexico", February 2017." Available at: <https://chinaeconomicreview.com/chinese-wages-higher-brazil-mexico/>

<sup>12</sup> There is no logical reason why this should not be a trilateral agreement involving Canada as well.

reciprocal, allowing investigations of worker rights violations in either country.<sup>13</sup> Here again there is precedent: during the original *bracero* program that brought Mexican farm workers into the US during World War II, the U.S. agreed that the Mexican government could send in labor inspectors to ensure that the workers were not exploited on US farms.<sup>14</sup>

The Brown-Wyden proposal should be developed and strengthened to assign stakeholders, such as workers' unions and civil society groups, a strong recognized role in identifying violations of the USMCA labor rights commitments. Existing provisions for public submissions (Article 23.11) should be revised to give stakeholders the opportunity to identify specific firms and facilities that are alleged to be in violation of the agreement and to require the governments to investigate within strict time limits, including through use of the cross-border inspection capacity. Results should be made publicly available in a timely manner. When violations are found there should be a requirement to deny entry to the goods, in order to incentivize prompt remediation as well as to create the desired deterrent effect. Enforcement would be further strengthened by adding a legal right for stakeholders to compel action by the governments through national courts.<sup>15</sup> These measures would address the problem of lack of political will to pursue action against labor rights violators, a problem demonstrated by the U.S. reluctance to use the dispute settlement mechanisms to enforce labor obligations over the 25 years that such obligations have been part of trade agreements, beginning with NAFTA.

The U.S. Congress might wish to assign itself a role in overseeing the implementation of the labor provisions of the USMCA, either alone or in concert with legislative bodies in Mexico (and perhaps Canada). This could entail a standing committee that regularly reviews developments in the three countries' labor markets and compliance with the labor obligations contained in the agreement. The committee could invite labor unions and other workers' rights organizations to submit complaints of non-compliance and utilize its various authorities to press the executive branch into active enforcement. Congress could also create a right for legislators or their designees to join the cross-border inspection teams. This could be accomplished through the implementing legislation for USMCA or as part of the renegotiation of the agreement.

### ***Applying the lessons learned from experience with labor chapters in trade agreements***

Substantial experience has been gained during the decades since labor obligations were first included in trade agreements. Perhaps the most striking lesson, identified above, can be learned from the failure of the U.S. to prevail in the Guatemala case, the only labor case it has taken to dispute settlement. A study of the decision in that case demonstrates the fundamental weaknesses and flaws of the dispute settlement mechanism under which that case was brought.<sup>16</sup> The

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<sup>13</sup> Politico Morning Trade, April 23, 2019. Available at: <https://www.politico.com/newsletters/morning-trade/2019/04/23/mexico-open-to-using-bilateral-usmca-enforcement-tool-427767>

<sup>14</sup> See for example Gamboa, Erasmo, *Mexican Labor & World War II: Braceros in the Pacific Northwest, 1942-1947*, Seattle: University of Washington Press, 1990.

<sup>15</sup> This could require amending Article 31.21 of the agreement, which reads: "No Party shall provide for a right of action under its law against another Party on the ground that a measure of that other Party is inconsistent with this Agreement and Article 25.3 (4), which reads: "Nothing in this Chapter shall be construed to empower a Party's authorities to undertake labor law enforcement activities in the territory of another Party."

<sup>16</sup> Polaski 2017 op.cit.

mechanism put forward in the USMCA, while narrowing one loophole, fails to correct the many profound deficiencies of that approach.

Beyond this damaging precedent, two other important lessons can be gleaned from the experience to date. First, the most substantial improvements achieved under labor-trade linkages have occurred *before* ratification of the related trade pacts. For example, reforms to labor laws, regulations and institutions in Colombia were required by Congress before ratification of the U.S.–Colombia Trade Promotion Agreement.<sup>17</sup> Similarly, the previous Mexican government undertook changes to constitutional protections for labor rights in order to facilitate its accession to negotiations and in anticipation of difficult ratification of the now-abandoned Trans-Pacific Partnership (TPP). Unfortunately, in the case of Colombia the implementation of reforms slowed after ratification and by now the reforms have been largely abandoned.<sup>18</sup> In the case of Mexico, the previous administration reversed course on implementation of the constitutional reforms after the U.S. withdrew from the TPP in 2017. These two examples illustrate a broader lesson. It is easier to elicit improvements in labor rights as a *positive* incentive (to enable access to a reward) than as a *negative* incentive (punishment for failure to reform). This is because the desire to achieve the reward—enhanced market access—aligns the incentives facing the government of the trading partner country and the private firms in that country which will have to change their behavior.<sup>19</sup> Strengthening labor laws and requiring increased respect for workers’ rights substantially shifts the power balance between workers and employers/investors and the latter typically resist any government action to make such a shift. However in the face of desirable access to affluent markets, the employer resistance can be reduced.<sup>20</sup> By contrast, negative incentives—that is, the possible withdrawal of market access—depend on the credibility of enforcement mechanisms to change behavior by firms. If the possibility of enforcement, whether by their own government or another party to the trade agreement, is seen as weak, it does not serve as an effective deterrent. This experience reinforces the lesson that strong enforcement mechanisms are an essential ingredient if labor clauses in trade agreements are to be effective.

A second important lesson that can be drawn from experience is that labor rights violations tend to be concentrated in some firms or sectors in trading partner countries. Appropriately robust measures should be available to target those violators. This will both serve as the most efficient

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<sup>17</sup> Congressional Research Service, “The U.S.–Colombia Free Trade Agreement: Background and Issues,” M. Angeles Villarreal, February 14, 2014.

<sup>18</sup> AFL-CIO, “Making the Colombia Labor Action Plan Work for Workers,” April 2014. Available at: <https://aflcio.org/reports/making-colombia-labor-action-plan-work-workers>; Feingold, Cathy, “Murdered Trade Unionists: The Truth Behind Colombia’s Trade Agreement,” May 16, 2019. Available at: <https://aflcio.org/2019/5/16/murdered-trade-unionists-truth-behind-colombias-trade-agreement>

<sup>19</sup> Polaski, Sandra, “Protecting Labor Rights through Trade Agreements: An Analytical Guide,” *Journal of International Law and Policy*, Vol. 10:13, 2004. University of California, Davis. Available at: <https://carnegieendowment.org/2004/09/14/protecting-labor-rights-through-trade-agreements-analytical-guide-pub-15796>

<sup>20</sup> Although not a free trade agreement, a similar dynamic was observed under the U.S.–Cambodia Textile Agreement, which allowed for an increase in quotas for Cambodian textile and apparel exports to the U.S. if worker rights in the sector were improved. Firms had the incentive to comply with labor laws and respect workers’ trade unions rights because they could gain valuable market access and grow as a result. See Polaski, Sandra, “Combining Global and Local Forces: The Case of Labor Rights in Cambodia,” *World Development* 34(5): 919-932, January 2006. Available at: <https://carnegieendowment.org/files/WDCambodia1.pdf>

use of resources and also create deterrent effects for other firms and sectors. This dynamic, which is a key strength of the Brown-Wyden cross-border inspection approach, was also seen in the U.S.-Cambodia textile and apparel quota experiment.<sup>21</sup> Firms that did not respect labor laws and workers' rights lost access to the U.S. market, deterring other firms from such abuses. And because of an innovative accompanying program launched by the U.S. and Cambodian governments, the ILO undertook monitoring of all factories in the sector and reported the results transparently, by factory name, on the Better Factories Cambodia website. This enabled buyers to see the pattern of compliance or non-compliance across the sector and direct their orders to compliant firms. As a result, the entire sector improved, with violators losing orders and going out of business and more compliant firms gaining orders and expanding production and hiring.<sup>22</sup> Adding an effective, independent and credible monitoring mechanism to the labor provisions of the USMCA would further strengthen the likelihood that the trade agreement would improve labor rights in the three countries and could support labor reforms and upward convergence of wages in Mexico. Again there is a lesson from experience. The secretariat of the North American Commission for Labor Cooperation, an institution created by the original NAFTA, had a very limited mandate and eventually proved to be incapable of useful, independent work. It was suspended in 2011. However a new monitoring body could be created that avoided the flaws of that early attempt. If such an effort is undertaken, it will require: a mandate that allows it to inspect any workplace where violations are alleged, free from interference; secure and adequate funding; staffing by competent and independent experts; and insulation from political interference by any of the three governments. It could be given a dual reporting relationship to both the executive and legislative branches of the three countries and should have an oversight body that includes bona fide workers' representatives. A credible, independent monitoring body is possible, as demonstrated by the Better Factories Cambodia program and its expansion as the Better Work program.<sup>23</sup> However those programs have struggled for adequate and sustained funding and they are limited to one sector. A new monitoring program that could effectively oversee compliance with a robust USMCA would be an ambitious undertaking.

## ***Conclusion***

The above assessment demonstrates that the USMCA requires significant amendments before it can be deemed a good deal for U.S. and North American workers. The minor improvements made to the labor chapter will be meaningless without very robust additional enforcement mechanisms. Given the negligible overall economic impact of the deal found in the USITC and IMF studies cited above, it is clear that the main effect of USMCA will be redistribution, not overall growth. In addition to the labor issues, USMCA also creates new advantages for certain favored sectors including biotechnology, digital platforms and other technology firms that could constrain future U.S. action to make medicines more affordable and to protect the public from

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<sup>21</sup> See footnote 20.

<sup>22</sup> Polaski 2006, op.cit.

<sup>23</sup> For more information about the programs see <https://betterwork.org/> and <https://betterwork.org/where-we-work/cambodia/>



harmful content and violations of privacy on the internet.<sup>24</sup> Unless the agreement is revised to shift the balance in favor of workers and the public in North America it should be rejected.

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<sup>24</sup> Polaski, Sandra, Jeronim Capaldo and Kevin P. Gallagher, "Small Gains and Big Risks: Evaluating the Proposed United States-Mexico-Canada Agreement," Boston University Global Development Policy Center, GEGI Policy Brief 007, 2019 (forthcoming).