CHAPTER 8. ECONOMICS OF LABOUR STANDARDS IN FREE TRADE AGREEMENTS: PROSPECTS FOR THE TTIP

Inmaculada Martínez-Zarzoso
Professor of Economics, University of Göttingen

"TTIP: chance to enhance labour rights globally must not be missed"
"The TTIP should promote mutual supportiveness between trade and labour policy and include a strong role for civil society. The differences between the EU and U.S. approaches to labour provisions in trade agreements should not be an impediment but rather a unique opportunity for ambitious and innovative coverage of provisions on labour rights in the TTIP."
Press Release 14/11/2014 No 64. European Economic and Social Committee

Introduction

This paper explores the interactions between countries' participation in FTAs and labour market conditions in the participant countries from an economics perspective. We specifically focus on FTAs between developed and newly industrialised countries (OECD members). In this way, we aim to identify the most controversial economic issues that merit inclusion in the Transatlantic Trade and Investment Partnership (TTIP) negotiations ongoing between the EU and US concerning labour issues. The main approach consists of comparing the bilateral or regional FTAs that have recently been signed by the US and the EU with third-party OECD countries and that include labour provisions (LPs). They are: NAFTA in 1994, US-Chile in 2004, US-Australia in 2005 and US-Korea in 2011; EU-Mexico in 2000, EU-Chile in 2004, EU-Korea in 2012 and EU-Canada negotiations. The chapter then identifies the LPs that have most frequently been included in FTAs and the prospects for TTIP negotiations concerning LPs. The labour conditions in the signatory countries are then analysed across agreements and over time by using a comparative approach to identify whether changes in labour conditions (minimum wage, severance pay, and strictness of labour regulations) could be attributed to the LPs contained in the agreements. In this way, we will be able to infer whether FTAs including more comprehensive LPs contribute to maintaining or improving labour conditions in the participant countries. We specifically compare the EU and US FTAs with OECD countries and examine the convergence or divergence in a number of labour conditions in the participant countries.

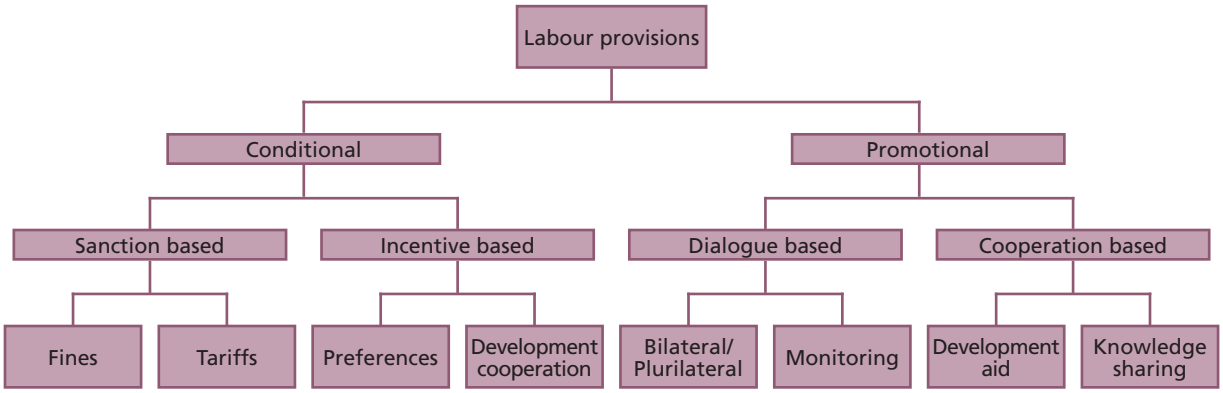
Section 2 describes the main approaches used in trade agreements to include LPs, compares the EU and US approaches and refers to the International Labour Organization (ILO) conventions and their importance. Section 3 compares the evolution of labour conditions in signatory countries. Finally, Section 4 presents prospects and policy conclusions for future agreements, in particular for the TTIP.

Main approaches to labour provisions in trade agreements

The failure to include labour standards in multilateral trade negotiations in the 1990s led main economic players in the world economy, namely the EU and the US, to consider the inclusion of LPs in FTAs (Grandi, 2009; Nkowawani, 2009; Peels and Fino, 2015). The first attempt was made by the US in 1994 though North American Free Trade Agreement (NAFTA) negotiations, which was accompanied by a side agreement, the North American Agreement on Labour Cooperation (NAALC). This side agreement addressed a number of labour issues, and in particular those relating to eleven labour standards, among them the four core ILO standards that were later defined in the 1998 ILO Declaration. Nevertheless, no explicit reference to the ILO was made in the text. After NAFTA, all trade agreements signed by the US have included LPs in their main text, albeit with some notable differences in the FTAs signed before and after 2006. On the one hand, the agreements signed before 2006 only refer to three out of the four core standards in the ILO 1998 Declaration, omitting the non-discrimination principle. Furthermore, they only explicitly refer to ILO convention 182, which addresses the prohibition of child labour. On the other hand, the agreements signed after 2006 also refer to the non-discrimination principal (Peels and Fino, 2015).

The first EU FTA that included LPs was signed in 2004 with South Africa and the main text of the agreement included an explicit reference to the ILO standards contained in the ILO's fundamental conventions (as with the Agreement with Chile in 2005). Since then, the majority of EU trade agreements refer to the ILO Declaration, and after 2009, they also refer to the 2006 UN Ministerial Declaration on Decent Work for All. Several EU agreements focused on cooperation and dialogue on labour issues such as working conditions, migrant communities or gender equality. Examples include agreements with Jordan, Morocco and Iraq.

Figure 1. Main approaches regarding labour provisions in trade agreements



Source: Ebert and Posthuma (2011).

The two main general approaches regarding the inclusion of LPs in trade agreements are summarised as in Figure 1.The US has principally adopted the conditional approach, whereas the EU has generally opted for the promotional approach. Within the conditional approach, some

FTAs included pre-ratification conditionality while others incorporate post-ratification sanctions comprising the imposition of tariffs or fines on countries that do not comply with the agreed labour regulations (NAFTA, US-Chile).There has, however, been only one such case– within the framework of CAFTA, where a complaint was raised against Guatemala in 2008. The case is still unresolved and to date no sanctions have been imposed. Hence, in the absence of a consistent application of sanctions, most authors argue that up to now, the main enforcement tool of LPs has been public censure. Other LPs are exclusively incentive-based and offer additional reductions in tariffs or additional aid that are conditional on compliance (EU Generalised System of Preferences+ (GSP+), US African Growth and Opportunity Act (AGOA)). Examples of the promotional approach can be found among the EU and US agreements, most of which are dialogue and cooperation based (EU-South Korea, EU-Chile, US-Australia, US-Cambodia Textile Agreement). According to the ILO (2015), of the 58 FTAs with LPs more than half (34) use only promotional elements. The effects of conditional versus promotional approaches have been discussed in the ILO (2015). The main conclusion is that pre-conditionality has gone some way to improving domestic labour laws prior to ratification (EU-Chile, EU-Australia). Conversely, the effects of the complaint mechanism have been limited to raising awareness rather than addressing the corresponding concern. The effects of the promotional approach have yet to be comprehensively evaluated and more field research is thus required.

Focusing more specifically on the content of the most recent FTAs in relation to labour issues, three key features characterise the LPs: (a) referral to International Labour Standards (ILS); (b) monitoring and cooperation issues; (c) dispute resolution (Ebert and Posthuma, 2011). As regards the ISL, the FTAs signed by the US and the EU in the late 2000s both refer to the 1998 ILO declaration. However, the wording and implications differ. Whereas the US agreements stress the effective implementation of national labour legislations, the EU agreements stress the effective implementation of the ILO conventions. With regard to monitoring and cooperation issues, both the US and the EU EIAs provide for a joint board to oversee the implementation of the labour chapter, as well as institutional mechanisms for recommendations from civil society and for cooperation activities. However, the mechanisms differ slightly from one agreement to the next. Finally, there are also differences in the dispute settlement mechanisms. On the one hand, the EU provides for a dedicated mechanism for labour issues consisting of government consultation and a panel of experts, which have to take ILO activities into consideration and seek ILO advice and assistance. On the other hand, in the US, the standard mechanism for dispute settlement applies if the Cooperative Labour Consultations fail. The ILO supervisory mechanism is also envisaged as an indirect source of dispute settlement.

Table 1 shows the agreements signed from 1994 onwards by the EU and the US with OECD member countries and highlights main differences concerning the three above-mentioned characteristics. It is worth mentioning that only one agreement, EU-Mexico, does not have a chapter dedicated to this issue and the text contains only indirect references to human rights. As regards the ILS referrals, all recent FTAs signed by the EU and the US include references to the 1998 ILO Declaration, however, the EU stresses the effective implementation of the ILO Conventions (EU-Rep. of Korea,

2011), whereas the US stresses the effective implementation of national labour legislations which should, nevertheless, be in compliance with the Principles of the ILO 1998 Declaration (US-South Korea, 2012).

Table 1. Free Trade Agreements with LPs signed by the EU and US with OECD countries, 1994-2014

Name and Date	Referral to ILS/National laws	Scope and content	Enforcement
NAFTA (US, Canada, Mexico) NAALC (1994)	**Ensure** that national laws provide for high labour standards.	**Strive for** a high level of national labour laws.	**Fines up** to US$20 million.
US-Chile (2004) Ch. 18	Requires enforcement of national laws, 1998 ILO Declaration.	Strive to ensure labour standards and minimum working conditions.	Fines up to US$ 15 million.
US-Australia (2005) Ch. 18	**Requires enforcement of** national laws and 1998 ILO Declaration.	**Not fail to effectively enforce** labour laws. Extensive labour cooperation mechanism.	**Different enforcement** of commercial and labour disputes.
US-South Korea (2012) Ch. 19	**Requires enforcement of** national laws, which must conform to ILO 1998 Declaration.	**Not fail to effectively enforce** labour laws.	**Identical enforcement** of commercial and labour disputes.
EU-Mexico (2000)	**No labour chapte**r only indirect references.		
EU-Chile (2005) Art 44 (social cooperation)	The parties **acknowledge the importance of social development**.	**Social development** must go hand-in-hand with economic development.	**Cooperation** shall contribute to facilitating women's access to all necessary resources to allow them to fully exercise their fundamental rights.
EU-South Korea (2011) Art 13 (Trade and Sustainable Development)	**Acknowledging the right** of each party to establish its own levels of labour protection.	The parties commit to initiating **cooperative** activities as set out in the Annex.	**Designated national offices**, which shall serve as a contact point with the other party for the purpose of implementing this chapter.
CETA (EU-Canada, negotiations concluded in September 2014)	**ILO** Declaration and conventions.	Each party shall **effectively enforce** its national labour laws.	**General Dispute Settlement** Procedure Art 33.

Source: CEPR (2013). ILS stands for international labour standards.

Another important aspect to be considered is the state of ratification of the different ILO conventions by the countries participating in FTAs with LPs. Table 2 shows the number of ILO conventions ratified by country and the year of ratification of the eight main conventions concerning core labour standards. Of particular note is the comparison between the US, which has only ratified 14 conventions, and France (part of the EU), which has ratified 125. Mexico and Chile have ratified 78 and 61 conventions, respectively. Concerning the eight core conventions, the US and South Korea have not yet ratified the conventions that deal with freedom of association issues, and the US has not ratified the two conventions tackling discrimination issues. Surprisingly, the non-ratification of these conventions does not prevent the US from claiming to comply with the corresponding labour rights nor from incorporating provisions in FTAs that "require the enforcement" of laws related to labour discrimination and freedom of association in their FTA partner territories (Meyer, 2015). The US is followed by South Korea and Canada in the ranking based on the number of ILO Conventions ratified.

Table 2. Number of ILO conventions ratified by country and year of ratification of main conventions									
LO Conventions		Freedom of association		Forced labour		Discrimination		Child labour	
Convention N°:		C087	C098	C029	C105	C100	C111	C138	C182
Country	Number	Year of Ratification Fundamental Conventions							
Australia	58	1973	1973	1932	1960	1974	1973	-	2006
Canada	34	1972		2001	1972	1972	1964	-	2000
Chile	61	1999	1999	1933	1999	1971	1971	1999	2000
South Korea	29	-	-	-	-	1997	1998	1999	2001
Mexico	78	1950	-	1934	1959	1952	1961	-	2000
U.S.	14	-	-	-	1991	-	-	-	1999
EU (France)	(125)	All 8 conventions ratified by all EU states, over a number of years							

Source: Compiled by the author using ILO data. Only OECD countries with recent TAs with LPs included. France has been chosen to represent the EU.

Labour conditions in member states

An important issue is the impact of the agreements and whether they depend on differences in the LPs included and their quantitative and qualitative scope. Martínez-Zarzoso (2015) is the only author who has recently examined the effect of the inclusion of LPs in FTAs on labour conditions in the signatory countries. Her findings show that labour conditions in countries that are members of RTAs with labour provisions tend to converge, and that increasing bilateral trade also reduces divergences in domestic labour conditions in certain cases. In particular, the minimum to median wage and the average severance pay converge at 8% and 19% per year, respectively, indicating that some harmonisation exists within FTAs with LPs.

Kamata (2014) analysed a related aspect, specifically whether trading more intensively with partner countries in FTAs with LPs has a positive impact on labour earnings, and whether labour clauses reduce the trade-promoting effect of trade agreements. The main findings indicate that there is no clear answer to the first question due to a lack of statistically significant data of the trade-intensity variable, whereas concerning the second question, a slightly negative effect of the LPs on the growth of trade is found.

The main difficulty in finding an answer to these complex matters is to find adequate comparable data on labour market outcomes. The obvious source for these data should be the International Labour Organization (ILO), but indicators at country level are only available for the period 2009-2013, and in many cases the amount of missing data and lack of comparability across countries is a major drawback. Accordingly, two alternative sources of data are considered: World Bank data and OECD statistics.

The recently released World Bank *Doing Business* dataset measures the regulation of employment that affects the hiring and redundancy of workers and the rigidity of working hours.[1] The indicators encompass four broad areas, each with different subsections. The first, rigidity of employment, covers three sub-areas: hiring difficulties, rigidity of hours and redundancy issues. Some of the aspects covered, as well as the main differences in OECD countries are shown in Table

1. For three years the World Bank worked with a consultative group which included labour lawyers, employer and employee representatives and experts from international organizations (ILO and OECD), as well as from the civil society and the private sector. The dataset covers the period from 2007 to 2014. The data are based on a detailed questionnaire and are made comparable across economies by using a number of assumptions about the worker and the business. The worker is a full-time employee that works as a cashier in a supermarket or grocery store and is not a member of a labour union, unless this is mandatory in the sector/country. The business is a limited liability company (or the equivalent in the economy), which operates a supermarket or grocery store in the economy's largest (second largest for 11 economies) business city and has 60 employees.

3. Most of these variables do not change over time; therefore it is only possible to compare the differences for a cross-section of countries in a given year. In general, the US, Australia and Canada exhibit lower labour-protection levels, whereas EU countries, South Korea and occasionally Chile have stricter conditions in place concerning the three sub-areas.

Table 3. Labour protection in OECD countries

Hiring difficulties	Rigidity of hours	Redundancy issues
Fixed-term contracts prohibited for permanent tasks: No: Australia, Canada, Chile, Germany, Italy, UK, Korea and US Yes: France and Mexico	**Working week can extend to 50 hours or more (including overtime):** No: France and Australia (2006) Yes: Australia (2014), Canada, Chile, Germany, Italy, UK, Korea, US, France and Mexico	**The employer is required to notify a third party to make 1 worker redundant (group of 9 workers):** No: Australia and Canada, France, Italy (2006), UK, US (Australia, Canada, UK and US) Yes: Chile, Germany, Italy (2014), Korea and Mexico (Chile, Germany, France, Italy, Korea and Mexico)
The maximum cumulative duration of fixed-term contracts in months: No limit: Australia, Canada, Mexico UK and US Limit: Korea (24), Chile (12), Germany (24), Italy (44) and France (18)	**Average paid annual leave for workers with** tenure (days): US (0), Canada(10), Chile (15), Mexico (16), Korea (19), Italy (21), Germany (24), Australia (25),UK (28) and France (30)	**Priority rules apply for redundancies (reemployment):** Yes: France, Germany, Italy, and Mexico (Korea, Mexico, Italy and France)

Redundancy cost measures	
Notice period for redundancy dismissal after 20 years of continuous employment (months): Zero: US and Mexico 4: Australia and Korea 8-10: Canada, France, Italy and UK 15-26: Germany	**Severance pay for redundancy dismissal after 20 years of continuous employment (months):** Zero: US, Italy and Australia (2006) 10-25: UK, Canada, Australia (2014), France (2006:23), Germany (22) and Mexico (30) 26-86: Chile (43) and Korea(43)

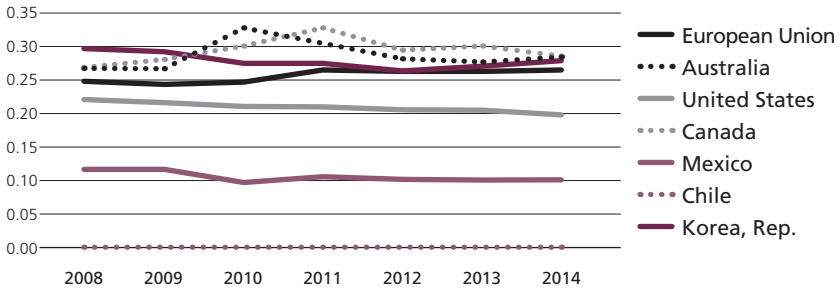
Source: World Bank Doing Business (2005). Changes in the regulation are indicated by the year in brackets.

As regards redundancy cost measures reported in the second part of Table 2, the average notice period required is reported in column 1 and the severance payments and penalties due when making a worker redundant expressed in weeks of salary is reported in column 2. Rigidity of employment and redundancy costs display similar disparities, with the US having no such measures in place and most EU countries exhibiting maximum values.

Of the available indicators, only the data on minimum wage in dollars (MWD) and the ratio of minimum wage to average value added per country (MWDR) change over time (available since 2008) and could be used to compare pre-FTA and post-FTA conditions. We only include the second as we consider it more comparable across countries, since it takes into account the standard of living, which is closely related to labour productivity proxied by the value added per worker.

Figure 2 shows that some convergence in this ratio is observed between the EU and most of its trading partners in recent FTAs, including LPs, namely with Australia, Canada and Korea, whereas no convergence is observed between the US and those three countries, plus Mexico and Chile.

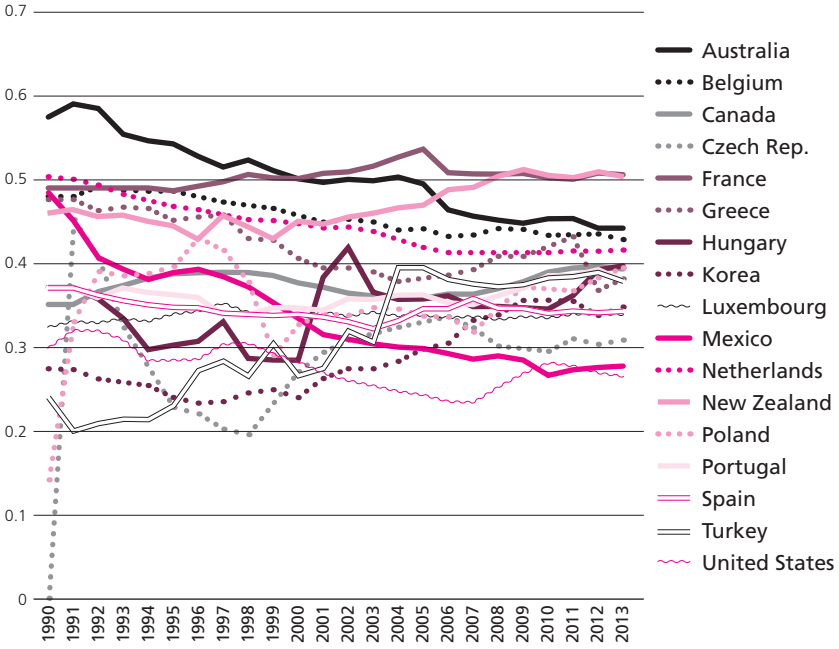
Figure 2. The ratio of minimum wage to the average value added per worker



Source: World Bank Doing Business.

Another source of comparable data is the OECD Employment and Labour Market Statistics (OECD, 2015).[2] The indicators available are minimum/mean wage ratios and indices for strictness of employment protection legislation, the latter constructed using information about individual and collective dismissal as well as strictness of employment protection legislation for regular and for temporary employment.

Figure 3. Ratio of minimum wage to mean wage



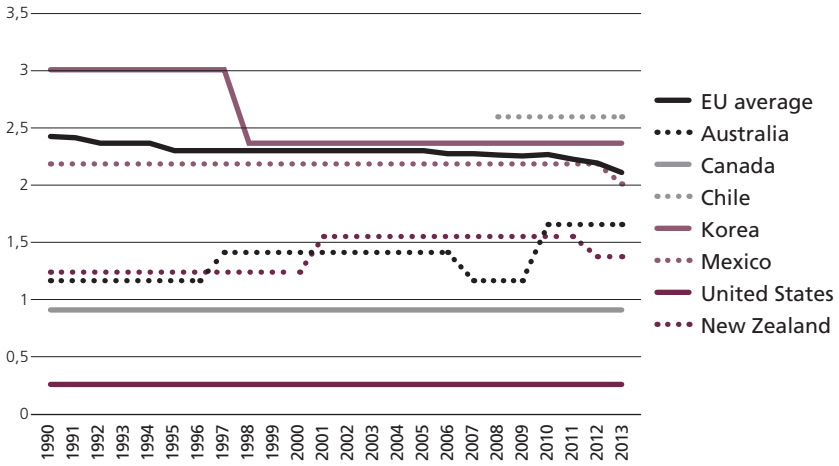
Source: Compiled by authors using OECD data.

Indicators are available from 1990 to 2013 and comparable over time and across countries. Figure 3 also shows some convergence between EU countries and others. However, this is not the case for the US and the trading partners with which it has RTAs with employment protection provisions on minimum/mean wage ratio – a similar measure to the one shown in Figure 2 but computed using national statistics averages instead of survey data as in Figure 2.

2. http://stats.oecd.org/BrandedView.aspx?oecd_bv_id=lfs-data-en&doi=data-00658-en.http://www.keepeek.com/Digital-Asset-Management/oecd/employment/oecd-employment-outlook-2013_empl_outlook-2013-en#page7.

Figure 4 shows strictness of employment protection legislation for regular employment for the OECD countries involved in FTAs with LPs. The index varies between 1 and 6 according to the strictness (level of labour protection) of the contract concerning notification procedures for dismissal, length of notice period, severance pay and length of trial period, compensation for unfair dismissal and maximum time to make a claim and possibility of reinstatement after unfair dismissal. Excluding the US, Canada and Chile, some convergence is observed towards average values, with the EU, Mexico and Korea showing lower strictness over time, the latter after 1998, while New Zealand and Australia show increasing index values over time. It is worth noting that the US and Canada exhibit the lowest figures and show no changes over time in the index.

Figure 4. Strictness of employment protection – Individual and collective dismissals in standard contracts



Source: OECD employment protection statistics, available at stats.oecd.org.
A summary of the graphical analysis in this section indicates some evidence of convergence only for the EU agreements.

Prospects for the TTIP: A mixed approach?

Given that a draft of the TTIP agreement has not been made available, probably the most convenient blueprint is the draft of the chapter included in the agreement between the EU and Canada (CETA). Article 2 of chapter 24 of the CETA provisional text (Trade and Labour) states the following:

> *"Recognizing the right of each Party to set its labour priorities and to adopt or modify its relevant laws and policies … each party shall strive to continue to improve those laws and policies with the goal of providing high levels of labour protection"*

Article 3 of the same chapter states that each party shall ensure compliance with the obligations as members of the ILO and commitments under the ILO Declaration and the four core labour standards.

Generally speaking, the effectiveness of the labour provisions has proven difficult to demonstrate conclusively. Evidence so far is limited to provisions

with *conditional elements.* Evidence of improvements in labour standards at national level has been highly case specific and dependent on the interplay between a variety of political, social and economic factors (ILO, 2015). Incentive-based elements seem to work better in the developing world and an integrated and multi-faceted approach seems most promising. According to Kraazt (2015), the TTIP can potentially establish a standard concerning the inclusion of extensive labour provisions in the main text of the agreement and provide for a comprehensive approach based on the recent convergence observed in existing agreements.

Conclusion

The inclusion of labour provisions in trade arrangements offers a number of opportunities to promote labour standards through the mechanisms of international economic governance. The main unresolved question is how the practical application of labour provisions in trade arrangements, as well as the use of the different *conditional or promotional* elements, can contribute to the improvement of employment and working conditions in the global economy. One pending undertaking, especially in the case of the US, is to ensure coherence between the application of labour provisions and the ILO's international labour standards concerning ratification issues.

The majority of labour provisions in trade agreements now refer to ILO instruments, mostly in the form of the ILO 1998 Declaration. An important challenge is to align the practical application of these labour provisions with the ILO's instruments, mechanisms and activities so as to ensure policy coherence on labour standards at international level.

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