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## Trade and labour linkages and the US-Guatemala panel report: Critical assessment and future impact

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European Trade Union Institute

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# Table of contents

Introduction .....	5
<b>1. US-Guatemala Panel Report.....</b>	<b>8</b>
1.1 The disputing parties' arguments.....	8
1.2 The Panel's interpretation of the phrase 'in a manner affecting trade'.....	9
1.3 The Panel's application of the 'in a manner affecting trade' test.....	12
<b>2. Why the US-Guatemala Panel's interpretation of 'in a manner affecting trade' is unconvincing.....</b>	<b>14</b>
2.1 The ordinary meaning does not support the imposition of an 'actual' trade effect condition.....	14
2.2 CAFTA-DR's object and purpose do not support the imposition of an 'actual' trade effect condition.....	15
2.3 The Panel's application of the 'trade link' requirement remains ambivalent .....	17
<b>3. Trade (and investment) linkages in labour obligations: where do we go from here? .....</b>	<b>19</b>
3.1 'In a manner affecting trade or investment' .....	19
3.2 'To encourage trade or investment' .....	21
3.3 'Material impacts on trade or investment ... arising as a result of significant divergences' in the EU-UK TCA.....	23
3.4 Policymakers' options going forward: two examples from USMCA .....	23
<b>Conclusions.....</b>	<b>26</b>
<b>References.....</b>	<b>27</b>



## Introduction

'The Members recognize that unfair labour conditions, particularly in production for export, create difficulties in international trade, and, accordingly, each Member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory.'

Article 7.1 Havana Charter  
24 March 1948

Over the past three decades, several countries have recognised the link between trade and the protection of social values (such as labour standards) and have included specific 'disciplines' (or 'chapters') in their regional trade agreements (RTAs). The 1992 North America Free Trade Agreement (NAFTA) was the first such agreement to contain specific labour disciplines. They were contained in a side agreement to NAFTA, titled the North American Agreement on Labor Cooperation (NAALC), which imposed on the contracting parties, for example, an obligation to provide for high labour standards (defined with reference to 11 labour principles) (Annex 1, NAALC), as well as obligations concerning the enforcement of domestic labour laws. The NAFTA approach has inspired many subsequent RTAs, including those concluded by the European Union (EU) (which often includes labour disciplines in 'sustainable development' chapters). Labour disciplines in trade agreements have evolved over time, particularly in terms of making reference to a greater number of international labour conventions and expanding the availability of enforcement mechanisms.

This contribution focuses on a specific phrase that is often found within these labour disciplines, expressly linking labour standards (or their violation) to trade. For example, in the 2004 Dominican Republic-Central America FTA (CAFTA-DR), Article 16.2.1(a) requires the parties not to fail to effectively enforce their labour laws (through a sustained or recurring course of action or inaction) 'in a manner affecting trade between the Parties'. The meaning of 'in a manner affecting trade' has been the subject of much discussion recently, particularly following the decision by a panel rejecting the United States' complaint brought against Guatemala. Relying on a relatively narrow interpretation of the relevant phrase – 'in a manner affecting trade' – the Panel concluded that the United States had failed to demonstrate the required link between Guatemala's failure to enforce its labour standards effectively and trade between the CAFTA-DR parties (US-Guatemala Panel Report 2017).

Was the US-Guatemala panel correct in its interpretation of the specific language on trade linkages in Article 16.2.1(a) of CAFTA-DR? As many labour obligations in RTAs adopt similar language, answering this question has become crucial in order to assess the strength of labour obligations in trade agreements (Claussen 2020: 32). The EU has, for one thing, used the same language in its recent FTAs, not only with regard to so-called non-enforcement clauses (such as the one in Article 16.2.1(a) CAFTA-DR), but also with regard to non-derogation clauses (Bronckers and Gruni 2019; Hallak 2021). Article 13.7 of the 2010 EU-Korea FTA provides



a good example of non-enforcement and non-derogation clauses using the same relevant phrase ‘in a manner affecting’:

1. A Party shall not fail to effectively enforce its environmental and labour laws, through a sustained or recurring course of action or inaction, in a manner affecting trade or investment between the Parties.
2. A Party shall not weaken or reduce the environmental or labour protections afforded in its laws to encourage trade or investment, by waiving or otherwise derogating from, or offering to waive or otherwise derogate from, its laws, regulations or standards, in a manner affecting trade or investment between the Parties.

Furthermore, the interpretation given by the US-Guatemala panel may also influence the future application of labour obligations contained in other RTAs that employ differently worded trade linkages. One example is the 2016 EU-Canada CETA, which links both non-derogation and non-enforcement clauses to an ‘encouragement’ test. Article 24.5 of the EU-Canada CETA reads, in relevant part, as follows:

2. A Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, its environmental law, to encourage trade or the establishment, acquisition, expansion or retention of an investment in its territory.
3. A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its environmental law to encourage trade or investment.

A second example is found in the recent 2020 EU-UK Trade and Cooperation Agreement (TCA) in the context of the complex section on the ‘level playing field for open and fair competition and sustainable development’ (Title XI). Article 411.2 (or 9.4.2) EU-UK TCA, for example, permits either party to take appropriate ‘rebalancing measures’ in order to address significant divergences between the Parties with respect to, inter alia, labour and social protection if they have resulted in ‘material impacts on trade or investment between the Parties’.

Accordingly, the aim of the present paper is to critically assess the decision of the US-Guatemala panel with regard to the phrase ‘in a manner affecting’ and attempt to sketch how similar clauses should be interpreted in future disputes. This paper puts forward two related arguments. First, while the US-Guatemala decision was correct in focusing its analysis under ‘in a manner affecting trade’ on the impact of the respondent’s conduct on the *conditions of competition in international trade*, it erred in apparently excluding from the linkage analysis that conduct’s *potential* impact on those conditions. Second, an interpretation based on actual and potential effect on the conditions of competition in trade or investment should also be extended to similar linkage clauses in other FTAs.

The paper first describes the US-Guatemala panel report with regard to the phrase ‘in a manner affecting trade’ (section 1). The paper then offers a critical assessment of the panel’s interpretation and application of the specific trade linkage at issue in

the US-Guatemala dispute (section 2) and an examination of the potential impact that the panel report may have on how similar provisions will be interpreted in future disputes or clarified by future trade agreements (section 3).

# 1. US-Guatemala Panel Report

Following a complaint from the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and six Guatemalan labour unions in 2008, in 2011 the United States requested the establishment of a panel pursuant to Article 20.6.1 of CAFTA-DR to consider whether Guatemala had failed to effectively enforce its labour laws related to the right of association, the right to organise and bargain collectively, and acceptable conditions of work in violation of Article 16.2.1(a) of CAFTA-DR.

Article 16.2.1(a) stipulates that '[a] Party shall not fail to effectively enforce its labor laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties, after the date of entry into force of this Agreement'.

While the Panel identified several interpretive issues, the key issue for purposes of the present analysis is what a complaint must show in order to establish that a failure to enforce labour laws through a sustained or recurring course of action or inaction is 'in a manner affecting trade between the Parties' (para 107). This section briefly identifies the disputing parties' arguments (section 1.1), and describes in detail both the panel's interpretation of the relevant phrase (section 1.2) and its application to the specific facts of the case (section 1.3).

## 1.1 The disputing parties' arguments

Based on its ordinary meaning and relying on the broad interpretation given to a similar term in the context of Articles III GATT and I GATS, as well as on the Agreement's objective to 'promote conditions of fair competition' in Article 1.2, the United States submitted that 'in a manner affecting trade' means 'that has a bearing on, influences or changes cross-border economic activity, including by influencing conditions of competition within and among the CAFTA-DR Parties' (paras 153–56). According to the United States, a complaining party needs to present evidence demonstrating (1) that there is trade between the Parties; and (2) that, based on the responding Party's failure to effectively enforce its labor laws, there has been a modification to the conditions of competition. Crucially, the United States pointed out that an econometric analysis of the effects on trade is not required, as there is no need to show 'actual trade effects'. The United States added that such a requirement would not be 'reasonable or feasible' in the context of labour disputes under the CAFTA-DR.

On the other hand, Guatemala submitted that Article 16.2.1(a) requires an ‘unambiguous showing that the challenged conduct has an effect on trade between the Parties’ (para 157). In other words, the complainant must prove ‘actual trade effect’, and that this can be shown by a change in prices of or trade flows in particular goods or services.

## **1.2 The Panel’s interpretation of the phrase ‘in a manner affecting trade’**

The Panel’s analysis can be divided into three parts: first, the Panel focused on the meaning of the phrase ‘in a manner affecting trade’; second, it dealt with the arguments advanced by the disputing parties; and, finally, the Panel put forward what must be shown by a complaining Party in order to satisfy the ‘in a manner affecting trade’ test.

- (i) The meaning of ‘in a manner affecting trade’: ‘trade-related’ v ‘affecting conditions of competition’

First of all, focusing on the wording of the relevant provision, the Panel excluded an interpretation of ‘in a manner affecting trade’ as equivalent to ‘trade-related’. In other words, in the view of the Panel, a failure to effectively enforce labour laws would not be ‘in a manner affecting trade’ ‘simply because it occurred in a traded sector, or with respect to an enterprise engaged in trade’ (para 168). Pointing to the ‘trade-related’ language used in the context of the NAFTA side agreement on labour, the Panel said that if that had been the intention of the CAFTA-DR parties, they could have easily done so using such language.

Second, while the Panel emphasised at least three relevant objectives of the CAFTA-DR – (1) to ‘enforce basic worker rights’, (2) to ‘build on their respective international commitments in labour matters’, and (3) to ‘promote conditions of fair competition in the free trade area’ – the Panel seems to privilege the last of these in its interpretation of Article 16.2.1(a). The Panel noted as follows: ‘[a]ddressing failures to effectively enforce labour laws that are not in a manner affecting trade, while perhaps desirable for other reasons, presumably would do little if anything to promote conditions of fair competition “in the free trade area”’ (para 171). In other words, while requiring effective enforcement of labour laws may respond to the objective of enforcing basic worker rights, it would not per se promote conditions of fair competition in the free trade area. The Panel thus concluded that a failure to enforce through a sustained or recurring course of action or inaction is ‘in a manner affecting trade’ only if it ‘confers some competitive advantage on an employer or employers engaged in trade between the Parties’ (para 190).

Thirdly, the Panel explains the link between the ‘failure to enforce’ and the ‘effect on trade’ in the following three steps:

- first, a failure to effectively enforce labour laws ‘may affect costs, risks or potential liabilities associated with production processes’;

- second, relieving an employer of such costs or risks ‘could provide a competitive advantage to such employer’ (for example, enabling the employer or employers in question to make economic gains at the expense of employers who are in compliance with the law and in turn incentivising other employers not to respect the rights in question, weakening their protection by law) (para 173);
- lastly, these competitive advantages could in turn affect conditions of competition in international trade (ie, affect international trade) as long as the ‘advantaged’ employer or employers are engaged in export or competing with imports (para. 174).

In other words, according to the Panel a failure to effectively enforce labour laws may reduce an employer’s costs or risks, which in turn could provide a competitive advantage to such an employer, which in turn could affect conditions of competition in international trade, if the employer is engaged in export or competing with imports.

(ii) Addressing the disputing parties’ arguments: ‘relatively narrow’ v ‘relatively broad’ interpretation

Based on this interpretation, the Panel, first of all, rejected the ‘relatively narrow’ interpretation advanced by Guatemala. According to the Panel, limiting the ambit of Article 16.2.1(a) to failures that produced effects on prices or quantities sold in international trade, as argued by Guatemala, would exclude certain failures to enforce in a way that would not be consistent with the Agreement’s objectives and would often make proof of trade effects practically impossible (para 176).<sup>1</sup> Second, the Panel also rejected the ‘relatively broad’ interpretation advanced by the United States, that had relied on the interpretation of the term ‘affecting’ in the context of the GATT and GATS. In that context, the WTO Appellate Body has interpreted the term ‘affecting’ (in Article III:4 GATT and Article I:1 GATS) to include measures that might ‘adversely affect’ or ‘bear upon’ conditions of competition between domestic and imported products/services. However, in the view of the US-Guatemala Panel, the function of the relevant term in Article III:4 GATT and Article I:1 GATS is ‘significantly different’ from the function of the same term in Article 16.2.1(a) CAFTA-DR: in the former, the term ‘affecting’ assists in defying the types of measure that fall within the scope of the national treatment obligation (or the GATS), whereas in the latter, the relevant term is used in a phrase that forms an essential part of the obligation itself (paras 185–186).

(iii) The ‘in a manner affecting trade’ test: ‘actual’ v ‘potential’ effects?

Turning to the question of what must be shown by a complaining Party to establish that a failure to effectively enforce labour laws ‘confers a competitive advantage on

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1. ‘If a Party, for example, fails to effectively enforce its labor laws in a way that lowers cost structures of firms operating within its territory, and competing firms in other CAFTA-DR countries respond by lowering wages sufficiently to maintain their market share, there may be no obvious effects on trade flows, and yet the conduct would have affected trade’ (para 179).

a participant or participants in trade between the Parties and thus is in a manner affecting trade’, the Panel’s analysis seems (eventually) to point to the need for the complainant to show actual effects. First, the Panel’s acknowledgement that the question whether any given failure to effectively enforce labour laws affects conditions of competition by creating a competitive advantage is ‘a question of fact’ (para 192) seems to point to the need to show actual rather than potential effects. Second, the requirement to show actual effects appears implicit in the Panel’s statement that ‘we need only determine that a competitive advantage has accrued to a relevant employer to find that there is an effect on conditions of competition’ (paras 192–195). Even if only with regard to one relevant employer, the Panel seems to imply that an actual effect on the conditions of competition needs to be demonstrated.

In a later section, the Panel confirms its emphasis on actual effects when, in order to determine whether a failure to effectively enforce is ‘in a manner affecting trade’, the Panel sets out the following three-part test:

- whether at the relevant time the enterprises in question exported to one or more of the CAFTA-DR Parties in a competitive market or competed with imports from one or more of the CAFTA-DR Parties;
- what effects, if any, failures to effectively enforce labor laws had on any of those enterprises; and
- whether these effects are sufficient to confer some competitive advantage on such an enterprise or such enterprises. (para 449)

The use of the past tense (‘exported’ and ‘had’) seems to indicate that the Panel requires a complaining Party to prove that (a) the enterprise in question has *actually* been involved in trade and (b) the failure to effectively enforce labour standards has *actually* conferred some competitive advantage on such an enterprise. In other words, the Panel seems to focus on ‘actual’ effect, rather than just ‘potential’ effect.

However, all these elements are simply *indicia* of the purported (strict) test as the Panel does not expressly state that actual effects are indeed required or that potential effects are not sufficient. In fact, one can even find a potentially contradictory element in the Panel’s reasoning when the Panel appears to soften the test being formulated by lowering the standard of proof. The Panel states that (i) ‘for a given set of facts, competitive advantage may be inferred on the basis of likely consequences of a failure or of failures to effectively enforce labour laws, or other aspects of the totality of the circumstances’ (para 194), and (ii) that proving competitive advantage does not require proof of cost or other effects ‘with any particular degree of precision’ (para 195).

In conclusion, while the US-Guatemala Panel’s interpretation of the phrase ‘in a manner affecting trade’ seems to imply the need to show *actual* effects on the conditions of competition in international trade, the Panel does not conclusively clarify this issue at this stage.

### 1.3 The Panel's application of the 'in a manner affecting trade' test

Moving from the Panel's *interpretation* of the phrase 'in a manner affecting trade' to its *application* to the specific case at hand, the US-Guatemala Panel does appear to confirm that the claimant needs to show that the respondent's failure to enforce its labour laws has had actual effects on the conditions of competition in international trade.

Having concluded that Guatemala had failed to 'effectively enforce its labour laws' with respect to 74 workers at eight worksites,<sup>2</sup> the Panel then tackled the relevant question of whether these failures were 'in a manner affecting trade'. While the Panel's analysis involved several companies in three different sectors (shipping, garment manufacturing and rubber plantation), the Panel concluded that the United States had indeed managed to prove that Guatemala's failures to effectively enforce labour laws were 'in a manner affecting trade' only with regard to one garment manufacturer (Avandia). The Panel eventually found that Article 16.2.1(a) had not been breached, on the ground that the only failure to effectively enforce labour laws that *did* affect trade was not enough to meet the additional requirement imposed by Article 16.2.1(a) that such a failure be 'through a sustained or recurring course of action or inaction' (para 505).

However, in order to better understand the nature of the 'in a manner affecting trade' test, it is useful to focus on the Panel's application of the test with regard to all three garment manufacturers considered by the Panel (Fribo, Alianza, Avandia).

Applying the three-part test advanced above to the three garment manufacturers, the Panel first of all quickly found that the employers in question were indeed engaged in CAFTA-DR trade at the relevant time (para 468). With regard to the other two components of the test – whether the failures to effectively enforce labour laws had any effect on those enterprises and whether such effects were of sufficient scale and duration to confer a competitive advantage on them – the Panel reached different conclusions depending on two sets of costs at issue. The United States had argued that failure to effectively enforce labour laws with regard to the employers at issue had meant that such employers had avoided both (a) costs associated with paying wages owed to workers who had not been reinstated and with paying fines imposed to sanction unlawful dismissals ('compensation and sanction costs'), and (b) costs linked with workers' ability to advocate for better pay and working conditions through the formation of a union ('unionisation costs').

With regard to compensation and sanction costs, while the Panel found that there was evidence establishing that each of the three employers avoided these costs, it could not conclude that the failure to ensure the payment of such compensation

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2. The Panel found that Guatemala had failed to compel compliance with court orders to reinstate and compensate workers who had been unlawfully dismissed in the context of union organising activities and also to impose sanctions for such unlawful dismissals (para 428).

and penalties in itself conferred a competitive advantage on the garment manufacturers. The Panel found that there was ‘no evidence’ with regard to ‘the total amounts owed to the workers’ and to ‘the significance of those amounts in relation to the overall labour costs of each firm’ (para 471).

With regard to the unionisation costs, the Panel found that the failure to enforce orders remedying reprisals against union leaders *did* confer some competitive advantage to one of the three employers (Avandia), even if there was ‘no direct evidence’ of the impacts that the dismissals of the entire provisional executive committee of a union in formation had on workers’ attempts to form a union and bargain collectively (para 487). While the Panel reiterated that a complainant will generally be required to introduce evidence of the extent and duration of effects of the failure to effectively enforce labour laws protecting the right to organise or the right to bargain collectively (para 485),<sup>3</sup> the Panel also reiterated its willingness to soften the complainant’s evidentiary standard in certain cases. The Panel noted that there may be circumstances in which ‘the consequences of a failure to remedy serious violations would be so evident on the face of the failure that further proof would not be necessary, and a Panel could conclude that the failure was in a manner affecting trade’. Based on the circumstances surrounding the failure to enforce the court orders against Avandia, the Panel was prepared to conclude that such failure ‘necessarily conferred some competitive advantage to Avandia by effectively removing the risk that Avandia’s employees would organize or bargain collectively for a substantial period of time’ (para 487).

On the other hand, the Panel concluded that there was insufficient evidence to prove that (a) the failures to effectively enforce court orders against the other two employers (Fribo and Alianza) conferred some competitive advantage on them,<sup>4</sup> and (b) the failures with regard to all three garment manufacturers incentivised others to violate the relevant labour provisions (para 490). These further conclusions eventually led the Panel to find that Article 16.2.1(a) had *not* been breached as the only failure to effectively enforce labour laws that did affect trade (with regard to Avandia) was not enough to meet the additional requirement imposed by Article 16.2.1(a) that such failure was ‘through a sustained or recurring course of action or inaction’ (para 505).

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3. The Panel recognised, in principle, ‘the possibility that a failure to enforce laws against retaliatory dismissals can place an employer at liberty to use effective intimidation tactics’, and that this will in turn ‘provide such an employer with a competitive advantage by substantially lowering the risk of unionization within its facilities on an ongoing basis’ (para 483). However, according to the Panel, ‘this does not mean that such consequences necessarily will flow each and every time there is a failure to effectively enforce labor laws in relation to freedom of association and the right to bargain collectively. Whether such a failure substantially impairs the ability of an employer’s workforce to exercise such rights is a question of fact to be determined in light of the circumstances of each case. Factual circumstances such as the number of workers dismissed, the timing of their dismissal, whether union leaders were dismissed, and the length of time that failure to enforce legal remedies persists may contribute to the likelihood of the failure to enforce necessarily leading to the hypothesized consequences’ (para 484).
  4. ‘The Panel cannot conclude, without more information, that the delay in enforcing reinstatement orders against Fribo and the failure to enforce payment orders in favor of seven workers necessarily substantially impaired the capacity of its workforce to organize and bargain collectively’ (para 488).



## **2. Why the US-Guatemala Panel's interpretation of 'in a manner affecting trade' is unconvincing**

The Panel's interpretation of the 'in a manner affecting trade' language as requiring that complaining Party establish that (1) the enterprise(s) in question has *actually* been involved in trade among the FTA Parties and (2) the failure to effectively enforce labour laws has *actually* conferred some competitive advantage on such enterprise(s) is not convincing because the Panel fails to offer any cogent reason to support its conclusion.

### **2.1 The ordinary meaning does not support the imposition of an 'actual' trade effect condition**

The reasons advanced by the Panel to support its textual interpretation of the relevant phrase do not really offer a solid justification for requiring 'actual' trade effects. First, the ordinary (ie dictionary) meaning of the term 'affecting', which is 'having an effect on' or 'making a difference to', appears to leave open the question of whether the existence of *actual effects on one or more employer(s)* is indeed a necessary condition. The phrase 'in a manner affecting trade between the Parties' neither specifies that the effects (of the failure to effectively enforce labour laws) should have actually materialised nor refers to an effect on any individual employer.

Similarly, the Panel's rejection of an interpretation of the 'in a manner affecting trade' phrase that is equivalent to 'trade-related' (ie it occurred in a traded sector, or with respect to an enterprise engaged in trade) does not on its own justify reading 'affecting' as 'having had *actual* effects on an individual employer', either.

Furthermore, the Panel's rejection of an interpretation based on the 'trade-related' language shows the Panel's heavy reliance on the 'plain meaning' of the term 'affecting', without taking into account other contextual elements. For example, while the Panel pointed to the NAALC choice of 'trade-related' (to show that the CAFTA-DR parties could have 'easily' used that language, if they had wanted to), the Panel did not seem to consider the relevance of the history of labour obligations in trade agreements and particularly the role that the NAALC and the United States had played as part of that history. As noted above, the NAALC was the first attempt to link labour disciplines in a trade agreement and since then many other trade agreements have included similar disciplines. What is interesting is that the evolution over the past thirty years has been principally to extend those disciplines (for example, by including more references to international labour conventions) and to make them more effective (for example, through binding provisions and

greater availability of enforcement mechanisms). Based on this history and evolution, the US-Guatemala Panel could have inquired whether the CAFTA-DR Parties had actually meant to impose a (more demanding) condition on the obligation to effectively enforce their labour laws compared with the condition imposed by the NAALC.

It is moreover interesting that, following the US-Guatemala Panel report, the United States, Mexico and Canada have actually clarified the term ‘in a manner affecting trade’ in the new chapter on Labour of the United States-Mexico-Canada Agreement (USMCA), which modernises the old NAFTA. Footnote 11 in Article 23.5.1 states as follows:

For greater certainty, a ‘course of action or inaction’ is ‘in a manner affecting trade or investment between the Parties’ if the course involves: (i) a person or industry that produces a good or supplies a service traded between the Parties or has an investment in the territory of the Party that has failed to comply with this obligation; or (ii) a person or industry that produces a good or supplies a service that competes in the territory of a Party with a good or a service of another Party.<sup>5</sup>

This definition appears to be very similar to the ‘trade-related’ language that the US-Guatemala Panel had quickly rejected and it thus represents a plausible interpretation of the phrase ‘in a manner affecting trade’ (see below section 3).

## **2.2 CAFTA-DR’s object and purpose do not support the imposition of an ‘actual’ trade effect condition**

As noted above, the Panel found that CAFTA-DR’s relevant objectives include (i) the enforcement of basic worker rights, (ii) building on their respective international commitments in labour matters, and (iii) promoting conditions of fair competition in the free trade area. However, none of them appears to support an interpretation of ‘in a manner affecting trade’ as requiring ‘actual trade effects’.

First of all, in its interpretation of the phrase ‘in a manner affecting trade’, the Panel relies heavily on the objective of promoting conditions of fair competition. However, the Panel’s interpretation of ‘affecting trade’ as meaning ‘affecting conditions of competition in international trade’ does not seem to require *per se* showing that a competitive advantage has *actually* been conferred on an *individual employer*. A failure to effectively enforce labour laws that has only the *potential* to modify the conditions of competition in the free trade area should be sufficient. This is what the United States had in fact argued for: in order to determine whether a failure to effectively enforce labour laws influences conditions of competition within and among the CAFTA-DR Parties, there is no need to carry

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5. Footnote 12 moreover clarifies that ‘[f]or purposes of dispute settlement, a panel shall presume that a failure is in a manner affecting trade or investment between the Parties, unless the responding Party demonstrates otherwise’.

out an econometric (ie empirical or quantitative) analysis of the effects on trade of such a failure. However, the Panel rejected the United States' argument and required instead *actual* effects.

The only justification advanced by the Panel to require *actual* effects on the conditions of competition in international trade appears to be the rejection of the relevance of the broad interpretation of 'affecting' given in the context of the GATT and GATS, as argued by the United States. As noted above, the Panel judged that relevance to be 'misplaced' because the function of the relevant term in Article III:4 GATT and Article I:1 GATS is 'significantly different' from the function of that same term in Article 16.2.1(a) CAFTA-DR. The Panel reasoned that, in the former two provisions, the term 'affecting' assists in defying the scope of the national treatment obligation and the GATS, respectively, whereas in the latter, the relevant term is used in a phrase that forms an essential part of the obligation itself. The Panel, however, fails to explain why the alleged different function justifies a different interpretation of the same phrase. It is submitted that whether a certain phrase (such as 'affecting trade') assists in defying the subject-matter scope of an obligation (or an agreement) or is used instead as an essential part of the obligation itself, should *not* be the basis for a different interpretation of that phrase, unless other contextual elements justify such difference. To follow the Panel's reasoning would lead to the conclusion that a broad interpretation is appropriate when it comes to the 'scope of application' of an obligation, while it would not be appropriate with regard to an essential part of the obligation itself. Such a conclusion would need to be explained and justified, which however, the Panel does not do.

Moreover, drawing a line between what defines the subject matter scope of an obligation (or an agreement) and what defines the content of an obligation is not always easy. Imagine that Article 16.2.1(a) had been drafted as follows: 'Any Party's failure to effectively enforce its labour laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties is prohibited.' In this version of the non-enforcement obligation, is 'in a manner affecting trade' part of the obligation's normative content or scope of application?

More fundamentally, the Panel seems to miss the implication of interpreting the phrase 'affecting trade' on the basis of the CAFTA-DR objective of promoting conditions of fair competition in the free trade area to mean 'affecting conditions of competition in international trade'. Conditions of competition in international trade may be affected by a particular governmental conduct even if there is no actual trade at the time of the conduct itself. Accordingly, while a failure to effectively enforce labour laws that has an 'actual impact' on trade will fall under the notion of a failure 'affecting trade', the same should be said for a failure to effectively enforce labour laws that only has a 'potential', that is 'future', impact on trade. Protecting 'conditions of competition' in international trade is not aimed simply at protecting existing trade flows, but also includes potential trade

flows.<sup>6</sup> Accordingly, in the context of Article 16.2.1(a) CAFTA-DR, in which, as correctly stated by the Panel, a relevant treaty objective includes the promotion of conditions of fair competition in the free trade area, the interpretation of ‘in a manner affecting trade’ should ensure that any failure to effectively enforce labour laws is prohibited when such failures have either an actual (ie past) or potential (ie future) impact on the conditions of fair competition of trade (in goods or services) among CAFTA-DR parties.

Second, the Panel’s interpretation of ‘in a manner affecting trade’ that requires actual effects on specific employers also appears to go against the other relevant objective of CAFTA-DR, namely ‘enforcing basic worker rights’. As an instrument for enforcing basic workers’ rights, Article 16.2.1(a) should be seen principally as addressing ‘failures to effectively enforce labour laws’. That is the key object of the provision under review. The provision does limit the prohibition through the reference to ‘a sustained or recurring course of action or inaction’ and ‘in a manner affecting trade between the Parties’; however, a narrow interpretation of those two phrases may excessively limit the key objective of addressing failures to effectively enforce labour laws. Conversely, an interpretation of the phrase ‘in a manner affecting trade’ that includes both actual and potential impact on trade between CAFTA-DR Parties would also be in line with the additional, key objective of enforcing basic labour rights.

### **2.3 The Panel’s application of the ‘trade link’ requirement remains ambivalent**

Lastly, it may be worth noting that the US-Guatemala Panel itself seems to acknowledge the problematic implications of its emphasis on ‘actual’ effects by softening the evidentiary standard that its emphasis on ‘actual effect on individual employer engaged in CAFTA-DR trade’ would otherwise require. As noted above, the Panel admits that there may be circumstances in which ‘the consequences of a failure to remedy serious violations would be so evident on the face of the failure that further proof would not be necessary, and a Panel could conclude that the failure was in a manner affecting trade’. The softening of the standard of proof clearly makes a claim based on a failure to enforce labour laws easier. Unsurprisingly, the only instance in which the Panel applied such evidentiary softening (with regard to Avandia, a garment manufacturer) was the only instance in which the Panel found that the failures to effectively enforce labour laws were indeed ‘in a manner affecting trade’.<sup>7</sup>

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6. In the context of Article III GATT, the broad reading of the term ‘affecting’ is linked to the drafters’ intent to provide ‘equal conditions of competition’ to domestic and imported products and thus includes the protection of ‘competitive opportunities’ for imported products rather than existing ‘trade flows’. ‘[I]t is well established that WTO rules protect competitive opportunities, not trade flows’. Appellate Body, *US–Tuna*, WT/DS381/AB/R, 16 May 2012, para 239.

7. The United States’ claim nevertheless failed because the Panel found that there was no sustained course of action, as there was only *one* failure to effectively enforce labour laws in a manner affecting trade.

More fundamentally, it is not clear what such softening would entail. If there is no evidence showing that certain failures to enforce labour laws have *actually* conferred some competitive advantage on an enterprise, would a panel be able to rely on certain assumptions similar to those permitted to show *potential* effects? For example, the failure to enforce court orders to reinstate union members may be seen as *necessarily* providing a competitive advantage for the employer who is not abiding by such reinstatement orders simply by assuming that such failure would in principle avoid certain ‘unionisation costs’, which in turn would affect conditions of competition in international trade (whether existing or future trade). Ultimately, is such softening of the standard of proof capable of de facto transforming the required ‘actual’ effect test into a ‘potential’ effect test for the purposes of a claim under Article 16.2.1(a) CAFTA-DR? As these questions remain unanswered in the US-Guatemala Panel report, the Panel’s approach with regard to the meaning of the ‘in a manner affecting trade’ requirement remains somewhat ambivalent.

### **3. Trade (and investment) linkages in labour obligations: where do we go from here?**

It is difficult to assess what impact the US-Guatemala panel report is going to have on how similar provisions will be interpreted in future disputes (or, for that matter, clarified in future trade agreements). Formally speaking, the US-Guatemala decision does not constitute a binding precedent for future dispute settlement panels, whether interpreting the same language in Article 16.2.1(a) CAFTA-DR or similarly worded provisions in other FTAs, as there is no rule of *stare decisis* (or binding precedent) in international law (Acquaviva and Pocar 2012). It will, however, have the potential of representing a persuasive precedent which (at least one of) the disputing parties may rely on and which the adjudicator may in turn need at least to consider (Guillaume 2011; Bhala 1999). Accordingly, the potential impact of the US-Guatemala panel report will depend on the perceived strength of its underlying reasoning.

Moreover, while the future relevance of the US-Guatemala panel report may also rely on adjudicators' general unwillingness to expressly overrule or contradict past decisions, various judicial techniques exist that make it possible to move past an 'uncomfortable' precedent without expressly acknowledging the conflict. Aside from ignoring it altogether, adjudicators can clarify or reinterpret what the past decision stands for; they can also supplement the earlier decision or distinguish it (Hanna 1957: 371).<sup>8</sup> Future adjudicators enjoy plenty of leeway in interpreting the same or similar language linking trade with labour law that was at issue in the US-Guatemala dispute. The following sections highlight (i) how future dispute settlement panels should approach these linkages, particularly focusing on the lessons learned from the US-Guatemala decision (sections 3.1–3.3), and (ii) how policymakers have reacted to the US-Guatemala decision, focusing on the USCMA (section 3.4).

#### **3.1 'In a manner affecting trade or investment'**

It is submitted that the interpretation of the phrase 'in a manner affecting trade' in other labour (or sustainable development) chapters of FTAs should focus, as in the US-Guatemala panel report, on the effect that the respondent's conduct under review has on the *conditions of competition in international trade* rather than on trade flows. However, the US-Guatemala panel's apparent reliance on 'actual'

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8. For an example of 'distinguishing' involving the US-Guatemala panel report see the recent Report of the Panel of Experts pursuant to the EU-Korea FTA, 20 January 2021, paras 90–93.

effects should be rejected in favour of allowing both *actual* and *potential* effect on the conditions of competition in international trade.

This broader interpretation is in line in particular with the ordinary meaning of the relevant phrase and the object and purpose of the labour disciplines in trade agreements. As noted above, the term ‘affecting’ (or ‘having an effect on’) does not limit the relevant effect to ‘actual’ effects and thus the term could be interpreted to include ‘potential’ effects, too.

The object and purpose of the trade agreement is then key to interpreting the phrase ‘affecting trade’. The US-Guatemala panel was correct in identifying multiple relevant objectives, in particular the ‘enforcement of basic worker rights’ and the ‘promotion of fair competition in the free trade area’. These two objectives are central to understanding the labour disciplines included in many trade agreements (including CAFTA-DR) concluded over the past thirty years and thus they play an important role in interpreting a phrase such as ‘in a manner affecting trade’. Accordingly, ‘affecting trade’ should be interpreted as affecting the conditions of competition in international trade (rather than affecting trade flows), and an effect on conditions of competition should include both actual and potential effects (rather than just actual effects). As noted above, a narrow interpretation (focusing on either trade flows or actual effects on trade only) would undermine the two key objectives of promoting fair competition in the free trade area and enforcing basic worker rights.<sup>9</sup>

An interpretation that focuses on the (actual or potential) impact on the conditions of competition would be valid independently of the specific labour provision to which it is applied. For example, in addition to other non-enforcement provisions similar to Article 16.2.1(a) CAFTA-DR (such as Article 13.7.1 EU-Korea FTA), it would also apply to non-derogation provisions requiring a party not to waive or derogate from its labour laws and regulations ‘in a manner affecting trade’ (such as Article 13.7.2 EU-Korea FTA) (Mitchell and Munro 2019: 686).

What would a complaining party have to prove in order to establish that, for example, a ‘derogation from’ or ‘failure to enforce’ its labour laws has an effect on the conditions of competition in international trade? There appear to be two key elements in applying the ‘actual or potential effect on conditions of competition’ test identified above. First, a complaining party would need to establish that either a derogation from its labour laws or a failure to enforce (through a sustained or recurrent course of action or inaction) such laws has modified the conditions

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9. This conclusion may be strengthened if the parties to the applicable trade agreement have put greater emphasis on the protection and promotion of labour rights. See the Report of the Panel of Experts EU-Korea FTA 2021, para 93: ‘Even if the matters raised before the CAFTA-DR Panel were identical to those in the EU’s Panel Request, the Panel notes that there are important differences between the texts of the CAFTA-DR Agreement and the EU-Korea FTA which would require careful examination. Most notably, the CAFTA-DR Agreement’s Chapter 16, which contains the provision upon which the United States of America made its complaint against Guatemala, does not have the same contextual setting of sustainable development as the EU-Korea FTA, nor does it refer to the range of multilateral and international agreements and declarations which the Parties have included in the EU-Korea FTA.’

of competition, for example, by reducing the costs of the domestic producers or service providers. For example, in the US-Guatemala dispute, the United States had argued that it had demonstrated such modification of the conditions of competition by showing, for example, that Guatemala’s failure to compel compliance with court orders for reinstatement had permitted Guatemalan employers to evade the payment of back wages, economic benefits and fines ordered by the domestic labour courts. The focus should be on the conduct under review (ie the derogation from, or failure to enforce, labour laws) and its ability to affect the conditions of competition.

Second, a complaining party would also need to show that a derogation from, or failure to enforce, labour laws has modified the conditions of competition on *international trade*. If the employer (benefitting from the derogation or failure to enforce labour laws) produces goods or provides services that are exported abroad or that compete with imports, such a second requirement would easily be met.<sup>10</sup> This would arguably also include the case of products and services that are components of products and services that are actually traded as the alleged derogation and failure to enforce labour laws with regard to the components may affect the entire supply chain. Furthermore, it is argued that a derogation from, or failure to enforce, labour laws can also modify the conditions of competition on international trade *even if* the products or services affected have *not* yet been traded (as imports or exports), as long as those products or services could be lawfully traded. For example, a derogation from or failure to enforce labour laws may ‘affect trade’ simply by (contributing to) preventing the importation of a competing product or service from abroad.

### **3.2 ‘To encourage trade or investment’**

In certain trade agreements, labour disciplines employ different terminology in linking trade (and investment) with specific labour obligations, such as non-derogation and non-enforcement provisions. As noted in the introduction, Article 24.5 EU-Canada CETA links the parties’ obligation not to derogate from, or fail to effectively enforce, their labour laws with the encouragement of trade or investment. For example, Article 24.5.3 EU-Canada CETA reads as follows:

A Party shall not, through a sustained or recurring course of action or inaction, fail to effectively enforce its environmental law to encourage trade or investment.

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10. As noted above, this is the definition of ‘in a manner affecting trade’ that has recently been included in the USMCA: ‘For greater certainty, a failure is “in a manner affecting trade or investment between the Parties” if it involves: (i) a person or industry that produces a good or supplies a service traded between the Parties or has an investment in the territory of the Party that has failed to comply with this obligation; or (ii) a person or industry that produces a good or supplies a service that competes in the territory of a Party with a good or a service of another Party.’



The origin of this language appears to be the environmental non-derogation clause contained in the investment chapter of NAFTA.<sup>11</sup> The aim was to address so-called ‘incentives competition’ and avoid a possible ‘race-to-the-bottom’ by prohibiting a host State from derogating its environmental laws for purposes of attracting a specific foreign investor (UNCTAD 2003). The phrase ‘to encourage’ (or ‘as an encouragement’) can now be found in labour (or sustainable development) chapters as a substitute for the ‘in a manner affecting’ language (see, for example, the 2019 EU-Mercosur and the 2018 EU-Mexico FTAs, both agreed in principle).

Some commentators have suggested that ‘encouraging’ is narrower than ‘affecting’ (Mitchell and Munro 2019: 686) and that it appears to require an ‘intent’ to affect trade (Bronckers and Gruni 2019: 1597). According to Mitchell and Munro, the prepositions ‘to’ and ‘as’ suggest that, in order to fall within the scope of the labour obligation (ie non-derogation provision), the derogation from labour laws ‘must be the mechanism through which the “encouragement” is given effect’ (Mitchell and Munro 2019: 680). In other words, the ‘purpose’ or ‘intention’ of the derogation must be the encouragement of trade (or investment).<sup>12</sup>

It is submitted that future adjudicators should interpret the ‘to encourage trade’ language in light of the US-Guatemala panel report and the ensuing discussion regarding labour (and environmental) disciplines in trade agreements. For example, interpreting the ‘to encourage trade’ phrase as imposing a requirement on the complaining party to establish the responding party’s *subjective intention* linking the derogation from, or failure to enforce, labour laws with the encouragement of trade (or investment) should be rejected as too restrictive and not in line with the relevant object and purpose of the trade agreement. A more convincing alternative interpretation would be to focus instead on whether the derogation or failure to enforce *is capable of* encouraging trade (or investment). The analysis should thus focus on the *potential* of the conduct under review (ie a derogation or failure to enforce labour laws) to encourage trade rather than on the Party’s intent to do so. In this sense, Bartels has pointed to the WTO Appellate Body’s reliance on ‘objective intention’ in order to interpret the phrase ‘so as to afford protection’ in the context of Article III GATT (Bartels 2017: 206), which involves an ‘objective analysis of the structure and application of the measure’ rather than ‘the many reasons legislators or regulators often have for what they do’ (Appellate Body Report *Japan Alcoholic Beverages II* pp 27 and 29).

Accordingly, a determination of whether a derogation from, or failure to effectively enforce, labour laws is ‘to encourage trade or investment’ will involve an examination not dissimilar to the one based on ‘in a manner affecting’, as

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11. ‘[...] a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. [...]’ see Article 1114(2).
  12. Mitchell and Munro refer to a decision of the WTO Appellate Body stating that ‘[t]he word “to” in adverbial relation with the infinitive verb “protect” indicates a purpose or intention. Thus, it establishes a required link between the measure and the protected interest.’ Appellate Body Report, *Australia – Measures Affecting the Importation of Apples from New Zealand*, para 172, WTO Doc. WT/DS367/AB/R (29 November 2010).

suggested above: the adjudicator’s key question would be whether the derogation or failure has the *potential* to encourage exports or inward foreign investments by, for example, reducing the costs of manufacturers or service providers (operating in the territory of the responding party) and thus affecting the conditions of competition on trade or investment.

### **3.3 ‘Material impacts on trade or investment ... arising as a result of significant divergences’ in the EU-UK TCA**

While the discussion linked with the US-Guatemala panel report can certainly be instructive in the interpretation of other relevant linkages between labour and trade – as, for example, in the novel ‘rebalancing’ provision of the EU-UK TCA (Article 411 or 9.4) – future adjudicators should also be mindful of any relevant textual and contextual differences.

The rebalancing provision in the EU-UK TCA requires that a significant divergence in labour laws has ‘material impacts on trade or investment’. It is submitted that, similar to the linkage clauses in the more traditional labour disciplines examined above, the rebalancing provision in the EU-UK TCA focuses on whether a significant divergence in labour laws has an impact *on the conditions of competition* on trade or investment between the two parties. However, different from the linkage clauses in more traditional labour disciplines, the rebalancing provision in the EU-UK TCA specifies that the impact be ‘material’ (that is, ‘significant’), and that it be ‘based on reliable evidence and not merely on conjecture or remote possibility’ (Article 9.4.2 EU-UK TCA). These two additional requirements seem to impose a higher threshold for establishing the required link between ‘impact on trade or investment’ and ‘regulatory divergence’ compared with the ‘affecting’ or ‘encouraging’ language examined above. However, it is submitted that the nature of the analysis is not fundamentally different. Even the express reference to ‘reliable evidence’ and rejection of ‘conjecture’ do not appear to exclude reliance on the *potential* impact on trade or investment stemming from such regulatory divergence.

### **3.4 Policymakers’ options going forward: two examples from USMCA**

The recent NAFTA update, the USMCA, provides an interesting case study of how policymakers may react to the US-Guatemala decision or more broadly to the challenges of labour disciplines in trade agreements. The section focuses on (i) the clarification of the phrase ‘in a manner affecting trade’ and (ii) the introduction of the labour value content (LVC) rule for automotive trade.

- (i) Clarification of the phrase ‘in a manner affecting trade’

As noted above, following the US-Guatemala Panel report, the United States, Mexico and Canada have clarified the term ‘in a manner affecting trade’ in the USMCA non-enforcement provision with the addition, in a footnote, of the following language:

For greater certainty, a ‘course of action or inaction’ is ‘in a manner affecting trade or investment between the Parties’ if the course involves: (i) a person or industry that produces a good or supplies a service traded between the Parties or has an investment in the territory of the Party that has failed to comply with this obligation; or (ii) a person or industry that produces a good or supplies a service that competes in the territory of a Party with a good or a service of another Party. (Article 23.5.1 footnote 11)<sup>13</sup>

The new USMCA language clearly challenges the strict interpretation given to ‘in a manner affecting trade’ by the US-Guatemala panel (Zandvliet 2019: 221), and appears to adopt a broader understanding of the required linkage between the responding party’s conduct (ie the failure to effectively enforce labour laws) and trade between the parties. In particular, the choice of the verb ‘to involve’ seems to exclude the need to demonstrate an actual impact on trade (as required by the US-Guatemala panel), and to point instead to conduct that may more simply ‘concern’ or ‘relate to’ trade. Furthermore, the new language also clarifies the meaning of ‘trade between the parties’ by specifying that the relevant conduct under review involves ‘a person or industry producing a good or supplying a service that is traded between the Parties’ or is ‘in competition with a good or service of another Party’.

While not altogether clear, a reading of the new language does not seem to require that the employer benefitting from the responding party’s failure to effectively enforce its labour laws be directly involved in international trade. However, a failure to enforce labour laws taking place along the supply chain (whether upstream or downstream) could be said to be indirectly involving a person or industry producing a good or supplying a service that is traded or in competition with a good/service of another party.

The USMCA also makes it easier for the complaining party to satisfy the trade linkage requirement by establishing a presumption in favour of an effect on trade in the following terms:

For purposes of dispute settlement, a panel shall presume that a failure is in a manner affecting trade or investment between the Parties, unless the responding Party demonstrates otherwise. (Article 23.5.1 footnote 12)

(ii) The labour value content rule

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**13.** Same clarification has also been added in other labour obligations in USMCA, such as the non-derogation provision in Art 23.4.

The new labour value content (LVC) rule introduced by USMCA provides a second interesting example of possible reactions to the frustration, following the US-Guatemala decision, of ensuring the protection of labour rights and fair competition through traditional labour disciplines in trade agreements. The new LVC rule basically requires that, in order to enjoy the preferential tariff treatment of the USMCA (zero tariff), a minimum of 40 per cent of the value of a vehicle's content must be produced by workers earning at least US\$16 per hour. In other words, the new LVC rule is a 'rule of origin' based on a non-product-related (NPR) process and production method (PPM) (see further Conrad 2011).

In theory, the new LVC rule will either push wages up in the automotive sector (particularly in Mexico, where the current average wage in manufacturing appears to be one-third of the US\$16 per hour rate set in USMCA) or increase demand for automotive parts produced in USMCA parties with already high wages (like the United States). While the actual impact of the new rule of origin for the automotive sector remains unclear, it seems that, from the perspective of the 'protection of labour rights' and the 'improvement of working conditions' (see USMCA preamble), the impact is, even in the best case scenario, limited in important ways. Besides the fact that the new LVC rule applies only to the automotive sector, the rule has an inherently strong trade linkage feature as it functions only as a condition for preferential tariff treatment. In other words, the LVC rule will push up automotive workers' wages only to the extent that the relevant vehicle is exported and the preferential tariff treatment (for example, US MFN tariff for passenger cars is 2.5 per cent ad valorem) outweighs the higher costs of production.

## Conclusions

The US-Guatemala panel report clearly highlights the importance of the trade and labour linkage in trade agreements. Specifically, many (but not all) of the labour obligations included in trade agreements are subject to a more or less specific trade linkage requirement. Such a trade linkage requirement seems to be justified on the basis that labour disciplines in trade agreements respond to two distinct objectives, the protection of labour rights and the protection of fair competition between the contracting parties. Furthermore, the language used to capture the trade linkage requirement often lacks precision (and differs from provision to provision and from trade agreement to trade agreement) and thus will need to be interpreted by a dispute settlement panel in case a dispute arises. As the US-Guatemala dispute shows, the interpretation of the specific trade linkage requirement may play a crucial role in enforcing labour disciplines in trade agreements. In the paper, it has been submitted that, while the US-Guatemala decision was correct in focusing its analysis under ‘in a manner affecting trade’ on the impact of the respondent’s conduct on the *conditions of competition in international trade*, it erred in apparently excluding from the linkage analysis the conduct’s potential impact on those conditions.

Looking forward, this paper has also argued that future dispute settlement panels should interpret similar linkage clauses by focusing on the actual or potential impact of the respondent’s conduct on the conditions of competition in trade or investment. However, policymakers should consider two options. The first option is to clarify the meaning of the trade linkage, as the United States, Mexico and Canada have attempted to do in the context of the USMCA. The clarification could of course go in different directions, either tightening or loosening the link. The second option is to eliminate any specific trade linkage for labour obligations in trade agreements, thus strengthening such disciplines. As confirmed by the Panel of Experts in the EU-Korea FTA, there already exist labour provisions in trade agreements that do not require such a link (this is in particular the case of those provisions requiring that the contracting parties implement certain multilateral labour obligations, such as Article 13.4 EU-Korea FTA or Article 23.3 EU-Canada CETA). If the parallel demands for more labour rights protection and fair competition among countries continue to grow, one should not be surprised if future trade agreements will increasingly adopt the latter option.

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