GLU Global Labour Column
UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG
column.global-labour-university.org | Number 327, December 2019

The Labour Value Content clause in the US-Mexico Canada trade agreement: a boon to workers?

Christoph Scherrer and Emilie Segura

The renegotiation of the North American Free Trade Agreement (NAFTA), initiated by President Donald Trump, bears the hallmark of US corporate interests by further safeguarding intellectual property and the free flow of data, yet also contains a number of rules that could enhance protections for workers in the free trade zone. In addition to tightening the rules of origin, the agreement, still pending ratification, contains an innovative Labor Value Content (LVC) clause. The LVC clause is intended to help increase wages in Mexican production plants, effectively eliminating the incentive to outsource to existing lower-wage markets. In essence, the clause stipulates that a manufacturer may import vehicles duty-free from one USMCA (US-Mexico-Canada) member country to another, but only if wages for a specific percentage of manufacturing average $16 per hour.

This article evaluates the clause against the normative objective of preventing incentives for wage dumping.[1]

Description of the LVC clause

The LVC clause only applies to manufacturers of passenger cars, small trucks and heavy trucks operating in North America. The clause is complex and somewhat ambiguous. It does not prescribe a minimum wage, but rather a minimum average wage for a certain part of the manufacturing costs (USMCA, Chapter 4, Appendix, Article 7). From one to three years after the agreement is ratified, the required LVC components increase incrementally from 30% to 40% for passenger cars (USMCA, paragraph 1 (a) to (d)).

The LVC is the sum of three different calculations. It includes all materials and parts originating from outside or in-house suppliers in North America which pay an average minimum wage of $16 per hour to their production employees (excluding skilled workers' salaries) plus those labour costs in the company's own final assembly where an average of $16 per hour or more is paid, divided by the net manufacturing cost of the vehicle.

If a manufacturer already achieves an LCV of 40% on the basis of this calculation, there is no need for further calculations. If this is not the case, the manufacturer can add wages and salaries for research and development and IT up to 10% of their total wage costs at their North American LVC production facilities. In addition, they can earn five more percentage points to meet the 40% LVC quota if they can demonstrate that they own an engine, transmission or battery plant (or long-term supply contracts) in North America that pays at least $16 per hour on average. These firms are not required to exclusively supply plants whose manufacturing meets LVC certification.

The introduction of the LVC clause can only be understood within the context of the relocation of automobile production from North America to Mexico, which occurred as a result of NAFTA. While almost no new final assembly plants were built in the US and Canada, new plants in Mexico accounted for approximately 20% of North American production in 20182. In 1986, Mexican production accounted for only 2.5% of total North American motor vehicle production. The hourly wages of employees in Mexican automobile production average $7.3 in final assembly and $3.4 in subcontracting in 2017; in the US and Canada, on the other hand, they are over $20.

To our knowledge, no existing study specifically assesses the consequences of this clause as distinct from other provisions of the USMCA.

A study by the US Trade Representative office, without detailing its calculations, concludes that in the five years following implementation, some 76 000 new jobs will have been added to the automotive industry (USTR, 2019). The US International Trade Commission, which operates independently of the Trump administration, draws a less positive conclusion: the USMCA would raise employment rates by just 5.5 % (USITC, 2019: 85-87). The International Monetary Fund assesses the impact of USMCA negatively. Without substantiation, it assumes the LVC clause will result in a short-term 50% wage increase for lower-wage parts-production workers in Mexico, but might fall later as demand for labour decreases due to higher production costs. Wages for unskilled and skilled workers would remain the same in the US (Burfisher et al., 2019: 8, 19).

It can be safely assumed that the LVC clause would affect

[1] The authors thank the Labor Chamber in Vienna (AKWien) for providing financial support for a study on LVC.
[2] This share is well below Mexico's 29% share of the total population of North America. Mexico's share in the registration of new vehicles in North America is lower still, at 7 % in 2018.

manufacturers to varying degrees. Traditional US manufacturers would benefit further from crediting wages in research and development and IT, as well as through the 5% rule for existing engine, transmission and battery plants, than manufacturers based outside North America, which have engine plants based in Mexico. Additionally, car suppliers would incur higher relative costs in providing evidence of compliance with the rules of origin and the LVC clause, as they lack the personnel necessary for conducting such assessments (USITC, 2019: FN 133). Other commentators suggest that it may be more advantageous for producers to pay the 2.5% duty applicable to the US market, rather than complying with the rules of origin and LVC clause.

The US trade unions' verdict

The LVC clause has received surprisingly little attention, not least from trade unions in the region. During US congressional hearings in March 2019, the Union of Automobile Workers, the primary union concerned, did not comment on this clause. Unions' attention instead focused on the change in Mexican labour legislation in favour of independent trade unions and the corresponding enforcement of labour laws as provided in the USMCA. Only the AFL-CIO trade union confederation submitted testimony, which included the following points:

- The prescribed average hourly wage of $16 is too low to prevent car manufacturers from further outsourcing production to Mexico;
- As there is no adjustment to the inflation rate, the $16 per hour could lose value in the medium term;
- The $16 hourly wage is not a minimum wage, but only an average wage, so wages may remain low, especially if other workers receive a higher wage;
- The clause does not provide a minimum average wage for research and developmen and IT workers, some of whom are paid less than $16 per hour;
- Procedures for certifying compliance with the LVC quota and how to proceed in the event of non-compliance are still lacking;[3]
- The clause is restricted to the car industry, although workers in numerous other sectors are also negatively affected by outsourcing (Drake, 2018).

The criticism of the average wage and the complicated crediting of the LVC quota are especially valid. Further automation of production will increase the proportion of workers with higher qualifications and correspondingly higher wages. As a result, firms could meet the average wage level without paying higher wages to low-skilled workers. The complexity of the provisions leaves considerable room for interpretation for both manufacturers and government in implementing them. This poses an obstacle to verifying compliance with the rules.

Improving the clause

Instead of an average wage that remains constant for the duration of the agreement, an inflation-linked minimum wage paired with productivity gains should be at the core of an LVC clause. Such a wage ensures that the most vulnerable workers in the labour market receive necessary protection. Furthermore, a minimum wage is easier to control and avoids differential treatment of old and new manufacturers. It can be assumed that the minimum wage will also have a positive effect on the remuneration of other employees, since companies are typically incentivized to raise all wages when increasing those in the lowest wage groups.

In sum, while the LVC is an innovative element for the protection of workers in a trade agreement, the current clause falls short of that potential. Thus, the question for the US trade union movement and other progressive forces in US society is whether approval of the USMCA is justified, given that other chapters of the USMCA would effectively result in a deterioration of the position of wage earners. Protections for the pharmaceutical industry would lead to higher drug prices, while securing the free flow of data would render it more difficult to protect personal data. The possibility for corporate groups to sue state institutions in Mexico and the US would remain, albeit more limited than under NAFTA.

Christoph Scherrer is Professor for Globalization and Politics at University of Kassel, Germany, executive director of the International Centre for Development and Decent Work, and a member of the steering committee of the Global Labour University.
Emilie Segura is an organizer who studied sociology at Barnard College as well as Labour Policies and Globalisation in the Global Labour University program in Germany.

References

Burfisher, M.E., F. Lambert and T. Matheson (2019) NAFTA to USMCA: What is Gained? *IMF Working Paper* WP/19/73.

Drake, C. (2018) *AFL-CIO Pre-Hearing Brief for the U.S. International Trade Commission's "Investigation No. TPA-105-003, United States-Mexico-Canada Agreement".* Washington, DC: AFL-CIO.

USITC (2019) *U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors.* Washington DC: United States International Trade Commission

USMCA. n.d. https://usmca.com.

USTR (2019) *U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors.* Washington, DC: Office of the United States Trade Representative

[3] In the meantime, the USTR has proposed at least one inter-ministerial body to develop the procedure.

The GLC has been supported in 2019 by the German Trade Union Confederation (DGB), the ICDD at Kassel University and the Center for Global Workers' Rights at Penn State University.