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Outsourcing Liability: Are the True Causes of Unemployment Hiding Behind the Corporate Veil?

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FEATURE ARTICLE

OUTSOURCING LIABILITY: ARE THE TRUE CAUSES OF UNEMPLOYMENT HIDING BEHIND THE CORPORATE VEIL?

by CYNTHIA HERRERA

Chronic unemployment in the United States is at its highest level since the Great Depression.[1] In the past decade, more than 5.5 million manufacturing jobs have been lost, and nearly 50,000 manufacturers have folded.[2]

These circumstances, troubling byproducts of automation and globalization,[3] have devastated many Americans.[4]

Foreclosure rates, debt and bankruptcy rates have all reached historic peaks in recent years.[5] The wealth gap between white and black Americans is the widest since the U.S. census began tracking this data.[6] The employment-based system of health insurance has left many Americans without medical coverage and facing staggering hospital bills.[7] Vast numbers of Americans are losing their jobs and falling out of the middle class, and they are acutely aware that globalization has played a part in creating this epidemic.[8]

Globalization's role is complex, but it is clear that, with the rapid growth of this new structure, workers have suffered.[9] Transnational corporations ("TNCs") have disenfranchised workers for the sake of profit by effectively exploiting certain mechanisms within the legal system.[10]

First, international trade agreements ("ITAs") have provided the setting for TNCs to move business operations offshore more easily.[11] Because the United States leaves enforcement of labor and employment law to the countries in which business operations are conducted,[12] the relaxed or non-existent labor laws of developing countries[13] make offshore operations attractive to TNCs.

Next, existing laws shield TNCs from liability for their offshore activity and that of their subsidiaries.[14] Referred to as the "corporate veil," this current legal scheme encourages the lowering of labor standards.[15] The immunity afforded parent corporations[16] incentivizes these TNCs to cut corners abroad and remain complicit in their subsidiaries' labor abuses, while still reaping the resulting profits.[17]

Congress and U.S. labor unions should utilize the models and legal avenues available to reign in this exploitation of regulatory labor law. Unions and corporations should explore the benefits of the international framework agreement ("IFA") model currently gaining popularity in Europe. And Congress, which has the power to act extraterritorially,[18] should enact legislation that would hold TNCs responsible for their actions and those of their subsidiaries here and abroad.

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International Trade Agreements Allow Companies to Move Abroad

ITAs, also known as free trade agreements, result not only in the less restrained movement of products, but in greater flexibility for TNCs to move business operations abroad.[19] This "reduction of national barriers to global trade and investment" has made it easier for TNCs to relocate business operations offshore.[20]

Since the North American Free Trade Agreement ("NAFTA") took effect in 1994, for example, 879,280 U.S. jobs have been offshored.[21] According to one scholar, "NAFTA has also contributed to rising income inequality, suppressed real wages for production workers, weakened workers' collective bargaining powers and ability to organize unions, and reduced fringe benefits."[22]

Free trade can offer economy-wide benefits, but only when the gains of the "winners" exceed the losses of the "losers."[23] With statistics confirming that the top 1 percent of the U.S. population continues to reap most of these benefits,[24] it is clear that the "losers" are those comprising the majority of the American public.

The United States currently has free trade agreements in force with 17 countries,[25] and Congress has recently added three more countries to the list: South Korea, Colombia and Panama.[26] While some contend that such dealings benefit the United States by opening up new markets to domestic goods,[27] others attribute job losses directly to such agreements.[28] For example, the Economic Policy Institute predicts that the trade deal with South Korea could cost nearly 160,000 American jobs.[29]

The free movement component of ITAs allows TNCs to outsource various business functions to cheaper locations.[30] "Low total labor costs – wages, benefits and other labor standards that apply – play a significant role in making [these] decisions."[31] Because labor costs in developing countries are often a fraction of what they would be in the United States,[32] offshoring previously U.S.-held jobs is an attractive and often irresistible prospect for TNCs.[33]

THE CORPORATE VEIL IS HIDING UNFAIR LABOR PRACTICES

The United States leaves enforcement of labor and employment law to the countries where business operations are conducted.[34] This means that U.S. employment laws – those governing workplace safety, discriminatory practices and sexual harassment, for example – do not cover the overseas employees of U.S. companies.[35]

These workers, though employees of American companies, are instead subject to the employment laws of the countries in which they work, which are often less protective.[36] This policy can allow U.S. corporations to engage in labor practices, such as child labor,[37] that do not comport with American political and moral standards.

The result is that foreign workers in these offshored jobs receive significantly lower wages and have few to none of the safeguards that workers in the United States have.[38] These workers are also less likely to bring legal claims against employers,[39] presenting TNCs with the attractive prospect of avoiding high legal costs often associated with doing business in the United States.[40]

Because labor standards in developing countries are "less strict"[41] or "non-existent,"[42] offshoring allows TNCs to increase profit margins by avoiding the costs of complying with the stricter regulations and legal obligations found in the United States.[43] Ultimately, U.S. workers are unable to compete with these unfairly low labor standards to which foreign workers are subjected.[44]

TNCs further encourage the lowering of labor standards through the use of subsidiaries. In the United States, "labor and employment laws generally only apply to *employers*, and the employees of independent contractors are not considered employees of the TNC at the top of the supply chain."[45]

U.S. courts have found that in order for an entity to be considered an employer, it must be shown to "possess the right to control and direct activities of [the employee] or manner and method in which work is performed."[46] This requires a "day-to-day authority over employment decisions."[47] Also, U.S. courts often do not hold TNCs liable for their actions or their subsidiaries' actions abroad, out of respect for the sovereignty of foreign nations.[48]

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As Prof. Mike Zimmer, an expert on international labor and employment law at Loyola University Chicago School of Law, explains, "They effectively insulate themselves from the enforcement of the labor and employment laws of the countries where they operate."[49] The current legal foundation also allows TNCs to avoid liability for claims of labor abuses by exploiting the immunity they enjoy from their subsidiaries' actions.[50]

The practice of shifting labor and employment law enforcement to developing countries is unsound because TNCs often have more resources and international clout than the countries in which they operate.[51] Through their intricate corporate organization, TNCs can often avoid the jurisdiction of the countries in which they operate.[52]

When TNCs are allowed to reap profits from the unfair labor practices of their subsidiaries without fear of reprisal, they are encouraged to remain complacent in the disconcerting practices of their subsidiaries and are discouraged from regulating or guiding their practices.

The Prospect of International Framework Agreements

One promising model for designating more accountability to TNCs has come in the form of IFAs, a practice that has developed over the last two decades, primarily in Europe.[53] An IFA is an agreement between TNCs and global unions to ensure that companies act in accordance with the core labor rights set by the International Labour Organization in every country in which they operate.[54] Some agreements go further to guarantee rights beyond these.[55]

By signing IFAs, companies improve their image in regard to ethical standards and bolster their competitiveness in the global marketplace.[56] In addition, unions are able to organize more freely with little threat of managerial hostility.[57]

These agreements primarily establish core principles, such as freedom of association and the abolition of child labor, forced labor and discrimination.[58] Their success, however, indicates the potential for more encompassing agreements. Ultimately, IFAs can help reduce some of the negative attention TNCs face when offshoring jobs to countries with more lax labor standards, because the company will be bound by an IFA to respect the same core labor rights in all countries.[59]

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In the absence of voluntary measures, the United States has the ability to act in order to dampen these unfair labor practices. The U.S. Supreme Court has warned TNCs that "Congress has the authority to enforce its laws beyond the territorial boundaries of the United States."[60]

Unfortunately, Congress has yet to choose to exercise this power. As a result, U.S. courts continue to assert that TNCs are not liable for acts committed by their subsidiaries.[61]

Proposed legislation introduced in May 2011 aims to change this stance by extending the definition of "United States person" to "foreign subsidiaries, foreign affiliates or foreign joint ventures controlled in fact by any companies or any entities operating in the U.S., or organized under the law of, the U.S."[62] If passed, the U.S. government would be empowered to more directly regulate and influence the activities of those subsidiaries "controlled in fact" by American TNCs.[63]

Given the power of Congress, it appears the only thing needed to effect change on this topic is political will. This may not bring back every job lost in recent years, but it would go a long way to stemming the flow of American jobs overseas.

NOTES

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5 Dina ElBoghdady & Nancy Trejos, *Foreclosure Rate Hits Historic High*, WASH. POST, June 15, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/06/14/AR2007061400513.html; Atif Mian & Amir Sufi, *Consumers and the Economy, Part II: Household Debt and the Weak U.S. Recovery*, FRBSF ECONOMIC LETTER, Jan. 18, 2011, http://www.frbsf.

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7 *See* Steven Reinberg, *Unemployment Adds 9 Million Uninsured in U.S.*, USA TODAY, March 18, 2011, *available at* http://yourlife.usatoday.com/health/healthcare/insurance/story/2011/03/Unemployment-adds-9-million-uninsured-in-US/45047794/1.

8 *See* Lori G. Kletzer, *Globalization and Job Loss, from Manufacturing to Services*, ECON. PERSP. 38 (2005).

9 *See generally* Nash-Hoff, *supra* note 2 (discussing the loss of U.S. jobs and revenues in relation to international trade agreements).

10 *Id.*; *Doe I v. Wal-Mart Stores, Inc.*, 572 F.3d 677 (9th Cir. 2009) (discussing the reasoning for the court's refusal to hold parent corporations liable for their subsidiaries' actions).

11 Zimmer, *supra* note 3.

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13 *Id.*

14 *See Doe I*, 572 F.3d 677.

15 *See* Armou, *supra* note 12.

16 *See Doe I*, 572 F.3d 677.

17 Ann Marie McLoughlin, *International Trend of Multinational Corporate Accountability for Human Rights Abuses and the Role of the United States*, 33 OHIO N. U. L. REV. 153, 158 (2007).

18 *Equal Emp. Opp. Comm'n v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991).

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23 Kletzer, *supra* note 8.

24 Censky, *supra* note 4.

25 OFFICE OF THE U.S. TRADE REP., http://www.ustr.gov/trade-agreements/free-trade-agreements (last visited Oct. 21, 2011).

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31 *Id.*

32 *See* Ron Hira, *Offshoring U.S. Labor Increasing*, POPULATION REFERENCE BUREAU, Oct. 2008, http://www.prb.org/Articles/2008/offshoring.aspx.

33 *See generally It is cheaper to offshore jobs*, THE HINDU, (Jan. 29, 2011, 1:03 PM), http://www.thehindu.com/business/article96487.ece (noting that IT engineer costs in India and China are about half that of the United States).

34 Armou, *supra* note 12.

35 *Id.*

36 *Id.*

37 McLoughlin, *supra* note 17, at 170.

38 Armou, *supra* note 12.

39 *Id.*

40 *See* Jim Saxton, *Improving the American Legal System: The Economic Benefits of Tort Reform*, JOINT ECON. COMMITTEE STUDY, March 1996, http://www.house.gov/jec/tort/tort/tort.htm.

41 *Id.*

42 *Id.*

43 *See generally* Douglas S. Morrin, *People Before Profits: Pursuing Corporate Accountability for Labor Rights Violations Abroad Through the Alien Tort Claims Act*, 20 B.C. THIRD WORLD L.J. 427 (2000) (discussing the U.S. government's failure to regulate TNCs' actions abroad and the incentivizing effect of such).

44 *See generally It is cheaper to offshore jobs, supra* note 33.

45 Zimmer, *supra* note 3; *see Doe I*, 572 F.3d 677 (in which the term "employer" is defined as "an entity possessing the right to control and direct activities of person rendering service, or manner and method in which work is performed; and where finding of right to control employment requires comprehensive and immediate level of day-to-day authority over employment decisions").

46 *Doe I*, 572 F.3d at 682.

47 *Id.*

48 McLoughlin, *supra* note 17, at 170.

49 Zimmer, *supra* note 3.

50 *See Doe I*, 572 F.3d at 682.

51 *Id.*

52 McLoughlin, *supra* note 37.

53 Sarah Coleman, *Enforcing International Framework Agreements in U.S. Courts: A Contract Analysis*, 41 COLUM. HUM. RTS. L. REV. 601 (2010).

54 *Id.*

55 *Id.*

56 *Id.*

57 *Id.*

58 *Id.*

59 Coleman, *supra* note 53.

60 *Equal Emp. Opp. Comm'n v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991).

61 *See Doe I*, 572 F.3d 677.

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63 *Id.*