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LABOR STANDARDS AS A TRADE ISSUE

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ABSTRACT

The current attempts by the United States to introduce core labor standards into its bilateral and regional trade agreements and into the World Trade Organization (WTO) are discussed. Labor standards are already an important aspect of several international organizations and agreements. The role of labor standards in the ILO, EU, U.S. trade law, and the OECD are discussed. The rationale and arguments against labor standards are evaluated. Models attempting to determine the economic implications of imposing minimum labor standards on low-standard nations are reviewed; assumptions as to whether capital and technology inflows are affected by labor standards are critical to these results. Generally, it appears that Southern nations have more of an incentive to establish labor standards as part of a global agreement rather than implementing them unilaterally. The political economy of this issue both within the Southern and industrial nations is considered, as well as the global political economy of getting standards introduced into the WTO.

I. INTRODUCTION

One of the stated international trade policy objectives of the Clinton Administration has been to introduce a set of labor standards into newly negotiated bilateral and regional trade agreements as well as into the recently created World Trade Organization (WTO). Countries which failed to observe these standards could have restrictions or additional tariffs placed upon their products in international commerce. The labor standards issue is part of a larger trend in international commercial negotiations where less emphasis is being placed on tariff reductions and more emphasis on setting the rules of international commerce covering such issues as intellectual property protection, environmental regulations, government procurement codes, and product standards. Although labor standards are often referred to as a new trade issue, this is really not the case. Labor standards are already incorporated into a number of U.S. trade laws, and have been an important issue over the last decade concerning increased integration within the European Union; attempts to integrate labor standards into the international organizations governing international trade go back half a century. There is, however, much opposition to this movement both from

¹ The views expressed are those of the author and do not necessarily reflect the positions of the U.S. Government or the U.S. Department of Labor. A later version of this paper was published under the same title as chapter 4 in Khosrow Fatemi (ed.), *The New World Order: Internationalism, Regionalism, and the Multinational Corporations*, Pergamon Press, 2000; if cited please use that citation.

governments in the least developed and newly industrializing nations (henceforth, Southern nations) whose labor practices are being questioned and from free-trade conservatives who believe the labor standards movement is really a disguise for protectionism and an attempt to take away these nations' comparative advantage of low labor costs.

The rest of this chapter is divided as follows. Section II defines exactly what is meant by labor standards and provides the rationale for linking labor standards to trade. In section III, current labor standards that already exist in international agreements are reviewed, and section IV discusses the status of efforts for incorporating labor standards into future trade agreements and into the WTO. Section V provides a more theoretical discussion of the likely effects of global labor standards, and section VI addresses some common arguments that have been advanced against mandated labor standards. Section VII discusses the political economy of the issue both on a global level and within the industrial and Southern nations, and section VIII provides a summary.

II. THE DEFINITION AND RATIONALE FOR LABOR STANDARDS

Labor standards is a general term which refers to the rights and working conditions of workers. Which specific rights and working conditions are included in existing and proposed legislation and international agreements varies significantly. One widely accepted definition is referred to as "core labor standards" and is composed of five basic labor rights, each of which is covered by a convention of the International Labor Organization (ILO). These core labor standards cover: 1) freedom of association (ILO convention 87), 2) the right to organize and bargain collectively (ILO convention 98), 3) prohibition of forced labor (ILO conventions 29 and 105), 4) freedom from discrimination in employment (ILO convention 111), and 5) limitations on the use of child labor (ILO convention 138). The focus of the movement to incorporate labor standards into the World Trade Organization has concentrated primarily on these core standards. However, more progressive labor activists have suggested extending these more basic political rights into more economic benefits for labor including medical insurance, length of the work day, vacations, and wages. Even the idea of a global minimum wage has been suggested. Opponents of global labor standards often use these more extreme measures as straw men to argue against global standards, but currently only the core standards are being seriously proposed for the WTO. Obviously, which standards are to be included and how they are to be interpreted are issues still to be negotiated.

The United States has incorporated a set of minimum labor standards into a number of its trade and investment laws. The U.S. standard is more comprehensive in that it covers not only the core standards but also requires foreign nations to maintain minimum conditions on wages, hours,

and health and safety.² Determining what are appropriate wages and hours of work are very judgmental issues which are also obviously related to the level of development.

Clearly the labor standards incorporated into the European Union's Social Cause are much more extensive and really have more of a parallel with national labor laws than international standards which are the focus of this chapter. However, the European Union in its trade relations with outside nations has also been insisting on a binding human rights clause which generally covers the core labor standards.

What is the rationale for promoting labor standards? The justification for labor standards fall into four broad areas -- 1) human rights, 2) avoiding a race to the bottom, 3) unfair trade, and 4) historical experience. First, it is argued that core labor standards are basic human rights independent of the level of development or the type of economic or political system. Indeed, the core standards are included in the United Nations Declaration of Human Rights, and international support for them was recently reiterated at the 1995 Copenhagen World Social Summit. Since it is argued that these are basic human rights, dictatorships or even democracies with different cultural traditions cannot violate them. Supporters of this view argue that it is the lack of basic labor rights in many Southern nations which are partially responsible for the low pay and inhumane working conditions in these nations; the international community therefore needs to impose them out of humanitarian concern.

A second argument is that minimum labor standards are needed to avoid a global "race to the bottom" as workers in one country are forced to compete with workers in other nations with lower standards; the result is lower wages, fewer rights, and inferior working conditions worldwide. The term "race to the bottom" is somewhat of a misnomer since the argument is not that standards will fall to the absolute lowest level, but only that there will be pressure to lower standards to a lower level than they would be otherwise. Theoretically, there are conditions in which some kind of race to the bottom could occur, the question is whether those conditions are present and whether this theoretical possibility is, in fact, empirically important. The conditions under which a race to the bottom can occur and the role of labor standards in limiting it are explored further in section V.

A third argument for minimum global labor standards is that countries without standards have lower production costs and are thereby able to obtain an unfair trading advantage. As is often pointed out by opponents of labor standards, the "unfair trade" argument is theoretically invalid,

²Travis, Karen, "Women in Global Production and Worker Rights Provisions in the U.S. Trade Laws," *The Yale Journal of International Law*, Winter 1992, Volume 17, Number 1, pp. 173-194.

the benefits of trade derive from differences in comparative costs and the source of those costs differences -- whether due to technological, factor abundance or institutional differences are irrelevant to the gains from trade. Although true, there are a number of important qualifications to this proposition. Firstly, the same argument holds in regards to foreign government subsidies and non-predatory dumping, yet there is no strong movement to remove countervailing and antidumping duties as trade policy tools; there seems to be a double standard in terms of unfair trade when business interests are involved compared to labor interests. Secondly, the argument against unfair trade is based on real trade theory and there may be macroeconomic and adjustment costs which need to be considered.

Finally, and most importantly, it must be understood that the global trading system is an institution and when people evaluate the functioning of institutions, their perceptions of the fairness of the process are often as important and legitimate as their evaluation of the final outcome. Consider the institution of democracy: is it accepted because it is likely to produce the best government that will provide the highest level of social welfare, or do people accept it because there is something “inherently fair” about the process of one man and one vote? The point being, that when people evaluate the acceptability of the social institutions that govern their lives, they often and perhaps correctly, weigh the fairness of the process as much as the final outcome. Yet the welfare conclusions of real trade theory are only concerned with the final outcome. It is quite reasonable to think that it is unfair to displace a middle-aged man near retirement and eliminate all his accumulated human capital by transferring his job to a political prisoner or a bonded child worker.

A secondary issue that has been raised as an unfair trade practice concerns situations where countries limit labor rights in selected sectors. Labor rights are often lower in free trade zones than in the rest of the economy, and Malaysia has special restrictions against unions in the electronics sector in order to attract foreign investment into that sector. These practices produce outcomes similar to direct government subsidies to specific industries but are treated entirely differently by the WTO.

A final factor which suggest the need for minimum global labor standards is the observation that historically, whenever regions have become economically integrated there has arisen the need set some basic minimum labor standards. This was the case for the United States much of the labor legislation has been set nationally instead of at the state level. The creation of the European Union also shows that integration brings forth pressures for harmonization. With goods, services, and capital markets becoming integrated on a global scale at an accelerating pace, the question obviously is whether there is a need for a similar process on a global level.

III. LABOR STANDARDS IN INTERNATIONAL AGREEMENTS

Labor standards are already incorporated into a number of international agreements or organizations. The International Labor Office (ILO) has been the primary international organization promoting labor standards, while a number of international commodity agreements through the years such as the international tin, sugar, cocoa, and rubber agreements have had a labor clause. There is also an OECD code of conduct for multinationals. The United States has labor standards requirements for a number of its trade and investment laws, and the European Union (EU) has been progressively moving to establish EU-wide labor practices. The role of labor standards in each of these areas are discussed as background for the discussion about linking labor standards to trade through the WTO.

ILO Labor Standards: Any discussion of labor standards usually begins with the International Labor Office which has through the years adopted a number of specific labor standards or conventions which countries approve individually; each convention is only binding amongst those that have ratified it but there are no sanctions for noncompliance. There are over 140 ILO conventions covering labor standards. Some of the conventions have been ratified almost universally (although none has 100 percent ratification), while others have been ratified by only a few nations. Some are clearly related to the level of development while others are more likely to be viewed as fundamental human rights; some are quite specific, some are rather general. One interesting paradox is the fact that the United States has ratified few of the ILO's labor standard conventions but nevertheless appears to be the most strident proponent for incorporating labor standards into the WTO.

Labor Standards in U.S. Trade Law: Labor standards are already a very integral part of U.S. international trade law and are currently incorporated into seven specific trade laws and agreements. These include the Generalized System of Preferences (GSP), the Caribbean Basin Economic Recovery Act (CBERA), the Andean Trade Preference Act (ATPA), the Overseas Private Investment Corporation (OPIC), the Multilateral Investment Guarantee Agency (MIGA), Section 301 of the Trade Act of 1974, and the North American Free Trade Agreement (NAFTA). The first legislation to link trade with foreign labor conditions was the McKinley Act of 1890 which restricted imports produced by prison labor;³ later the GATT (Article XXe) accepted the right of countries to restrict these items. The CBERA (signed in 1983) which allows 24 Caribbean beneficiary nations duty-free access to the U.S. for 6,700 tariff-line items (out of a total of 11,400)

³ Perez-Lopez, Jorge, "Conditioning Trade on Foreign Labor Law: The U.S. Approach," *Comparative Labor Law Journal*, Volume 253, 1988.

was the first legislation to link trade preferences with a more detailed set of labor standards (i.e., the U.S. definition discussed in section II). The GSP which provides duty-free access for 4,500 items to 150 (non-industrialized) countries did not have a workers rights requirement when initially created in 1976, but did contain one when it was renewed in 1984. (Note that the EU also has a GSP program conditional on labor rights.) When the ATPA which gives duty-free access for 6,550 items imported from Colombia, Peru, Ecuador, and Bolivia was created in 1992, it incorporated similar language covering labor standards.

Through the years, a number of countries including Romania, Burma, Nicaragua, Liberia, Sudan, Paraguay, Chile, and the Central African Republic have lost GSP eligibility (some were later reinstated) due to the failure to observe worker rights. Obviously it would be quite useful to know if there was clear evidence that the GSP labor rights requirements had altered labor practices in the GSP beneficiary nations. An analysis by Dorman concludes that in a number of cases the timing of labor law changes, and the close attention paid by governments and businesses to the GSP review process suggest that there has been a connection.⁴

OPIC was created in 1969 to assist U.S. private foreign investment by providing insurance and loans guarantees. There are numerous restrictions on their activities and in 1985 they were restricted from involvement in projects in countries that do not respect worker rights. OPIC uses the GSP process for GSP beneficiaries but makes its own assessment for nations not covered by the GSP; through the years it has determined that Ethiopia, China, and Korea are not in compliance.

The MIGA is an international organization associated with the World Bank which insures investments and provides assistance in creating a positive investment climate in the member countries. The U.S. legislation authorizing U.S. participation (signed in 1987) required the United States to attempt to include workers' rights criteria in the charter of the organization and restricts the United States from voting for any benefits for a nation not complying with internationally recognized worker rights. The United States failed to get worker rights included in the charter and since then has not voted against extending benefits to any country explicitly based on the workers' rights criteria.

Section 301 (created in 1974) allows the United States to retaliate against foreign nations that unreasonably restrict U.S. exports or do not abide by existing trade agreements. An

⁴Dorman, Peter, *An Evaluation of Worker Rights Conditionality Under the Generalized System of Preferences*, Washington, D.C.: U.S. Department of Labor, April 1989.

amendment to this act (1988) allows failure to respect workers' rights to be considered if it restricts U.S. commerce. Given the difficulty in making such a connection, no Section 301 cases have been instituted based on workers' rights.

The labor standards provisions in the NAFTA side agreement (created in 1994) list 11 specific worker rights which include the areas covered in the GSP definition (but perhaps at a higher level) with added protections concerning employment discrimination (based on race, sex, religion and age), equal pay for men and women, compensation for occupational injuries, and protections for migrant workers. It was generally agreed that each nation's labor laws adequately protected these rights and thus the only requirement would be that each nation properly enforce its own labor legislation. Each country set up a National Administrative Office (NAO) to deal with complaints; in the United States the NAO is part of the U.S. Department of Labor. Although several cases have been brought to the U.S. NAO during the first two years about restrictions on the right of unions to organize in Mexico, the NAO concluded in each case that Mexican labor laws had not been broken. Whether the NAFTA labor side agreements are more symbolic or whether they have resulted in significant changes in Mexican labor practices is open to debate; nevertheless, Mexican companies continue to routinely violate the core labor standards.⁵

Labor Standards in the EU: The degree to which economic integration has resulted in the harmonization of social legislation in Europe is open to debate as is its relevance to the issue of global standards. From the beginning, the objective in Europe has been political integration (as a way to limit hostilities); economic integration was a means to this end rather than the objective itself. Nevertheless there is a significant political segment within Europe which has come to believe that the European model of social democracy is no longer viable (due to economic integration) and the only way to preserve it is to create comparable European institutions similar to their domestic ones. With the southern enlargement of the EU during the early 1980s concerns arose about "social dumping" with standards falling to the level of the member with the lowest standard. Before the Single Economic Act of 1986, social harmonization was quite limited due to the need in the EU for unanimous agreement. After 1986, decisions by qualified majority were introduced for some areas covering health and safety issues but the high standard states only relinquished their veto power under the understanding that common standards would be set at the highest level. The Maastricht Treaty in 1991 enlarged the possibility for social harmonization but Britain was excluded from it and unanimous decisions of the remaining states are required for legislation. European-wide labor legislation remains rather limited; for example, there is still no

⁵ Bachman, S.L., "Young Workers in Mexico's Economy," *U.S. News and World Report*, September 1, 1997, pages 40-42.

EU right to bargain collectively or strike.⁶ However, the EU was able to require the British to alter their pension system which had allowed women to retire at an earlier age than men.⁷

Throughout much of this process the high standard states have had to buy off the low standard states through transfers such as the structural and regional funds. The European experience in harmonizing labor standards is motivated by a different agenda and has achieved remarkably little -- and only this through payments to low standard nations. Thus the European experience provides some evidence that integration brings forth pressures for harmonization, but that experience also suggests that harmonization through the WTO is going to be slow and extremely limited and require concessions in other areas by the industrial nations.

The OECD Code for Multinationals: Another area in which there are international labor standards is a set of guidelines for multinationals which were adopted by the Organization of Economic Cooperation and Development (OECD) in 1976. These generally cover the basic core labor standards in addition to more specific ones covering in-house training, hiring and firing, and promotions. A basic principle incorporated into these standards is that the multinationals should adopt labor practices which are at a minimum at least comparable with the labor practices of large domestic companies in the host country. There is evidence that multinational affiliates in the South do pay wages that are above those paid by domestic companies.⁸

Voluntary Labeling Agreements: As the public in the major industrialized nations have become more aware of the existence of child labor and other sweatshop conditions, there has developed a movement by producers of some products to voluntarily set some minimum labor standards amongst themselves. The "Rugmark" label for carpets produced without child labor and the "No Sweatshop" label for apparel are two recent examples. Some companies such as Starbucks have adopted their own "codes of conduct" to protect the rights and working conditions of the employees of their suppliers or subcontractors. The ILO has proposed a "global social label" which could be placed on products from countries with comprehensive respect for labor rights. Despite the success and potential of these labeling agreements in improving working conditions in

⁶Martin, Andrew, "The European Union's Social Dimension," presented at the Symposium on International Labor Rights and Standards After NAFTA, Rutgers University, May 1996.

⁷Mitchell, Daniel and Jacques Rojot, "Employee Benefits in the Single Market," in Lloyd Ulman, Barry Eichengreen, and William Dickens, (Eds.), *Labor and an Integrated Europe*, Washington, DC: Brookings Institution, 1993.

⁸ Koudal, Peter, "Workers and Transnational Corporations: A Tale of Two Labor Markets?," in Denise Dimon, Irene Tomlinson, and Sue Nichols, (Ed.), *Competitiveness in International Business and Trade*, Laredo, TX: Texas A&M International University, 1996.

some industries, it is unlikely that voluntary agreements can attain the scope and depth that is possible with mandatory standards.

IV. LABOR STANDARDS IN THE WTO AND REGIONAL AGREEMENTS

Current attempts to insert labor standards into the organization governing the rules of international commerce are the return of an old issue. The International Trade Organization (ITO) which was proposed after WWII had a labor standards element but that organization was never approved by the U.S. Congress; instead, the much more modest General Agreement on Tariffs and Trade (GATT) was created. The United States was unsuccessful in incorporating a labor article into the GATT in 1953 and tried and failed again during the Tokyo Round. Currently the United States is the leading nation actively promoting efforts to put a trade and labor standards linkage into the WTO; France, Belgium and the Nordic nations are also providing support while many of the less developed and newly industrializing nations are actively opposing it.

This chapter will not attempt to evaluate every countries' compliance with each of the core labor standards, but based upon an analysis by the OECD, it appears that a good case could be made that many of the non-industrial countries, including some of the most important trading nations such as China, Taiwan, Singapore, Mexico, Malaysia, Indonesia, and Turkey are not in compliance with core labor standards. Thus if the WTO were to adopt a social clause, how the standards would be evaluated would be quite important, and a strict interpretation of the standards would require some fundamental changes in labor laws and/or practices in many of countries. The most likely scenario would be that if a linkage is adopted, the WTO would initially interpret the standards rather loosely so as to avoid any large disruption of trade; WTO action would be used only occasionally and reserved for the stragglers. Through time the requirements and procedures would be refined. It is also unclear exactly what would be covered, would the WTO only be concerned with the production of goods that enter international trade, or would a country's labor practices be evaluated more generally, and any penalties applied to all their trade? Interestingly, the U.S. Fair Labor Standards Act of 1938 which included the minimum wage, originally only covered workers producing goods involved in interstate trade, although it has since been progressively expanded to cover most of the U.S. workforce.

At this point there is not sufficient international support to put a labor clause into the WTO, but the United States had hoped to at least establish a WTO working party to investigate the issue at the first WTO Ministerial in Singapore in December 1996. However opposition to this was quite strong and since the United States and the EU were unwilling to make any significant concessions, the working party was not approved. Until the European Union develops a consensus to fully support this issue, and the United States and the EU become willing to offer significant

concessions, or the opposition in the Southern nations weakens as they come to view labor standards as being in their own interests, there is likely to be little progress at the WTO.

During the U.S. presidential race in 1992, Clinton took the position that labor and environment concerns should be part of regional trade agreements such as NAFTA, and as discussed, the labor side agreements were added as a concession to get moderate democratic support for NAFTA. The disagreement about whether the United States should include labor and environmental standards derailed the enlargement of the NAFTA to include Chile during 1996. By the fall of 1997, however, Clinton had largely dropped the demand to include labor standards as an integral part of future regional trade agreements in order to get Congressional approval for “fast-track” authority; however, he pledged to seek labor side agreements, as with NAFTA, and to continue the effort to get a labor clause into the WTO.

It is also likely that the United States will use the Asian Pacific Economic Cooperation (APEC) to raise issues concerning democracy, human rights, and labor standards amongst its members. Although there is no stated linkage between these issues and trade liberalization, their discussion within the same forum suggests a vague connection which could ultimately become more explicit.

V. THE LIKELY EFFECTS OF LABOR STANDARDS

What are the likely economic efficiency and distributional effects of imposing labor standards on low-standard nations? What are the secondary effects on the high-standard nations? The answers to these questions are not clearly understood. Proponents of labor standards obviously feel that higher standards would improve the income, leisure, and other quality of life factors for a majority of workers without unduly harming economic efficiency. Opponents concentrate on the efficiency costs and may even feel the likely distribution consequences are undesirable. Given that the core standards represent alterations in a number of vastly different labor market practices, and often deal with complex market failures and imperfect information that varies from country to country, it is difficult to make generalizations about their effects.

For example, just the questions as to whether unions improve or harm economic efficiency and income distribution are unresolved. It may be the case that labor needs to be unionized to properly balance the effects of “monopoly capitalism” or correct some other distortions in the labor market. However, it is also possible that too much labor power can result in the inefficient allocation of labor. Likewise for distribution, when the wages of some are raised at the possible expense of jobs for others, are the distributional consequences desirable? Thus, within the South there is certainly a lot of disagreement about whether unions improve or worsen social welfare. At

one extreme, the example of India could be put forth where union members have been able to secure privileges for themselves with considerable costs to the rest society. At the other extreme there are the union movements in Central America which often appear to be the only forces there working for equity and human rights. These examples perhaps explain the ambiguous attitude towards unions and labor standards in the South.

Since a major justification for imposing labor standards on Southern nations is the belief that their lack of standards also have negative consequences for other nations, the international ramifications are of equal concern. Therefore labor standards ideally need to be modeled within a global general equilibrium framework. Brown, Deardorff and Stern (BDS) using a variant of their Michigan World Trade Model have attempted to explore these issues; since it is unclear how to model labor standards BDS try three different approaches, standards are considered as 1) an additional social cost equivalent to a negative production externality, 2) a non-traded good that requires factors in order to be produced, or 3) something that reduces the available supply of factors.⁹ Since these models have a Heckscher-Ohlin core, a critical assumption concerns whether labor standards are labor or capital intensive. BDS conclude that freedom of association, freedom from forced labor, minimum age, minimum wages and hours of work are labor-using, while occupational safety will generally require both factors and may possibly be capital intensive.

The implications for labor standards vary depending on a number of additional assumptions but generally BDS find a few conclusions that appear robust. For a small country, (e.g., unable to affect its terms of trade) acting alone, the country should pursue the policy that maximizes its social welfare without regard for what other countries are doing about labor standards; if each country followed this rule, the result would be a Pareto optimum for the world. If instead, there is a collective agreement internationally, a country may desire to set a different standard than what it would set on its own. The fundamental difference is that in the latter case, the terms of trade can be influenced by the global labor standard. Generally, a labor-using standard imposed on the labor abundant country has the effect of improving the terms of trade of the labor abundant country due to the reduction in the world supply of its export good (the labor-intensive product) based on Rybczynski effects. Thus if a country can influence its terms of trade either because it is a large country or because of an international agreement, there is an incentive to set labor standards higher than the level which would be set purely to optimize domestic considerations. It should be noted that this does not necessarily imply that in either of these cases that the Southern countries would actually desire labor standards because although a standard will

⁹Brown, Drusilla, Alan Deardorff, and Robert Stern, "International Labor Standards and Trade: A Theoretical Analysis," in Jagdish Bhagwati and Robert Hudec, (Eds.), *Fair Trade and Harmonization*, Cambridge, Mass: MIT Press, 1996, pp. 227-280.

improve the terms of trade it could also lower output, and which effect dominates the welfare outcome would depend on a number of parameters. The potential welfare of the industrial countries falls from imposing standards on the South due to their falling terms of trade. However, with less trade, labor in the industrial nations may gain if the resulting Stolper-Samuelson distributional effects outweigh the terms of trade effects. Generally, these conclusions suggest that the larger Southern nations or the South collectively should be working with labor organizations in the industrial nations to establish minimum labor standards.

The BDS analysis does not consider capital flows and multinational investment and for that reason does not really address the race to the bottom argument which is based on capital flows. If it were purely a trade issue, the race to the bottom would be of questionable theoretical significance since trade is based on comparative as opposed to absolute advantage. It is the ability of capital and technology to move to the lower standard countries that is likely to put pressure on standards in the high standard countries. Herman Daly's main concern about a race to the bottom focuses not on the industrial countries but on the developing nations that desire to have labor standards but cannot because they must compete for international capital with other developing nations that do not have standards.¹⁰ Introducing capital mobility provides yet another reason for the Southern nations to act collectively, perhaps through the WTO, instead of establishing labor standards unilaterally. Nevertheless, the establishment of global standards could reduce capital and technology flows to the South in aggregate and thus Southern nations would have reason to oppose them even when considered as a collective proposal.

In conclusion, BDS suggest there is a paradox because it is the South that has the most to gain from labor standards, the industrial nations can only lose; yet it is several of the industrial nations that are advocating labor standards. This conclusion is based on the fact that labor standards improve the South's terms of trade; however, if labor standards are also allowed to affect investment and technology flows to the South, the South may no longer gain and there may no longer be a paradox. In addition, there may be no paradox if income distributional considerations dominate potential social welfare considerations in government decision making. Nevertheless, the BDS finding that the gains from standards are greater (or costs lower) for a given Southern nation if the South acts collectively (as opposed to individually) is further strengthened when investment flows are considered.

Although a race to the bottom in setting labor standards is a theoretical possibility, very little has been done to try to assess the importance of this within the international economics

¹⁰Daly, Herman, *Beyond Growth: The Economics of Sustainable Growth*, Boston, Mass.: Beacon Press, 1996.

literature. There is, however, a sizable literature surrounding the race to the bottom in regards to environmental and tax policy within the local public economics literature. In summarizing this literature, Wilson concludes that there are numerous instances in which decentralized decision making by local governments is inefficient and therefore requires central government action, but a race to the bottom is not a generic feature of systems with independent governments.¹¹ Although there has been no systematic study about the pressure to lower labor standards in the face of competition from low standard nations, there are numerous examples of anecdotal evidence. According to union officials, the threat of moving offshore has become a standard response to labor demands in the industrialized nations. The Malaysian government decided to maintain a ban on unions in the electronics industry after threats by multinationals to leave. There have been several episodes in U.S. history where individual states have become involved in a competition to lower standards in the absence of federal regulation; for example, this was the case after federal regulations covering child labor were overturned by the Supreme Court in 1918.¹² Thus, there is a significant amount of anecdotal evidence of labor standards being lowered to maintain competitiveness or to keep capital at home, but there has yet to be any systematic study of its true extent.

Given the complexity in modeling the economic consequences of labor standards, there have been several recent empirical studies which look at a cross-section of Southern nations to see how the presence or absence of labor standards have impacted these nations' comparative advantage, labor costs and trade competitiveness and their ability to attract foreign investment. A study by the OECD concluded that nations without the core standards did not have a better export performance or more foreign investment or lower real wage growth than countries respecting core standards.¹³ However, Rodrik found that low-standard nations had significantly lower labor costs (after controlling for productivity), and a larger revealed comparative advantage in labor intensive products such as textile and apparel.¹⁴ Rodrick's evidence on investment was less clear; he found that high-standard countries attracted the most direct foreign investment in majority-owned affiliates of U.S. multinationals but more general foreign investment was not evaluated. Given the

¹¹Wilson, John Douglas, "Capital Mobility and Environmental Standards: Is There a Theoretical Basis for a Race to the Bottom?," in Jagdish Bhagwati and Robert Hudec, (Eds.), *Fair Trade and Harmonization*, Cambridge, MA: MIT Press, 1996, pp. 393-427.

¹²Elmslie, Bruce and William Milberg, "Free Trade and Social Dumping: Lessons from the Regulation of U.S. Interstate Commerce, *Challenge*, Vol. 39, No. 3, May-June 1996, pp. 46-59.

¹³ Torres, Raymond, "Labor Standards and Trade," *The OECD Observer*, No. 202, October-November 1996, pp. 10-12.

¹⁴Rodick, Dani, *Has Globalization Gone Too Far*, Washington, D.C.: The Institute for International Economics, 1997.

conflicting empirical evidence, and its importance in modeling and assessing labor standards, more empirical analysis is critical.

VI. SOME COMMON ARGUMENTS AGAINST LABOR STANDARDS

The previous sections explained the justification for linking labor standards to trade and attempted to outline the implications of this. In this section some of the most frequent arguments against a linkage are presented, and for each a rebuttal is offered. A common argument made against linking labor standards with trade regimes is that it will lead to widespread protectionism, and since the ILO already exists and has as its primary mission the improvement of labor standards, the ILO should remain the central organization dealing with labor standards.¹⁵ The problem, of course, has been that the ILO lacks any enforcement mechanism and has not been effective in promoting this issue; the current movement to use the WTO derives from this current lack of progress. Only trade sanctions have the “teeth” that can effectively bring about change. Given that the concern about labor standards being a cover for protectionism is advanced so frequently, it is surprising that there is so little evidence that this has happened since labor standards do have a track record as part of U.S. and EU trade law. The labor standards complaints raised in implementing U.S. trade law have not been dominated by bogus protectionists but have generally represented legitimate labor rights violations; in addition it would be the WTO and not the U.S. government making decisions and they would in all probability be less swayed by protectionists lobbying. Likewise in the EU, the European Court of Justice has not allowed the Social Charter to be used to advance the interests of protectionists.

Another argument is that labor standards violate national sovereignty. However, it has already been accepted that the WTO has jurisdiction over such things as government subsidies, intellectual property protection, health and safety regulations, product standards, and production with prison labor; thus it is difficult to argue that there is some principle of national sovereignty at stake. That principle has already been surrendered -- now it is simply a question as to what specifically will be covered.

Srinivasan has asked why supporters of labor standards are not more generous with Southern workers if they are indeed motivated by humanitarian concerns.¹⁶ Why not more

¹⁵ Bhagwati, Jagdish, “Policy Perspectives and Future Directions: A View from Academia,” in *International Labor Standards and Global Economic Integration: Proceedings of a Symposium*, Bureau of International Labor Affairs, US Department of Labor, July 1994.

¹⁶ Srinivasan, T.N. “International Trade and Labor Standards from an Economic Perspective,” in Pitou Van Dijk and Gerrit Faber, *Challenges to the New World Trade Organization*, The Hague: Kluwer Law International, 1996, pp. 219-243.

foreign aid and more liberal immigration policies? Srinivasan fails to appreciate the view that the workers are being denied their basic economic and human rights by the other segments of their society. That being the case, it is the obligation of the oppressive segments to reform. For example, when apartheid was being practiced in South Africa, the moral obligation was on the white minority to change, not on other nations to allow blacks to immigrate to their countries. Likewise if a man beats his wife, it is not up to the neighbor to send the wife a gift to improve her situation, it is the husband's behavior that needs correcting.

Some have argued in the case of child labor, that the poverty of some of these nations is such that children simply have to work in order to produce a subsistence level of output. This argument implicitly assumes that everything else will remain the same so that the families' real income will fall by the amount of the lost income of the child. However, the wages of the parents could rise for any number of reasons. For example, fewer workers raise the marginal products and wages of the remaining workers. Under conditions of labor surplus where wages have been set "institutionally" at the subsistence level, the wage rate would rise; a similar thing could happen with legally set minimum wages. In addition, some items such as housing or farm land have a rent component which is determined largely by the ability to pay; as this ability is reduced their rent payments would also be reduced.

Krugman has argued that although the workers may be working under sweatshop conditions, they are still better off than they would be without these jobs.¹⁷ Implicit here is the view that these jobs would not exist if there were labor standards, but no one is suggesting that the standards be set so high (and implementing the core standards would surely not bring about excessive standards) that the existence of large number of jobs would be compromised, only that labor should receive a slightly better proportion of the output and be granted basic human freedoms. However, it must be conceded, as with the minimum wage in the United States, that there may be some loss of jobs for a few, although large numbers of others would benefit. Clearly some additional social safety net may be required for the few that are displaced.

It is also argued that many nations do not have the administrative capacity to enforce labor standards when surplus labor, family operations, rural sites, etc., make enforcement so difficult. Although these are valid concerns, the GSP program has been able to avoid setting standards at levels which were unattainable. It's not unreasonable to suggest that the WTO would only require countries to make good-faith efforts in this regard.

¹⁷Krugman, Paul, "In Praise of Cheap Labor: Bad Jobs at Bad Wages Are Better Than No Jobs at All," *Slate*, (www.slate.com), March 20, 1997.

VII. THE POLITICAL ECONOMY OF LABOR STANDARDS

In order for labor standards to be adopted much more widely throughout the South, there will need to be some fundamental changes in the positions currently held by the industrial and Southern governments. Until the South comes to believe that their self-interests are served by global minimum labor standards or there is a better demonstration of how the North is injured by the lack of standards, it is difficult to see how the political economy of the issue will bring it into the WTO. Additional Southern support is especially required since the balance of power within the WTO is undergoing a process of “UNification”; power is slipping away from the industrial economic powers to a more democratic basis.

There is currently much debate in the industrialized countries about the role of trade with low-wage nations in creating unemployment and the two-decade long wage decline. Regardless of the correct answer, a sizable fraction of the U.S. public feels trade is a significant factor and this is working to make opposition to further trade liberalization politically popular. This opposition may be contained if the public can be convinced that the WTO will maintain “fair trade.” Thus there may develop more political pressure to hold out for Southern concessions on this issue, or to offer concessions in other areas to get the South to adopt higher labor standards. For example, Rodrik has suggested that the United States could alter its antidumping procedures, which are widely viewed as needing reform;¹⁸ Milberg and Elmslie argue for a “Tobin tax” on international financial flows, which may offer benefits in itself, but the revenue generated could be used to compensate the South for raising labor standards.¹⁹ Likewise, if Southern nations come to believe that Northern markets may be closed to them because of these political considerations, they may be willing to accept labor standards in the WTO as a price to get further liberalization (as Mexico was with NAFTA).

Besides external pressure to change, it may be that internal developments in the Southern nations could alter their opposition to higher labor standards. As the institutions of democracy are strengthened, governments in the South may become more receptive to higher labor standards both at home and as part of the WTO. Although the possibility cannot be ruled out that labor standards could harm the South through reduced capital and technological flows and increased economic inefficiency, as labor power increases more than is necessary to correct labor market distortions, there is a good case to be made that Southern governments are not representing their societies’ true interests by opposing labor standards. Three possibilities for this are discussed below -- ignorance,

¹⁸ Rodick, Dani, *Has Globalization Gone Too Far*, Washington, D.C.: The Institute for International Economics, 1997.

¹⁹ Milberg, William and Bruce Elmslie, “Saving Free Trade From Itself: Overcoming the Obstacles to International Labor Standards,” *New Labor Forum*, forthcoming, Volume 1, No. 1, 1997.

special interests, and short-run adjustment costs including unemployment. These are not being advanced in a demeaning manner towards Southern governments since economic policy in the industrial nations is often dominated by these same influences.

It is possible that Southern governments do not support higher labor standards because they have failed to properly analyze their implications. The economic consequences of policy actions are often quite complex and initiate secondary effects that may ultimately undo or even reverse entirely the initial impact effect of the policy. For example, it is doubtful if many Southern governments have actually considered the potential terms of trade benefits of labor standards or fully appreciate how the exchange rate may undo any loss of competitiveness due to higher labor costs. Few politicians understand how labor market distortions create inefficiency, or how an improved income distribution may promote human capital accumulation.

Another possibility is that the decisions of governments of most Southern nations are dominated by the interests of capital owners and the business elite, and since they may suffer some income loss from instituting labor standards these governments are not willing to back this issue even if the overall gains to their societies are positive. It is even possible that authoritarian regimes' ability to remain in power could be threatened by the creation of unions and freedom of association. That special interests can govern trade policy in a way that is not in the societies' interests was of course the general pattern in the South in the first three decades of the post-war period if one accepts the growth-crippling effects of the import-substitution policies which were practiced throughout the South.

In addition, there may be macroeconomic considerations. Although adjustment costs are often quite small compared to long run gains, short-sighted voters may create short-sighted politicians. Consider that foreign subsidies and dumping are generally beneficial for an importing nation in terms of real trade theory; the exception is the case of predatory pricing. Yet throughout the world, importing nations act aggressively to limit imports which are subsidized or dumped, although in most cases predatory pricing is not a factor. In fact in U.S. trade law, although predatory pricing is often mentioned in the legal justification for countervailing and antidumping duties, for specific cases there is no legal requirement to even demonstrate an intent to price in a predatory fashion. Thus, short-run macroeconomic adjustment factors often dominate long-run real income factors in policy making.

VIII. SUMMARY

Economic integration has generally been accompanied by the establishment of minimum labor standards. With the increased integration of the global economy it may now be the time for

global labor standards. The United States has over the last twenty years incorporated labor standards into a number of its trade and investment programs. Although the benefits may have been marginal, it is also the case that they have not been used inappropriately by protectionist interests. The economic implications of global labor standards are difficult to determine, but numerous analyses suggest that the South could benefit from their establishment. Nevertheless, Southern governments currently strongly oppose global standards. It is possible that labor standards could reduce capital and technological inflows and provide labor more power than is needed to correct any labor market distortions thereby reducing economic efficiency. However, there is also the distinct possibility that Southern governments may not be acting in their own countries' interests. There are numerous reasons why Southern nations would desire a coordinated global agreement through the WTO instead of instituting labor standards unilaterally. The overall welfare effects of higher Southern labor standards on the industrial countries are ambiguous, but there are likely to be benefits to labor in terms of higher wages.

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