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Labor Standards and the World Trade Organization

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A Position Paper

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1. Introduction

The interaction of labor standards and international trade has become a key issue in the relations between the advanced industrialized and developing countries in the past decade. Proponents of the international enforcement of labor standards present two lines of argument. First, organized labor and social activists in the United States and other industrialized countries argue that "unfair" labor practices and conditions exist in many developing country trading partners and need to be offset by appropriate trade policy measures in order to "level the playing field." Second, many social activists argue that workers in developing countries are subject to exploitative and abusive working conditions, and that their wages are suppressed. The proposed solution is for the United States and other industrialized countries to take steps to ensure that labor standards are enforced through mechanisms such as the World Trade Organization (WTO) and bilateral and regional trade agreements.

While we embrace the goal of improving the wages and working conditions of workers in poor countries, we take the position that attaching labor standards to the WTO and trade agreements will not achieve this goal, nor will it have the desired effect of keeping more jobs in the industrialized countries. In fact, such a policy could make things worse for many workers in developing countries. Alternative policies and existing institutions must be deployed to ensure that: (a) workers in industrialized countries will not be adversely affected by freer trade and globalization in general; and (b) wages and working conditions of workers in the developing countries can be improved at a sustainable pace.

2. Definition and Scope of Labor Standards

Although existing codified labor standards vary from country to country, depending on the stage of development, per capita income, political, social, and cultural conditions and institutions, efforts have been made to identify and achieve consensus on a group of so-called core labor standards that ideally should apply universally. According to the Organization for Economic Cooperation and Development (2000, p. 20), there are eight fundamental International Labor Organization Conventions that form the basis of consensus among the ILO's constituents. These include: (1) prohibition of forced labor (ILO Convention No. 29 and 105); (2) freedom of association and protection of the rights to organize and to collective bargaining (No. 87 and 98); (3) equal remuneration for men and women for work of equal value (No. 100); (4) nondiscrimination in employment and occupation (No. 111); and (5) minimum age of employment of children and abolition of the worst forms of child labor (No. 138 and 182).

Agreement on the universality of these core labor standards derives ostensibly from adoption of the United Nations Universal Declaration of Human Rights in 1948, acceptance (though not necessarily ratification) of the pertinent ILO Conventions that deal with human rights and labor standards, and the ILO Declaration on Fundamental Principles and Rights at Work in 1998. In addition to these aforementioned core standards, there are other labor standards that are currently being discussed by labor advocates that relate to "acceptable conditions of work," which include: a minimum (living) wage; limitations on hours of work; and occupational safety and health in the workplace.[1] These core plus "other" standards are supported by the many non-governmental organizations (NGOs) that deal with the international monitoring of labor rights.

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[1] See Brown, Deardorff, and Stern (1996, Appendix Table 1) for the definitions and principles of the core and other labor standards that are articulated in U.S. trade law, based on Lyle (1991, pp. 20-31).

3. Effects of Labor Standard

Advocates argue that enforcement of labor standards through trade agreements will improve the working conditions and wages of workers in poor countries, thereby reducing the wage differentials between rich and poor countries. They believe that this will protect jobs of workers in the rich countries. The question is whether working conditions in poor countries can be raised, and whether jobs of workers in rich countries can be protected with the application of standards that are designed and enforced by the rich countries.

In this connection, there is evidently a marked difference between the worldview of most advocates linking international labor standards to trade and most economists, including ourselves. Advocates of attaching labor standards to trade agreements seem to see the world in terms of a struggle between capital and labor for the rewards from production, without much regard to the determinants of the size of the output that each party gets. These advocates see the outcome as depending on power, not on economics. Economists see the world in terms of how resources are allocated to production with a view to maximizing the total output. They see the distribution of that output between capital and labor as depending on scarcity and productivity, not on power. Therefore labor standards advocates favor the use of intervention to tilt the balance of power in favor of labor, believing then that labor will get a larger share of a fixed pie. Economists have found that those same policies shrink the pie while altering the slices, i.e., by making poor workers in developing countries poorer and more numerous. This, we argue is not a result of changing power but due to changing the markets within which scarcity determines the rewards to capital and labor.

3.1 Effect on Rich Countries of Low Labor Standards in Poor Countries

In order to establish the need for "leveling the playing field," it must first be demonstrated that low labor standards in poor countries negatively impact workers in rich countries. Proponents of attaching labor standards to trade agreements argue that low labor standards act through two channels: a) goods from low labor standard countries displace products made by workers in high labor standard countries and hence reduce employment in the latter; b) multinational enterprises outsource jobs to countries with lower labor standards to take advantage of lower labor costs. The evidence suggests, however, that the observed patterns of traded goods and foreign direct investment (FDI) do not reflect inter-country differences in labor standards.

Regarding traded goods, the OECD study of *Trade, Employment and Labour Standards* (1996, pp. 12-13) concludes that:[2]

> ...a detailed analysis of US imports of textile products (for which competition from low-standards countries is thought to be most intense) suggests that imports from high-standards' countries account for a large share of the US market. Moreover, on average, the price of US imports of textile products does not appear to be associated with the degree of enforcement of child labor standards in exporting countries….

Aggarwal (1995) investigated the relationships of labor standards and the pattern of U.S. imports from ten major developing countries that accounted for 26.5 percent of U.S. imports in 1994. She concludes that:

> Sectors typically identified as having egregious labor conditions do not occupy the only or even the primary share of these countries' exports.
>
> Comparisons across more export-oriented and less export-oriented sectors indicate that core labor standards are often lower in less export-oriented or non-traded sectors such as agriculture and services.
>
> Similarly, within an export-oriented sector, labor conditions in firms more involved in exporting are either similar to or better than those in firms that are less involved in exporting.
>
> Changes in technology and the structure of international trade are leading developing countries to compete in a race upward in terms of product quality rather than a race downward with respect to price.

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[2] See also OECD (2000, esp. pp. 31-42) for further discussion and references.

With respect to FDI, there is evidence indicating that multinational enterprises are not seeking low labor standards. This is borne out by the fact that the vast majority (approximately two-thirds) of all FDI flows each year are between the high labor standards industrialized countries (UNCTAD, 2001). Rodrik (1996, p. 22), concluded that low labor standards may be a hindrance, rather than an attraction, for foreign investors. Aggarwal (1995, p. 7) reached a similar conclusion, as did the OECD (1996, p. 13). Along these same lines, Brown, Deardorff, and Stern (2002, p. 51) concluded in their literature review that "…there is no solid evidence that countries with poorly protected labor rights attract FDI."

We do not ignore the fact that in the past two decades, wages of low-skilled workers in the US (and in many other industrialized and developing countries) have been growing at a slower pace than wages of high-skilled workers. Brown (2000), who has surveyed the relevant empirical evidence on wages and trade in the industrialized countries, found that that there is a preponderance of evidence suggesting, for the US at least, that trade was not the major reason for the observed widening of the skilled/unskilled wage differential. The literature suggests that biased technical change rather than trade may have increased the demand for skilled workers, thus widening the US wage gap. This further suggests that, since imports from developing countries account for a relatively small proportion of total industrialized country imports, trade may more generally have a limited impact on the wages of unskilled workers in the industrialized countries.

Thus, the empirical evidence suggests that there is no basis for claiming that allegedly low labor standards in developing countries have a significantly adverse effect on wages in industrialized countries, provide developing countries with an unfair advantage in their export trade, or distort the geographic distribution of FDI between low and high standards countries.

3.2 Effect on Poor Countries of Raising Labor Standards

If raising labor standards of workers in poor countries will not help protect jobs in the industrialized countries, can we perhaps expect that mandated standards will at least improve wages and working conditions of workers in poor countries? We find this prospect highly unlikely since several of the labor standards being proposed will raise the cost of labor above its level of productivity. As economic theory has shown, workers may suffer negative consequences when their wages are raised above the market value of their productivity. There is a large body of literature supporting this premise. For example, numerous empirical studies using data from around the world have measured the degree to which workers were displaced when mandated minimum wages were raised by different amounts. Given that that the level of the minimum wage has been relatively low and increases small in the US, we see small (and sometimes no) negative employment effects in this country (see for e.g., Brown, 1999 for a review of the US evidence). However in countries where the minimum wage is high and increases are large, the employment effects are significant (see e.g., Gindling and Terrell, 2003, for Costa Rica; and Rama, 2001, for Indonesia). Similarly, protective labor legislation can backfire when the measures are too costly for the employer. Heckman and Pages (2000) have shown that high levels of severance pay have resulted in reducing the hiring rate in some countries in Latin America. In Senegal, attempts to create more secure employment in the Labor Code resulted in a larger share of the workforce employed on short-term (three month) contracts (Terrell and Svejnar, 1989). There is anecdotal evidence of companies being driven out of a sector as unions made very costly demands (e.g., United Fruit in Costa Rica). Finally, child labor laws are often circumvented by the poor families hurt by them.

It is widely known that developing countries are characterized by "dual economies," one part which affords workers employment with higher wages, better working conditions and some labor protection, and the other part (the "informal sector" or the "shadow economy") which resides out of the reach of government regulation and taxation and tends to provide workers poorer wages and working conditions. The imposition of labor standards that are too high (e.g., minimum living wages that are set above the level of labor productivity) will push more workers out of the "formal" sector (which tries to abide by them) and into the "informal" sector, thus exacerbating rather than diminishing the existing inequality in terms of wages and working conditions within the developing countries. By making the poor workers poorer, this policy will lead to a reduction of the true (rather than official) average wage in the poor country – counter to the professed goal.

More generally, we have learned from decades of experience with economic development that imposing "outside" institutions or policies on countries that are not ready for them, is a recipe for failure. Numerous stories abound from the 1960s when modern plants built by a developing country government rusted away as the needed infrastructure, human resources and input markets were not there to sustain them. Unless a country has the resources to uphold these institutions or policies, they will not be sustainable. In sum, there is little compelling empirical evidence suggesting that mandating higher labor standards will improve wages and working conditions in developing countries and some evidence that it may make poorer workers worse off.

4. An Alternative Route

It seems inevitable that the process of globalization will continue and trade and international capital flows will expand. In this process, as countries continue to specialize based on their factor endowments and technology and as economies adjust, some workers will gain and some will lose in the short-run. However, if the process continues to increase the size of the pie (as expected), all workers can gain over time. Hence, we argue that the way to protect workers in rich countries and to improve the wages and conditions of workers in poor countries is not through mandating labor standards which are enforced by the rich on the poor through the WTO or regional and bilateral trade agreements. It is rather to devise economic policies that can help provide new opportunities for workers that may be adversely affected by globalization (in either rich or poor countries) and at the same time improve the earnings of workers in the poor countries.

In rich countries there is a need for public sector involvement to assist workers to transition from jobs in the declining to the growing sectors. This means making sure that displaced workers are given temporary financial assistance and retraining opportunities to take advantage of growing sectors in those economies. Many rich countries already have such programs in place, and there is a continuing need to adequately fund these programs.

In poor countries, it is necessary to continue the many existing economic and social development efforts, deployed by the international organizations (such as the OECD, UN agencies and the World Bank), government aid agencies, NGOs, etc. These organizations must continue to provide both financial and technical assistance to deal with the underlying causes of poverty in poor countries, especially the low levels of education. For example, programs, such as Progressa in Mexico, which have proven to be effective in increasing school attendance among poor children as the poor families are compensated for the child's foregone earnings, are effective in both reducing child labor and providing opportunities for a brighter future for these children. The problem of bad working conditions and poor labor standards can be addressed effectively only in the context of improving opportunities and living conditions.

In addition to these development agencies, multinational corporations (MNCs) are showing they too can play a role. Many MNCs have developed international codes of conduct that can assist in improving labor standards and working conditions in their affiliates and subcontractors in host developing countries. While these codes of conduct are essentially voluntary in nature, and there is no guarantee that they will be effective in all circumstances in developing countries, they serve an important role insofar as they help to focus attention on the importance of the root causes of underdevelopment and the types of business practices that may help developing countries to raise per capita incomes and improve conditions of work.[3]

Finally, the role of consumers in rich countries is worth mentioning. There has been a groundswell among a group of "conscientious consumers" who are willing to pay more for products not made under "sweatshop" or exploitative conditions in poor countries (e.g., fair trade coffee). In this regard, consumer labeling can be used to provide a market-based method for improving labor standards. The advantage of labeling is that it provides information about production processes and allows consumers in making their consumption choices to reflect the satisfaction that they derive from the presumed realization of higher labor standards internationally. An example cited by Arggarwal (1995, pp. 39-40) is the Child Labor Coalition, which was formed in 1989 by several religious, human rights, and union groups and has sponsored the so-called Rugmark campaign that provides producers with a certifying label that they can attach to their exports indicating that they do not employ child labor. A similar labeling system could be extended to clothing and other products.[4]

What is important is that these various public and private actions can be carried out without the coercion that may be involved when efforts are made internationally to influence governments to change their domestic labor-market policies.

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[3] See Brown et al. (2002) for an elaboration of the case to be made for voluntary codes of conduct and an assessment of the role and activities of the Fair Labor Association (FLA) and Workers Rights Consortium (WRC) that monitor the MNC production and sale of clothing articles bearing US university and college logos.

[4] Obviously, firms/countries that do not obtain this labeling will be negatively impacted. However, the higher price that consumers are willing to pay for these goods will provide a market based incentive for firms in those countries to improve working conditions.

5. Conclusions

The motivation for this policy brief has been to consider whether international labor standards should be incorporated into the WTO and other trade agreements. The empirical literature summarized above suggests that mandating unsustainably high labor standards will not improve average wages and working conditions in poor countries. In fact, such mandates can both reduce the number of workers with better pay and working conditions and increase the number in poorer conditions, hence creating further inequality. The literature also shows that low labor standards do not provide developing countries with an unfair advantage in their export trade nor do they drive FDI. Hence, raising labor standards in poor countries will not protect jobs of workers in industrialized countries. What then should be done on the global level?

If one looks at the economic development of the United States, Western Europe, Japan and other advanced industrialized countries over the past century, it is evident that the real incomes of workers have increased dramatically and that the conditions of work have improved concomitantly. In recent decades, there have been similar improvements in a substantial number of developing countries, especially in East and Southeast Asia as well as in Latin America. What the historical record suggests therefore is that it is not through the external enforcement of labor standards that improvements have been realized, but through internal economic and social development and growth in a country's GNP. This means that governments in poor countries must implement solid growth strategies and target policies to eradicate poverty. Governments in rich countries can also help increase demand for poor countries' output by reducing the barriers to imports from these countries. Finally, conscientious consumers in rich countries can also play a small role in increasing demand for products that are not produced by children or sweatshops, while MNCs can ensure their affiliates also follow better labor practices. Although this strategy is more multifaceted and will seem to take longer than mandates, it will achieve the goal of improved labor standards and wages that are sustainable in the currently poorer countries.

As for the rich countries, their governments should assist workers in recognizing they can benefit from the globalization process. Rather than setting up barriers to imports from poor countries and seeking to enforce labor standards in poor countries, efforts should be focused on preparing workers to be more flexible and able to adapt to the evolving global economy. In particular, more resources can be allocated to retraining workers in declining sector jobs so they may unleash their talent in the growing sectors.

The process of economic change is complex and cannot be managed by mandates. The alternative policies we propose will be far more effective in making workers and the economies better off than trying to mandate change.

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