




## Are International Labor Standards Needed to Prevent Social Dumping?

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*International labor standards have become the newest point of contention in trade disputes between industrial and developing countries. Are they necessary or are they disguised protectionism?*

A US PRESIDENTIAL task force composed of apparel industry representatives, unions, and human rights activists recently agreed to codes of conduct for labor practices by multinational corporations; in response to negative publicity, Nike, the athletic shoe and apparel company, hired former US ambassador to the United Nations Andrew Young to conduct an independent investigation of its labor practices; and the Federation of International Football Associations announced it would not buy soccer balls made with child labor. These events point to a growing concern in

industrial countries about labor standards in the developing world. But developing countries have also expressed concern that the industrial countries' new emphasis on labor standards is just protectionism in disguise.

In the first decades after World War II, the developed countries (the North) took dramatic steps toward trade liberalization in the context of negotiations surrounding the General Agreement on Tariffs and Trade (GATT). At that time, most developing countries (the South) were pursuing protectionist import-substitution policies and calling for a new international economic order to redress the alleged unfairness of the international economic system, while remaining, for the most part, on the sidelines of GATT negotiations. More recently, high unemployment rates in Western Europe and stagnant wages of unskilled workers in the United States have contributed to a new ambivalence in the developed countries about the benefits of trade with developing countries. Many fear that Northern wages and benefits are being forced down by unfair competition from countries with much lower labor costs—so-called social dumping. Meanwhile, the experiences of the East Asian miracle countries, along with the collapse of communism, have persuaded much of the developing world and the economies in transition to liberalize trade and participate actively in the new World Trade Organization (WTO), the GATT's successor.

One manifestation of this ironic reversal of positions is the emergence of international labor and environmental standards as a major issue on the post-Uruguay Round trade agenda. Labor unions and human rights activists in developed countries argue that market access in the North should be conditioned on raising labor standards in the South, to prevent social dumping and a "race to the bottom" in wages and benefits. Trade sanctions imposed in response to violations of labor standards are sometimes referred to as a "social clause." Developing countries tend to view such social clauses as disguised protectionism and have fought vigorously against initiatives by the United States and other developed countries to give the WTO a role in the area of labor standards.

### Competition or human rights?

There are two main arguments—an "economic" one and a "moral" one—for the international harmonization of labor standards. The economic argument suggests that low wages and labor standards in developing countries threaten the living standards of workers in developed countries. The moral argument asserts that low wages and labor standards violate the human rights of workers in the developing countries.

Various institutions and countries differ in their precise formulations of international labor standards, but these generally reflect both economic and moral concerns. For example, consider the list of labor stan-

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dards applied in much US trade legislation:

- freedom of association;
- the right to organize and bargain collectively;
- prohibition of forced or compulsory labor;
- a minimum age for the employment of children; and
- a guarantee of acceptable working conditions (possibly including a maximum number of hours per week, a weekly rest period, limits to work by young persons, a minimum wage, minimum workplace safety and health standards, and elimination of employment discrimination).

Such lists blend labor “rights,” such as freedom of association, with regulations on working conditions and wages, which are economic in nature. In this spirit, the International Labor Organization (ILO) and the Organization for Economic Cooperation and Development (OECD) have moved to identify core labor standards around which an international consensus might be obtained. The ILO and OECD core labor standards are very similar to the first four on the US list; the fifth is limited to the elimination of employment discrimination.

Some commentators consequently claim that a near consensus has been reached by the major protagonists to focus solely on a widely agreed set of core labor standards. Although some progress has clearly been made, this view may overstate the extent of agreement. Of course, proponents of the social clause will not usually admit openly to any protectionist intent. But developing countries remain deeply suspicious that disguised protectionism motivates many of the calls for compliance with core labor standards, especially if the latter are to be enforced with sanctions. Some unions and human rights groups in the United States continue to insist that conditions on wages and benefits be attached to agreements on labor standards. A recent US presidential task force on apparel industry labor standards, for example, agreed on anti-harassment and child labor provisions but was deeply divided on the issues of minimum wages and work hours.

In practice, it is not always easy to separate the economic and moral aspects. For example, the OECD’s provision on child labor calls for “elimination of *exploitative* forms of child labor.” Most parents care about their children, and what appears to be exploitative child employment may, in fact, be merely a family’s desperate response to poverty. Limits on collective bargaining may also be defensible at times. In developing countries, unions often

protect a tiny labor aristocracy to the detriment of the remainder of the work force. The principle of nondiscrimination between men and women may not be accepted in some societies.

## Labor costs

According to classical Ricardian trade theory, international differences in labor costs do not preclude mutually beneficial trade. On the contrary, international trade theory suggests that the gains from trade increase with the economic diversity of partners. Fears that high-wage countries are unable to compete with low-wage countries (the sweatshop labor argument) often confuse the fundamental distinction between comparative and absolute advantage. Classical trade theory teaches that overall differences in productivity (absolute advantage) determine wages, while sector-specific variations in productivity and costs (comparative advantages) determine trade patterns.

For example, suppose wages and productivity in Malaysia’s manufacturing sector are both 10 percent of what they are in the United States but that the Malaysian/US productivity ratio is greater than 10 percent in simple products such as textiles and less than 10 percent in sophisticated products like machinery. If skill-adjusted wages are about the same in all industries in Malaysia, as they should be in a competi-

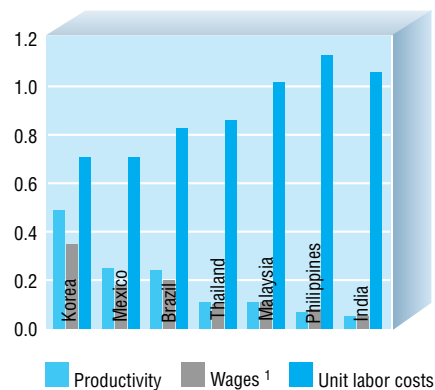
tive labor market, Malaysia’s relative unit labor costs will be low in textiles and high in machinery. If so, Malaysia will export textiles and import machinery. Of course, there are other determinants of comparative advantage besides sectoral labor productivity and labor costs. The important point is that both developed and developing countries benefit from specializing in what each produces efficiently, regardless of the overall level of labor costs.

A key element in this argument is that if low wages reflect low labor productivity, any advantage accruing from employing low-wage labor is offset. Even if nominal wages are rigid (or, as is often alleged, artificially repressed) exchange rate adjustments could offset international differences in costs. Empirical evidence confirms that labor costs and labor productivity are related, although exchange rate movements and other macroeconomic shocks can sometimes induce substantial short-run deviations. The chart shows average manufacturing wages, labor productivity, and unit labor costs (the ratio of wages to productivity) in 1990 for several emerging economies relative to the United States. Productivity and wage levels are closely related—that is, international differences in unit labor costs are much smaller than differences in wage rates suggest—in most cases. In fact, calculations indicate that unit labor costs in several emerging economies in 1990 were actually higher than those in the United States—the productivity gap is even bigger than the wage gap. There is also evidence that wages and productivity generally move together over time. For example, Korea had the most rapid productivity growth and the highest wage growth.

The unfair standards argument often focuses on fringe benefits and safety conditions, rather than wages, but it also confuses comparative and absolute advantage. First, for a given level of labor costs, the division between wages and fringe benefits is largely irrelevant for international competitiveness, although it may not be a matter of indifference to workers. Second, wages are the most important component of labor costs even in developed countries. Third, mandating increases in fringe benefits, such as vacation and maternity leave, may simply alter the composition of labor compensation and not its total size. Fourth, even when they do affect labor costs, weak labor standards, like low wages, are likely to be a consequence of low productivity and poverty, not an independent source of international comparative advantage. Economic development, cultural differences, or

**Developing country labor productivity, wages, and unit labor costs, relative to the United States, 1990**

(United States = 1.0)



Source: Author’s calculations.

<sup>1</sup> Wages here are for the manufacturing sector. They include fringe benefits received by workers (for example, maternity pay and payment in kind) but exclude employer contributions to social insurance funds, owing to lack of data for the developing countries. To the extent that such employer contributions account for a larger share of labor costs in the United States than in most developing countries, US labor compensation is understated, relative to compensation in those countries. Any such understatement is limited, however, since employer contributions account for only about 20 percent of US labor costs.

other national preferences may give rise to different choices about labor standards. These national characteristics, along with factor endowments and other more traditional forces, determine national comparative advantage. Low labor standards and low wages both reflect the abundance of unskilled labor and low productivity in developing countries.

The volume of trade is also inconsistent with fears about the competitiveness of low-wage countries. The table shows trade in manufactures with industrial countries for some newly industrializing economies. Exports of manufactures from developing countries to the North have increased rapidly, but the majority of these countries continue to run trade deficits in manufactures, since their imports have grown nearly as much as their exports. For many of these developing countries, manufacturing trade with the industrial countries is now quite large in relation to their national outputs (Brazil and India are exceptions). North-South trade in manufactures is, on the whole, much more important for the

South than for the North, as measured by its share in their respective GDPs.

## Human rights

Human rights activists believe that raising labor standards in developing countries will benefit workers in these countries and that some labor practices are morally intolerable. To analyze these concerns, it is important to separate labor standards relating to conditions of work—such as minimum wages, health and safety benefits, hours, and, possibly, the minimum age of employment—from labor rights—such as bans on forced labor, harassment, and discrimination.

Everyone agrees that improving living standards in the South is desirable. The question is how to achieve this. Attempting to mandate certain labor market processes, such as the setting of minimum wages, under conditions where they are inappropriate may not improve labor market outcomes. Most developed country labor standards are simply not feasible for many developing countries. Consider again the

difficult problem of child labor. It is indeed deeply disturbing that young children in developing countries toil under harsh conditions for low pay. But the earnings of these children may be important to their families'—and their own—survival. Further, setting strict standards in a developing country's formal sector may consign children to even more degrading and less remunerative work in the informal sector.

Many developing countries do, in fact, have detailed labor standards, but these may cause more harm than good. In the North American Free Trade Agreement (NAFTA) debate in the United States, it was widely recognized that Mexico's legislated labor standards are, in fact, stronger than those of the United States and Canada, although enforcement of them is often weak. Labor market regulations such as minimum wages are often cited as a major contributor to the problem of economic dualism—the twin evils of excessively high wages and high unemployment in urban areas—in developing countries.

The pursuit of trade and labor market policies conducive to high growth is far more effective in raising incomes than mandated levels of wages and benefits. Such growth-oriented labor market policies need not follow a laissez faire approach. Government investments in education and training, in particular, are likely to be beneficial. Loss of access to markets in the developed world hamper the growth prospects of developing countries and thereby retard the upgrading of their labor standards. Trade sanctions are thus likely to be counterproductive as a means of encouraging improvements in such standards.

National labor market policies may at times enhance both efficiency and equity by remedying market failures. But why should this problem not be left to each country to decide for itself? One frequent argument is that the nondemocratic political regimes in much of the South prevent the expression of the public's true preferences. Even if it is accepted that a developing country is not democratic, it does not follow that developed countries can legitimately impose higher standards or that doing so will raise welfare in developing countries. Instead, a more direct and effective method of expanding the public's voice in setting standards would be to encourage the spread of democracy in the developing world.

Finally, if the goal is to enhance the welfare of the South, trade sanctions hardly seem an appropriate and effective approach. T.N. Srinivasan points out that the most effective way of raising standards for

### Developing and industrial country trade in manufactures

(percent of developing country GDP)

		Exports to industrial countries	Imports from industrial countries	Trade balance
Brazil	1970	0.3	2.8	-2.5
	1980	1.1	2.2	-1.1
	1990	2.2	1.5	0.6
	1995	1.7	3.1	-1.4
China	1990	2.6	3.8	-1.2
	1995	8.8	7.7	1.0
India	1980	1.1	1.8	-0.7
	1990	2.1	2.2	-0.1
	1995	3.8	3.3	0.5
Indonesia	1970	0.1	5.0	-4.9
	1980	0.5	6.3	-5.8
	1990	4.8	8.5	-3.7
	1995	6.4	8.7	-2.2
Korea	1970	6.1	9.8	-3.7
	1980	14.3	11.4	2.9
	1990	15.2	11.6	3.5
	1995	12.3	13.9	-1.6
Malaysia	1970	8.0	13.6	-5.5
	1980	9.3	19.1	-9.8
	1990	19.1	31.3	-12.2
	1994	33.2	45.0	-11.8
Mexico	1970	0.8	4.3	-3.4
	1980	0.7	5.7	-5.1
	1990	3.7	6.8	-3.1
	1995	19.3	16.8	2.5
Thailand	1970	1.3	9.6	-8.3
	1980	4.2	9.4	-5.2
	1990	10.7	17.3	-6.6
	1995	12.8	21.9	-9.1

Sources: United Nations Trade Analysis and Reporting System trade database; IMF, *International Financial Statistics*.

workers in developing countries would be to allow free international migration from low- to high-standard countries, an argument rarely made by proponents of harmonizing labor standards. Even if immigration is judged infeasible, direct income transfers, which could be used to upgrade living standards in the South, would be both more consistent with a humanitarian motivation and more economically efficient.

Some labor practices—most obviously slavery and harassment of workers—are almost universally regarded as unacceptable. However, as noted earlier, international consensus on the treatment of unions, child labor, and discrimination based on gender may be impossible. Without a clear basis for international agreement, enforcement of international labor standards could degenerate into protectionism.

Another argument against harmonization of basic labor rights is the arbitrariness of focusing on labor rights to the exclusion of other human rights problems, such as lack of freedom of expression. The focus on labor rights, rather than human rights in general, suggests that economic considerations, more than ethical concerns, underlie some of the calls for harmonization of labor standards.

## Policy issues

Regardless of the merits of the competitiveness and human rights arguments for harmonizing labor standards, there is considerable popular support for them in the United States and other developed countries, as indicated by a series of recent agreements made by companies to voluntarily raise labor standards in their foreign operations. Some such steps may be necessary to maintain the legitimacy of the global trading system. Popular support for open trade, especially with developing countries, is likely to be more fragile than for many other market relationships.

**International agreements.** The ILO, founded in 1919, is responsible for establishing and monitoring international labor standards. It has no power to impose trade sanctions for violations of standards but relies, instead, on voluntary compliance and peer pressure. The ILO brings together representatives of governments, labor organizations, and employers, and drafts conventions on labor standards subject to ratification by member countries. There are over 170 international labor conventions in force, although the number of countries that have ratified each convention varies considerably. Countries are bound to abide by any conventions they have ratified and are

subject to regular supervision by the ILO. The ILO is empowered to investigate complaints about a country's violations of a convention made either by the country's own labor or employer organizations, or by another country. The ILO provides guidance and technical advice while seeking a cooperative solution. The ILO's tripartite structure, experience, and large membership make it well suited for consensus building.

The mandate of the International Trade Organization (ITO), as enunciated in 1947 by the Havana Charter, called for countries to take measures against "unfair labor conditions." But the ITO was never implemented. It was replaced by the less ambitious GATT, which virtually ignored the issue of labor standards, except for a provision allowing countries to impose trade barriers on goods produced with prison labor. In recent years, greater pressure for enforcement of international labor standards has emerged in the United States and some European countries. Repeated attempts to include violations of labor standards among the responsibilities of the new WTO have been turned back in the face of very strong opposition from developing countries. It is clear that international agreement on the use of trade sanctions for enforcing adherence to labor standards is out of the question at present.

**Product labeling.** As Richard Freeman has emphasized, consumers can set a market price for labor standards through organized boycotts or individual purchasing decisions. The main market failure is consumers' lack of information about workplace conditions. Public or private organizations can fill this gap, and, indeed, human rights organizations already do this. Producers may be very responsive to such concerns, since even moderate losses of market share can strongly affect profitability. Moreover, firms show, through their philanthropic contributions and some of their advertising, that their public images are important to them. They therefore have an incentive to monitor themselves. Given the danger of protectionist abuse of, and lack of consensus on, trade sanctions, the flexible and voluntary nature of product labeling is an advantage.

**Corporate codes of conduct.** A complementary proposal, forcefully made by Jagdish Bhagwati, is for multinational companies to adhere to the same labor standards abroad that they follow at home, either unilaterally or through an OECD code. Some developed country standards that set minimum wages and working conditions are inappropriate for developing

countries. But in other cases, such as child labor laws and worker safety, the case for international codes of conduct is stronger. While developed country standards may impose costs based on a strictly economic point of view, instituting codes of conduct regarding basic labor rights provides offsetting benefits by responding to the perceived moral problems posed by certain practices. Efforts by both developing countries and private firms to adhere to some of these core standards are unlikely to impinge severely on trade patterns. Developing countries must weigh the increased support for open markets in the North against the costs of enforcing labor standards. The South has a very high stake in maintaining access to markets in the North and hence in forestalling protectionist pressures.

Codes of conduct and product labeling regarding basic labor rights and some particularly controversial workplace practices are less intrusive ways of addressing the calls for international harmonization than trade sanctions. Compliance should be voluntary, but the importance for companies of moral pressures and product images should not be underestimated.

More fundamentally, Europe and North America must seek more effective ways to implement policies that improve labor market conditions for the poor and the unskilled. International trade and technological change increase national income and potential welfare, but the gains can be highly skewed. These societies need to find ways both to improve labor market flexibility and to ensure that the gains from structural change are broadly shared. Otherwise, calls for protection are likely to increase.

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