

# International Workers' Rights and Competitiveness

**Paper to be presented at GLU-Conference "Labour and the Challenges of Development" at the University of the Witwatersrand, Johannesburg, South Africa, 1-3 April 2007**

## Abstract

Core workers' rights are violated on a massive scale world wide. Most violations take place in production for domestic consumption; nevertheless, about 10 percent of products traded internationally originate from countries that repress workers' rights systematically. If standards are as beneficial as some claim, why are they not voluntarily adopted? Some of the motives for not signing on to the ILO conventions are political. There are also economic reasons. While the "high road" promises long-term benefits, it may incur short-term costs. While attempts to assess the cost impact of adherence to ILO conventions have not delivered reliable results thus far, even small differences in production costs can be expected to be decisive for market success. Most export goods from developing countries are sold to wholesalers or transnational corporations, which command a strong market position vis-à-vis the producers. This competitive situation, however, is the very reason why social standards have to be negotiated internationally. As long as it is possible for an economic region to gain competitive advantage by undercutting the social standards in other regions, these other regions are in danger of losing market share and hence employment opportunities. The greater the similarity between the competing regions with regard to factor endowment and market position, the more acute is this danger. It will be particularly high if market success depends on a single factor, namely low-skilled labor. In such a case, the danger from lower standards cannot be offset by other factors. This situation is particularly true of developing countries, which face the constant risk that new regions with an even larger reservoir of cheap labor will break into the world market. For these reasons, developing countries cannot raise their social standards in isolation but only in conjunction with other countries by multilateral agreement. There is no need to fear a decline in the overall demand for goods from the developing countries, as their long-term growth depends primarily on the training level of their workers and on transfers of technology. International standards can therefore plausibly be justified in terms of development theory.

## Economic Justifications for International Workers' Rights

The debate about international workers' rights revolves primarily around the introduction and raising of standards in developing countries. Workers' rights, therefore, can also be justified by the contribution they make toward enhancing these countries' prospects of industrialization. Opponents of internationally enforced workers' rights see them as an

obstacle to closing the industrial gap. They argue that better living and working conditions cannot be legislated but would be the natural outcome of industrialization. Economic development and respect for human rights would be best promoted by ensuring that the trading system was as free as possible (Srinivasan 1996; Bhagwati 2000; Krugman 1994).

## **Do Higher Standards Follow Trade Liberalization?**

Does the development and expansion of the export sector necessarily lead to an improvement in living and working conditions? Apparently not. In many countries of the South, the liberalization of foreign economic policies went along with increasing social inequalities and a massive expansion of the informal sector, where labor rights are generally violated (Altvater/Mahnkopf 2000: 317-363, Marjit and Maiti 2005). In many of the multiplying export-processing zones, the right of freedom of association is restricted (OECD 1996: 41). The Caribbean is a striking example: Despite a massive increase in export production and in employment, working conditions did not improve; on the contrary: wages fell. Harsh competition on the world market made the export success of Caribbean countries dependent on low wages, which were enforced by credible threats to relocate (Frank 1998: 168-176; Portes 1994: 168). The Indian export boom for hand-made carpets merely led to the spread of child labor, not to better working conditions. In other countries with high export growth, like Thailand, the use of child labor also increased (Haas 1998: 76-81; ILO 1998). Even in a country that experienced the economic miracles of the eighties, such as South Korea, a visible improvement in living standards and in securing labor rights was achieved only as a result of very hard trade union campaigning (Ch'oe 1989).

An OECD study entitled *Trade, Employment, and Labour Standards: A Study of Core Workers' Rights and International Trade* (1996) attempted to find out whether trade liberalization precedes freer association rights. It looked at those 44 countries that put into place a major trade-reform program between 1980 and 1994. In fifteen of these countries, free association rights tended to improve at least three years after the start of trade reforms. Better association rights preceded the trade reforms by at least three years in nine countries. The two processes began about the same time in eight countries. In six countries trade reforms were pursued without any observable improvement in association rights. The sample information was insufficient for the remaining countries. In sum, no single pattern was dominant. Such inconclusive empirical evidence at the level of aggregate cross-national comparisons has also been found for the linkage of transnational corporations and human rights in their host

countries (Meyer 1999; Smith et al. 1999). These findings support the theoretical assertion that the extent of benefits of trade and investment liberalization critically depends on the institutional context (Palley 1998).

## **Neoclassical Defense of Workers' Rights**

The question whether international workers' rights are economically justified touches upon the fundamental economic understanding of the nature of the market as a social regulatory mechanism. In highly simplified terms, the various concepts of the market can be reduced to two paradigmatic approaches: the neo-classical and the neo-institutional "schools" (Kochan/Nordlund 1989).

From the neo-classical standpoint, welfare-increasing efficiency gains can be achieved in foreign trade only if unhindered trade permits product specialization on the basis of comparative cost advantages. Even in the case of infant industries, protection is considered to be a suboptimal policy. Any domestic distortions should be addressed by subsidies, rather than protection (Johnson 1965/1987). The neo-institutional approach, by contrast, points to the destructive potential that market mechanisms can have in trade between nations because of the absence of a central regulatory authority at an international level. According to that view, foreign trade should therefore be flanked by domestic social legislation and regulated externally by multilateral agreements (Piore 1994).

The criticism of social standards from a development perspective comes in two forms. The "hard" variant takes the position that industrial development requires a repressive employment regime. It is put forward by Gary Fields but enjoys little support in the economic profession. The "soft" variant only demands that the employment regime contains no minimum standards that slow down development. It enjoys support among the majority of neoclassical economists.

The soft variant of the criticism takes issue with international standards mainly in the areas of pay, health, and safety at work (standards under consideration for some codes of conducts and social labeling programs), but also in the field of workers' rights. As a rule, it is argued that every officially imposed increase in production costs harms the prospects of sales in the world market, and hence the development prospects of the countries concerned. Every increase in labor costs supposedly jeopardizes the developing countries' main comparative advantage, namely abundant labor.

Core workers' rights can, however, also be justified within the neoclassical paradigm, mainly as responses to specific market failures. For example, freedom of association is a means to counterbalance the market power of employers. The bargaining power of an individual worker may be very limited faced with a powerful corporate employer or group of employers. The prohibition of forced labor and the exploitation of children belongs to the core principles of the neoclassical market order: the market is defined as an exchange of goods among free persons. Furthermore, the adherence to these rights can enhance market efficiency. If discrimination is practiced, employment and earnings opportunities are allocated based on considerations not related to how well someone does a job. Anti-discrimination measures may facilitate the employment of individuals in jobs for which they are best suited (Swinnerton 1997). Collective bargaining institutions allow efficiency gains by encouraging workers to share their views with management about the running of the enterprise (OECD 1996: 79-81; Freeman/Medoff 1984; Hansson 1983: 45-66).

Market failure is also to be found on the world market. Due to the leveling effect of competition, violations of core workers' rights in some countries can lead to their disrespect in one's own country (Leebron 1996: 54). In the extreme, a race to the bottom can ensue, pushing the standards of all trading partners to the lowest level. Most neoclassical economists reject the argument of a "race to the bottom" (e.g., Klevorick 1996). The term "destructive competition," however, has been used within the neoclassical paradigm (Bator 1958; for a discussion within the debate on international labor standards, see Krueger 1996). If, for whatever reason, market exit is difficult, supply might stay the same or even expand despite lower prices. Destructive competition takes place in the labor market when workers offer their labor power at wages that do not cover their reproduction costs. Reproduction costs cannot be determined precisely. They are dependent on the level of economic development, social status, and customs. A well-paid manager who suffers a heart attack before her retirement due to work-related stress, has given too much of her labor power. An industrial worker who cannot afford to send his children to vocational training programs, has not given his labor power according to his reproduction needs.

Rapid population growth contributes to a structural oversupply of labor power in the non-OECD world. Insufficient social standards are among the causes of population growth, especially the discrimination of women in education and in occupations. Without welfare measures for old age, having a large number of children may remain attractive. Even without population growth labor power can be in oversupply. This is the case when industrial agriculture or world-class manufacturing meets subsistence or traditional industry. The

displacement of the low-productivity subsistence agriculture or of inefficient industry (which had been protected by high transport costs or high tariffs) can release workers faster than the more productive market-oriented agriculture or modern manufacturing industry can absorb. This oversupply of labor power is exacerbated by impediments to market exit. In the case of manufacturing plants, market exit will be postponed because of sunken costs. In agriculture, non-economic motives, such as the preference for independence and emotional ties to the soil, frequently lead to postponing the inevitable, i.e. abandoning the farm. The “doubly free” wage laborer usually lacks an alternative to wage labor. Once the subsistence economy has been left, return is almost impossible. For one, the subsistence agriculture will be pushed from the more fertile soil by the more productive industrial agriculture. The remaining pockets of subsistence agriculture will increasingly be less able to support its population and even less any returnees from urban areas. The other reason is that those who have left frequently find the hard work in traditional agriculture even less attractive than a life on the margins of big cities.

The lack of a social safety net as well as falling wages increase the need to expand the supply of labor power. Without corrective intervention, the impoverishment of large segments of workers can turn into a self-supporting downward spiral: an increase in labor supply forces real wages down, lower wages in turn increase the labor supply in the next round. In the extreme, children are forced to work in order to secure the survival of the household. The more children are employed, the more adults are made redundant, which in turn forces them to send their daughters and sons to work. If the budget for education were to be cut because of a debt crisis, the number of children working would increase. This causal connection has been well documented for Peru (Pollmann/Strack 1995: 26-27) and for Thailand after the Asian currency crisis (ICFTU 1999).

In order to restore an economic equilibrium according to market logic, some suppliers have to exit the market. Some neoclassical welfare theorists have rejected this solution even in the case of industrial plants. They argue that if the momentarily underutilized capacities would find demand at a later point in time, but if at that time it would be very costly to rebuild these capacities, then the regulation of competition is justified (Kahn 1971: 175). Market exit is not a viable solution for most wage earners for the above-mentioned reasons. Therefore, the regulation of competition is to be preferred, i.e. limitations on working time. In a historic perspective, this has been the answer to the oversupply of labor power during industrialization: the struggle for the eight-hour day, the prohibition of child labor, and (from today's viewpoint more problematic) the displacement of women from gainful employment. If

such collective solutions are not available, the destructive competition can cross borders via trade (see below).

Most opponents of international workers' rights, however, consider lower standards as a result of international competition legitimate. To the neoclassical economist, there is an international market in state regulation. In such a market, mobile capital would be the purchaser and the individual authorities the suppliers. This, however, leads to circular reasoning: The market is designated as the mechanism for determining the regulatory scope of the market (Langille 1996).

## **Neo-institutional Arguments: Workers' Rights for Sustainable Development**

From a neo-institutional perspective in economics, workers' rights contribute to long-term sustainable development. Both demand-side and supply-side arguments are put forward to demonstrate the stimulatory growth effects of workers' rights. From a demand-oriented perspective, highly unequal income distribution is regarded as an obstacle to development. First, it is argued that such inequality impedes the emergence of a mass market in durable consumer goods so that developing countries cannot emulate the "Fordist" growth model of the United States and Western Europe. Second, the concentration of national income in the hands of a few people produces an excessively high savings ratio, so that growth-stimulating investment is too low. It also increases the likelihood of capital flight. Throughout the 1980s, profits from investments in Latin America were not reinvested fully, but largely transferred abroad (Altvater 1992: 219-236). Freedom of association and the right to collective bargaining are necessary preconditions for a more equal distribution of income (Rothstein 1993: 1-2).

The supply-side neo-institutionalists cite two reasons why minimum social standards and resulting higher wages have a positive effect on a country's economic development prospects. First, higher wages promote the development of "human capital," without which no economic development is possible. Wages close to or below the minimum subsistence level make it impossible for workers to invest in their own education, or that of their children, and are often insufficient to pay for necessary health care. Higher wages, on the other hand, would not only enable workers to maintain and enhance their qualifications but would also increase the incentive to attend school and to adopt performance-oriented behavior (Sengenberger 2002). There is evidence that the early involvement of children in work can have serious

consequences for their health and development (Forastieri 1997). Furthermore, a study among Indian carpet weavers showed that 95 percent of parents who sent their children to work were illiterate and had been forced themselves to work while growing up (Haas 1998: 65-68).

Second, they argue, social standards are necessary for making the transition from an extensive to an intensive use of labor. Under the prevailing system of sweatshops, employers have no particular interest in using labor intensively because, first, workers are paid on a piece basis and hence no fixed labor costs arise, and second, their capital stock is usually small and consists of outdated machinery that cannot be used more efficiently. The resulting low labor productivity in turn precludes raising wages. In such a situation, minimum social standards could increase interest in measures to raise productivity by changing the structure of incentives for firms and workers. For firms, they would make the extensive use of labor less attractive; for workers, they would make it more rewarding to strive for the success of the firm. If, for instance, a strategy of “flexible specialization” is to succeed, certain preconditions must be met that ensure that workers can earn better wages, show themselves to be cooperative, and acquire professional qualifications. Social standards could help create those preconditions (Piore 1994). For example, as the minimum wage in Puerto Rico increased, turnover and absenteeism declined, job applicants were more thoroughly screened, and “managerial effort” improved (Card/Krueger 1995: 247).

Neo-classical economists doubt whether a minimum wage could eradicate the sweatshop system; they consider it more likely that a minimum wage above the market-clearing price would lead to unemployment and a growing informal sector. If the efficiency wage argument were applied, firms would voluntarily make it the basis of their system of remuneration. The strategy of “flexible specialization” therefore requires no special regulation. In their view, the resolution of the classical tension between a system of incentives and productivity on the one hand and the impermissible withdrawal of labor and free-loading on the other, depends mainly on the production technique and on preferences such as between work and leisure, risk and the employment regime, including the prevailing ideology (i.e., worker morale; Srinivasan 1990: 68-69). It has to be asked, however, whether these latter factors are not precisely those conditions that the neo-institutionalists consider necessary for the strategy of “flexible specialization” and that have to be set politically.

## **Head-to-Head: South-South Competition**

If standards are as beneficial as it is claimed, why are they not voluntarily adopted? While many countries have ratified ILO conventions (180 countries were members of the ILO as of February 2007), the new export nations in particular have been slow to follow suit. Some of the motives for not signing on to the ILO conventions are political in character. Dictatorships have good reasons to believe that trade unions might become places of government opposition (e.g. Solidarnosc in Poland). There are also economic reasons. While the “high road” promises long-term benefits, it may incur short-term costs. The amount of these costs, their impact on competitiveness, and their long-term rewards are difficult to appraise.

In a theoretical exercise, Peter Dorman (1995) attempted to gauge the impact of the adherence to core workers’ rights on labor markets. He came to the conclusion that the implementation of these rights will lead to an expansion of those labor-market segments that pay higher wages. For example, the prohibition of child labor will lead to wages above the level paid previously for adults. For one, the elimination of competition from forced (child) labor will allow higher wages. In addition, if freedom of association exists, adults will be more likely than children to obtain better working conditions and wages through collective action. This argument has been confirmed by the experience of an Indian exporter of carpets, OBEETEE, in the 1970s. This firm had experimented with the production of carpets in large-scale workshops without child labor. After a short while, the newly hired adults organized an union and pressed successfully for higher wages. The firm reacted by restoring child labor (Haas 1998: 80).

In a next step, in an attempt to assess empirically the impact of core workers’ rights, Dorman used a simple regression analysis of labor rights and manufacturing wages in a sample of developing countries. His results suggest that increases in these rights were associated with increased wages. Because of numerous data shortcomings, however, he professed not much faith in his results (1995: 27). Trade economist Dani Rodrik had more confidence in a similar method. He calculated that going from no child-labor legislation to having such legislation is associated with an increase in annual labor costs of \$4,849-\$8,710 per capita. Yet he admitted that his indicator on child labor may capture other effects as well (Rodrik 1996: 52). In contrast to Rodrik, ILO studies conducted in India suggest that, as a portion of the final price of carpets or bangles to the consumer, any labor-cost savings realized through the employment of children are surprisingly small – less than 5 percent for bangles and between 5 and 10 percent for carpets (Anker et al. 1998).

However, the likelihood of higher wages does not automatically translate into higher production costs. According to the neo-institutional argument mentioned above, the



observance of labor rights will lead to greater efficiency, which compensates for higher wages. The previously mentioned OECD study has made an attempt to assess whether freedom-of-association rights lead to higher prices for the respective goods. U.S. import prices of textiles served as its empirical base were. The study revealed that the prices of imports from developing countries tend to be rather uniform, even though the degree of enforcement of freedom-of-association rights varies substantially among these countries. Similarly, export prices of hand-made carpets do not reflect the use of child labor, since the export price of a hand-made carpet ranges from over \$40 in China to almost \$70 in Nepal, where child labor is reportedly pervasive (OECD 1996: 102-104, 138).

In what ways export prices are supposed to reveal differences in production costs remains the secret of the OECD authors. In a competitive market it would be quite surprising if prices were to differ much among similar products. Furthermore, little insight can be gained by a static price comparison, unless differences in quality, changes in market share over the previous years, and the hypothetical production costs of Nepalese carpets in the absence of child labor are known. The lower prices of Chinese carpets, for example, went along with a much greater market share; just as economic logic would have it (*ibid.*).

In sum, attempts to assess the cost impact of adherence to ILO conventions have not delivered reliable results thus far. Given that most export goods from developing countries are sold to wholesalers or transnational corporations, which command a strong market position vis-à-vis the producers, even small differences in production costs can be expected to be decisive for market success. The competition among the countries of the South has not received nearly as much attention as the North-South trading relationship. Therefore, empirical evidence is scant. However, there is some evidence that in a number of product lines fierce competition has led to an environment conducive to violating core workers' rights. For example, the trade in hand-made carpets is dominated by just a few firms. They exert massive pressure on the producers. A survey of carpet importers in a United States city found that, if the price of carpets in India rose by more than 15 percent, the importers would stop buying them from that country (Levison et al. 1996). In the early 1970s, Indian producers replaced the traditional market leaders of Iran. The Iranian export prices had gone up because of a literacy campaign, rising income levels, and an appreciation of the Iranian currency. In the 1980s, Indian producers in turn came under pressure from Chinese, Pakistani, and Nepalese carpet makers. Increased use of child labor and a weak currency allowed them to defend their market position (Haas 1998: 71-87; Große-Oetringhaus 1995: 178).

In the last two decades, competition among emerging economies has increased considerably. Half the world's population lives in five low-income Asian countries: China, India, Indonesia, Pakistan, and Bangladesh. In the 1960s and 1970s, all of them were largely closed to trade, and thus their workers did not stand in international competition to each other. By the mid 1980s, Indonesia and China were opening up to trade, and the others followed in the 1990s. An analysis of the product range exported from Asian countries to the United States, Japan, and the European Union revealed a striking similarity in export specialization among a number of Asian countries. For example, on a two-digit level of industrial classification (SITC), 53 percent of exports from India and 62 percent from Thailand were similar to those from China in 1997 (BIS 1999). Throughout the 1990s, China seems to have expanded its market share in the United States at the expense of its Asian competitors, at least in relative terms (Rosen 1999; Noland 1998). The Bank of International Settlements identifies this competitive strength of China as one of the reasons for the Asian currency crisis, which started in Thailand in 1997 (BIS 1999: 127). Adrian Wood argues that the movement away from labor-intensive manufacturing in South Korea, Hong Kong, Taiwan, and Singapore (the so-called Four Tigers) was accelerated when other East Asian countries with lower wages (especially China) also adopted export-oriented policies. This competition tended to reduce the wages of unskilled workers in the Four Tigers, with the exception of Korea, where the massive expansion of higher education led to a decline in the number of unskilled workers (Wood 1999: 169f; 1994: 241-246). Raul Picard, the president of the Mexican national manufacturing industry chamber, Canacindra, recently proclaimed that the entry of China into the World Trade Organization will result in the loss of 60 percent of small- and medium-sized companies in Mexico (Daily Brief, June 16, 2000, Vol. 49, Issue 12, <http://brief.tradecompass.com/>).

The Chinese competitive threat is likely to continue. While the Four Tigers displayed rapid wage convergence with the U.S. until the Asian crisis in 1997 (from five percent of the U.S. wage level in 1975 to 46 percent in 1996 in the case of South Korea, the most impressive increase among the Tigers), the vast size of the Chinese workforce will prevent wage convergence with China any time soon. In the years from 1980 to 1996, Chinese wages remained below four percent of the U.S. level (Erickson/Mitchell 1998: 165, 168-169).

The "soft" objections to internationally enforced core workers' rights ultimately rest on the argument that adherence to these rights will push wages above the market-clearing price, which in turn will threaten the competitiveness of firms. This threat to competitiveness, however, is the very reason why social standards have to be negotiated internationally. As

long as it is possible for an economic region to gain competitive advantage by undercutting the social standards in other regions, these other regions are in danger of losing market share and hence employment opportunities. The greater the similarity between the competing regions with regard to factor endowment and market position, the more acute is this danger. It will be particularly high if market success depends on a single factor, namely low-skilled labor. In such a case, the danger from lower standards cannot be offset by other factors. This situation is particularly true of developing countries, which face the constant risk that new regions with an even larger reservoir of cheap labor will break into the world market. For these reasons, developing countries cannot raise their social standards in isolation but only in conjunction with other countries by multilateral agreement.

### **At the Margins: North-South Competition**

The above argument runs counter to public discourse on globalization. The effects of globalization are usually discussed in a North-South perspective. Most studies focus on how increased trade with developing countries affects wages and labor standards in industrial countries. A number of advocates for international workers' rights have singled out the South as the main threat to the working and living conditions achieved in the North. It is argued that for some years now producers in OECD countries have encountered increasing competition from firms producing in countries with far lower wages, fewer social benefits and rights of co-determination, as well as fewer environmental requirements. If productivity were more or less equal, this competition would drive industry to the wall in the existing industrial countries. If this occurred more rapidly than the structural shift toward higher-value products and services, as these advocates fear, the existing level of social standards in the OECD countries would come under great pressure. The former U.S. Labor Secretary Ray Marshall summarized this argument succinctly when he stated that "bad standards tend to drive out good standards" (Marshall 1994: 72).

From the perspective of the classical theory of comparative cost advantages, however, a welfare gain generally stems from trade between unequal economic areas, each specializing according to its particular comparative advantage. Specialization increases the efficiency of production, which benefits all market participants (Hufbauer 1989).

Objections to classical theory have been raised on theoretical grounds for some time, but it was not until incontrovertible empirical evidence emerged from the U.S. that the advocates of free trade had difficulty justifying their stance. It was found that real wages in the U.S. had

fallen (by 7.8 percent between 1980 and 1990) at the same time as the US economy was becoming more open. The decline in real wages of low-skilled workers was particularly pronounced (16.9 percent; Juhn/Murphy 1995, p. 27).

This divergence in wage income distribution corresponds with the Stolper-Samuelson theorem, which states that the dismantling of trade barriers leads to an equalization of factor prices in the countries involved. The income of the relatively scarce production factor will fall as the latter becomes less scarce as a result of trade. Applied to trade between industrial and developing countries, this theorem leads one to expect that the pay for low-skilled workers in industrialized countries will approach the level obtained in developing countries. Numerous studies have been carried out to prove or disprove the Stolper-Samuelson effect. Recently, a number of authors who are generally supportive of the free trade argument have conceded that trade did contribute to a further widening of wage income differentials between low-skilled and high-skilled workers in the United States. However, they maintain that increased automation of production is a much more important factor and that trade shares its role with immigration (Rodrik 1999; Cline 1999; see also Brauer/Hickock 1995; Borjas et al. 1992). Furthermore, some studies have begun to distinguish between the effect of OECD and non-OECD competition. Edward Leamer, for example, is inclined to think “that the threat of competition, not from the low-wage Asia, but from Japan and Korea was an important part of the story in the 1980s” (Leamer 1999: 149). This view corresponds with research on the effect of foreign competition in the two industries that contributed most to the U.S. trade deficits in the 1980s: automobile and steel (Scherrer 1992).

The work of Leamer confirms the previously stated insight that the greater the similarities between competing regions with regard to factor endowment and market position, the fiercer the competition among them. In comparison to the impact of noncompliance of core workers' rights among the developing countries, the North-South impact appears to be small.

## **Will the South Suffer Under Global Rules?**

The objective of global rules for workers' rights is to take them out of the competition among producers. If efforts succeed to make these rules binding for every country, the competitive situation among countries will change. Individual countries will no longer fear that they will suffer competitive disadvantages by adherence to these rights. Instead, they will be able to assume that their labor competes under similar conditions.

The need for international agreements is demonstrated particularly well in the case of child labor. Some authors see only two alternatives for children in economic problem areas: work or starvation. Since exploitation is better than starvation, they opt against prohibiting child labor (Freeman 1994: 89; Bhagwati 1994: 59). However, such harsh alternatives exist only under *ceteris paribus* conditions; that is, when the rules for competition have not changed. If child labor were to be prohibited in just one region in, say, carpet weaving, there is of course the risk that the carpet companies in that region will lose their market share. By contrast, if child labor were to be prohibited in all regions, then a loss in market share is not likely. Then family living wages could be paid to adults. Indian carpet makers would no longer be in competition with Pakistani carpet makers on labor costs but with industrial manufacturers of carpets. In this hypothetical case, the risk is whether the higher prices for carpets, which all carpet makers could charge, would lead to a diminishing overall demand for hand-made carpets.

To answer this question, the substitution or demand elasticity has to be known. Experts are not of one mind concerning the degree of demand elasticity for products from the South. Adrian Wood assumes that the demand in the North for products of the South does not react to price because most products of the South are no longer in direct competition with those of the North. He therefore estimates that an increase in prices by one unit would cause a decrease in demand by just one half of a unit (price elasticity of demand of 0.5; Wood 1994: 144). Robert Lawrence, on the other hand, has calculated that one-unit price increases reduce demand by 1.7 units (1996: 45-51).

Even if a "correct" value for the price elasticity of demand could be established, it would probably not reflect the reality of many exporters in the South. The elasticity of substitution and demand would vary considerably from product to product. Hand-made carpets, handicrafts, and tropical agricultural products can be substituted by products from the North only to a limited degree. Thus demand for these goods is rather insensitive to changes in prices. The income elasticity of demand for these products will be quite high, since they do not belong to the group of staple goods. The demand for these goods will depend on the business cycle. Furthermore, their production costs are rather low relative to the final sales prices. For some brand-name products, production costs are unrelated to sales prices. The most telling example is that set by the shoe producer Nike. Its products are assembled for 70 or 80 cents and may sell for \$120 (Ross 1997: 26). Increases in production costs can be easily absorbed by distributors or retailers. Most child labor occurs in labor-intensive industries. It

can therefore be safely assumed that the prohibition of child labor would not infringe upon the export opportunities of the South in the North.

Demand elasticity would be much more pronounced for complex industrial supplies from the South. These products are in direct competition with those from the North. Since they usually would not yet have reached the same quality levels, they would compete mostly on price. These kinds of products are produced in emerging economies, some of which violate core workers' rights. Nevertheless, it can be assumed that higher wages would not necessarily translate into higher prices. Compared with the hand-made products mentioned above, the higher degree of capital intensity keeps the share of wages to total production costs lower. In addition the efficiency wage argument is applicable at this higher level of industrial development. Workers' qualifications and their motivation are important for mastering complex production processes. The general increase in wages can also be beneficial for the development of domestic demand, which in turn accelerates the move up along the industrial learning curve and helps realize economies of scale. Nevertheless, the more effective enforcement of workers' rights may carry with it adjustment costs in the short term.

Higher costs in the short term, however, are not likely to influence the long-term growth of developing countries. Growth prospects are more dependent on the education level of the workforce and on technology transfer than on the level of wage compensation. Even where minimum standards are maintained, wage costs are significantly lower than in the OECD countries. In addition, higher labor costs do not necessarily lead to higher prices for consumers in the OECD countries. They could be either neutralized by currency devaluation or absorbed by export price profit margins (Singh 1990: 52-254; see also Erickson/Mitchell 1998: 179).

The OECD study mentioned earlier attempted to measure these adjustment costs by comparing the trade performance of countries before and after a period of repressed labor rights. Democratization went hand-in-hand with improved trade performance in the cases of Spain and Portugal. In the case of Chile trade performance remained unaltered. In Argentina, Korea, and Chinese Taipei, the restoration of democratic institutions was followed by worsening trade performance. The authors caution against attributing all changes in trade performance to democratization. Chronic labor shortage, currency appreciation, and other factors have to be taken in account for the East Asian countries (OECD 1996: 92-96). Thomas Palley improved upon the OECD study by controlling for the growth rate at the time the reform was instituted and for the effect of global economic performance. The unambiguous conclusion of his regression results is that improved rights of freedom of association have a

largely positive and statistically significant effect on country GDP growth rates in the five-year period after implementation of these rights (1998). A few years later, a World Bank study came to the conclusion that freedom of association has a positive impact on growth five years after this freedom was granted (Aidt/Tzannatos 2002).

Even the more ambiguous results of the OECD study concerning the effects of the democratization of individual countries under current competitive constraints suggest that in the counterfactual case of a successful international enforcement of the right of freedom of association, most countries will not suffer a decline in trade performance. In fact, the effective enforcement of core workers' rights is most likely to improve the competitive position of most emerging economies. This is because of China. The most populous country of the world, and one of its most dynamic economies, at the same time belongs to the group of countries where labor is most repressed. In case of effective enforcement, this main competitor of the Asian Tigers and Little Dragons would at least no longer enjoy the dubious, short-term competitive advantage of suppressed workers' rights.

This counterfactual reasoning provides some clues concerning the impact of internationally enforced core workers' rights on unemployment and the distribution of income in the North (see above). The prohibition of child labor will have no effect on employment in OECD countries since child labor is almost exclusively used for goods produced with labor-intensive, simple production techniques. These products are no longer made in the North. The great success of Chinese products in the American market during the 1990s suggests that effective enforcement of the rights of freedom of association and collective bargaining will also have little impact on the North. The Chinese success happened only to a small degree at the expense of production facilities in United States. In the main, Chinese manufacturers displaced products from other emerging economies and, due to their very low prices, created new markets (Rosen 1999; Klitgaard/Schiele 1997). However, if China and other countries that violated core workers' rights, succeed in the future to move up to the next levels of industrial development without simultaneously striving to honor these rights, then they may have an additional competitive edge that will hurt OECD producers.

In sum, the more an economy is capital, research, and service intensive, the less it will be affected by violations of core labor rights. Workers in Greece or Portugal will enjoy greater material benefits from the worldwide enforcement of core workers' rights than will workers in Germany or Japan. The main benefits would, therefore, accrue to the developing countries. Developing countries trying to respect these rights and improve working and living conditions are the most vulnerable to being undercut in world markets by countries seeking comparative

advantage through the suppression of workers' rights. Often the victims are young and unorganized female workers in export processing zones that advertise the absence of trade union rights in order to attract investment. For these reasons, developing countries cannot raise their social standards in isolation but only in conjunction with other countries by multilateral agreement.

## Literature

- Aidt, Toke, and Zafiris Tzannatos, 2002: Unions and Collective Bargaining: Economic Effects in a Global Environment, Washington, D.C., World Bank, June.
- Altvater, Elmar, 1992: *Die Zukunft des Marktes*. Münster: Westfälisches Dampfboot.
- Altvater, Elmar, and Birgit Mahnkopf, 2000: *Grenzen der Globalisierung. Ökonomie, Ökologie and Politik in der Weltgesellschaft*, 4<sup>th</sup> revised edition, Münster: Westfälisches Dampfboot.
- Anker, Richard, et al. 1998: Economics of Child Labour in Hazardous Industries of India, Barodi: Center for Operations Research and Training, New Dehli: distributed by Hindustan Pub. Corp.
- Bator, M., 1958: The Anatomy of Market Failure, in: *Quarterly Journal of Economics*, 72: 351-379.
- Bhagwati, Jagdish, 2000: The Wind of the Hundred Days: How Washington Mismanaged Globalization, Cambridge, MA: MIT Press.
- Bhagwati, Jagdish, 1994: A View from Academia, in: U.S. Department of Labor, Bureau of International Labor Affairs: *International Labor Standards and Global Economic Integration: Proceedings of a Symposium*, Washington DC: GPO: 57-62.
- BIS, 1999 - Bank for International Settlements: *69th Annual Report*, 1st April 1998–31th March 1999, Basle.
- Borjas, George J., Richard B. Freeman, and Lawrence F. Katz: On the Labor Market Impacts of Immigration and Trade, in: George J. Borjas and Richard B. Freeman (eds), *Immigration and the Work Force: Economic Consequences for the United States and Source Areas*, Chicago, IL: University of Chicago Press: 213-244.
- Brauer, David A., and Susan Hickock, 1995: Explaining the Growing Inequality in Wages across Skill Levels, in: *Economic Policy Review*, 1(1): 61-75.
- Card, David, and Alan B. Krueger, 1995: *Myth and Measurement. The New Economics of the Minimum Wage*, Princeton, NJ: Princeton University Press.
- Ch'oe, Chang-jip, 1989: *Labor and the authoritarian state : labor unions in South Korean manufacturing industries, 1961-1980*, Jang Jip Choi, Seoul, Korea: Korea University Press.
- Cline, William R., 1999: *Trade and Income Distribution: The Debate and New Evidence*, International Economics Policy Briefs No. 99-7, September, Washington, D.C.: Institute for International Economics.
- Dorman, Peter, 1995: *Policies to Promote International Labor Rights: An Analytical Review*. Report for the Bureau of International Affairs, U.S. Department of Labor.
- Erickson, Christopher L., and Daniel J.B. Mitchell, 1998: Labor Standards and Trade Agreements: U.S. Experience, in: *Comparative Labor Law and Policy Journal*, 19(2): 145-183.
- Erickson, Christopher L., and Daniel J.B. Mitchell, 1998: Labor Standards and Trade Agreements: U.S. Experience, in: *Comparative Labor Law and Policy Journal*, 19(2): 145-183.
- Forastieri, Valentina, 1997: *Children at Work: Health and Safety Risks*, Geneva: International Labour Office.



- Frank, Volker, 1998: Zwei Fallbeispiele: Guatemala und die Dominikanische Republik, in: Christoph Scherrer, Thomas Greven and Volker Frank, *Sozialklauseln. Arbeiterrechte im Welthandel*, Münster: Verlag Westfälisches Dampfboot: 149-205.
- Freeman, Richard B., and James Medoff, 1984: *What Do Unions Do?* New York: Basic Books.
- Große-Oetringhaus, Hans-Martin, 1995: Rücksichtslos billig. Kinderarbeit in der indischen Teppichproduktion, in: Hans-Martin Große-Oetringhaus and Peter Strack (eds.), *Verkaufte Kindheit. Kinderarbeit für den Weltmarkt*, Münster: Westfälisches Dampfboot – terre des hommes book: 177-181.
- Haas, Daniel Philipp, 1998: *Mit Sozialklauseln gegen Kinderarbeit? Das Beispiel der indischen Teppichproduktion*. Münster and Hamburg: Lit.
- Hansson, Göte, 1983: *Social Clauses and International Trade: An Economic Analysis of Labour Standards and Trade Policy*. New York: St. Martin's.
- Hufbauer, Gary Clyde, 1989: *The Free Trade Debate. Reports of the Twentieth Century Fund Task Force on the Future of American Trade Policy*. New York: Priority Press.
- ICFTU, 1999 - International Confederation of Free Trade Unions: *Internationally-Recognised Core Labour Standards in Thailand*, Report For The WTO General Council Review Of The Trade Policies Of Thailand, (Geneva, 15 and 17 December).
- ILO, 1998 - International Labour Office, Governing Body, Working Party on the Social Dimensions of the Liberalization of International Trade: *Overview of global developments and Office activities concerning codes of conduct, social labelling and other private sector initiatives addressing labour issues*, GB.273/WP/SDL/1(Rev.1), 273rd Session, November, Geneva: International Labour Office.
- Johnson, Harry G., 1965/1987: Optimal Trade Intervention in the Presence of Domestic Distortions, in: Bhagwati, Jagdish N., (ed.) *International Trade*, 2<sup>nd</sup> edition, Cambridge, Mass.: MIT Press: 235-264.
- Juhn, Chinhui, and Kevin M. Murphy, 1995: Inequality in Labor Market Outcomes: Contrasting the 1980s and Earlier Decades, in: *Economic Policy Review*, 1(1): 26-32.
- Kahn, Alfred E., 1970/1971: *The Economics of Regulation: Principles and Institutions*. 2 vol., New York: John Wiley.
- Klevorick, Alvin K., 1996: Reflections on the Race to the Bottom, in: Jagdish Bhagwati and Robert E. Hudec (eds), *Fair Trade and Harmonization. Prerequisites for Free Trade? Vol. 1: Economic Analysis*, Cambridge, MA: MIT Press: 459-468.
- Klitgaard, Thomas, and Karen Schiele, 1997: The Growing U.S. Trade Imbalance with China, in: *Current Issues in Economics and Finance*, Federal Reserve Bank of New York, 3(7).
- Kochan, Thomas A., and Willis Nordland, 1989: *Reconciling Labor Standards and Economic Goals: A Historical Analysis*. Washington, DC: U.S. Department of Labor, Bureau of International Labor Affairs, September.
- Krueger, Alan B., 1996: *Observations on International Labor Standards and Trade*. Cambridge MA: NBER – *NBER Working Paper Series*, Nr. 5632.
- Krugman, Paul, 1994: »Does Third World Growth Hurt First World Prosperity?«, in: *Harvard Business Review*, 72(4): 113ff.
- Langille, Brian A., 1996: General Reflections on the Relationship of Trade and Labor (Or: Fair Trade Is Free Trade's Destiny), in: Jagdish Bhagwati u. Robert E. Hudec (eds), *Fair Trade and Harmonization. Prerequisites for Free Trade? Vol. 2: Legal Analysis*, Cambridge, MA: MIT Press: 231-266.
- Leamer, Edward E., 1999: Competition in Tradables as a Driving Force of Rising Income Inequality, in: Horst Siebert (ed.), *Globalization and Labor*, Tübingen: Mohr Siebeck: 119-152.
- Leebron, David W., 1996: Lying Down with Procrustes: An Analysis of Harmonization Claims, in: Jagdish Bhagwati and Robert E. Hudec (eds), *Fair Trade and Harmonization. Prerequisites for Free Trade? Vol. 1: Economic Analysis*, Cambridge, MA: MIT Press: 41-118.

- Levison, Deborah, Richard Anker, Shahid Ashraf and Sandhya Barge, 1996: *Is child labour really necessary in India's carpet industry?*, Labour Market Paper No. 15, Geneva: International Labour Office.
- Marjit, Sugata, and Maiti, Dibyendu S., 2005: 'Globalization, Reform and the Informal Sector', Expert Group on Development Issues, United Nations University – WIDER, Helsinki, Finland.
- Marshall, Ray, 1994: The Importance of International labour Standards in a More Competitive Global Economy, in: Werner Sengenberger and Duncan Campbell (eds), *International Labor Standards and Economic Interdependence*, Geneva: International Institute for Labour Studies: 65-78.
- Meyer, William H., 1999: Confirming, Infirmiting, and "Falsifying" Theories of Human Rights: Reflections on Smith, Bolyard, and Ippolito Through the Lens of Lakatos, in: *Human Rights Quarterly*, 21(1) 220-228.
- Noland, Marcus, 1998: "US-China Economic Relations," in Robert S. Ross (ed.), *After the Cold War: Domestic Factors and US-China Relations*. Armonk: M.E. Sharpe.
- OECD, 1996 - Organisation for Economic Co-operation and Development: *Trade, Employment and Labour Standards. A Study of Core Workers' Rights and International Trade*, Paris: OECD.
- Palley, Thomas I., 1998: *The Beneficial Effect of Core Labor Standards on Economic Growth*, manuscript.
- Piore, Michael J., 1994: International Labor Standards and Business Strategies, in: U.S. Department of Labor, Bureau of International Labor Affairs: *International Labor Standards and Global Economic Integration: Proceedings of a Symposium* (Washington, DC: GPO): 21-25.
- Pollmann, Uwe, and Peter Strack, 1995: Zwischen Überlebensnotwendigkeit and Ausbeutung, in: Hans-Martin Große-Oetringhaus and Peter Strack (eds), *Verkaufte Kindheit. Kinderarbeit für den Weltmarkt*, Münster: Westfälisches Dampfboot – terre des hommes book: 14-29.
- Portes, Alejandro, 1994: By-Passing the Rules: The Dialectics of Labour Standards and Informalization in Less Developed Countries, in: Werner Sengenberger and Duncan Campbell (eds), *International Labor Standards and Economic Interdependence*, Geneva: International Institute for Labour Studies: 159-176.
- Rodrik, Dani, 1996: Labor Standards in International Trade: Do They Matter and What Do We Do About Them, in: Robert Z. Lawrence, Dani Rodrik and John Whalley (eds), *Emerging Agenda for Global Trade: High Stakes for Developing Countries*, ODC Policy Essay, No.20, Washington DC: Overseas Development Council.
- Rosen, Daniel H., 1999: *China and the World Trade Organization: An Economic Balance Sheet*, IIE Washington DC.
- Ross, Andrew, (ed.) 1997: *no sweat. fashion, free trade, and the rights of garment workers*, London: Verso.
- Rothstein, Richard, 1993: *Setting the Standard. International Labor Rights and U.S. Trade Policy*, Briefing Paper, Washington DC: Economic Policy Institute.
- Scherrer, Christoph, 1992: *Im Bann des Fordismus. Die Auto- and Stahlindustrie der USA im internationalen Konkurrenzkampf*. Berlin: Ed. Sigma Bohn.
- Sengenberger, Werner, 2002: *Globalization and Social Progress: The Role and Impact of International Labor Standards*, Bonn, Friedrich- Ebert- Stiftung.
- Singh, Ajit, 1990: »Southern Competition, Labor Standards and Industrial Development in the North and South«, in: U.S. Department of Labor, Bureau of International Labor Affairs: *Labor Standards and Development in the Global Economy* (Washington, DC: GPO): 239-264.
- Smith, Jackie, Melissa Bolyard, and Anna Ippolito, 1999: Human Rights and the Global Economy: A Response to Meyer, in: *Human Rights Quarterly* 21(1): 207-219.
- Srinivasan, T.N., 1996: International Trade and Labor Standards from an Economic Perspective, in Pitou van Dijck and Gerrit Faber (eds.), *Challenges in the New World Trade Organization*, Amsterdam: Kluwer Law International: 219-243.

- Swinerton, Kenneth A., 1997: An Essay on Economic Efficiency and Core Labor Standards, in: *The World Economy*, 20(1): 73-86.
- Wood, Adrian, 1994: *North-South Trade, Employment, and Inequality: Changing Fortunes in a Skill-driven World*. Oxford: Clarendon Press u. New York: Oxford University Press.
- Wood, Adrian, 1999: Openness and Wage Inequality in Developing Countries: The Latin American Challenges to East Asian Conventional Wisdom, in: Richard E. Baldwin, Daniel Cohen, Andre Sapir, and Anthony Venables (eds), *Market Integration, Regionalism and the Global Economy*, Cambridge, Cambridge University Press, 153-180.