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International Trade, Labour and the WTO

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PART IV LABOR PROTECTIONS IN INTERNATIONAL TRADE NEGOTIATIONS [189 pp + 1 articles]

International Trade, Labour and the WTO

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Part I Introduction and Overview

The steady march of global economic integration and trade-policy liberalization facilitated by the General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO) over the past half century has been accompanied by an ever-louder drumbeat warning of the consequences for wages, employment and working conditions. Indeed, over the last decade, labor interests in the West have sought to slow the pace of international trade negotiations, seeking some protections in the WTO Charter itself and in individual trade agreements.

Our central focus in organizing this collection is to provide the reader access to the economics literature analyzing the accommodation of labor interests within the WTO. However, before presenting a set of arguments relating to the WTO structure, we must first develop an understanding of the interaction between global goods, capital and labor markets and the national government institutions that regulate their function. In selecting papers for this volume, we have attempted to identify the most important contributions to the debate. Additional related readings are also discussed and listed in the bibliography.

We begin by reviewing the basic elements of international trade theory connecting international trade to labor-market outcomes. Alan Deardorff and Robert Stern provide a brief overview of recent trade history and the essential trade theories within which we can evaluate arguments and evidence. They then present the orthodox response to the critics of the recent wave of globalization.

Part II Trade and Wages: Historical Evidence and Contemporary Experience

Jeffrey Williamson (2005) finds compelling evidence supporting the orthodox view of trade theory and policy in his 2002 WIDER Annual Lecture. He summarizes the empirical and theoretical connections involving international trade, factor flows, relative factor prices and trade policy during the first globalization century. The link between globalization and any economic indicator – economic growth, income inequality, migration, relative factor prices, domestic policy, foreign policy, etc. – is complex and almost always depends on context. Nevertheless, the evolution of relative factor prices between 1500 and 1913 is well explained by conventional trade theory and trade-policy liberalization takes center stage determining relative factor prices beginning around 1850.

The orthodox view of recent episodes of trade and liberalization is not unchallenged, however. Notably, Freeman (2004) argues that major trade agreements such as the U.S.-Canada Free Trade Agreement, NAFTA, etc., were swamped by other economic events. As a consequence, predictions of trade-driven economic growth in each case never materialized.

Historical evidence offered in Williamson's Wider Lecture is contained in two papers. We have selected "From Malthus to Ohlin: Trade, Growth and Distribution Since 1500," with Kevin H. O'Rourke, which analyzes the key determinants of the distribution of income in Europe between 1500 and 1914. Europe up through 1750 is Malthusian in character. As the land-labor ratio declines, the wage-rent ratio declines. Relative factor prices are fundamentally determined on domestic markets by relative factor endowments.

Sometime between 1750 and 1850, Europe underwent a structural change. Wages began to rise in the face of expanding labor supplies. According to conventional wisdom, this rise in the standard of living is attributed to the advances of the industrial revolution. Technological change is thought to be the over-riding force driving up living standards for workers. However, O'Rourke and Williamson find evidence that trade liberalization and the consequent international convergence of commodity prices and technological change are equally important factors determining the distribution of income.

The first globalization was, in large part, driven by the decline in transportation costs. As a consequence, international commodity markets came to be globally integrated, producing a remarkable convergence in commodity prices. In fact, Williamson (2002), reports that commodity price convergence in Latin America, Asia and the Middle East was greater than in the Atlantic economy. However, in spite of convergence in commodity prices between the center and the periphery, per capita income diverged between these two regions. Williamson argues that the decline in the relative standard of living in the periphery reflects a growing technology gap between north and south.

Thus, trade-driven changes in relative factor prices during the first global century (1850-1913) narrowed the distribution of income between land and labor in the industrializing world. British imports were land-intensive, thereby driving down the return to land and raising the real wages of unskilled workers. These trends stand in stark contrast to events of today in which we focus on the impact of unskilled-labor intensive imports from industrializing countries on the wages of unskilled labor in the West.

Indeed, the impact of international trade on relative and absolute wages has emerged as a central theme in analysis of late 20th century international trade, as well. Robert C. Feenstra and Gordon H. Hanson (2003), in "Global Production Sharing and Rising Inequality: A Survey of Trade and Wages," provide a summary of the state of debate as of 2000. The debate begins when labor economists noted that between 1979 and 1995, the real wages of U.S. workers who did not complete high school exhibited a 20.2 percent decline. Over the same period, high school graduates experienced a smaller 13.4 percent decline. In contrast, workers with 16 or more years of education had a 3.4 percent rise in wages. In light of the fact that U.S. imports appeared to be increasingly unskilled labor-intensive, this decline in the relative returns of unskilled labor is precisely what the Stolper-Samuelson Theorem would lead us to expect.

Trade economists, however, were skeptical of the trade-to-wages explanation, preferring instead to attribute the rise in the return to skilled labor to skilled-labor-biased technological change. Trade economists based their conclusions on three arguments: (1) the volume of trade is not large enough and sufficiently unskilled-labor intensive to explain such a large swing in wages, (2) prices of unskilled-labor-intensive imports were not falling, as required for a Stolper-Samuelson explanation, and (3) virtually all industries were shifting away from an unskilled-labor-intensive technique of production even as unskilled labor was becoming less expensive. All three of these pieces of evidence point to skilled-labor-biased technological change rather than international trade as the major cause of the rise in the skill premium during between 1980 and 1995.

The seemingly limited role of international trade in determining relative wages at the end of the 20th century contrasts importantly with Williamson's analysis of the 19th century. Williamson finds that trade accounts for about half of the dramatic rise in real wages between 1840 and 1936. He argues that the failure to find a trade-wages link today is a consequence of focusing on data only from 1979. He believes that if analysis were to span the entire period of the second global century, 1940-present, trade would emerge as an important explanation of the growing wage gap between skilled and unskilled workers.

Feenstra and Hanson concur, albeit for a different reason. They argue that in order to accurately capture the impact of trade on wages today, we need to model the recently emergent phenomenon of out-sourcing. Western producers in many industries are increasingly taking the most unskilled-labor-intensive parts of their production process and relocating them in low-wage developing countries. They note that such a phenomenon closely mimics a technological improvement. Testing their out-sourcing framework, Feenstra and Hanson find that international trade may well have been as important as computerization in moving the relative wages of skilled and unskilled workers.

The full complexity of the link between international trade and changes in trade policy to employment, wages and poverty is reviewed by Goldberg and Pavcnik (2004), in their paper, "Trade, Inequality, and Poverty: What Do We Know? Evidence from Recent Trade Liberalization Episodes in Developing Countries." In this *survey of surveys*, Goldberg and Pavcnik review the state of evidence, particularly focusing on outcomes for workers in developing countries.

For an example of the type of work Goldberg and Pavcnik review, the reader is referred to Hanson (2006) in which analysis of the impact of the Mexican trade liberalization during the 1980s is presented. Orthodox trade theory would tell us to expect that trade liberalization by an unskilled-labor-abundant country such as Mexico should raise the wages of unskilled workers relative to those of skilled workers and capital. Thus, trade liberalization for developing countries should typically be egalitarian, narrowing the distribution of income. However, Hanson finds that prior to the 1990s episode of liberalization, the northern part of Mexico was already more trade exposed than the south. This difference in relative exposure may in part explain the fact that incomes in the north were already higher than in the south during the pre-liberalization period. The 1990s liberalization increased the trade-exposure gap between the northern and southern regions of Mexico. As a consequence, Hanson finds that labor income in the low-exposure states fell by 10 percent relative to high-exposure states following the 1990s liberalization.

Hanson's results for Mexico are echoed in anecdotal evidence from China. Most of the trade liberalization in China has focused on the coastal cities. The subsequent rise in income in these cities accompanying the liberalization produced a widening gap between the urban coastal cities and the interior. By contrast, in a recent working paper, Topalova (2006) finds that the most trade-exposed rural poor in India gained less than other groups.

There are two ancillary strands of the debate concerning the impact of trade on wages. The first concerns the impact that mobile capital has on its relative bargaining position with labor. Rodrik (1997) notes that international trade increases the elasticity of demand for labor, thereby reducing labor's relative bargaining power. Chau and Kanbur (2003) formally explore this idea in their paper, "On Footloose Industries, Asymmetric Information, and Wage Bargaining." They find that in a more fully developed theory of the bargaining environment, international capital mobility has an ambiguous effect on labor's share of economic rents.

Scheve and Slaughter (2004), in their paper, "Economic Insecurity and the Globalization of Production," note that capital mobility may make the demand for labor more elastic, but may also increase uncertainty in the form of employment and/or wage outcomes. Empirical analysis from Britain during the 1990s finds that increased foreign direct investment (FDI) activity is positively correlated with worker perceptions of insecurity.

Part III International Trade and the Race to the Bottom in Core-Labor-Market Protection

Labor concerns with the implications of international commerce for labor-market outcomes are accompanied by a similar set of concerns surrounding governmentally-enforced labor protections. Will labor market forces erode compliance with the core-labor market protections that comprise: (1) freedom of association and collective bargaining, (2) nondiscrimination in employment, (3) elimination of exploitative child labor and (4) forced labor? A second closely related question is: "Will governments actively reduce statutory protection of core-labor protections in an effort to attract foreign capital and improve international competitiveness? In a set of three papers, we consider the evidence on the impact of increased integration with global markets and the compliance with core-labor standards.

Sandra Black and Elizabeth Brainerd (2004) consider the evidence on nondiscrimination in their paper, "Importing Equality? The Impact of Globalization on Gender Discrimination." They note that the intensification of competition that comes about with globalization should pressure firms engaging in gender discrimination to end this sub-optimal practice. They indeed find for U.S. industries between 1976 and 1993 that the residual gender gap narrowed more rapidly in concentrated industries than in competitive industries. Thus, the pressures of international trade appear to erode the ability of firms in concentrated industries to indulge a taste for discrimination.

The channels through which trade impacts employment of children are more complex. In their thorough going analysis of Vietnam's integration into the global rice market, Edmonds and Pavcnik (2005) find that the incidence of child labor depends on each family's asset holdings. Between 1993 and 1998, Vietnam removed rice-export restrictions, producing a 29 percent increase in the domestic price of rice. From a theoretical perspective, the subsequent rise in the return to land and labor in rice production has an ambiguous impact on working children. On the one hand, the rise in adult wages in rice production increases the opportunity cost of household production. As a consequence, the rise in the wages of rural mothers may lead some families to draw their daughters out of school and into household production. Similarly, the rise in the wages of children working in the rice sector could increase the opportunity cost of child leisure and schooling. Families for which these substitution effects dominate may actually respond to the rise in the price of rice by increasing child labor. On the other hand, rising household income will increase the demand for quality children. Rising household wealth will relax the liquidity constraints that families face when trying to make education investments in their children.

Edmonds and Pavcnik (2006) find that households with large and medium-sized landholdings reduced the amount of time their children work and increased leisure and schooling. The effect is particularly pronounced for older girls. Thus, the income effect dominated some of the other forces that might have drawn children further into rice or household production. However, children in families with small landholdings increased their supply of labor to the rice market. Thus, trade increased the employment opportunities for these children. Furthermore, urban households suffered a decline in real income when the price of rice rose. These families also increased the time their children spent working. It should be noted, though, that on balance, child labor declined in Vietnam following the liberalization of the rice market. A 30 percent increase in the price of rice resulted in a nine percentage point decline in child labor.

Edmonds and Pavcnik report similar results for a cross-country analysis in their paper, "International Trade and Child Labor: Cross-Country Evidence." Trade openness and child labor are *negatively* correlated. Each one percent increase in trade openness reduced child labor by 0.7 percent. Edmonds and Pavcnik find that the negative correlation between child labor and income is primarily driven by the positive correlation between trade openness and income growth.

Neumayer and de Soysa (2005b), in their paper, "Trade Openness, Foreign Direct Investment (FDI) and Child Labor," extend the results of Edmonds and Pavcnik to include FDI. Not only do countries open to trade have a lower incidence of child labor, countries with a larger stock of capital also have fewer working children. Indeed, there seems to be little empirical evidence that capital owners are attracted to markets in which child labor is common. In fact, the opposite appears to be the case.

Neumayer and de Soysa (2005a, 2005c) find a similar conclusion when analyzing the connection between trade and gender discrimination, forced labor, free association and collective bargaining. Even in a sub-sample of developing countries, the correlation between trade/FDI openness and labor protections is either positive or zero.

In a related area of inquiry, Ann Harrison and Jason Scorse (2004) study the impact of globalization on compliance with minimum-wage law in their paper, "The Impact of Globalization on Compliance with Labor Standards: A Plant-Level Study." They study the impact of export orientation for minimum-wage law compliance for Indonesian firms during the 1990s. Over this period, Indonesia quadrupled its minimum wage in nominal terms, resulting in a doubling of the real minimum wage. Harrison and Scorse find that foreign owned firms were more likely to be in compliance than domestic-owned firms, even controlling for worker and plant characteristics. Furthermore, export-oriented firms were also more likely to be in compliance.

However, Harrison and Scorse attach an important caveat to their results. Firms that were export oriented began the decade with *poorer* compliance performance than firms supplying the domestic market. It was not until the middle of the 1990s that export-oriented firms produced a record of compliance that exceeded that of domestic producers. Harrison and Scorse speculate that anti-sweatshop agitation early in the decade along with U.S. threats to retract tariff preferences under the Generalized System of Preferences (GSP) may have raised wages in export-oriented firms. That is, they find some evidence that Western buyers were sourcing from low-cost vendors paying below-market wages. Such firms may therefore have been a worthy target of human-rights activists.

An important aspect of the trade and labor debate concerns the efficiency properties and potential effectiveness of internationally coordinated legislation regulating core labor practices. To this end a number of scholars have attempted to identify the root causes of poor core-labor-rights compliance. While the literature on the policy efficiency and effectiveness of labor standards lies outside the scope of this volume, we offer several suggestions for further inquiry.

A summary of the literature on the root causes of child labor and implications for domestic and international regulation is provided by Basu (1999). A seminal contribution to the understanding of child labor is provided by Baland and Robinson (2000) in their paper, “Is Child Labor Inefficient?” They ultimately lay the blame for inefficient child labor on two market failures. Child labor is efficiently supplied when the return to the last hour of work by a child is equal to the present discounted value of the increased future productivity of an additional hour of education. Will a family be able to satisfy such a condition?

Baland and Robinson find that two obstacles prevent families from reaching the optimal outcome. First, children cannot credibly pre-commit to compensate parents out of their future enhanced income for the cost of education borne by the parents. Second, collateral-poor parents may not be able to borrow against the child’s future earnings in order to finance an education. Thus, Baland and Robinson see two market failures: a bargaining failure and a failure in the market for capital. In both cases, a law requiring a small reduction in child labor is Pareto improving, but such a response is second best. There is a range of policy options that can help families address the core cause of the market failure.

A third market failure producing inadequate human capital investment in children is analyzed by Bellettini, Ceroni and Ottaviano (2005) in their paper, “Child Labour and Resistance to Change.” They find a coordination failure between the family and the firm.

Families will not invest in human capital if firms do not invest in human capital-using technologies, and firms will not invest in human-capital using technologies if families do not invest in education. Belletini et al. find that a subsidy to technological innovation is the first-best solution. Compulsory schooling laws or a ban on child welfare are not only second-best, they may even be welfare-reducing.

Dessy and Pallage (2005) also find that a ban on even the worst forms of child labor is likely to be welfare-reducing. Particularly egregious forms of child work expose children to physical and psychological stress. Examples include drug-trafficking, deep-sea fishing, prostitution and pornography. As awful as these activities seem, they argue in their paper, “A Theory of the Worst Forms of Child Labour,” that altruistic parents knowingly and rationally place their children in these dangerous occupations. For a family in extreme poverty, such choices may dominate more benign but lower-paying occupations. Even the children themselves may be better off if the proceeds of their work are used to pay for their education. Dessy and Pallage argue that if such practices are made illegal, they must be accompanied by poverty-alleviation programs to replace the lost income to the family.[1]

Our ethical principles are similarly challenged by Genicot (2002) in “Bonded Labor and Serfdom: A Paradox of Voluntary Choice.” Clearly outright slavery is universally deplored. However, freely accepted bonded-labor contracts constitute a gray area in international labor standards. In such a contract, a worker voluntarily gives up freedom in exchange for a lump-sum payment. Such contracts are common in communities of people who have no other collateral to post for a loan. Repairing the attendant capital market failure will address the problem at its source. However, Genicot argues that a ban

[1] A similar argument is advanced by Fan (2004).

on such contracts also has its place. She notes that a borrower may take out multiple loans. The question is: which lender's claim on the borrower's income takes precedence? Genicot reasonably notes that the claim held by the lender holding the bonded contract takes precedence. As a consequence, any conventional lender knows that his claim to repayment can be superseded by a bonded-labor contract. This fact may deter the conventional lender from offering a loan. As a consequence, the market failure that sets the stage for the bonded-labor contract is itself created by the legal possibility of such a contract. Genicot argues that market function will improve if bonded-labor contracts are illegal. With the bonded-labor option off the table, the conventional lender can now make a loan without fearing that his claim to be repaid will be superseded by another contract.

Basu (2002) finds a similar argument for banning practices of sexual harassment in the workplace. In his paper, "Sexual Harassment in the Workplace: An Economic Analysis with Implications for Worker Rights and Labor Standards Policy," Basu finds a basis for outlawing such workplace conduct even if the workers employed in such firms know harassment is commonplace and are paid a compensating differential.

Review of the theoretical literature on the causes and optimal-policy responses produces an array of somewhat counter-intuitive results. In some cases, laws prohibiting certain types of contracts may indeed be welfare-enhancing. We turn now to two questions: (1) Do such laws, as a practical matter, have the desired effect? And (2) do labor-market regulations have positive or negative consequences for workers in developing countries?

Child-labor laws from the early part of the 20^{th} century provide some interesting evidence on the effectiveness of legal remedies for socially undesirable conduct. Moheling (1999) looks carefully at the introduction and expansion of laws in the United States between 1880 and 1910. In the wake of the rising incidence of child labor between 1890 and 1900, many U.S. states enacted laws regulating the employment of 13-year old boys and girls. In her paper, "State Child Labor Laws and the Decline of Child Labor," Moheling attempts to identify the role of these laws in the subsequent decline in child labor during the early decades of the 20^{th} century.

Of course, many factors could be reducing child labor, not just legal restrictions. In order to isolate the impact of the laws, Moheling compares the employment practices of 13-year old children to whom the laws applied relative to 14-year old children for whom the laws did not apply. Using a *difference-in-difference-in-difference* methodology, she finds that labor practices of 13-year olds were mirrored in the labor practices of 14-year olds. Moheling concludes then that the laws were not driving behavior. Rather, some other exogenous force was simultaneously leading to legal restrictions on 13-year olds and employment habits of 13 and 14 year old children.

Indeed, Brown, Christiansen and Philips (1992) discuss what some of these exogenous forces might be. In their paper, "The Decline of Child Labor in the U.S. Fruit and Vegetable Canning Industry: Law or Economics?" they argue that child-labor laws were often written to suit the needs of employers rather than to protect children. Labor laws in the fruit and vegetable canning industries were most common and intensively enforced in the urban areas where canning factories had become more capital intensive, dangerous and in operation year round. Legal restrictions targeted mothers who brought small children to work with them. Laws were much less common and less intensively enforced in rural settings in which fruit and vegetable processing was seasonal, involving little technology.

By comparison, Lleras-Muney (2002) finds that laws compelling school attendance and regulating child labor enacted between 1931 and 1939 where quite effective in reducing child labor and increasing educational attainment. Furthermore, she establishes that these laws were not only effective but also not endogenous.

The consequences for workers of laws regulating working conditions also vary with market setting. For example, Besley and Burgess (2004) analyze the impact of amendments to the procedures for resolving industrial disputes in India. They report in their paper, "Can Labor Regulation Hinder Economic Performance? Evidence from India," that Indian states that amended their procedures in a "pro-labor" direction between 1958 and 1992 suffered a relative decline in economic performance across several dimensions. Similarly, Lai and Masters (2005) find negative employment and wage effects from of mandatory maternity benefits imposed in Taiwan reported in their paper, "The Effects of Mandatory Maternity and Pregnancy Benefits on Women's Wages and Employment in Taiwan, 1984-1996." Finally, MacIssac and Rama (2001) find that workers in Peru "pay" for their benefits through lower wages. Benefits that are excessively high may even fund consumption levels for unemployed workers that are higher than for employed workers.

These results are as we might expect when labor markets are perfectly competitive and workers are paid their marginal value product. However, does labor-market regulation have a role when there is some evidence of monopsonistic power exercised by employers? Harrison and Scorse (2004), in their paper, "Moving Up or Moving Out? Anti-Sweatshop Activists and Labor Market Outcomes," answer "yes." Returning again to the aforementioned quadrupling of the minimum wage in Indonesia in the early 1990s, basic theory tells us to expect that employment in affected industries should decline and footloose industries might relocate to competing-supplier countries. However, Harrison and Scorse find employment expanding in precisely those industries most likely to be affected by minimum-wage legislation. Thus, again, they argue that there was considerable monsopsonistic market power exercised in Indonesia's export sectors. As a consequence, tighter enforcement of minimum-wage law was feasible without reducing employment or driving firms to relocate.

Furthermore, and perhaps more importantly, enforcing process-oriented rights (as opposed to outcome-oriented rights) may help markets function more effectively. To this end, Galli and Kucera (2004) study the effect of enforced rights to collective bargaining and free association on labor market organization for 14 Latin American countries during the 1990s. They are specifically trying to address the question as to whether employers will attempt to avoid recognizing these civic rights by informal employment practices. However, in their paper, "Labor Standards and Informal Employment in Latin America," Galli and Kucera find that greater recognition of labor rights is negatively correlated with informal employment. This is the case both across countries and across time.

In light of the evidence that at least some labor protections increase production cost, we need to consider the possibility that in a globalizing environment, some governments may scale back labor protection in order to gain a competitive edge. This *race to the* *bottom* in labor protections lies at the heart of organized labor's objections to further trade liberalization.

Some of the theoretical issues are discussed by Will Martin and Keith Maskus (2001) in their paper, "Core Labor Standards and Competitiveness: Implications for Global Trade Policy."[2] Brown, Deardorff and Stern (1996), in their paper, "International Labor Standards and Trade: A Theoretical Analysis," also discuss a number of channels through which international trade may affect incentives for labor legislation. A common theme throughout this literature is that often trade provides incentives for a *race to the top* rather than the *bottom*.

For example, consider discrimination in employment. Martin and Maskus point out that employment discrimination against any particular group of workers is inefficient and, therefore, actually lowers productivity. So a government looking for international competitiveness might strengthen anti-discrimination legislation. They point out that the only core labor protections that might erode competitiveness are the rights to free association and collective bargaining that provide workers with the ability to constrain the supply of labor in the export sector.

The analytical framework used by Martin and Maskus is implemented empirically by Matthias Busse (2002). He reports in his paper, "Do Labor Standards Affect Comparative Advantage in Developing Countries?" that discrimination in employment against females weakens comparative advantage in unskilled-intensive production as Martin and Maskus predicted. However, lax enforcement of laws regulating forced labor and child labor does, indeed, improve comparative advantage.

[2] See also Maskus (1997) for an extended analysis of international trade and domestic policy regulating core labor practices.

Brown, Deardorff and Stern acknowledge that in some contexts labor protections such as health and safety may increase the cost of production. In a closed economy, some of these costs may be passed on to consumers, thus making them politically more palatable. But firms in a small open economy face fixed world prices. As a consequence, all of the cost of the standard will be borne by the producer.

Nevertheless, even in this context, some countries will have an incentive to tighten standards. Such an outcome will emerge if labor standards are labor-using. Some examples of labor-using standards are restrictions on hours worked or minimum age of employment. An internationally adopted labor-using standard will contract the supply of labor on the world market. The contraction in the supply of labor in labor-abundant countries will improve the terms of trade at the expense of labor-scarce countries. As a consequence, labor abundant countries could be motivated to set labor standards both to achieve domestic objectives as well as to capture a terms-of-trade benefit.

A third consideration is raised by Dani Rodrik (1998) in his paper, "Why Do More Open Economies Have Bigger Governments?" It is true that trade openness may lead domestic producers to seek relief from costly labor standards. However, capital owners are not the only factor of production competing in the political arena. Workers in a globalizing economy also face more wage, price and employment volatility. Governments may be pressured to play a risk-reducing role either through expenditures or regulations.

Indeed, as an historical matter, labor has typically won this contest. Michael Huberman (2002), in his paper, "International Labor Standards and Market Integration before 1913: A Race to the Top?" examines the evolution of labor protections during the first globalization century. As discussed above, this period is characterized by profound convergence in factor prices. One might expect to observe convergence in labor-market institutions as well. However, this is not the case until the eve of WWI. For the most part, countries typically developed idiosyncratic labor protections that reflected their own particular political and social institutions.

Moreover, to the extent that standards converged, they converged up. In a companion piece, Huberman and Wayne Lewchuk (2002) discuss the emergence of the Labour Compact between 1850 and 1913. In their view, the rise in wage and employment instability that accompanied rising trade shares led workers to demand greater government protections against employment risk and uncertainty. Governments that adopted labor protections also found labor willing to support greater trade liberalization. Thus, trade begat labor protections and labor protections begat trade openness.

Rodrik comes to the same conclusion based on analysis of data from the second half of the 20^{th} century. Those open economies with the largest terms of trade volatility also have larger governments.

One final *race to the bottom* argument concerns the impact of weak labor protections on foreign direct investment. It seems intuitive that foreign capital may seek out the lowest cost and most malleable labor force. However, there is little empirical evidence to support this line of thought. For example, David Kucera (2002), in his paper, "Core Labour Standards and Foreign Direct Investment," finds that capital appears to be drawn to markets in which free association and collective bargaining rights are protected and child labor and discrimination in employment are prohibited.

Foreign capital typically looks for stable labor markets that are not disrupted by political and labor violence. Further, foreign capital is typically not interested in working with the skill levels possessed by child labor. And, perhaps most importantly, societies that protect labor rights are more likely to enforce contracts and protect ownership rights generally. These are two features of the political environment that the foreign capital owners are seeking when searching for a location to install capital.

Part IV Labor Protections in International Trade Negotiations

So, should labor rights be protected in the WTO? That is a complicated question. Two papers work through the complex array of issues that must be considered. Maskus (1997), in his paper, "Should Core Labor Standards be Imposed through International Trade Policy?" and Brown's (2001) paper, "Labor Standards: Where Do They Belong on the International Trade Agenda?" lay out a range of issues that must be considered when answering this question. A history of labor standards in international negotiations can be found in Stanley Engerman's (2003) paper, "The History and Political Economy of International Labor Standards."

In the final analysis, Panagariya's (2001) answer to the trade-labor link is an unequivocal "no." Labor practices and regulations will inevitably vary across countries and times, reflecting each country's situation and tastes. There is no one single set of political and economic institutions that maximizes welfare in all situations. For the sake of efficiency, each country must be allowed to undertake its own cost-benefit calculation where labor protections are concerned.[3]

[3] This point is originally made by Bhatwati and Srinivasan (1996) in the context of the role of environmental issues in the WTO.

Kyle Bagwell and Robert Staiger (2001a), however, point out that in a global trading environment, governments weighing costs and benefits will not choose efficient labor standards. Setting labor standards, to the extent that they alter the volume of trade, will generate external effects on trade partners. These external effects will be ignored in a simple calculation based on domestic costs and benefits.

Thus, Bagwell and Staiger argue that labor standards should indeed be brought into the WTO. However, they do not propose entering into the morass of negotiations over labor standards directly. Rather they propose simply to require any domestic policy changes that reduce market access to foreign suppliers be offset by further tariff reductions that restore market access. The end result is to internalize any external effects that the domestic standards setting has on foreign producers. Such an arrangement preserves domestic autonomy over labor-standards setting without letting countries use standards to achieve strategic gains in international trade. Bagwell and Staiger make a formal presentation of this point in their paper, "Domestic Policies, National Sovereignty, and International Economic Institutions." [4]

Following Bagwell and Staiger's analysis of negotiating labor standards within the WTO, several papers emerged that address the question of issue linkage in international trade negotiations. Most of these papers emphasize the fundamental principle that whatever negotiating framework emerges, the agreement must be self-enforcing. There is no super-national authority that can compel countries to comply with the provisions of an agreement once the negotiations are concluded. Punishment for defection is limited in some form or another to reverting to the Nash equilibrium which, typically in international trade negotiations, suffers from a prisoner's dilemma.

[4] A less technical version of these ideas can be found in Bagwell and Staiger (2001b).

There are several considerations that determine what issues should be linked in an agreement. Giancarlo Spagnolo (2001) addresses the issue of enforcement. The tools of enforcement in the International Labor Organization (ILO), in which matters of international labor standards coordination have historically resided, are quite weak. Compliance is voluntary. The ILO is essentially an institution that provides advice and technical assistance. By contrast, mechanisms of enforcement in the WTO are more powerful. Any country that reneges on its commitments following a round of trade negotiations can expect retaliatory withdrawal of concessions by its trade partners.

Spagnolo asks in his paper, “Issue Linkage, Credible Delegation, and Policy Cooperation,” under what conditions should we remove negotiations over labor practices from the ILO and embed them in the WTO? That is, within the WTO, a country can use the more powerful enforcement mechanisms to punish trade partners that deviate from commitments on labor practices. Or, more specifically, should international negotiations be structured so that a country with poor labor practices can be punished by withdrawing market access for its exports?

Spagnolo’s answer to this question depends on how countries calculate the payoffs from cooperation on the two issues. If a failure to reach a cooperative agreement on one issue increases the value of cooperation on the other issue, then Spagnolo describes these two coordination objectives as *substitutes*. In this case, countries will find it easier to sustain cooperation on either issue if negotiations on both issues are linked in a single agreement. A country considering defection on labor practices, for example, will see cooperation collapse on labor and trade if cooperation is linked in a single agreement. The consequent increase in the cost of defection achieved by linking issues will strengthen the capacity of countries to negotiate self-enforcing agreements on both trade and labor issues. By contrast, linkage is not desirable if the two policy issues are *complements*. In this case, failure to reach a cooperative agreement on one issue lowers the value of cooperation on the other.

One of the concerns that trade economists have raised with issue linkage in international trade negotiations is that some enforcement power will be redirected from trade issues to labor issues. That is, in the pursuit of closer cooperation on labor issues, we may end up with weaker cooperation on trade barriers. Nuno Limao (2005), in his paper, “Trade Policy, Cross-Border Externalities and Lobbies: Do Linked Agreements Enforce More Cooperation Outcomes?” concludes that enforcement power may indeed be reallocated between issues when negotiations are linked. But this is not inevitable. Linking may also create enforcement power, as argued by Spagnolo.

Reallocation will take place when governments see labor and trade issues independently but are having more trouble finding a mechanism for enforcing a labor agreement than a trade agreement. Trade negotiations may be motivated by a desire to eliminate the prisoner’s dilemma in tariff setting whereas labor negotiations may be animated by concern with violations of the basic human rights of workers. In this case, negotiators linking trade and labor negotiations will re-deploy enforcement on trade agreements to the labor agreement. Negotiations of both issues simultaneously will produce stricter labor standards but less trade liberalization than would be otherwise forthcoming from two separate negotiations.

The enhanced enforcement benefits of linking agreements identified by Spagnolo are also greatly weakened when countries affect each other only through the terms of trade, as argued by Josh Ederington (2002) in his paper, “Trade and Domestic Policy Linkage in International Agreements.” In Ederington’s set-up, each country only cares about its trade partner’s labor practices to the extent that those practices affect the terms of trade. There are no other cross-border external effects that arise from labor-standards setting behavior.

In this context, as noted by Bagwell and Staiger, a country that gives up its ability to manipulate its terms of trade with trade barriers may resort to manipulating its labor standards in order to achieve its terms-of-trade objectives. For this reason, full efficiency requires that countries negotiate over both trade and labor standards. However, it makes no difference whether these negotiations take place in a linked fashion or separately.

The need to link issues in international negotiations may also arise when countries have asymmetric interest in issues under negotiation. For example, one country may be concerned with access to agricultural markets but the other is principally interested in labor practices. Horstmann, Markusen and Robles (2005) discuss how this asymmetry will affect the structure of negotiations. In particular, the negotiations will involve a certain amount of horse-trading, that is, concessions on agriculture in exchange for concessions on labor. They also note that a country may attempt to structure the sequence of negotiations so that issues in which it is seeking concessions are discussed before issues in which it will be giving up concessions.

V. Market-Based Mechanisms Protecting Labor Rights

Given the limitations of using international trade negotiations within the WTO to manage humanitarian externalities arising from the labor practices in trading partners, we turn now to other channels through which these concerns might be mediated. Freeman (1994) argues that product labels can be used to identify products that are made under humanitarian working conditions. Several such certification agencies are actively monitoring production facilities in Asia and Latin America. The efforts of these groups are detailed in "Vigilantes and Verifiers," in *Can Labor Standards Improve under Globalization?* by Kimberly Ann Elliott and Richard Freeman (2003). In a recent working paper, Hiscox and Smyth (2006) find a striking willingness to pay for labeled products.

Though intuitively appealing, product labels are limited in their ability to accomplish their principle objective of improving working conditions for workers in a developing country. The weaknesses are drawn out by Basu, Chau and Grote (2006) in their paper, "Guaranteed Manufactured without Child Labor**:** The Economics of Consumer Boycotts, Trade Sanctions and Social Labeling." In a model with north-south trade, they find that product labels can help Western consumers identify products made with adult labor. However, this does not imply that working children are better off as a consequence. Furthermore, if consumers refuse to purchase unlabeled products, the South suffers a deterioration in its terms of trade, but the incidence of child labor is strictly unaffected.

It is important to realize that product labels help consumers sort themselves into those who want goods produced under humane conditions and those who do not care. This does not imply, though, that this sorting can be accomplished without altering the incidence of inhumane labor practices. Davies (2005), in his paper, "Abstinence from Child Labor and Profit Seeking," points out that the creation of a market niche for goods produced with adult labor also creates a market niche for goods produced with child labor.

Brown (2000) shows in “A Transactions Cost Politics Analysis of International Child Labor Standards” that this sorting can be accomplished by creating two groups of firms. One group produces labeled goods manufactured only with adult labor. The other group produces goods combining child and adult labor in a cost-minimizing fashion. The adult-labor only firms have a higher cost of production that must be covered by the labeling premium paid by socially-conscious consumers.

This arrangement, however, does not imply that children or their families are better off. The label premium is entirely dissipated while covering the higher production cost of the adult-only technology. Working children are released from the production of goods destined for socially-conscious consumers. But in a small price-taking economy, working children can be absorbed into other sectors without altering factor prices or factor supplies. Thus, product labeling may affect the industry in which children and their parents work, but it does not affect the number of children working or the wages they receive.

Some of the weaknesses of product labeling can be addressed by taking a more holistic approach to labor practices worldwide. We have selected Dara O’Rouke’s (2003) paper, “Outsourcing Regulation: Analyzing Nongovernmental Systems of Labor Standards and Monitoring,” which provides a critical assessment of the process and mechanisms through which multinational enterprises (MNEs) may affect working conditions in global supply chains. However, such ideas were first proposed by Sabel, O’Rourke and Fung (2000) in their paper, “Ratcheting Labor

Standards: Regulation for Continuous Improvement in the Global Workplace." They argue that corporations with far flung global supply chains have "mastered the disciplines that foster excellence and innovation among their own … suppliers." The specific knowledge that these firms have concerning continuous improvement in production efficiency and product quality can turn to more social concerns, as well. Through a process of setting their own corporate codes of conduct, educating factories on acceptable labor-management practices, and partnering with NGOs that deliver services to workers and monitor working conditions, corporations with global supply chains can meaningfully improve the lives of workers in their supply chains and model exemplary corporate behavior for their competitors.

Corporations that engage in a program of continuous improvement in labor practices may be rewarded by socially conscious consumers and stockholders. There may also be price, quality and productivity benefits to the extent that these more humane work practices are also more efficient.[5] In the process of ratcheting labor practices globally, multinationals may also find themselves working directly with worker organizations in the supplier factories. Riisgaard (2005a) details the example of the 2001 agreement between Chiquita and the Latin-American Coordination of Banana Workers Union in his paper, "International Framework Agreements: A New Model for Securing Workers Rights?"

MNEs have long realized the value of controlling the way in which capital is used in global supply chains. MNEs acquire control of physical capital through direct ownership or foreign direct investment. Within the context of the international labor standards

[5] For empirical evidence on the productivity benefits of enhanced labor management practices, see Ichniowski, Shaw and Prennushi (1997).

debate, MNEs have also discovered that they would like to control the way labor is managed in their supply chains. The theory as to why MNEs want to control the management of labor and the mechanisms through which MNEs acquire control are both under-developed. Nevertheless, Riisgaard's rendition of this one particular example in which the MNE reaches around the local managers and negotiates directly with labor provides an informative anecdote.

The reader is also referred to two final pieces. Lone Riisgaard (2005b) discusses the manner in which labor standards have been incorporated into regional trade agreements. In his paper, "The Labor Dimension of the Emerging Free Trade Area of the Americas," Charnovitz (2005) details the manner in which labor standards can be brought into trade negotiations outside of the WTO. Similarly, Polaski (2006), in her recent working paper, "Cambodia Blazes a New Path to Economic Growth and Job Creation," describes the Cambodian experiment in which the Cambodian government, the U.S. government, the ILO, NGOs and apparel retailers partner to expand markets for apparel factories with responsible labor management practices. She details the background of the project and the receptivity by buyers and factories and closes with a cost-benefit analysis.

VI. Conclusion

In this volume we have attempted to bring together many of the key contributions to the debate on labor and international trade. As should be apparent by now, there are few settled issues and most conclusions depend on the specific context. This is a continuously evolving literature. New theory and evidence will emerge even before this book appears in print. We hope that the introduction and readings will, nevertheless, provide scholars and students perspective on the historical and contemporary debate over the intersection between trade and labor.

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