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Srinivasan, Thirukodikaval N.

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YALE UNIVERSITY

P.O. Box 208269
27 Hillhouse Avenue
New Haven, CT 06520-8269

CENTER DISCUSSION PAPER NO. 765

TRADE AND HUMAN RIGHTS

T. N. Srinivasan

Yale University

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TRADE AND HUMAN RIGHTS

Abstract

The use, or threat of use, of trade policy instruments to ensure that human rights are respected by governments of partner countries is not new. Its latest and controversial manifestation is the proposal for the inclusion of a so-called social clause in the mandate of the World Trade Organization (WTO) that would condition access of a member to markets of other members on that member's ensuring that certain 'core' labour standards prevail in its economy. The proposal is ostensibly based on a sweeping claim of universality and eternity for a particular set of 'core' labour standards, viz. freedom of association, the right to organize and bargain collectively, freedom from forced labour, and a minimum age for employment of children.

The paper analyzes the moral, philosophical and economic arguments for and against linking trade and human rights. It finds that while claims of universals of labour standards are overblown, addressing the legitimate concerns that citizens of one country may have about what they deem 'poor' conditions of work or 'exploitation' of children by parents or employers in other countries are better does not require the use of trade sanctions. The fact that the proposal for a social clause is being pushed by major developed countries when labour-intensive imports from developing countries are penetrating their markets suggests that protectionist interests have captured the drive for labour standards. The paper concludes with a discussion of the role of multilateral institutions in improving labour standards.

Keywords: Human Rights, Labour Standards, International Trade, Developing Countries, Prison Labour, World Trade Organization (WTO), International Labour Organization (ILO)

December 1996

TRADE AND HUMAN RIGHTS

T. N. Srinivasan*

1. Introduction

The use, or threat of use, of trade policy instruments to ensure that human rights are respected by governments of partner countries is not new. The most notable instance, of course, of multilateral trade sanctions to punish and eliminate the violation of human rights was against the South African government's apartheid policies. Clearly the collapse of the apartheid regime has been attributed by many to the opprobrium, if not the economic cost to South Africa, of the sanction.

Again, human rights advocates in the United States have lobbied, without success so far, against the renewal of Most Favoured Nation (MFN) status to China. Ever since President Clinton issued an executive order in 1993 requiring that the Secretary of State shall not recommend renewal of MFN status unless certain human rights conditions are met, an annual battle between human rights groups and those, prominently business groups with significant stakes in trade with and investment in China, has raged over the renewal. The inefficacy of the ambiguous signals that a divided US political scene sends to China is seen from the fact that, despite immense pressures not to do so, China recently charged and sentenced Wang Dan, a prominent student leader of the pro-democracy demonstrations in Tiananmen Square in Beijing in 1989, with the capital crime of conspiracy to overthrow the

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*Samuel C. Park, Jr. Professor of Economics, Yale University. This paper was presented at the Conference on Representation of Constituent Interests in the Design and Implementation of U.S. Trade Policies, University of Michigan, November 8-9, 1996. I thank Steve Charnovitz, Phil Levy, my discussant Robert Pahre, and the participants for their comments. Jagdish Bhagwati's detailed and valuable comments on an earlier draft helped me in clarifying the analytics as well as the political economy of labour standards. Dani Rodrik and Alan Krueger were generous enough to read and respond to my criticisms of their work on labour standards. Of course, neither they, nor any of the others who commented on the paper, are necessarily in agreement with all the views expressed here. Research support of Ford Foundation under Grant 950-1341 to the Economic Growth Center, Yale University is gratefully acknowledged.

government, after holding him in prison for over six years. In his report on this event, Patrick Tyler of the New York Times writes

> "For the Clinton Administration, the prospect that the youthful Mr. Wang could receive a new and lengthy prison term presents a difficult foreign policy challenge. Earlier this year, Mr. Clinton privately signaled Beijing that if re-elected, he would like to bring a permanent end to the campaign of sanctions and trade pressure that Washington has used to win improvements in human rights conditions here.
>
> To go forward with this plan, Mr. Clinton urged Beijing to show compassion to those who had been harassed or locked up for expressing political views.
>
> Now, in the midst of a Presidential campaign in which his foreign policy is under assault, Mr. Clinton will be under greater pressure to explain how his position toward Beijing has garnered any results and how the United States can influence the deteriorating conditions under which many intellectuals and political dissidents live in China.
>
> Most of the political prisoners on whose behalf Mr. Clinton has interceded with Chinese leaders are now back in prison or in permanent exile." (New York Times, October 13, 1996, p. 1)

But South Africa and China have not been the only cases that have drawn the attention of human rights groups. There is significant support in the U.S. for trade sanctions against Myanmar to punish human rights violations of the military dictatorship there. Interestingly, while the U.S. administration has suggested that by 'constructively engaging' China economically through the grant of MFN status the cause of human rights there would be better served, it has opposed the same argument advanced by ASEAN countries against trade sanctions against Myanmar! The facts that political and trade relations with China are far more consequential to US foreign policy and business interests than those with Myanmar certainly played a role in differing US stance in the two cases.[1]

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[1]Of course, it should be no surprise that domestic politics, foreign policy, and trade policy interact. As early as a quarter century ago, Richard Cooper (1972) recognized the linkage, at least of the last two, by entitling his article "Trade Policy is Foreign Policy" and publishing it in Foreign Policy! The most recent instance is the intense pressure put on Mexico to agree not to sell their tomatoes in the U.S. (with which it has a Free Trade Agreement) at a price lower than 20.68 cents a pound. David Sanger [New York Times, October 12, 1996] quotes a senior official of the Clinton Administration: "This was Mexico's moment to pay back for the bailout" (p.1) presumably referring to the U.S. decision to lend Mexico $12.5 billion following the peso crisis of December 1994. He quotes another official as saying "The math was pretty simple, Florida has 25 electoral votes, and Mexico doesn't" (p.9).

The latest, and internationally controversial, issue relating to trade and human rights is that of labour standards.[2] It has surfaced in international fora including the World Trade Organization (WTO). I will focus exclusively on this issue in the rest of this paper since an analysis of it illustrates almost all of the difficult economic, moral, philosophical and political problems associated with using trade policy as an instrument for enforcing human rights. Indeed, the Council of Economic Advisers (CEA) to the President of the United States view 'core' labour standards as representing "fundamental human and democratic rights in the work place, rights that should prevail in all societies whatever their level of development" (CEA (1995), p. 250, emphasis added).

Thus a sweeping claim of universality and eternity is made for a particular set of "core" labour standards viz. "freedom of association, the right to organize and bargain collectively, freedom from forced labour, and a minimum age for the employment of children" (ibid, p. 250). Acceptance of such a claim will of course imply, for example, that any diversity in the content and scope of core standards among countries according to stage of development would be illegitimate. As such, one has to examine the validity of the claim and I do so in Section 2. Section 3 is devoted to moral and philosophical arguments, such as the humanitarian concern that citizens of one country may have about what they deem "poor" conditions of work or "exploitation" of children by parents or employers. It will be argued that although such concerns are legitimate, their alleviation requires solutions that do not include the use of trade sanctions. Section 4 analyzes the economic arguments, pro and con, for the use of trade policy instruments and briefly reviews the empirical evidence on the effects of diverse labour standards on export performance and inflow of foreign direct investment. Section 5 discusses the role of multilateral institutions in improving labour standards and concludes the paper.

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[2]Lal (1981, Chapter 3) offers a trenchant critique of human rights arguments in favour of minimum labour standards.

2. Universality and Eternity of Human Rights and of Core Labour Standards

According to a recent report from the Organisation for Cooperation and Economic Development (OECD), starting from several international treaties early in this century on the elimination of slavery, a body of international law on human rights, including certain basic workers' rights, has evolved. This body of law

> "considers human rights as universal, transcending all political, economic, social and cultural situations. They are characterised as such because they involve the fundamental liberty, dignity and respect of the individual. Moreover, freedom of association, prohibition of forced labour, elimination of child labour exploitation and the principle of non-discrimination are well established elements of the human rights international jurisprudence; in fact these workers' rights are an inseparable part of human rights" (OECD (1996), p. 7).

The World Social Summit of the United Nations held in Copenhagen "reinforced international consensus on fundamental human and workers' rights. In Commitment 3 of the Declaration from this summit, nations affirm their adhesion to certain workers' rights, which are identical to the core labour standards selected in this study" (ibid).

The International Labour Organization (ILO), founded in 1919 as part of the implementation of the Treaty of Versailles[3],

> "...over the past 75 years ... has adopted a series of conventions which set international labor standards. Through ratification, these conventions create binding obligations for member states. The conventions cover a wide range of issues in the world of work, including basic human rights such as freedom of association, the right to organize and bargain collectively, freedom from forced labor, freedom from discrimination in employment, and severe restrictions on the use of child labor" (Maier (1994), p. 12).

Nine ILO conventions are particularly relevant from the perspective of labour standards. These relate to freedom of association such as the right to organize (No. 87), and collective bargaining (No. 98), forced labour (no. 29) and its abolition (No. 105), non-discrimination in employment and occupation (No. 111) and in remuneration (No. 100), employment policy (No. 122), minimum age of

[3]Some of the conventions adopted by the ILO over the years reflect the tenor of the times: a faith in the need for the state to play a very active role in the economy and its ability to fulfill the assigned role efficiently and effectively. Such a faith would seem misplaced in the light of experience.

employment (No. 138) and tripartite (i.e. workers, employers and government) consultation (No. 144).

Although the CEA, as noted in the introduction, views several of the subjects of these conventions as representing "fundamental human and democratic rights in the work place," ironically the US has ratified only two of the nine conventions just cited: those on abolition of forced labour and on tripartite consultation (World Bank (1995), Table A4). Indeed, the record of US ratification of ILO conventions is even more disappointing. Charnovitz (1995, p. 178) reports that

> "The United States has become a party to only 12 ILO conventions, including 5 in recent years. This is the worst record of any major industrial nation...This disinclination to ratify ILO conventions stems mainly from two concerns. First, because U.S. treaties are the "supreme law of the land," ratifying an ILO convention could supersede federal and state labor laws if provisions of the convention can be enforced in domestic courts. Second, many Americans are reluctant to have U.S. policy reviewed by an international organization. As a consequence, the United States has not ratified the core ILO conventions on freedom of association and the right to organize, nor has it ratified any of the child labor conventions."

Interestingly, OECD countries other than the U.S. have ratified most of the nine conventions. At the same time, the conventions on freedom of association and forced labour and non-discrimination have been ratified by all but a handful of countries who are members of ILO. Although President Carter signed a convention on Women's Rights in 1980, the U.S. Senate is yet to ratify it (New York Times, December 11, 1996, p. A7).[4] Compliance, however, is another matter, though (and this is important) it is subject to periodic monitoring and review once a convention is ratified.

Ever since its creation, the United Nations (UN) has been concerned with human rights. Article 55 of the UN charter requires that countries should, inter alia, promote respect for human rights and basic liberties for all, without distinction of race, gender language or religion, not only as an end in itself, but also as a necessary condition for maintenance of peaceful relations between countries.

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[4]Negotiating and signing a treaty or convention by a representative of the U.S. executive are the initial steps, and its ratification by the U.S. Senate is the final step, in its becoming legally binding on the U.S. government.

The Universal Declaration of Human Rights of 1948 adopted by the UN General Assembly without dissent gives an even more detailed description of human rights. These include

> "civil and political rights (the right to life, liberty, freedom from torture, freedom of opinion and expression, freedom from slavery and servitude, right to peaceful assembly and association) and economic, social and cultural rights (right to join and form trade unions, right to work, right to equal pay for equal work, right to education). Again, the right to decent living standards is regarded as one important element" (OECD (1996), p. 7).

The Declaration did not require ratification. It took nearly 20 years to transform the principles of the Declaration into treaty provisions establishing legal obligations on the part of each ratifying state. At the end of 1966, two covenants, one dealing with civil and political rights, the other with economic, social and cultural rights, and an optional protocol were adopted by the General Assembly. Another 10 years elapsed before the required minimum number of states ratified the two covenants and the optional protocol. As of this year, a total of 132 states (including the U.S.) have ratified the covenant on civil and political rights, 133 the covenant on economic, social and cultural rights and 87 the optional protocol. The U.S. has signed, but not ratified, the covenant on economic, social and cultural rights and is not a signatory of the optional protocol.[5] An even larger number of states (168) has ratified the UN convention on the Rights of the Child adopted in 1989. Clearly the obligations of the Charter are binding on members of the U.N.

Besides international agreements, conventions and covenants, the constitutions of some countries require their government to promote human rights. For example, the Constitution of India has a chapter entitled Directive Principles of State Policy which enjoins the state to strive to secure "a social order in which justice--social, economic and political--shall inform all the institutions of national life" and "to minimize inequality in income, status, facilities and opportunities, amongst individuals and groups." Further, the state is required to ensure "that the ownership and control of the material

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[5]I thank Bruce Russet for enlightening me on the history of human rights in the United Nations.

resources of the community are so distributed as best to subscribe to the common good; that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment" (Basu (1983). The constitution also protects the rights to work, to education, and to public assistance in case of unemployment, disability, or sickness.

This review leads to two conclusions: First, except for a notable few, almost all states have signed and ratified a set of covenants that recognize an immense and overwhelming array of civil, political, economic, social and cultural rights that go beyond the so-called 'core' labour standards. All of these are universal rights, not just the few selected for trade sanctions by the proponents of the Social Clause, whether at the OECD or by the CEA in Washington. That selectivity must be explained and has to do, in all likelihood, with competitive pressures rather than human rights (Bhagwati (1995)). Second, almost none of the many rights are satisfied in reality including in OECD countries: for example, discrimination on the basis of race and sex still exist even in the U.S. This suggests that, at best, the rights recognized are universal aspirations, perhaps to be attained at some unspecified and distant future, though cynics might view them as empty rhetoric. Be that as it may, it is worth reiterating that the claim of universality and eternity, for a subset of rights covering the so-called 'core' labour standards, is overblown.

In conclusion, let me cite one final comment by Heribert Maier, the Deputy Director General of the ILO, on the question of "core" labour standards: "the ILO has not yet reached a political consensus of its ILO constituents to identify clearly a core group of convention or minimum standards" (Maier (1994), p. 13).

3. Concern in High Income Countries About Labor Standards in Developing Countries

A concern about poor labour standards in general, and child labour in particular, has been expressed by various groups in high income countries. Groups in the U.S. such as "Save the Children" have raised funds to help poor children in less developed countries. It would indeed be wrong to

dismiss such concerns out of hand since they could arise from altruism, e.g. the welfare of workers and children in poor countries could be an argument in the utility functions of at least some individuals and groups in rich countries, so that their utility increases if the welfare of workers and children in poor countries increases. On the other hand, such concerns could also arise from purely selfish motives: the fear of erosion of one's high standards through a "race-to-the-bottom" in the global economy, where "low" labour standards anywhere threaten the sustainability of "high" labour standards everywhere. Thus low labour standards in one country are perceived as negative externalities imposed on high standard countries by low standard countries.

Altruistic citizens of rich countries have, in principle, many ways of more efficiently and effectively expressing their concerns than through lobbying for imposing trade sanctions on countries with poor labour standards in the expectation that such sanctions would be effective in inducing the governments of such countries to institute policies for raising labour standards. First of all, it is not inconceivable that a country threatened with trade sanctions for failure to raise its labour standards might not respond by raising them but instead choose to forego gains from trade. Second, instead of relying on the indirect means through linkage which depends on the desired response by the developing country for its success, the citizens of the developed countries could adopt a more effective direct means of pressuring their own governments to lift any restrictions on immigration of workers from countries with poor labour standards. If they choose to migrate, such workers would enjoy higher labour standards prevailing in the country of immigration. Indeed there is support for lifting such restrictions on moral-philosophical grounds as in the writings of John Rawls (1993a). He views freedom of movement and freedom of choice of occupation as essential primary goods equivalent to other basic rights and liberties, the entitlement to which is not open to political debate and allocation through the political process. While Rawls was writing about these freedoms in the context of constitutional essentials of a just society, implicit in the very expression of humanitarian concerns about others must be a view of the whole human race as one society. As such, a natural extension of

Rawls' ideas would treat freedom of movement of humans across artificial political boundaries as a basic human right.[6]

Even if lifting immigration restrictions is deemed infeasible politically, still citizens of rich countries could make income transfers to the workers in poor countries. With higher incomes, it is reasonable to presume that the supply price (broadly defined to include labour standard) of their labour would rise and to restore labour market equilibrium, labour standards would have to rise. Indeed a test of the depth of their humanitarian concern is the price that citizens are willing to pay for translating the concern into an actual increase in welfare of workers in poor countries. Willingness to make needed income transfers is a demonstration of the willingness to pay the price.

Turning now to child labour, excepting the abusive ones, most parents will weigh welfare of their children significantly in making choices for them. And in making those choices, given their resources and opportunities, such parents could reasonably be expected to take into account the cost of putting their children to work in terms of their health and education relative to the income they bring in. As such, if some parents choose to put their children to work, it reflects more than anything else the limitations of their resources and opportunities, viz. their poverty. Once again, citizens of developed countries concerned with the welfare of such working children among the poor in developing countries could influence the choices of parents away from putting their children to work altogether or at least reduce the amount of work done by their children through income transfers to parents. Such transfers relax their resource constraints.

The fear of a "race-to-the-bottom" arises from the expectation that faced with competition from low cost (because of their low labour standards) developing countries, producers in countries with high

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[6]By accepting existing political boundaries, Rawls himself does not make such an extension in his essay on "Law of Peoples" (Rawls 1993b) and is criticised for this failure by Ackerman (1994). In his earlier work, Ackerman (Ackerman (1971, pp. 89-95, 256-57)) argued that while there may be some grounds for restriction on immigration in real-world states, not only such restrictions should be exercised with great care, given the ease with which they may be abused, but also, such restrictions must be accompanied by a massive increase in foreign aid.

labour standards would lobby for lowering labour standards are home by threatening to move production to labour standard countries. Those who harbour such fears have the option of not buying such imported products so that domestic producers will no longer face import competition.

By not buying products of a firm or a country that does not observe what consumers view as acceptable labour standards they can send a clear and effective signal to that firm or country to force it to choose between observing standards and retain the market or lose the market altogether.[7] If it chooses to retain the market by observing acceptable labour standards, to the extent the cost of the import goes up because of such observance, both the exporting country and the buyers of imports share the cost of improving labour standards. If it chooses to forego the market, then while workers in the exporting industry do not gain welfare through higher standards, there is a penalty to the firm in the form of lost exports. If the citizens of the developed countries are interested only in raising the welfare of the workers and not in penalizing the exporting firm, they will have to compensate the firm or make income transfer to workers. The basic point is that there is a real cost to raising labour standards and that has to be incurred if the intended raise is to come about.

It should also be pointed out that the standard characterization of a "race-to-the-bottom" as a classic Prisoner's Dilemma game can be questioned. For example, consider a game of strategy between two countries with respect to their choice of labour standards. It has a conventional pay-off matrix

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[7]It might appear that consumers must have the information needed to distinguish the non-observing firms from observing ones to engage in such behaviour. However market forces might themselves generate such information as long as the consumers refuse to buy that product (or all products from a country) if they suspect some firms (or some products from that country) are being produced under unacceptable conditions. In such a case, producers (or countries) who maintain acceptable standards will have an incentive to invest in signalling (in a credible way) to the consumers that they in fact do so and thus distinguish themselves from those that do not.

Michiel Keyzer, in a private conversation, raised a troubling aspect of consumer boycott. Of course boycott of products produced under working conditions that consumers deem unacceptable would seem appropriate. But how should one view boycott of products because they have been produced by particular groups in other countries that consumers in one country deem unacceptable for reasons of racial, ethnic or other prejudices?

reflecting the real incomes yielded (in brackets) when different labour standards are set at levels "low" and "high" by the two countries, Home and Foreign.

There are thus four possible combinations of home and foreign labour standards. The pay-offs associated with each combination (with the first (resp. second) component being the pay-off of the Home (resp. foreign) countries are given by the following pay-off matrix:

		Foreign Strategy	
		Low	High
Home	Low	(-2,-2)	(2,-3)
Strategy	High	(-3, 2)	(1, 1)

It is easily seen that each country has a dominant strategy, viz. to set a low standard, because by doing so it maximises its pay-off whether the other country chooses to set a high or low standard. Yet, compared to this individually-rational dominant-strategy Nash equilibrium with both countries setting low standards, the collectively rational strategy of each setting a high standard will yield a higher pay-off for both.[8]

Of course competition need not necessarily lead to such a "prisoner's dilemma" type of Nash equilibrium. For example, if the pay-off matrix is as follows,

		Foreign Strategy	
		Low	High
Home	Low	(-4, -4)	(2, -3)
Strategy	High	(-3, 2)	(1, 1)

[8]Aficionados of common-knowledge repeated game theory will point out that the collectively rational outcome could be sustained as an equilibrium through a suitable punishment strategy for deviation as long as both participants do not discount the future too heavily. Despite the fascination of political scientists for repeated Prisoner's Dilemma games, their relevance for real-life politics is dubious.

then (Low,High) and (High,Low) are both (pure strategy) Nash equilibria. In each of these one jurisdiction sets a low standard while the other sets a high standard.

In both cases above, the Nash equilibrium is characterised by a "race to the bottom" in the sense that at least one country sets a low standard. But this need not be so, as consideration of the following pay-off matrix shows. Thus, consider:

		Foreign Strategy	
		Low	High
Home	Low	(-2, -2)	(2, -3)
Strategy	High	(-3, 2)	(3, 3)

It is readily seen that we have a unique Nash equilibrium where each country sets a high standard.

Of course, these are arbitrarily-constructed pay-off matrices and we need to ground them in underlying models of economies to see whether such outcomes are sensible within them. However, they are adequate to demonstrate that a destructive "race-to-the bottom" is not inevitable in the competition to set labour standards.

To sum up, the fact that citizens in rich countries could be, and often are, genuinely concerned about poor working conditions, and the use of child labour in poor countries does not necessarily imply that such concerns can be addressed only through the use of trade policy instrument.

4. Economics of Labour Standards

There is an extensive and growing literature on the economics (theoretical and empirical) of labour standards. Stern (1996) has critically surveyed this literature. Another useful survey is by Anderson (1996). Instead of going over the ground covered by them, I will confine myself here, first, to reproducing the argument that I have made elsewhere (Srinivasan (1996)) that diversity in labour standards among countries is not only legitimate but also does not detract from the case for free trade. In other words, such diversity, like diversity in tastes, technology or factor endowments, is a source for

gainful trade based on comparative advantage. Second, I will offer a critique of two recent contributions (Rodrik (1996) and Krueger (1996)). Krueger's contribution is particularly relevant from the perspective of political economy.

4.1. Legitimate Diversity of Labour Standards

In modeling diversity of labour standards, I follow Brown et al. (1996) in postulating that standards divert resources from production and they also affect welfare, as an argument of consumers' utility function in addition to the amounts consumed of various goods.

Consider first a small-open economy producing and consuming two goods. Let Q_i and C_i denote respectively the production and consumption of good i (i=1,2). Let S denote the level of economy-wide labour standards. Let $U[C_1, C_2, S]$ be the strictly concave Samuelson social utility function with $U_j > 0$, where U_j denotes the partial derivative U with respect to its jth argument. Let $Q_1 = F(Q_2, S; \bar{K}, \bar{L})$ denote the production possibility frontier denoting the efficient combination of Q_1, Q_2 that could be produced, given the level S of labour standard and inelastically supplied endowments of $\bar{K}$, $\bar{L}$ of capital and labour respectively. F is concave in Q_2 and S with $F \geq 0$, $F_1 < 0$, $F_2 < 0$, $F_3 > 0$, $F_4 > 0$, where F_j is the partial derivative of F with respect to its jth argument. In effect, the labour standard is treated as if it is a good produced and consumed within the country, i.e. a non-traded good. With good 1 as the numeraire let the world price of good 2 be π. Under balanced trade, the economy's choice of C_1, C_2, Q_1, Q_2 and S is determined by maximizing

$$U[C_1, C_2, S] \tag{1}$$

subject to

$$C_1 + \pi C_2 = Q_1 + \pi Q_2 \tag{2}$$

$$Q_1 = F[Q_2, S; \bar{K}, \bar{L}] \tag{3}$$

$$C_i \geq 0, Q_2 \geq 0; S \geq 0 \tag{4}$$

Substituting (2) and (3) in (1) the problem reduces to maximizing $U[F + \pi(Q_2 - C_2), C_2, S]$ with respect to Q_2, C_2 and S. Assuming an interior maximum, the first-order conditions yield

$$U_2/U_1 = \pi \tag{5}$$

$$F_1 = -\pi \tag{6}$$

$$U_3/U_1 = -F_2 \tag{7}$$

The interpretation of (5)-(7) is straightforward. Equation (5) states that the marginal rate of substitution in consumption of good 2 for 1 viz. U_2/U_1 equals its world price π. Equation (6) states that the marginal rate of transformation of good 2 into good 1 viz. $-F_1$ equals its world price π. Thus (5) and (6) together imply that both consumers and producers should face world prices were the optimum to be implemented as a competitive equilibrium. Thus free trade is the optimal policy. Equation (7) states that the marginal rate of substitution (MRS) of labour standard for good 1 in consumption viz. U_3/U_1 should equal the marginal rate of transformation (MRT) of labour standard and good 1 in production, that is, the cost of labour standard in terms of foregone output of good 1 in production viz. $-F_2$.

Since the exogenous variables of the problem are the terms-of-trade π and the factor endowments $\bar{K}$, $\bar{L}$ the optimal values of the endogenous variables Q_i, C_i and S will be functions of them. In a world of small open economies, in a free trade equilibrium, while π is the same for all countries, even if tastes and technology (i.e. the utility and production functions) respectively are the same, the endowment $\bar{K}$, $\bar{L}$ will in general differ. As such the optimal values of endogenous variables, particularly the level of labour standards would differ across countries. Under plausible assumptions on U and F it can be shown that a richer country, i.e. one with a greater endowment of one or both factors, will choose a higher standard. Clearly there is nothing illegitimate or unfair about such diversity.

In the above discussion the determination of π through global market clearance was left implicit. To make it explicit and to explore other aspects of labour standards, it is useful to set up the problem as one of choosing Pareto Optimal (across countries) levels of output, consumption and labour standards.

Let $(C_i^j,\ Q_i^j,\ S^j)$ denote respectively the consumption of good i, production of good i (i=1,2), and labour standard in country j (j = 1,...N). Under appropriate assumptions on utility functions and production functions, any Pareto Optimum can be characterized as the solution to the maximization of a positively weighted sum of individual country utilities,

$$\sum_{j=1}^{N} \alpha^j U^j(C_i^j,\ S^j) \tag{8}$$

subject to

$$\sum_j C_i^j = \sum_j Q_i^j \qquad i=1,2 \tag{9}$$

$$Q_1^j = F^j(Q_2^j,\ S^j;\ \bar{K}^j,\ \bar{L}^j) \qquad j=1,2,...N \tag{10}$$

$$C_i^j \geq 0,\ Q_i^j \geq 0,\ S^j \geq 0 \qquad i=1,2;\ j=1,2,...N \tag{11}$$

Equation (9) represents global market clearance for good i and it replaces the balance of trade equation (2) of the small-country problem.

Assuming that the non-negativity constraints (11) do not bind, the first-order conditions for the optimal choice of C_i^j, Q_i^j and S^j are:

$$\alpha^j \frac{\partial U^j}{\partial C_i^j} = \lambda_i \qquad j=1,...N; \quad i=1,2 \tag{12}$$

$$\alpha^j \frac{\partial U^j}{\partial S^j} = -\mu^j \frac{\partial F^j}{\partial S^j} \qquad j=1,...N \tag{13}$$

$$\lambda_1 = \mu^j \qquad j=1,...N \tag{14}$$

$$\lambda_2 = -\mu^j \frac{\partial F^j}{\partial Q_2^j} \qquad j=1,...N \tag{15}$$

In (12)-(15), λ_i is the Lagrangean multiplier associated with constraint (9), which ensures that there is no excess supply or demand for good i in the world. μ^j is the Lagrangean multiplier associated with the production transformation constraint (10) for country j. Taking (12) and (15) together, one gets:

$$\frac{\partial U^j}{\partial C_2^j} / \frac{\partial U^j}{\partial C_1^j} = \frac{\lambda_2}{\lambda_1} = -\frac{\partial F^j}{\partial Q_2^j} \tag{16}$$

Thus the MRS is consumption of good 2 for good 1, viz. $\left(\frac{\partial U^j}{\partial C_2^j} / \frac{\partial U^j}{\partial C_1^j} \right)$ is the same in all countries j,

with the common value being λ_2/λ_1. Also the MRT of good 2 for good 1 in production, i.e. $-\frac{\partial F^j}{\partial Q_2^j}$ is the

same in all countries j and its common value is also λ_2/λ_1. This in turn means that if the chosen Pareto Optimum (i.e. the one corresponding to a particular set of α^j) is implemented as a competitive

equilibrium, then consumers and producers in all countries will have to face the same relative price of good 2 in terms of good 1. In other words, a Pareto Optimum implemented as a competitive equilibrium will be characterized by free trade.

It is seen from (12)-(14) that the MRS of labour standard for good 1 in country j, viz. $\frac{\partial U^j}{\partial S^j} / \frac{\partial U^j}{\partial C_1^j}$ equals the MRT of labour standards for good 1 in production in country j, viz. $-\frac{\partial F^j}{\partial S^j}$.

However this common value of MRS and MRT can differ across countries. Once again such diversity is legitimate.

In the above analysis there was no requirement that each country's trade be balanced, only that globally there was no excess supply or demand for each commodity. Thus, given an arbitrary choice of α^j if the corresponding Pareto Optimum were to be implemented as a Pareto Optimum, the world market clearing relative price of good 2 in terms of good 1 will obviously be λ_2/λ_1. However, there is nothing to ensure that at these prices the value of the optimal consumption bundle of country j, i.e. $C_1^j + \frac{\lambda_2}{\lambda_1} C_2^j$ equals the value of its optimal production bundle, i.e. $Q_1^j + \frac{\lambda_2}{\lambda_1} Q_2^j$ (i = 1,2). However,

global clearance of the world market for each of the two goods ensures that for the world as a whole the value of its consumption equals value of production. In other words, while trade need not be balanced for any country, for the world as a whole it is balanced. Thus to implement any arbitrary Pareto Optimum transfers to each country (equaling the excess of the value of its consumption bundle over the value of its production bundle) will in general be required. Of course some countries will receive and others make positive transfers. Because world trade is balanced, such transfers added over all the countries is zero. Thus making such transfers is feasible. However, following Negishi (1960) it can be shown that a set of positive α^j will in general exist such that the associated Pareto Optimum

could be implemented without intercountry transfers. That is to say, a Pareto Optimum can be shown to exist which can be implemented as a competitive equilibrium at which the trade of each country is balanced. Let such a Pareto Optimum be denoted as No-Transfer Pareto Optimum or NTPO. For simplicity let us assume that NTPO is unique.

Clearly the analysis does not suggest that at such an NTPO the associated labour standard S^j is the same in all countries. Such diversity is legitimate: after all the situation being characterized is a Pareto Optimum and it does not call for intercountry transfers. What if the vector $(S^1, \ldots S^N)$ is deemed unsatisfactory in the sense that the standards in some country or countries are below some minimum acceptable level $\bar{S}$?

Suppose for concreteness, let $S^j < \bar{S}$ for $j = 1,2,\ldots M$ $(M < N)$. Leaving aside the questions as to how the minimum $\bar{S}$ is set and if there is a consensus on $\bar{S}$, how such a consensus came about, one could proceed as follows.[9] Suppose among the set of Pareto Optima (i.e. the set obtained as α^j are varied) there is a non-empty subset the elements of which satisfy $S^j \geq \bar{S}$ for all j. Then by definition any element of this subset will obviously meet the minimum standard criterion. However two points are noteworthy. First, by assumption NTPO is not an element of the subset. As such intercountry transfers would be necessary were any member of the subset is to be implemented as a competitive equilibrium. Second, if there is more than one element in the subset, different elements will differ with respect to the distribution of welfare as well as transfers among countries. However, there is no way to choose among elements of this subset since the only requirement was that the minimal standard $\bar{S}$ be met. In a sense this is nice since additional criteria about the distribution of welfare and transfer could

[9]Indeed with each country's labour standards entering only its production and utility functions, i.e. with no international spillover effects on other country's production or utility functions, it is hard to rationalize a common minimum standard $\bar{S}$. The case of spillover effects is considered below.

be brought to bear in making a choice. Be that as it may, the important point is that as long as there exists a non-empty set of Pareto Optima meeting the minimal standards, it is feasible to meet such standards with income transfers but without departing from free trade. As such there is no need for a social clause or to put it another way the only rationale for a social clause has to be the odious one of protection of import competing industries.

What if there is no Pareto Optimum satisfying $S^j \geq \bar{S}$ for all j? Suppose that the minimum $\bar{S}$ is the result of an international consensus as is the case with ILO conventions. Then it is natural to look for Restricted Pareto Optima, i.e. Pareto Optima subject to the additional restriction

$$-S^j \leq -\bar{S} \tag{17}$$

It can be seen that once (17) is added to (9)-(11), the only first-order condition that is altered is (13) which replaced by

$$\alpha^j \frac{\partial U^j}{\partial S^j} = -\mu^j \frac{\partial F^j}{\partial S^j} - \upsilon^j \qquad j=1,2,...N \tag{18}$$

where υ^j is the Langrangean multiplier associated with constraint (17). Taking (12), (14) and (18) together it follows that

$$\frac{\partial U^j}{\partial S^j} / \frac{\partial U^j}{\partial C_j^1} = -\frac{\partial F^j}{\partial S^j} - \frac{\upsilon^j}{\lambda_1} \tag{19}$$

Thus from (19) it is seen that now there is a wedge between MRS in consumption of good 1 labour standard, viz. $\frac{\partial U^j}{\partial S^j} / \frac{\partial U^j}{\partial C_1^j}$ and MRT in production, viz. $-\frac{\partial F^j}{\partial S^j}$, the wedge being $-\frac{\upsilon^j}{\lambda_1}$. Now $\lambda_1 > 0$ and $\upsilon^j \geq 0$ (the reason being reducing $\bar{S}$ cannot reduce global welfare). As such (19) implies that the

shadow consumer relative price of labour standard in terms of good 1, namely the MRS is lower than its shadow producer price, namely the MRT. Thus, in effect a consumer subsidy inducing demand for higher labour standards relative to goods or equivalently a producer tax that induces a lower supply of goods relative to standards is needed to sustain the optimum. However, since the other first order conditions are unchanged, it is the case that restricted Pareto Optima are characterized by free trade. Thus international income transfers (depending on α^j) and a domestic tax or subsidy to induce the appropriate level of standards are needed to sustain a Pareto Optimum. Indeed one could view the international assistance and domestic compliance measures associated with implementing ILO conventions as precisely the right approach.

The analysis thus far shows that diversity in labour standards or the implementation of a common minimal standards do not call for deviation from free trade as long as Pareto Optimality is the objective and there is willingness not only to make income transfers between countries as necessary but, to the extent standards in one country directly affects the welfare of another, such externalities are internalized in each country. What if this situation of "first best" does not obtain? In answering this question it is useful to distinguish between departures from first best in a closed economy from those in an open economy. Obviously the possible use of trade policy to improve labour standards arise only in an open economy.

In a closed economy, labour standards could be sub-optimally low because of possible market failures. For example, if improving the safety of the work environment involves some initial investment that will pay off in terms of improved future worker productivity, if capital markets are not efficient, the employer may not be able to obtain the resources for such investment. Suffices it to say that departures from first best arising from domestic market failures do not raise new issues in the context of labour standards. And policies that address the failure at its source (the capital market in the above example) are the appropriate interventions. Even if there are no market failures, so that the prevailing labour standards are consistent with a domestic Pareto optimum, still the real income

distribution associated with the laissez-faire Pareto Optimum may be deemed unsatisfactory. In particular, the labour standards (along with factor and commodity prices) are also a reflection of the real income distribution. Changing the income distribution through policy will also change the equilibrium labour standards. Once again there is nothing peculiar to labour standards in this and, as seen in the international context earlier, non-distortionary lump-sum income (or wealth) redistribution policy is the first best to move the income distribution (and consequently the equilibrium labour standards in the right direction). If the first-best policy is infeasible, then other policies (such as, for example, commodity or factor taxes or subsidies) could in principle be used to achieve a better income distribution and labour standards albeit at the cost of a dead weight loss. In general, which taxes and what levels are to be used in achieving the desired change in labour standards while minimizing the dead-weight loss will vary across economies.

One of the core labour standards promoted by the ILO is the freedom of workers to form labour unions and presumably engage in collective bargaining. Such rights are rarely absolute: some workers (e.g. in public administration) are denied these rights by law in many countries. Whether such freedoms should be deemed a fundamental human right on par with other primary goods in the Rawlsian sense is arguable. In any case, for an overwhelming majority of poor workers in developing countries whose dominant mode of employment is self-employment in rural agricultural activities or in the urban informal sector, unionization has little relevance. Even where relevant and where the freedom to form unions has been exercised to a significant extent, namely in the organized manufacturing and public sectors in poor countries, labour unions have been seen promoting the interests of a small section of the labour force at the expense of many.

Of course, whether or not unions promote general welfare there is no rationale for their suppression. But it should be recognized, first, that unionized labour often constitute a small labour aristocracy in poor countries. Besides, even in rich countries, members of some unions have little voice in decision making within the union, not to mention the association of organized crime with the

leadership of a few. Second, and more important, promoting labour standards that cannot be sustained in equilibrium at the particular stage of development of a country could be very expensive in terms of foregone growth. Depending on whether such standards vary across industries and the time phasing of their introduction, wage and profit rates, as well as employment in different industries as well as in the aggregate would be affected differently. As the analysis of Brown et al. (1996) shows, the effects will depend on the technology and the characteristics of labour standards and no general answer can be given.

Turning now to open economies, it is clear that in the absence of a first-best non-trade related policy, trade policies could be used to change equilibrium labour standards. This can be seen simply in the case of trade in a two-country world, where one of the countries is "small" in that it behaves as if it has no influence on its terms of trade. As we saw earlier, a "small" open economy's optimal choice of its labour standard depends on its factor endowment and terms of trade. By exercising its own trade policy instrument, say tariffs or quotas, the large country can influence the terms of trade faced by the small country and thereby affect its choice of labour standards. If the small country's labour standard influences the welfare of the citizens of the large country (because of their humanitarian concerns), then the terms-of-trade effect of its choice of tariffs has two effects on welfare of the large country. The first is the usual direct welfare effect of changes in terms-of-trade and the second is the indirect welfare effect arising from induced changes in small country's labour standard. To the extent a tariff shifts the terms-of-trade in favour of the large country, the first effect is positive. But the second effect could be negative since the adverse shift in terms of trade of the small country might induce a reduction in its labour standard. Depending on the balance between the two effects, it is possible that by choosing its welfare maximizing tariff, the large country could induce the small country to improve its labour standards relative to free trade.[10] But it could also deteriorate the standards if the balance

[10]With spillover externalities, a laissez-faire free trade equilibrium is not Pareto Optimal. However with a one-way spillover effect (i.e. labour standards of the small country affects the welfare

between the two effects were different. The upshot is that if first-best policy instruments are unavailable, trade policy instruments could, though not necessarily would, help in raising labour standards in poor countries. However, welfare of such countries need not rise.

4.2. Rodrik (1996) and Krueger (1996) on Labour Standards

Rodrik (1996) draws an analytical distinction between two arguments, which he claims "are often mixed-up" (p. 5), for the use of trade policy instruments for enforcing particular labour standards. The first is "that trade is a channel through which labour standards are arbitraged across countries towards the lowest level, requiring the use of trade policy to prevent a "race to the bottom" (p. 5). The second is "that trade (and trade sanctions in particular) should be used to enforce internationally agreed standards such as ILO conventions, or to simply get trade partners to improve their labour standards" (p. 5). The distinction arises from the intended effect of trade policy. In the first case, the primary intention is to prevent trade with poor countries eroding domestic labour standards, and not so much to change the labour standards in the poor countries themselves. On the other hand, in the second case, the primary goal is to enforce different, presumably higher, labour standards in poor countries than those prevailing in them through the threat of denial of access to markets of developed countries.

The first argument rests on the logic of competition among buyers and sellers of labour: no buyer will be able to hire a worker at terms worse than the best among those she can get from other buyers in the market and no worker can expect to sell his labour to a buyer at terms better than the best among those offered by other workers to that buyer. If labour standards are private goods and, for simplicity, the only component other than wages in terms of work for which there is competition, then,

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of the large country and not vice versa, with the unilateral exercise of market power by the large country, even though labour standards of the small country improves over its free trade value, welfare of the small country need not.

in a competitive equilibrium of a closed economy without any market failure of any kind, the wage structure will reflect labour standards across industries. Thus, equilibrium differentials in wages will compensate for any differences across sectors and occupations etc. in labour standards. Any 'moral' or other considerations relating to labour standards that workers deem relevant and hence embody in their preferences would be reflected fully in the equilibrium structure of standards. No mandatory regulations would be required to enforce them.

Workers in an economy open to trade in goods but not in labour do not directly compete with workers in other economies and, as such, the logic of competition among workers in a single market does not apply directly. But as generations of students have been taught, trade in goods is a substitute (and under appropriate situations, a perfect substitute) for trade and non-traded factors, including labour, that are involved in the production of goods. Indeed, the ancient pauper labour argument was in fact based on wage competition and the "race to the bottom" argument for the use of trade policy in enforcing on labour standards is the same old pauper labour argument, now couched in terms of competition in labour standards. But there is little empirical evidence for the actual use of labour standards as a competitive tool. The available evidence summarized in OECD (1996) suggests the core labour standards do not play a significant role in comparative costs and export performance. In any case, the conventional answer to the pauper labour argument in the context of trade between rich North and poor South, as Rodrik (1996) points out, is "While unskilled labor may lose, the North is richer as a whole, and if governments in the North wished to do so they could compensate the losers and still come out ahead" (p. 8).

Thus in the absence of market failures[11] and any constraints on the ability of Northern governments to compensate potential losers from competition in trade with the South, comparative advantage, even if it reflects in part differences in prevailing labour standards, is legitimate and so are gains from trade based on it. Thus, there is no case for trade restrictions. Clearly, if such advantage is gained by flouting universal moral norms, it is obviously illegitimate. For example, any cost advantage in products produced by prisoners could be universally deemed illegitimate. Indeed, it is for this reason that GATT-WTO allows countries to place otherwise disallowed quantitative restrictions on trade in such products. China has been accused of exporting such products.

If universal moral norms are indeed the foundations of the case against unfettered trade in products made by prisoners, then what should one make of the activities of UNICOR, a corporation wholly owned by the Federal Government of the U.S., run by the Bureau of Prisons in the United States?[12] It operates 100 factories, sells over 150 products including "prescription glasses, safety eyewear, linens, monogrammed towels, executive office furniture, bedroom sets, gloves, brooms and brushes of all kinds, even targets for target practice. They also make cables and electronic component parts for Army tanks, jet fighters and the Patriot missile." Its gross sales in 1995 were around $500 million, of which wages paid to prisoners was about $35 million! According to Mr. Schwlab, Assistant Director of Corporate Management of UNICOR, prisoners are "not covered by Fair Labor Standards

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[11]It is not very difficult to construct theoretical examples of failures in the labour market and of the possibility of multiple equilibria, where the imposition of labour standards could alleviate the market failure or move the economy to a Pareto superior equilibrium. But the issue is not one of theory but of its wide empirical relevance. Establishing the existence of a significant externality empirically in a convincing and econometrically sound fashion is more difficult and hence rare, than assertions of such existence. Also, it is not enough to show that mandating of labour standards would address the failure in labour markets. It has to be shown that there are no other more cost-effective means of addressing such failures. If everything else fails, a resourceful economist can always think up an uninternalized "externality" and the resultant market failure!

[12]The description of the activities of UNICOR and the quotations in this paragraph are taken from the transcript of the programme "60 Minutes" broadcast by CBS on October 20, 1996. [Transcript prepared by Burrelle's Information Services, Box 7, Livingstone, N.J.]

Act, minimum wage laws. They don't get retirement benefits, unemployment compensation, etc. They're workers, but they're not employees." Besides publicly owned UNICOR, private industry has been attracted and allowed to operate within prisons, and as the owner of one such private company agreed, it was a fantastic deal all the way around and he liked "the financial advantages of a prison business, namely, getting to hire the cream of the crop from a pool of cheap prison labor, not to mention the use of ... brand new air-conditioned factory space, rent free." The cost advantage of UNICOR and any private business operating with prison labour should be obvious. Yet, as the narrator of the story put it, without realizing the absurdity of the economic reasoning involved,

> "Back in 1934, when Congress created UNICOR, it restricted its sales to one and only one customer, the federal government. The reason: to prevent UNICOR's cheap prison labor from undercutting private industry in the commercial marketplace. But Congress also armed UNICOR with one big advantage: It gets first crack at the government's business, even at the expense of private companies competing for the same work."

Clearly, any sale to government by UNICOR displaces what another producer, domestic or foreign, would have made! It is irrelevant that UNICOR is not allowed to export or sell to domestic private sector. Yet those in the United States and the OECD, who accuse less developed countries with lower labour standards than their own as engaging in social dumping, fail to see that the operation of UNICOR has the same effect!

Instead of relying on universal norms to question the legitimacy of all trade in particular products, Rodrik (1996) builds his case on the arguments that "Nations do have collective preferences over what kinds of production technologies are admissible ("fair" or "legitimate") (p. 9) and "All governments take into account consideration of fairness and legitimacy in their regulations governing which technologies are admissible and with are not. The concern over labour standards is just another manifestation of this principle" (Rodrik (1996), p. 32).[13] He then appeals to the self-evident

[13]Rodrik rationalizes collective preferences over technologies with the argument that individuals "May have preferences not only over outcomes (their "consumption bundles") but over the processes through which these outcomes are generated" (Rodrik (1996), p. 32). For example, an individual may prefer a shirt produced by a worker above the age of 18 to that produced by one below

proposition that having an opportunity to exchange what one produces with one's resources for what one consumes through trade is equivalent to adding another technology to the domestic production technology for transforming one's resources for final consumption. As such, "free trade with a low-standard country would be no different than importing workers abroad and allowing them to work under the same poor conditions" (p. 11). If a country proscribes "sweat shops" at home, it should be allowed to reject free trade and importation of goods produced in "sweat shops" abroad.

Leaving aside the fact that there are numerous sweatshops in the U.S. itself and that the Department of Labour has confessed its inability to finance even moderately adequate enforcement of laws against their operation, Rodrik's argument does not carry weight if it is used to deny market access to foreign goods manufactured with domestically "unacceptable" procedures. First, government regulations operate not only with respect to labour standards, but also a whole host of other factors that influence cost of production, such as, for example, building codes, zoning laws etc. The Rodrik principle applied to these imply that, if a country prohibits certain types of structures (such as, for example, buildings that exceed a specified height) or the use of certain types of building materials within its territory, then free trade with, and importing the same product from, a country which does not have such regulations is no different than producing the same product at home in a structure that does not meet the regulations. Thus any and all regulations that affect the cost of production of any product at home in principle, could induce home producers to call for restrictions on imports of the same product. A moment's reflection is enough to convince oneself that this opens the door for

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18. Whether such a preference should be viewed as arising from an altruistic concern over the welfare of children below the age of 18 is arguable. Rodrik refers to Sen (1995) in this context. Sen's discussion of processes or procedures critically examines the distinction between consequentialist and deontological reasoning founded on procedural fairness. Whether procedural fairness is in effect consequentialist because the fairness of a procedure "rests squarely on previous evaluation of its consequences" (Dasgupta (1993), p. 31) or it is not, so that "pure procedural justice obtains when there is no independent criterion for the right result: instead there is a correct or fair procedure such that the procedure has been followed" (Rawls (1972), p. 86), it is hard to see how either view is of any relevance to Rodrik's characterization of individual preferences.

attempts to offset comparative advantage of foreign producers by depicting it as arising from differences in regulations relative to those prevailing at home.[14]

The second argument for the use of trade sanctions to enforce particular labour standards of advanced nations in poor countries is unpersuasive. As argued in Sections 2 and 3, first of all, in no sense can one attribute universality and eternity to those standards. Second, even if humanitarian concerns about the welfare of workers in poor countries were behind the desire to enforce higher standards on them, more efficient instruments than trade sanctions are available to enforce them. In any case, as Rodrik himself points out, in a related context, the reason why advanced nations do not "condone a substantially lower set of working conditions for migrant workers (temporary or otherwise) ... have less to do with humanitarian concerns for foreigners than with ensuring labor standards for domestic workers do not erode" (Rodrik (1996), p. 11). One is therefore led to conclude that conventional protectionist pauper-labour type argument, rather than lofty humanitarianism, that is behind the clamour for the use of trade policy instruments to enforce particular labour standards in poor countries. As such, succumbing to the clamour would amount to using inefficient distortionary trade restrictions, rather than non-distortionary domestic policies in rich countries, for redistributing gains from trade, thereby imposing avoidable welfare losses on poor countries.

Krueger (1996) analyzes some political economy aspects of linkage between trade policies and labour standards. He finds from his linear probability regressions that members of U.S. Congress

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[14]Distinguishing products by the processes by which they are produced can easily lead to the imposition of trade restrictions that are prima facie non-discriminatory but de facto discriminatory. I cannot resist quoting from Haberler's (1936, p. 339) classic work to illustrate this possibility:

"Another reason for the increasing complication of tariff schedules is the effort to evade the Most Favoured National Clause. To this end, the specialisation of tariff items is sometimes carried so far that a slight difference of quality, if it is found only in goods coming from a certain country or countries, is listed as a separate item. In this way it is possible, if desired, to reduce the duty on goods coming from one country without also reducing it--under the provisions of the Most Favoured Nation Clause--upon similar goods from other countries. The example of this always quoted is a provision in the German tariff, dating from 1902 and still valid, which is clearly meant to apply to Switzerland and Austria, relating to "brown or dappled cows reared at a level of at least 300 metres above the sea and passing at least one month in every summer at a height of at least 800 metres."

representing districts with relatively many unskilled workers, who are most likely to compete with child labour, are less likely to support a ban on imports made with child labour. He concludes from this finding that lobbying in industrialized countries for linking market access of developing countries to their observance of labour standards does not necessarily represent disguised protectionism. But, by the same token, it is not necessarily a refutation of the claim that it does. First of all, if a representative did not choose to cosponsor the Child Labour Deterrence Act of 1995, it does not imply his or her lack of support for the legislation, although, to be fair, cosponsoring could be construed as indicating stronger support. Second, since the proportion of eligible voters who actually vote differs across population groups and the less educated and unskilled are less likely to vote, their interests might weigh less heavily in the decision of the representative to cosponsor or not.[15] Third, and most important, even if one accepts Krueger's econometric analysis as valid, as Krueger himself notes, his regressions suggest that those who support international labour standards are more likely to support protectionist policies more generally and that representatives from districts that have a higher rate of unionization are more likely to be cosponsors.[16]

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[15]Whether or not Krueger's econometric estimates are biased for these reasons depends on the theoretical framework underlying the estimating equation. For example, consider a two-stage decision making by a representative. At the first stage the representative decides whether he would vote for any legislation that might come up mandating international labour standards. If he decides he would not vote, there is no second stage. If he decides that he would vote, then there is a second stage decision whether he would be proactive and cosponsor such legislation or not. Under some specifications of explanatory variables and distribution of error terms for each decision, a bias could arise in the estimates.

Also under certain circumstances even politicians who ignore worker's interests might still vote for import restriction. For example, consider a specific factors model in which the capital in industries competing with imports of products from countries with low labour standards is specific to those industries and suppose a proportion (but not all) of the unskilled labour force is employed in those industries as well. Intensification of import competition in these industries will affect the interests of owners of specific factors adversely, while its effect on the welfare of unskilled labour is ambiguous. Suppose it is adverse. Then even politicians who ignore interests of labour would support import restriction in this case since it protects the interests capital specific to these industries.

[16]It is argued by some that it is extremely unlikely that union members stand to gain from a ban on imports of goods made with child labour because almost all union members do not compete with child labour. However, there is a slippery-slope argument on the other side. If the unions did not

A number of empirical studies on various aspects of competitiveness in world markets, flow of foreign direct investment and labour standards are available. Serious data and econometric problems plague many of them. Most are based on multiple regressions usually estimated by ordinary least squares (OLS). Few of the regressions estimated are derived from any well-specified theoretical framework: the explanatory variables are often chosen based more on their plausibility than on theory. Proxies used, as for example by Rodrik (1996), for labour standards obtaining in a country (e.g. total number of ILO conventions ratified), statutory hours of work, etc.) are subject to significant measurement errors. Not all explanatory variables can be deemed truly exogenous. For example, whether to satisfy an ILO convention or not is a matter of choice. As is well known, if explanatory variables are either subject to measurement errors or endogenous or both, the OLS estimates of regression parameters will be inconsistent.

Stern (1996) and OECD (1996) summarize the results from many of the empirical studies. The conclusions of OECD (1996) are worth excerpting:

> <u>On core labour standards and export performance</u>:
>
> "Within these limitations, empirical findings confirm the analytical results that core labour standards do not play a significant role in shaping trade performance. The view which argues that low-standards countries will enjoy gains in export market shares to the detriment of high-standards countries appears to lack solid empirical support...Moreover, the main result that emerges form a cross-country analysis of comparative advantage is that patterns of specialisation are mainly governed by the relative abundance of factors of production and technology differences...These findings also imply that any fear on the part of developing countries that better core standards would negatively affect either their economic performance or their competitive position in world markets has no economic rationale." (p. 38)
>
> <u>On core labour standards and trade liberalization</u>:
>
> "The empirical results presented for the sample of 44 countries do not provide unambiguous support for one pattern of sequencing over the other as to whether trade liberalisation or freer association rights come first. Rather, the clearest and most

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take a stand on one labour issue, viz. ban on imports of goods made with child labour, albeit one in which their members may not have a direct interest, their credibility and clout could be weakened on other issues in which their members have a direct interest.

> reliable finding is in favour of a mutually supportive relationship between successfully sustained trade reforms and improvements in association and bargaining rights." (p. 43)

On core labour standards and FDI:

> "Empirical evidence on the direct relationship between FDI and core labour standards is scarce and remains open to different interpretations...According to reports by MNEs from OECD countries, core labour standards are not considered a factor in assessing investment opportunities in a potential host country." (p. 50)

On trade, employment and wages:

> "Typically, analysts find that the impact of trade on employment and wage relativities has been significant in specific sectors. They also find that the measurable negative impact arising through increased import penetration is highest in sectors that employ relatively large numbers of low-skilled workers. Almost all studies find that the impact of trade on employment is small relative to changes in employment overall." (p. 51)

In sum, economic theory and empirical evidence confirm that the case for linking trade with observance of core labour standards is far from persuasive.

5. Multilateral Institutions and Labour Standards

The deceptively appealing notion that lower labour standards in a country relative to its trading partners confer on it an unfair competitive advantage was already present in the charter of the International Trade Organization (ITO) negotiated by participant countries at Havana in 1948. Charnovitz (1987: 566-67), in his historical review of labour standards in the world trading regime, notes that Article 7 of the ITO stated that "The members recognize that unfair labor conditions, particularly in the production for export, create difficulties in international trade, and accordingly, each member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory." The ITO did not come into being primarily because the United States did not ratify its charter. However, the General Agreement on Tariffs (GATT) consisting of tariff reductions and general clauses consisting of a set of rules and obligations which had been negotiated earlier and intended to operate under the umbrella of the ITO, came to be applied through its Protocol of

Provisional Application. Except for allowing countries to prohibit trade in goods made with prison labour, the articles of GATT did not deal with labour standards. Various administrations in the United States (US), Democrat and Republican, have proposed the inclusion of a labour standards article in the GATT, unsuccessfully as it turned out, during several rounds of multilateral trade negotiations. Similar proposals have been made by political parties in national parliaments in several European countries and also in the European Parliament.

The latest proposal is for the formal inclusion of a "social" clause in the mandate of the WTO that would allow restrictions to be placed on imports of products originating in countries not complying with a specified set of minimum standards. Such a proposal in itself is not a surprise except in its timing, namely that it was raised after the painful and lengthy negotiations of the Uruguay Round had been completed, almost holding the negotiated agreement hostage. The agreement was signed, but not without an understanding that the topic of labour standards could be discussed by the preparatory committee for the WTO. Of course, the facts that the demand has been raised repeatedly and an understanding to discuss it has been arrived at do not necessarily make it legitimate. Indeed, as was argued below in Section 3, if ethical considerations were the only factor behind this recent interest in labour standards, there would be no reason for demanding a social clause.

The late Jan Tinbergen, Nobel Laureate in economics, pointed out that in general there must be at least as many instruments of policy as there are objectives and that in achieving any objective that policy instrument which has the most direct impact on that objective is most likely, though not always, to do so at the least social cost. His principle applies as well to the creation of agencies that set the rules governing international economic transactions and the specification of their mandates. Thus the GATT and the United Nations Conference on Trade and Development were created as agencies specializing in issues relating to international trade; the World Bank and the International Monetary Fund were designed to deal respectively with financing long-term development and short-term stabilization. Universal Postal Union covered postal and other matters of international

communication. Berne and Paris conventions addressed some aspects of intellectual property rights. The International Labour Organization (ILO) deals with labour issues. Clearly such specialization makes eminent sense. Loading one specialized agency with matters that fall within the purview of another, such as including a social clause in the mandate of the WTO rather than leaving labour standards within the purview of the ILO while ensuring consistency of actions of both through mutual consultation where appropriate, is not conducive to addressing them efficiently. Yet, ostensibly because of their presumed relatedness to trade, intellectual property rights and investment measures were included in the Uruguay Round (UR) of multilateral trade negotiations and have become part of the WTO. A committee on Trade and Environment has been constituted in the WTO as envisaged under the UR agreement.

It is becoming clear that the issues of labour standards, environment and employment "will be the big three issues, as will the integration of developing countries into the trading system" at the first Ministerial Meeting in December 1996 of WTO (R. Ruggiero, Director-General of WTO, in an interview, International Herald Tribune, July 29, 1996). Even though Australia, Japan and ASEAN nations have already expressed their opposition to the discussion of issues which are not specifically related to trade, such as corruption and social clauses, the Secretary of State of the United States, Mr. Warren Christopher, has gone on record at the July 1996 meeting of ASEAN that the relationship between trade and labour standards would be one of Washington's priorities besides the issue of illicit payments (i. e. corruption) at the Singapore meeting.

It is clear that the issue of labour standards will continue to be brought up in the WTO, particularly by the US, as it was several times in the past in GATT. But the facts that support for labour standards in developed countries rests in part on genuine moral grounds of the concern of their citizens with the welfare of children in developing countries and that the belief that "unfair" labour conditions, particularly in the production of export, create difficulties in international trade is long

standing, do not mean that protectionism is not currently the driving force behind the demand for a "social" clause in the charter of the WTO.

First of all, this demand is being pushed with great vigour by major developed countries at the present time when imports from developing countries are penetrating their markets to an increasing extent. Second, there is a curious asymmetry in the contents of the proposed clause: they focus almost exclusively on those labour standards which are presumed to be "low" in developing countries and not on those equally plausible ones which are absent in many, but not all, developed countries (Bhagwati (1995)). The asymmetry would be unlikely, if the driving force behind the social clause was some universal moral concern with labour standards. For example, along with the workers' right to unionize and bargain collectively, one might also include the right to be represented in the management of firms, if not a right to a share in the firm's profits. To take another example, it is argued that many developing countries do not enforce their own laws such as those relating to compulsory schooling or to labour standards. By the same token many developed countries do not enforce their own laws on drug use as effectively as their resources would allow. Should the resources devoted to law enforcement, given the resource and information constraints, and the difficult choices facing governments as to the allocation of these resources among alternative targets, become matters for <u>international</u> negotiations? Can developing countries tell the outgoing US Labour Secretary, Robert Reich, when he laments the lack of funds to bring monitoring of sweatshops up to snuff, that the U.S. must find the resources or face WTO suspension of market access for exports of goods that are produced in sweatshops?

The timing of the demand for and contents of the proposed clause as well as the concern only with enforcement of a particular set of laws, viz. those relating to labour standards, all point to only one conclusion: that protectionist interests have captured the drive for labour standards.[17] It is

[17]Robert Pahre, in his discussion, presented an example of a complete information game in which, but for the support of protectionists, the threat of trade sanctions is not credible. With such support and hence credibility of the threat, the country being threatened capitulates and improves its human rights record without the threatening country having to impose the sanctions. While this

extremely essential that developing countries together with Australia, Japan and other like-minded industrialized countries take a firm stand at the Singapore Ministerial Meeting against the inclusion of a discussion of labour standards in the agenda.[18]

Of course, excluding labour standards from the ambit of WTO does not mean the issue is neither important nor relevant for international fora. There is already an international forum for discussing it viz. the ILO. The main reason why the issue is being pushed in the WTO, rather than the ILO, is that while the ILO has no enforcement mechanism for its conventions other than persuasion and technical assistance, in the WTO there is the possibility of the use of trade sanctions as a means of enforcement. Since trade measures are not necessarily the best instruments of enforcement, a far better alternative than including a social clause in the WTO is to seek other ways of ensuring that members of ILO comply with conventions on labour standards that they sign and ratify. Clearly, with substantial overlap in the membership of the two organisations, even without a social clause in the WTO, if such a future ILO compliance mechanism fails, the members of ILO in their dual capacity as members of WTO as well, could decide to use trade measures if necessary.

Finally, there is the danger that if the issue of labour standards is not discussed in an appropriate multilateral forum such as the ILO, it will be taken up in other contexts such as bilateral, plurilateral and regional trade agreements.[19] For example, as part of the price to get congressional

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example highlights the role of credibility, the fact that credibility is achieved with the support of protectionists is incidental and not essential. The essential point is that credibility, however achieved, serves to ensure that the threatened country capitulates without sanctions having to be imposed.

[18]It is extremely heartening to note that at the Singapore meeting, the ministers, in their draft declaration, have wisely decided to "renew their commitment to core labour standards but say the International Labour Organisation is the competent body to set these standards. They affirm support for the ILO's work, reject the use of labour standards for protectionist purposes and say the comparative advantage of low-wage countries 'must in no way be put in question'" (Financial Times, December 13, 1996, p. 8).

[19]I should also mention here some unilateral actions. GATT allows developed countries to offer preferential access to their markets to developing countries under the Generalized System of Preferences (GSP). The US and EU have conditioned the grant of such preferences to the observance

approval in the US of the North American Free Trade agreement, Mexico and Canada had to agree to a side agreement on labour and environmental standards. Since the start of the Uruguay Round, there was a disturbing and unfortunate increase in the number of discriminatory regional trade agreements concluded, as well as proposed. Contrary to the expectation of some, the successful conclusion of the Round did not stop this trend--on the contrary, there is some evidence of acceleration. Many developing countries are already members or eager to become members of such agreements. This eagerness might lead them to accept side agreements on labour standards that are not necessarily in their interest.

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by developing countries of particular labour standards that the US and EU deem important. I should add, however, that whether or not its grant is conditional, GSP is the analogue of "crumbs from the rich man's table" which the developing countries should do well without.

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