

Labor standards and trade agreements: U.S. experience

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There has been much discussion of incorporating labor standards into international trade agreements, particularly in the context of the World Trade Organization (WTO). The U.S. has pushed for such arrangements, so far unsuccessfully, and has been joined in this effort by some other developed countries. Countries with emerging economies, however, have resisted such proposals. Within the North American Free Trade Agreement (NAFTA), covering the U.S., Canada, and Mexico, there is a side accord dealing with labor issues. A controversy now exists relating to the degree to which NAFTA-type labor policies might be extended to other countries negotiating with the U.S.

Three areas of confusion dominate these debates. The first is a failure to distinguish between wage determination and labor standards. The second is a failure to acknowledge the right of consumers in developed countries to exercise influence over the policies of multinational firms from which they buy. And the third is a failure, particularly in the U.S., to distinguish between the trade pattern (what kinds of goods are exported and imported) and the trade deficit (the difference between the value of exports and imports).

The Wage/Standard Confusion

Core labor standards should not be viewed as a global minimum wage. In fact, serious proposals to incorporate labor standards in trade agreements involve such prohibitions as child and forced labor and such rights as freedom of association and collective bargaining. Other variants, such as the NAFTA arrangements, include obligations on the trading partners to enforce their own domestic labor laws.

Were such standards to become part of global trade agreements, emerging economies would still have very different wage levels from those in developed countries. Their comparative advantage in labor-intensive products would remain. Labor standards would neither protect developed countries from low-wage competition nor would they

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impose severe economic distortions on emerging economies. The direct economic impact on both types of countries would be quite small. But there could be indirect benefits for emerging economies, namely greater access to developed markets.

It is also the case that labor standards enforcement would not be confined to emerging countries were such standards to become part of trade agreements. Under NAFTA, for example, there have been complaints about U.S. labor practices, even though most of the investigations which have resulted have centered on Mexico.

Consumer Sovereignty vs. National Sovereignty

A number of retailers and manufacturers in the U.S. have taken steps to avoid charges of exploitation in the production of their goods after embarrassing disclosures about working conditions at foreign suppliers. Included have been companies such as Wal-Mart, Disney, and The Gap. Proposals have been made for various forms of certification and/or labeling of products to provide consumer information. Although emerging nations may feel that it is a violation of their national sovereignty for core standards to be imposed on them, it is difficult to argue against consumer information. In some cases, foreign governments and producers have agreed to certification arrangements to preserve access to consumers in developed countries.

Trade Patterns vs. Trade Deficit

Debate in the U.S. over trade has a long history that pre-dates the recent controversy over labor standards. Through the 1950s, Republicans - originally representing the manufacturing-based, import-competing northern states - pushed for protection against foreign goods. Democrats, with a strong tie to the agriculturally-based, export-dependent south, pushed for free trade. Changes in economic structure and political alignment tended to reverse these positions beginning in the 1960s. Big business in the U.S. moved from domestic to multinational and thus generally favored expanded trade. Labor unions - tied to Democrats after the 1930s - felt themselves increasingly prone to foreign competition and pushed for protection.

Presidents, however, have tended to take a world view, regardless of party. As a result, Democrat Clinton relied heavily on Republican votes in Congress to pass NAFTA and the WTO treaty. Typically, the



rhetoric during such debates has centered on whether trade is "creating" or "destroying" jobs. Attractive though such arguments may be, they have a major analytical flaw.

In the short run, of course, trade may displace workers and cause unemployment. Or it could cause labor shortages. But in the longer term, the number of jobs in the economy is a function of labor supply and business cycle influences. Trade affects the pattern of production domestically and therefore the mix of jobs. It has little to do with the total number of jobs.

Long-standing economic theory suggests that countries with abundant supplies of unskilled labor would have a comparative advantage in products intensive in unskilled labor. Much trade, however, involves movement of goods between similar countries, e.g., the U.S. and Canada. We should therefore look to the theory to operate mainly for that subset of trade between the developed world and the emerging economies.

Empirical evidence, based on trade between the U.S. and selected emerging economies, bears out this expectation. We examined trade patterns between the U.S. and the four Asian "tigers" (South Korea, Hong Kong, Singapore, Taiwan) plus China during the period 1978-95. Exports from the U.S. to these countries tended to be in products featuring relatively high-wage labor. Imports tended to be in products with lower-wage labor than exports. However, towards the end of the period, both Asian export and import goods tended to have higher wages than the average for all U.S. output (goods and services). Trade with the rest of the world (i.e., excluding the four tigers plus China) involved goods with remarkably similar implicit wages, both exports and imports.

Our data suggest that the trade pattern with Asia might have aggravated wage inequality between high and low paid workers in the U.S. However, the overall effect - had trade been balanced - would have been very small since in aggregate exports and imports have been similar in implicit wage levels, despite the differences in the Asian subcomponent. But beginning in the 1980s, large American trade deficits appeared and continued into the 1990s.

Trade deficits primarily affect workers in manufacturing. They push workers out of manufacturing and towards other sectors as exports are reduced and/or import-competing industries are displaced. The total number of jobs in the economy may not change, but the sector of such jobs does. Given the deficits, our estimates suggest there



was a disproportionate push of workers with lower levels of education out of the trading sector. Had U.S. trade been balanced, this effect essentially would have disappeared. Note that the cause of trade deficits is rooted in low U.S. saving rates relative to investment. Labor standards have virtually no connection with these tendencies.

Future Concerns and Uncertainties

From the 1960s into the 1990s, wages in developed countries tended to converge with U.S. levels, most dramatically in the Japanese case. The four Asian tigers seem to be following Japan. They are roughly today where Japan was about 20 years ago in the convergence process. Although wages and labor standards are not the same thing, the convergence of wages in emerging countries with those of the developed world will tend to quiet the labor standards/trade issue.

Our data on China, however, are much more limited than those for many other countries. The limited data available do not suggest a convergence is underway in China despite that country's rapidly-expanding trade. China has a vast hinterland with a large potential labor supply. It could be that the future impact of China (and perhaps India) on wages in the U.S. and other developed nations will be unlike the impact of trade previously. If a major adverse impact were to occur, it is unlikely that putting labor standards in trade treaties would fend off a move to protection in the developed world.

Conclusions

If labor standards meant boosting wages in emerging economies, they potentially could have a major impact in canceling those countries' comparative advantage. But such wage-boosting standards have not been seriously proposed and any effect actual labor standards proposals might have is very small. Labor standards linked to trade, however, could have an indirect effect in keeping markets in the developed world more open. Much of the job creation/destruction rhetoric is misleading. Trade may have had some effect in aggravating wage inequality in the U.S. But the likely culprit - to the extent there is a trade/inequality effect - is the trade deficit. And labor standards have virtually nothing to do with domestic U.S. saving and investment behavior.

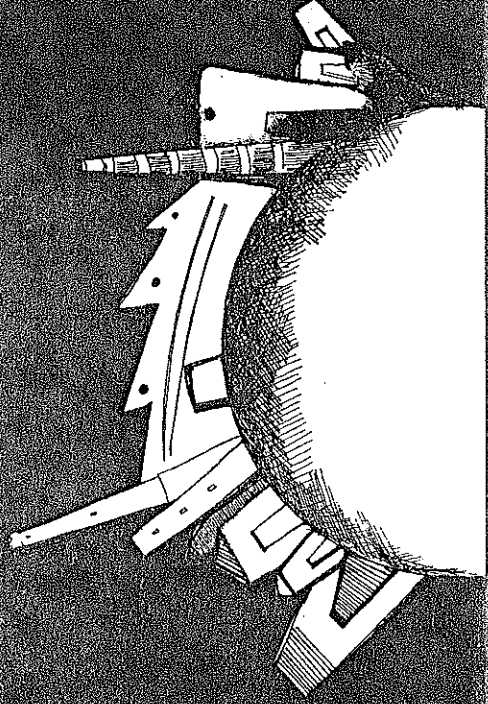


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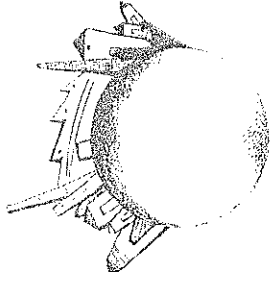
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