Specific concerns about low labor standards in developing countries arise in part from more general concerns about the effects of international economic integration, including freer trade and investment with LDCs. Moves toward freer trade and investment tend to create so-called "winners" and "losers." The net benefits of international economic integration—after accounting for the gains and losses to specific groups—accrue from shifts in the structure of production and trade between various sectors of the economy. As countries eliminate barriers to trade and investment, they shift resources—such as labor and capital—from less productive to more productive uses. Such shifts impose real costs on the workers and the owners of capital in declining industries. Workers, for example, must find new jobs, and some may earn lower wages after they do so. In the United States, freer international trade tends to shift labor and capital out of labor-intensive industries, especially those that rely heavily on low-skilled labor.

Economists have shown that the economic benefits of freer international trade and investment outweigh the costs. But because the winners need not compensate the losers, international economic integration may seem unfair, regardless of the labor policies of developing countries. According to a recent poll, more than half of the U.S. public thinks that trade agreements between the United States and other countries have cost U.S. jobs. (Only 5 percent of economists who were surveyed agree.)[12]

As for specific concerns that labor policies in developing countries adversely affect workers in the United States, the weight of the evidence suggests that low standards *per se* have little direct impact on most U.S. workers. Labor and trade economists offer different perspectives on working conditions, both leading to the same general conclusion.[13] Most labor economists look at domestic markets, focusing on the supply of and demand for labor. From their perspective, imports affect working conditions in a country to the extent that they "embody" foreign labor and so displace domestic labor. In their view, the relatively small percentage of imports in the U.S. economy means that imports probably have only a small effect on the supply of labor. Most trade economists, by contrast, look at international markets, focusing on the prices of traded goods. From their perspective, only changes in international prices will change the returns on domestic resources, such

12. Mario A. Brossard and Steven Pearlstein, "Great Divide: Economists vs. Public," *Washington Post*, October 15, 1996, p. A1.

13. For a more complete discussion of the divergent perspectives of labor and trade theorists, see Sherman Robinson and Karen Thierfelder, *The Trade-Wage Debate in a Model with Nontraded Goods: Making Room for Labor Economists in Trade Theory*, TMD Discussion Paper No. 9 (Washington, D.C.: International Food Policy Research Institute, February 1996).

as the real wage of low-skilled labor.[14] And in their view, few countries are large enough, in terms of market power, to affect the prices of internationally traded goods.

As for developing countries themselves, the evidence about whether efforts to raise standards help or hurt their workers is ambiguous. In some cases, higher standards might lower economic efficiency and retard economic growth. If workers are already paid in rough accord with their productivity, imposing higher standards could reallocate resources away from the most productive uses. In other cases, those standards might help to build or improve institutions that promote economic growth.

The Benefits of International Economic Integration

Most economists agree that the economic benefits of international economic integration, including freer trade and investment with LDCs, outweigh the costs. Those benefits stem from changes in resource allocation according to a country's comparative advantage, from economies of scale resulting from a country's access to larger markets, and from improvements in productivity.[15] In essence, economic gains occur because a country can use its resources, such as labor and capital, more effectively when it opens its borders to trade and investment.

A country's comparative advantage arises primarily from its endowments of resources. The United States, for example, derives comparative advantage from a relatively abundant supply of high-skilled labor and capital, whereas many developing countries derive comparative advantage from a relatively abundant supply of low-skilled labor. Firms in developing countries can produce goods that require intensive use of low-skilled labor at lower cost, relative to other goods, than can firms in the United States. Likewise, firms in the United States can produce goods that require intensive use of high-skilled labor and capital at lower cost, relative to other goods, than can firms in developing countries. On that basis, both the United States and developing countries gain when they trade.

The net benefits of freer international trade and investment result from gains and losses to specific groups as resources shift from less productive to more productive uses. The gains accrue to firms and workers in growing industries and, more generally, to consumers. Open markets ensure that consumers pay the lowest

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14. The relative abundance of resources determines the structure of production and trade, but international prices determine the returns on those resources. Thus, a change in resource supplies, such as the supply of low-skilled labor, could change the structure of production and trade but not the relative return, such as wages paid to low-skilled versus high-skilled labor. See Robinson and Thierfelder, *The Trade-Wage Debate.*

15. The gains from trade and investment are discussed in Congressional Budget Office, *A Budgetary and Economic Analysis of the North American Free Trade Agreement* (July 1993).

possible prices for the goods they buy, in part because international competition can eliminate monopolies in local markets. Moreover, consumers gain access to a wider variety of goods—that is, international trade increases their choices about what to buy. In addition, open markets can lower production costs by allowing firms to take advantage of the economies of larger-scale production. When unit costs drop, those savings can be passed on to consumers in the form of lower prices.

The losses, some temporary and some permanent, fall on workers and firms in declining industries. Workers who lose their jobs in an industry may require special assistance, including retraining so as to move to another industry and temporary income replacement.[16] Moreover, some workers may face lower wages even after they change jobs. That may be especially true for low-skilled workers.[17] (Intuitively, the relative abundance of low-skilled labor in developing countries compensates for the relative scarcity of low-skilled labor in the United States, so low-skilled labor becomes more valuable in the developing countries and less valuable in the United States.) Such losses are inherent in freer trade and are separate from any potential influences based on unfair trade practices.

How large an effect does international trade have on U.S. workers? A number of studies have looked at the impact on wages, employment, and income in the United States.[18] Many of those studies suggest that factors other than trade, such as technology, have had a more direct bearing on U.S. workers. They argue that changes in technology have shifted the demand for labor in the direction of high-skilled workers. Nevertheless, the possibility remains that international trade has contributed to the downward pressure on the wages of low-skilled workers in the

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16. Federal programs that provide such assistance include the Economic Dislocation and Worker Adjustment Assistance program and the Trade Adjustment Assistance program.

17. Economists predict that, under certain circumstances, open trade will equalize the returns on resources, such as the real wage of low-skilled labor, so that the real wage in one country will equal the real wage in another. For that to happen, the real wage of low-skilled workers would fall in the United States and rise in developing countries. That prediction is based on a simple model with two goods, two countries, two resources, perfectly competitive markets, and identical technology, in which both goods are produced in both countries. For a summary of the results, see Peter B. Kenen, *The International Economy*, 3rd ed. (Cambridge, England: Cambridge University Press, 1994), pp. 82-84. In practice, returns on resources may diverge because of barriers to trade, transportation costs, differences in technology, and other such departures from the simple model.

18. See Jagdish Bhagwati and Marvin H. Kosters, *Trade and Wages: Leveling Wages Down?* (Washington, D.C.: AEI Press, 1994); George Borjas, Richard B. Freeman, and Lawrence F. Katz, "On the Labor Market Effects of Immigration and Trade," in Borjas and Freeman, eds., *Immigration and the Work Force* (Chicago: University of Chicago Press, 1992), pp. 213-244; Gary Burtless, "International Trade and the Rise in Earnings Inequality," *Journal of Economic Literature*, vol. 33, no. 2 (June 1995), pp. 800-816; Paul Krugman and Robert Z. Lawrence, *Trade, Jobs, and Wages,* Working Paper No. 4478 (Cambridge, Mass: National Bureau of Economic Research, 1993); Robert Z. Lawrence and Matthew J. Slaughter, "International Trade and American Wages in the 1980s: Giant Sucking Sound or Small Hiccup?" *Brookings Papers on Economic Activity: Microeconomics*, no. 2 (1993), pp. 161-226; Edward E. Leamer, *Trade, Wages, and Revolving Door Ideas*, Working Paper No. 4716 (Cambridge, Mass: National Bureau of Economic Research, 1994); Jeffrey D. Sachs and Howard J. Shatz, "Trade and Jobs in U.S. Manufacturing," *Brookings Papers on Economic Activity*, no. 1 (1994), pp. 1-84; and Adrian Wood, "How Trade Hurt Unskilled Workers," *Journal of Economic Perspectives*, vol. 9, no. 3 (1995), pp. 57-80.

United States, either directly or indirectly. In particular, one study notes the difficulty of separating the effects of trade and technology "because, for example, increased competition from international trade could stimulate more rapid technological change and consequent changes in production processes."[19]

Do Labor Policies in Developing Countries Affect Workers in the United States?

Some policymakers and others fear that freer international trade and investment hurt U.S. workers because many developing countries have lower labor standards than the United States does. But the weight of the evidence suggests that the labor policies of developing countries have little direct effect on most U.S. workers. Drawing from the different perspectives of labor and trade economists, that conclusion rests on three key factors: the size of the domestic portion of the U.S. economy, the gap in the cost of low-skilled labor between the United States and most developing countries, and the inability of most LDCs to affect world prices. In sum, the major effects of low standards in LDCs (whether fair or unfair) are more likely to be felt in the LDCs, as they compete among themselves for market share, than in the United States.

The U.S. economy is open to international trade and investment, but most economic activity continues to be domestic. For example, in 1994, the total value of imports into the United States was equivalent to about 12 percent of U.S. gross domestic product, and exports to 10 percent.[20] In other words, most of the goods and services produced in the United States stay there, and most consumption is from domestic sources. Moreover, the U.S. economy tends to invest domestically. In 1994, new foreign direct investment totaled about $65 billion, less than one-tenth the amount of new domestic investment ($667 billion).[21] Intuitively, those figures suggest that the overall effects of freer trade and investment cannot be very large, regardless of the labor policies of LDCs.

The gap in the cost of low-skilled labor between the United States and most developing countries is so large that any realistic set of higher standards in LDCs is unlikely to close it enough to affect U.S. imports from those countries substantially.[22]

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19. Marvin H. Kosters, "An Overview of Changing Wage Patterns in the Labor Market," in Bhagwati and Kosters, *Trade and Wages*, p. 29.

20. Council of Economic Advisors, *Economic Report of the President* (1997), Table B-1.

21. The domestic investment is measured in terms of private expenditures on nonresidential fixed capital; ibid., Tables B-1 and B-105.

22. See Alan Krueger, *Observations on International Labor Standards and Trade*, Working Paper No. 5632 (Cambridge, Mass.: National Bureau of Economic Research, June 1996), pp. 12-13.

Most economists posit that in reasonably well-functioning markets, workers are paid in rough conformance with their productivity. In theory, such payments include the value of all working conditions, including wages and any fringe benefits the worker receives. The "market-clearing" payment, which reflects the worker's productivity, occurs when the amount of labor offered equals the amount of labor demanded. Productivity is measured as the value added by the last unit of labor hired. For goods that are traded internationally, that "value added" is determined in part by the price for which the good can sell in international markets.

Empirical evidence tends to confirm the notion that as productivity rises (in both developed and developing countries), wages also rise. This suggests that the large gap in the cost of low-skilled labor between developed countries such as the United States and most LDCs can be explained by differences in the productivity of labor. But in some instances, other factors may come into play. Working conditions, including wages, may be too low because a country tolerates or actively engages in exploitative labor practices, or because market institutions are poorly developed. Where such factors hold down the cost of labor to a level below its productivity, local distortions may misallocate resources.

Whether those distortions can affect trade depends in large measure on whether the country can affect the world prices of the goods it trades. If a country cannot influence world prices, it cannot affect the returns on labor and capital in other countries—such as the real wage of low-skilled workers—regardless of its domestic policies. If a country can affect the world prices of the goods it trades, it can in theory affect the returns on resources in the United States, even if it has very little trade with the United States. However, with the possible exception of China, few LDCs have a large enough share of the total production of a commodity they trade to influence its world price.[23]

In most cases, local distortions are unlikely to have a significant effect on a developing country's wealthier trading partners. Even if a large LDC lowers the export price of a traded good by suppressing the cost of labor in its domestic markets, it is more likely to displace other, similar goods that the United States imports from other LDCs than to displace U.S. production. Given the relative abundance of low-skilled labor in most developing countries, it seems unlikely that raising standards in those countries would benefit labor-intensive industries in the United States, even

23. Some countries that have significant problems with child labor, slavery, and other worker rights are among the poorest and the least able to influence world prices. For example, Alan Krueger reports that the highest employment rates for children ages 10-14 are in Burundi, Uganda, and Rwanda (at 49 percent, 45 percent, and 42 percent, respectively). See Krueger, *Observations on International Labor Standards and Trade*, p. 24.

if higher standards led to an increase in the cost of labor in the LDCs.[24] Thus, the effects of local distortions in most LDCs are unlikely to affect U.S. trade or U.S. workers much, if at all.

One of the major concerns about suppressive labor policies is that as one country's exports are displaced by another's, the displaced country might retaliate by lowering its labor standards to regain market share or attract foreign investment, and the process might snowball as other countries compete by lowering their standards. Whether such vicious cycles are a worldwide phenomenon or have influenced investment at the expense of labor has not been definitively observed.[25] Even if countries do not ratchet their standards downward, some economists argue that in the face of such competitive pressures, they might not raise them as rapidly as they would otherwise. However, those arguments assume a direct link between labor standards, labor costs, and trade and investment, which probably overstates their relationship. With regard to investment, other factors such as market access, infrastructure, political stability, and tax incentives may be as important as labor costs in attracting foreign capital.[26] Public opinion may be another important factor—a company may be reluctant to invest in a country with low standards if the appearance of unfair labor practices will hurt its public image. One large U.S. firm recently decided not to continue operating in China, allegedly because of concerns about human rights violations there.

What Effect Would Higher Standards Have on Workers in Developing Countries?

Some policymakers seek to raise standards in LDCs primarily for the benefit of the workers in those countries. They may seek higher standards to promote worker rights (as defined in the Trade Act) or as a first step toward overall reforms in economic, social, and political institutions. In either case, such proponents may favor higher standards for humanitarian reasons, apart from their concerns about international trade or investment.

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24. Dani Rodrik of Harvard University's Kennedy School of Government shows that higher labor standards are associated with higher labor costs, all else being equal. See Dani Rodrik, "Labor Standards in International Trade: Do They Matter and What Do We Do About Them?" unpublished paper (February 1996).

25. Asad Alam cites evidence of capital shunting (the shifting of production to countries with low labor standards) "not only in the channeling of U.S. investment but also in the direct contracting-out of work by U.S. manufacturers to apparel firms in South and Southeast Asia." See Asad Alam, "Labor Standards and Comparative Advantage" (Ph.D. dissertation, Columbia University, 1992), pp. 4-5. In contrast, Dani Rodrik finds that low standards may deter foreign direct investment, all else being equal; Rodrik, "Labor Standards in International Trade."

26. The Commerce Department reports that the location of overseas production by U.S. multinational companies appears to be determined more by access to markets than by access to low-wage labor or to natural resources. See Department of Commerce, *Survey of Current Business* (December 1996), p. 11.

But generalizing about the effects of labor standards on workers in developing countries is difficult. Efforts to raise standards in LDCs may help or hurt the workers in those countries depending in part on existing conditions. For example, if workers are already paid in rough accord with their productivity, higher standards could lower economic efficiency by reallocating resources away from the most productive uses. Standards that pushed wages and other forms of compensation above their market-clearing levels—so they no longer reflected productivity—could reduce employment in "formal" or regulated markets.[27] Such standards could be even more harmful if they undermined the countries' gains from trade.

By contrast, some standards may help to build or improve institutions that support free markets. If working conditions (including wages) are too low because a country tolerates exploitative practices, or because its market institutions are poorly developed, higher standards could promote economic development. For example, promoting a standard of nondiscrimination in employment in a country where discrimination is practiced can improve economic performance by bringing idle resources into use. Moreover, higher standards for some worker rights could dissuade a country from actively engaging in exploitative practices, with similar results. Such may be the case if a country employs forced labor.

Economic Arguments. What does economic theory say about labor standards? In the basic model of competition, firms and workers reach the highest levels of economic well-being, for themselves and their countries, when they are free to pursue their own economic interests. A policy that interferes with their freedom may force resources into less productive uses. On that basis, opponents of labor standards argue that they interfere with some freedoms by setting floors on working conditions, including wages and other forms of compensation. Such opponents assume that markets would work well in the absence of regulation.

But markets do not always work well—sometimes because existing policies deny, or do not ensure, certain freedoms. If market failures exist, firms may produce too little or too much of some goods, or underpay or overpay their workers, compared with the competitive benchmark. For example, where forced or compulsory labor is used and labor costs are artificially low, resources may be misallocated from more productive activities to less productive ones because of

27. For more on formal and informal markets, see Alejandro Portes, "When More Can Be Less: Labor Standards, Development, and the Informal Economy," in Stephen Herzenberg and Jorge F. Perez-Lopez, eds., *Labor Standards and Development in the Global Economy* (Department of Labor, Bureau of International Labor Affairs, 1990), pp. 219-237; Alejandro Portes and Richard Schauffler, "The Informal Economy in Latin America: Definition, Measurement, and Policies," in Gregory Schoepfle and Jorge F. Perez-Lopez, eds., *Work Without Protections: Case Studies of the Informal Sector in Developing Countries* (Department of Labor, Bureau of International Labor Affairs, 1993), pp. 3-39; and Schoepfle and F. Perez-Lopez, "Work and Protections in the Informal Sector," in *Work Without Protections*, pp. 247-279.

mistaken price signals. In such cases, standards could help to ensure that resources were used as effectively as possible, while serving other humanitarian goals.

Based on their opinions about how well local markets function, economists draw different inferences about the relationship between labor standards and economic development.[28] One group contends that prematurely raising labor standards in developing countries introduces economic distortions that could impede the growth of income and the creation of jobs. That group argues that working conditions should improve by themselves as an economy grows—because capital accumulation leads to increases in labor productivity, which are accompanied by increases in real compensation. Thus, from their perspective, each level of economic development has an appropriate set of working conditions, defined by the competitive benchmark. Anything that interferes with those conditions will hurt workers in the long run, they say.

Another group of economists views labor standards as a tool that could influence the social process of development in positive ways, depending on how policymakers applied them. That group seeks to find "the appropriate level of regulation to facilitate the operation of a socially acceptable and functional labor market."[29] Some members of the group perceive trade-offs between economic and noneconomic objectives, but those objectives are not always in opposition, as in the case of forced labor. Even if they are in opposition, lawmakers cannot ensure that one set of objectives will be realized when another is sacrificed.

Most economists would agree that the effects of a specific policy depend to a large extent on the conditions that exist when it is put in place. Developing countries vary widely, starting from very different economic, social, and other institutional bases. Consider the potential effects of a ban on child labor in a country that has unemployment.[30] In such a country, the ban would draw some adults into the workforce at existing rates of compensation. A household's income could rise or fall, depending on the distribution of new employment and the share of income previously coming from child labor. Alternatively, if a country had full employment, the ban would reduce the supply of labor and drive up compensation. A household's income could again rise or fall, depending in this case on the change in compensation

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28. For a more complete discussion of the "cleavage of opinion" among economists, see Overseas Development Council and Department of Labor, *Beyond Subsistence*, p. 9. For another presentation of the economic arguments for and against labor standards, see Mary Jane Bolle, *Worker Rights Provisions and Trade Policy: Should They Be Linked?* CRS Report for Congress 96-661 E (Congressional Research Service, July 30, 1996).

29. Overseas Development Council and Department of Labor, *Beyond Subsistence*, p. 9.

30. For simplicity, consider the effects in a developing economy that does not engage in trade. For more on specific standards under alternative market assumptions, see Göte Hansson, *Social Clauses and International Trade* (New York: St. Martin's Press, 1983), pp. 67-131.

and the share of income that had come from child labor. In either case, circumstances could improve for some children, but others could face additional hardship. Many people incorrectly assume that children released from employment will enter local schools, but the ban could push some children into more hazardous occupations, such as prostitution.

Some Empirical Evidence. The observable evidence offers some insight into the relationship between economic development and working conditions.[31] One economist, Gary Fields, used wage, employment, and income data to analyze the relationship between economic development and working conditions in four East Asian countries.[32] He found that over a period of several decades, working conditions—measured in terms of unemployment, the composition of employment, real earnings, and absolute poverty—improved in Hong Kong, South Korea, Singapore, and Taiwan, with only a few exceptions.[33] The data suggest that workers there shared in the growth of their countries' economies: "in all four economies in the 1980s, real labor earnings grew at least as fast as real per capita gross national product," with relatively low rates of unemployment and income inequality.[34]

Other economists provide further evidence that workers share in the improvements of their countries' economies. For example, Mita Aggarwal reported increases in real earnings—exceeding increases in real output—in Singapore, South Korea, Thailand, and the Philippines.[35] Two exceptions were India, where earnings grew more slowly than output, and Mexico, where earnings decreased even as output increased. Looking at data for textile industries by country, Aggarwal found that workers in Singapore, Hong Kong, South Korea, the Philippines, Indonesia, and India typically shared in the fates of their industries, for better or worse. And Alan

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31. A positive correlation exists between national income, as a measure of economic development, and the total cost of labor, as a measure of working conditions, in developed countries. See Organization for Economic Cooperation and Development, *Employment Outlook* (Paris: OECD, 1994), pp. 156-157, including Chart 4.2.

32. The data appear in Gary Fields, "Labor Standards, Economic Development, and International Trade," in Stephen Herzenberg and Jorge F. Perez-Lopez, eds., *Labor Standards and Development in the Global Economy* (Department of Labor, Bureau of International Labor Affairs, 1990), p. 23-25; Fields, "Employment, Income Distribution and Economic Growth in Seven Small Open Economies," *Economic Journal*, vol. 94 (March 1984), pp. 74-83; Fields, "Changing Labor Market Conditions and Economic Development in Hong Kong, the Republic of Korea, Singapore, and Taiwan, China," *World Bank Economic Review*, vol. 8, no. 3 (1994), pp. 395-414; and Fields, *Trade and Labor Standards: A Review of the Issues* (Paris: OECD, 1995), p. 18.

33. By contrast, Jong-il You describes poor safety conditions, long hours of work, and gender-based discrimination in Korea. See Jong-il You, "South Korea," in Herzenberg and Perez-Lopez, eds., *Labor Standards and Development in the Global Economy*, pp. 107-109.

34. Fields, *Trade and Labor Standards*, p. 17.

35. Aggarwal, *International Trade, Labor Standards, and Labor Market Conditions*, pp. 20-22.

Krueger found that the use of child labor declined sharply with increases in national income.[36]

Although the evidence suggests a positive relationship between economic development and working conditions, it does not explain the role of domestic policy. Fields found evidence of policies that restricted worker rights, especially in Singapore and South Korea, despite improvements in labor standards overall. Growth may have raised labor standards, as Fields argues, but how did domestic policy affect growth? Economists lack definitive answers. Domestic policies may have contributed to or detracted from growth.

U.S. POLICIES FOR PROMOTING WORKER RIGHTS

U.S. policymakers have sought to promote worker rights in developing countries to ease concerns about unfair competition and to ensure that the benefits of U.S. trade, investment, and aid programs reach the broadest sectors of the population in those countries. (See Box 1 for a list of U.S. legislation relating to worker rights.) In particular, special trade and investment programs, such as the U.S. Generalized System of Preferences program, the Caribbean Basin Initiative (CBI), the Andean Trade Preference Act (ATPA), and the Overseas Private Investment Corporation, and foreign assistance programs include criteria for worker rights. As a general rule, a country that loses access to the benefits of one of those programs because it fails to meet the criteria will lose access to the benefits of the others. Nonpreferential programs contain similar criteria for worker rights, but they have never been invoked.

In addition, U.S. policymakers have sought international cooperation in regional trade agreements and multilateral forums, including NAFTA, the GATT, the WTO, and international financial institutions such as the World Bank and the International Monetary Fund. The North American Free Trade Implementation Act of 1993 enacted a side agreement on labor cooperation between the United States, Mexico, and Canada. It addresses labor principles that indicate "broad areas of concern" for the three countries but does not seek to change their domestic laws (see Box 2). In some cases, violations of the provisions of the side agreement can result in fines or trade sanctions. Other recent initiatives, such as "Rugmark" and the "No Sweat" campaign, have focused on private voluntary efforts by nongovernmental organizations and companies to promote worker rights.

36. Krueger used data on employment among 10-year-old to 14-year-old children collected by the ILO; Krueger, *Observations on International Labor Standards and Trade*, pp. 24-25.