

Draft: For Discussion Only

## **WHAT ROLE FOR LABOR STANDARDS IN THE GLOBAL ECONOMY?**

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You are an executive with NEO Clothing, which out-sources production to less advanced countries around the world. Your career depends on your finding cheap reliable subcontractors. Do it well and you earn a bonus, your stock options are in the money, you get promoted. Lately profits have been down because competitors are importing clothes from China, and top management at NEO sees cost reductions as the only way to maintain your division. You find out that Sleazo Company, which operates in a low wage dictatorship, can produce NEO shirts for 5 cents less than your current producer. As they say in the Pajama Game, five cents isn't a helluva lot, but give it to me every hour every day ... and it cumulates. Currently Sleazo sells 20 million items around the world annually, so the extra 5 cents means \$1 million more dollars in the bottom line. Maybe more if NEO lowers its price and convinces Wal-Mart or Bloomingdale's to carry NEO shirts. But some trouble-making NGOs claim Sleazo doesn't treat its workers right. Should you give Sleazo the subcontract?

You are Joe Sleazo. You hire unskilled peasant girls to make clothing in old factory buildings. It's a tough business. Margins are tight. Your supervisors have to lean on the girls to get them to meet standards. If you keep costs down, you can send your kids to college, take a vacation, make it big. Some trouble-making NGO has asked you to improve working conditions and raise pay. But it's not your fault the peasant girls work for long hours and low pay. The country is poor, and your wages and working conditions are around average -- better than what the girls would make in agriculture. If they didn't work for you, they'd be breaking bricks or selling their bodies. Paying the least the market will bear to maximize profits is the heart of capitalism. Do anything else and you might be out of business. Should you improve conditions?

We all know the answer to these questions. Absent some outside pressures, Western executives will invariably let contracts to Sleazo, and Sleazo will squeeze its workers as much as it can. There

is no incentive to change.

But what if consumers in the advanced countries that constitute the bulk of the world economy want products made under acceptable conditions with workers paid some reasonable living wage?

What tools does the world community have to raise standards in less advanced countries to acceptable levels?

How can we fruitfully harness the desire of consumers to make lives better for workers in poor countries?

This essay seeks to answer these questions.

Section I shows that the demand for standards -- opposition to “sweatshops”<sup>1</sup> -- is grounded in economic fundamentals rather than rhetoric or protectionism. It is intimately related to individual preferences and behaviour toward fairness and the distribution of economic outcomes that shows up in a variety of settings. Demand for standards is a legitimate demand based on the willingness of consumers to pay more for products made under decent conditions. Section II examines six alternative modes to try to raise standards: product labeling, activist publicity; corporate codes of conduct; government sponsored partnerships; international agency programs; and making standards part of the world trade system. I find that no single approach is likely to succeed. Only a multi-pronged programme with consumers/activists pressing firms, governments and international organization pressuring governments in low standard economies, and NGOs or unions working directly with workers to improve worker rights in those economies is likely to have a sizeable effect on labor conditions.

Section III considers the danger that some types or levels of standards can cause more harm

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<sup>1</sup> While the term sweatshop usually refers to factory production in apparel manufacturing, I will use it more loosely as a catch phrase for any form of production under low labor standards.

than good for affected workers, and stresses the need for activists, firms, and governments to improve the alternatives available to workers (such as subsidies to go to school for the young) and the critical importance of freedom of association so that affected workers can gain the benefits of higher standards through self-organization. More optimistically, I show that consumer willingness to pay for improved standards offers sizeable funds for improving living conditions for affected workers in less developed countries.

In the final section, I argue that the major benefit of the campaign for standards may be that it creates a way for labor oriented groups to be “at the table” when the world community sets new rules for governing international finance and trade and decides how the world financial system will handle third world debt, regulate capital flows, and develop stabilization and adjustment programs. These rules have a much greater impact on the well-being of workers in poor countries than labor standards in export producing sectors on which the standards debate has concentrated.

## **I. CONSUMER DEMAND FOR STANDARDS**

The starting point for an economic analysis of labor standards is that people care about the work conditions associated with the goods they purchase. Treating standards as part of the product parallels Adam Smith's and Alfred Marshall's analyzes of compensating differentials. Marshall (1890) differentiated between the bricklayer who cares whether he works in a palace or in a sewer and the seller of bricks who doesn't care whether his bricks pave the palace or sewer. The bricklayer's concern creates compensating wage differentials in the job market: higher pay for sewer work. The consumer who cares about labor standards consumes not only physical goods but also the work conditions associated with them. He is in principle willing to pay higher prices for the goods produced under better conditions, which provides a financial margin for improving conditions or increasing wages in

less advanced countries. Since consumers want this outcome, producing under humane conditions in those countries would improve the world economy overall.

Some economists find the assertion that consumers care about the conditions of workers, particularly those in some far-off third world country, naive or disingenuous BS. Behind this alleged social concern, they see greed and self-interest -- special interests trying to con the rest of society for their advantage. After all, in the market economy homo oeconomicus rules, and oeconomicus asks not what he can do for society but what society can do for him. These economists believe that global social concerns, like patriotism, are the last refuge of the scoundrel. Employment protection and labor regulations? An effort by insider workers to screw unemployed outsiders. International labor standards? Protectionism by Northern unions. Socially responsible corporate behavior? Come off it!

T.N. Srinivisan has expressed distrust of labor and environmental standards clauses in international trade agreements in these terms: "the demand for linkage between trading rights and the observance of standards with respect to the environment and labor would seem to arise largely from protectionist motivation." The World Bank has declared: "The real danger of using trade sanctions as an instrument for promoting basic rights is that the trade-standards link could become hijacked by protectionist interests attempting to preserve activities rendered uncompetitive by cheaper imports."

<sup>2</sup>. Mahathir bin Mohammed of Malaysia is even more damning of Western concern with working conditions in less developed countries, "Western countries openly propose to eliminate the competitive edge of East Asia... professed concern about workers' welfare is motivated by selfish interest."<sup>3</sup>

These are not isolated voices. When I told one of my colleagues that I was pondering ways to

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<sup>2</sup> World Bank, World Development Report, 1995, p 79

<sup>3</sup> International Herald Tribune, 17 May 1994, p 6.

harness social concerns to improve labor standards in the world economy, he could barely contain a sneer. Waving his hand in front of his nose as if to swat away a fly, he declared: "that's no topic for an economist. Social concerns/labor standards are blather for moral philosophers or PC lawyers or, worse yet, sociologists. Remember what Mrs. T said: there is no such thing as society, just individuals trying to make money. If you think concern for world financial stability motivated Wall Street to bail out that bankrupt hedge fund, I've got a bridge in Brooklyn you might want to buy."

One way to respond to skeptics and find out if there really is a demand for labor standards is to ask consumers how much they value the labor conditions of the products they buy. In 1995 Marymount University's Center for Ethical Concerns asked a sample of Americans "if you were aware of a retailer that sold garments made in sweatshops, would you avoid shopping there". Seventy-eight percent of respondents said that they would. Eighty-four percent said that they would be willing to pay \$1 more for a \$20 garment if they knew it was made in a legitimate shop. A 1997 CAFOD/MORI poll in the UK found that 92% of British consumers believed that British firms should have a minimum standard of labour conditions for their Third World Suppliers.

In October 1998 I conducted a short pilot survey that expands on these results. Table 1 records the results from my pilot. Mimicking the Marymount findings, around 80 percent of respondents said that they would not buy products made under poor conditions or that they were willing to pay more if they knew the items were made under good conditions. I posed the issue in two ways: willingness to pay more for a product made under good conditions and the discount required to buy products made under poor conditions. The results show that consumers are willing to pay a modest premium for products made under good conditions but that they want a sizeable discount for those made under poor conditions. Because I was concerned about whether consumers valued conditions in the US differently than those in

other countries, I asked how much they would pay for goods made in the US, Latin America, and China and found little difference. But I imagine that respondents attached different meanings to good conditions in countries with different income levels.

Of course what people say on a survey may not accurately predict their behavior, and will not convince my skeptical colleague. No one this side of Gordon Gecko wants to admit that in fact he or she doesn't give a damn about anyone else. Indeed, the right strategy for *oeconomicus* is probably to declare that he is an honorable soul who gives to charity while he slips his hand into your wallet pocket. A better way to find out whether people are willing to pay extra for a product made under good labor conditions is to actually offer to sell it to them. Imagine three piles of t-shirts in a retail store. One says, Made Under Good Conditions meeting world labor standards (verified by ILO, the Catholic Church, Ralph Nader, Jesse the Body Ventura, the Good Housekeeping magazine, whatever). The second says, Made Under Unknown Conditions somewhere. The third says, Made by child labor in Sleazo's Sweatshop. At equal prices, how many consumers would buy the Good Conditions t-shirt rather than the Child Labor t-shirt? At a 50 cent premium, how many would make that choice? At a \$1.00, \$2.00, etc ?

I am willing to bet a small bundle that when we conduct the experiment (currently in the planning stage), we will obtain results comparable to those on the survey. The reason for my confidence in this outcome is that in recent years economists have conducted a large number of experiments that demonstrate that talk of fairness and concern for others is not BS but actually affects behavior. Indeed, there is **overwhelming** empirical evidence that people act as if fairness toward others is part of their utility function. Analyzes that take account of this predict behavior better than analyzes that make the *oeconomicus* assumption. On the basis of the main findings of experimental economics, I would expect people to be pay a bit more for goods that guaranteed fair

treatment of workers.

### **The experimental evidence**

Consider the findings from three important experiments (see table 2).

The Prisoner's Dilemma is the most famous experimental game in the social sciences. There are two players. If they cooperate each gains a certain amount of money; if one defects and the other cooperates, the defector gains more than he makes from cooperating while the cooperator gets the lowest payout. If both players defect each gets more than if they were the sole cooperator but less than if both cooperated. The rational response in a one period game is to defect. But in fact players frequently choose the cooperative strategy. To be sure, it is a stretch from the PD game to the standards problem. In the PD game "power" is equally divided between two players. The demand for labor standards depends solely on the consumer who can choose the cheap product if he/she so desires. But the outcomes from PD games call into question the assumption that people invariably behave the *oeconomicus* way.

The Ultimatum Game comes closer to the standards problem. It focuses on how individuals react to divisions of a given pie. The game has a simple structure. Player one -- the boss -- can divide a sum of money (say \$100) between him and player two -- the worker. If the worker accepts the boss' offer, each gets the amount the boss decided to give. If not, the entire amount disappears. In this game *oeconomicus* says that boss will take \$99.99 and offer the worker \$0.01. Since both are better off, the worker accepts. But in fact that is not how anyone behaves. If I offer you 1 cent while pocketing the rest, you will probably say "f you" and neither of us will get anything. Knowing this, most persons playing the boss offer workers a greater share of the pie: on average 30-40 percent, with a modal amount of 50 percent. Offers less than 20% are invariably rejected. In multi period versions

of the game, where the pie shrinks over time, workers often accept 2<sup>nd</sup> period offers that give them smaller absolute amounts of money than they could have in the first period, if the 2<sup>nd</sup> period distribution is more even. The "unfairness" of the boss taking the vast bulk of the funds affects behavior.

The stretch to the standards problem is shorter. If the consumer knows that the boss is taking \$99.99 and giving the worker just a cent, she may view this as unfair and choose a competing product where the division of income is less uneven. How would you respond if I offered you the choice between two identical equally priced computers: the first made by Company A whose CEO gets \$40 million a year and which pays its workers \$10 a day; the second made by Company B, whose CEO gets \$10 million a year and which pays its workers \$40 a day? The computers are identical. The price is the same. Choose.

The Dictators' Game fits our case even better. In this game whatever the boss says goes. Two players are selected and given envelopes. One envelope has a \$100 and the other has \$0. So if I get the \$100 envelope I can keep the \$100 and say to hell with you! Surely *oeconomicus* has this one right. Sorry, but no. In diverse variants of the Dictator's game only about 20% of players keep all of the money. Most people share some with their partners, albeit less than if their partner could veto their division. Even under highly stringent conditions designed to push people toward taking all the money, many still give some money to others.

Surveys that examine how people view economic actions offer guidance to why these experiments give the results they do. Kahneman, Knetch, and Thaler have shown that people care deeply about the social context in which decisions are made. People think it is fair to raise rents on elderly tenants when costs rise but not to raise rents when a drug dealer offers more money for the apartment. People do not look kindly on charging large sums for water to someone dying of thirst in a desert. Consider the

following two statements:

I am going to cut your pay. I am going to do this because unemployment rose and I can replace you easily. This will increase my profits and let me raise my pay. Fair or unfair?

I am going to cut your pay. The company is in big trouble and survival means we must all suffer. Profits are down and I've lost all my stock options. Fair or unfair?

Finally, there is the “real world” evidence of philanthropic behavior. People give to public radio and television. They give to church charities, to the United Way, to the Red Cross, and so on. They work for charitable organizations at lower wages than for other organizations. About 2% of US GDP consists of charitable donations. Over a quarter of Americans volunteer some time over the year according to the CPS.<sup>4</sup> Hours volunteered are 3-4% of working hours.

Much volunteering and giving occurs, it is important to recognize, in response to requests rather than by individuals deciding to do “good deeds” out of the blue. I worry about the Albanians whose homes the Serbs destroyed in Kosovo, but I do not wake up in the morning burning to volunteer time or give money for them. But if you call me up and say you are collecting clothes or funds or whatever to help the Albanians as part of a charitable drive, I would contribute something.

The fact that people respond to requests for charitable activity implies that a society can generate different amounts charitable behavior, depending on the effort devoted to inducing such behavior. The same is likely to be true of consumer demand for products with varying labor standards. Remind me that Sleazo sneakers are made by child labor paid abysmally low wages when I am about to make my purchase and I might shift to another brand. Even if I don't care about the conditions under which

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<sup>4</sup> The percentage volunteering is higher (50%)) in the Independent Sector's Gallup poll of Giving and Volunteering.

the product is made, I may refuse to buy Sleazo if my choice is publicly observable. Informational picketing, leaflets, and other advertisements not only raise consciousness about labor standards but makes the choice a public one.

Still, you might ask: if people in fact have a fairly well-defined demand for labor standards, why doesn't the normal market for goods produce the socially optimal level of standards? Why do we need trouble-making NGOs or government agencies to hassle firms?

### **the information problem**

The problem is that unlike the brick maker who knows whether he works in a sewer or palace, the consumer does not know directly if the t-shirt he bought was made under good or bad work conditions. And the cost of finding out and assessing work conditions, particularly in overseas countries, far exceeds the value of buying the product made under acceptable labor standards. Someone other than the consumer must uncover the facts and disclose them to the consumer.

Firms, be they retail or manufacturing, cannot readily perform the information/monitoring themselves. Firms which produce under poor conditions will never advertise the fact, lest consumers shun their products. Firms with good conditions can report that they treat their workers well, but so too will the Sleazos of the world. Hence, absent an independent monitor, that information will be useless. To be sure, for some brand names, the consumer may rely on the reputation of the firm -- if it's Levi Strauss, they must treat their workers well -- or on the reputation of the country of origin -- if it's Sweden, or Germany, or France, or Costa Rica, products must be produced under decent working conditions. But virtually all retailers sell products by subcontractors, who contract out some activities to other firms, about which the retailer will know little without making a substantial effort. Consider, for example, the chain of production for one US retailer, JC Penney, in one country,

the Philippines (table 3). JC Penney infant and children's apparel are procured from an importer who gets them from a contractor who relies on subcontractors and home-based production. Through the chain of procurement/ production, JC Penney contracts with over 2,000 suppliers in more than 80 countries, each of whom may subcontract to other producers. Another major US retailer, Nordstrom has more than 50,000 contractors and subcontractors. The National Labor Committee estimates that Wal-Mart has used 1,000 factories in China and that Walt Disney products are made in 30,000 factories around the world.

The problem of monitoring all of these operations is immense. Compounding the technical difficulty is that the incentive all along the line is to paper over any violations of standards on the general presumption that consumers will view products as "innocent until proven guilty" of being made under poor conditions. Even highly motivated monitors, such as those behind the Rugmark Campaign to produce rugs with no child labor in India find it difficult to monitor firms. Rugmark checks the looms of its producers twice a year, but its promise th<sup>5</sup>at none of the rugs are produced with child labour is undoubtedly exaggerated. Hilowitz quotes one Rugmark activist as admitting that "No inspection can verify that a carpet was made without child labour. When we get to the edge of the village, we see children running to the fields to hide". To be sure, one does not need perfect monitoring to get firms to improve standards, but the monitoring problem is a major one.

The situation is even more difficult in countries with more closed political systems. The U.S. currently imports billions of dollars of Chinese goods. Many of these goods are undoubtedly produced in firms that have good working conditions for a low income country, but some are surely not so produced. Who can tell whether the plastic super-hero toy or beanie doll you just bought for your child was produced under acceptable conditions or in a sweatshop? The US retailer bought the product

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<sup>5</sup> Janet Hilowitz, Labelling Child Labour Products: a preliminary study ILO

from an importer, who got it from some exporter in China or perhaps Hong Kong or Taiwan, who had it made in Hunan Province, or Guangdong or ... According to the US DOL “In the case of the People’s Republic of China -- the second largest exporter of garments to the US in 1995 -- documenting labor practices, including child labor, remains extremely difficult”<sup>6</sup> The National Labor Committee report on Chinese factories shows that difficult does not mean impossible, but imagine trying to assess conditions in the 1,000 or so Wal-Mart suppliers in China.

In short, while consumers are willing to spend a bit more for products made under good labor conditions and would penalize egregious cases of poor standards even more, there is no simple market mechanism to assure them that the extra 50 cents or whatever they might be willing to pay for higher labor standards in fact benefits the low paid workers who make the product. Something more is needed to marshal the “army” of dollars, yen, ~~marks, lira,~~ euros, and pounds that could raise labor conditions for at least some workers in less developed countries.

## II. POTENTIAL SOLUTIONS

So, how can the world community harness these concerns and potential funds to make life better for workers in poor countries?

Participants in the market for standards have taken six different routes to try to improve work conditions in poor countries. Some private sector groups have tried to label products by the conditions under which they are produced. Others have conducted media campaigns against major firms for subcontractor practices. These groups have provided the major impetus for change in the “market for standards”, raising public consciousness and putting the standards issue on the front burner in international discussion. For the most part, firms and governments have been reactive -- taking

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<sup>6</sup> US DOL, 1996, p 5.

action only after a public hullabaloo and often seeking to do the minimum possible to deflect public criticism and pressure. Firms have developed corporate codes of conduct that apply to subcontractors as well as to themselves. The US and UK governments have encouraged partnerships of unions, NGOs and firms to work jointly to improve conditions. The ILO has developed the International Programme on the Elimination of Child Labour (IPEC), which focuses on “intolerable” forms of child labour by providing technical assistance to governments and firms in less developed countries. Finally, under pressure from unions and labor rights activists the US added a weak labor standards side agreement to the NAFTA Treaty and has talked about adding standards clauses to future world trade agreements

The experience in all of these areas suggest that progress in improving standards will be slow and halting unless someone develops a more effective way to use consumer pressure and money to improve wages and conditions or to spur unionization in less developed countries.

### **private sector initiatives: labeling<sup>7</sup>**

The natural private market solution to the information problem associated with labor standards is through voluntary labeling of goods. The label tells the consumer when he makes the purchase that the good does/does not meet specified standards, such as being produced under good working conditions. Historically, the union label served such a purpose. In recent years, some socially concerned groups and producers have developed private sector labels, largely to deal with child labor. The promise on the label is that the product was made without children below a certain age, and that the labeling group had monitored production, at least up to a certain point.

The most famous example of product labeling is Rugmark. The Rugmark initiative was begun in

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<sup>7</sup> For an extensive and informative discussion of labeling issues and initiatives, see Janet Hilowitz, Labelling Child Labour Products : a preliminary study, ([www.ilo.org](http://www.ilo.org))

1995 by the South Asian Coalition on Child Servitude and a German foundation, with support from the German government. It is now financed in part by licensing fees paid by its 100 or so participating manufacturers. Exports of hand knotted oriental carpets had fallen in the previous decade, possibly due to publicity about child labour, so Rugmark offered manufacturers a possible way to regain sales. To obtain the label, carpet manufacturers commit themselves to produce carpets with no child labour, to pay the minimum wage, and to allow access to their looms for unannounced inspections. When the American Congress was considering a ban on imports made with child labour, the Indian government looked favorably on Rugmark, but with that bill past history, it has set up its own labeling initiative, Kaleen, which promises that “a portion of the proceeds will go to the rehabilitation of children”.

If there were a single recognized labeling organization, with sufficient resources to publicize its label to consumers and to monitor production in less developed countries, labeling might be “the answer” to the standards problem. One possibility would be for the ILO and other UN organizations to develop a world label, comparable the UNICEF “brand” of products. But this would be a bold and risky step. In 1995-96 the EU Commission rejected proposals to directly support or finance EU based labeling on the grounds that it was almost impossible to police effectively the small cottage industries where child labour is used and standards are low. The EU feared that any programme would be destroyed by fraud and malpractice, counterfeit certificates, stamps, and labels.<sup>8</sup>

Absent any “official” mechanism for labeling, there is open entry, and in handwoven rugs the number of labels has grown as different groups of retailers and producers seek to distinguish their products. In addition to Rugmark and Kaleen, there is another German-based label, Care & Fair,

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<sup>8</sup> See Hilowitz, part III, page 3.

established in 1994 by German rug dealers, and a Swiss-based label set up in 1995 by the STEP foundation based on Swiss rug dealers. Kaleen, Care& Fair, and STEP do not promise that carpets are made with no child labour but that they are trying to improve working conditions for carpet weavers. Outside Germany the Rugmark label is not well-known, and even in Germany there has been no definitive study showing the value of the label, though presumably firms that are paying to use it are doing so because it benefits them. As the number of labels rises, however, consumers will presumably have a harder time distinguishing among the alternatives. And the EU fears that Sleazo will tell his consumers the product is made the right way is likely to be realized. Only the best-informed consumers might know that the Sleazo Humanitarian Label is bogus. Absent some regulatory body, the final outcome from voluntary labeling may be so many independent labels that none will carry much if any weight.

#### **private sector initiatives: advocacy groups**

Human rights activists of diverse sorts have sought to pressure firms to improve work conditions and wages by generating **adverse publicity** for particular firms. The number of groups involved in the fight for higher labor standards and reduction of sweatshop production through consumer or investor activism has grown substantially in recent years. Table 4 provides a partial list of some of the activist groups, together with their websites. Most groups operate by providing information to consumers or shareholders about poor labor conditions and then seeking to pressure firms to improve these conditions. Many groups have a simple agenda: no child labor in a particular sector, without seriously considering the alternatives available to children. But others have a more complex assessment of the problem of low standards and what can be done.

The most innovative and successful group, the National Labor Committee (NLC), has pushed more

economics oriented demands: higher wages and better conditions for workers, including child labor. Operating on limited funds, with a tiny staff, it has successfully promoted the rights of workers through publicity campaigns against large corporations such as The Gap, Liz Claiborne, and most notably Kathie Lee Gifford/Wal-Mart. The NLC presents its facts simply and starkly, backing them up, when feasible, by a worker from the affected locale. When Americans see 15 year old Wendy Diaz, who worked in a Kathie Lee factory with other young children, on one side and a group of 50 year old corporate lawyers and flaks on the other, they know who to believe.

Because NLC campaigns involve active participation from religious groups, students, and community groups, they are able to generate considerable public pressure. In 1995 the NLC publicized problems with an El Salvador manufacturing plant for The Gap, which led to the company agreeing to have practices monitored by an independent group of volunteers from NGOs. In 1996 its Kathie Lee Gifford campaign gained national attention and turned the celebrity into an advocate of higher labor standards. But absent widespread independent monitoring of factory conditions in the corporations whose practices it has highlighted, the NLC seems more able to organize campaigns against billion dollar corporations in the US than to actually improve conditions in less developed countries.

### **corporate codes of conduct**

In 1991 Levi Strauss developed its Global Sourcing & Operating Guidelines, the first corporate code of conduct for labor standards in the firms to which it outsourced orders. Since then codes of conduct have proliferated.<sup>9</sup> By the late 1990s, almost all major retailers and manufacturers of apparel have explicit codes or policies that address working conditions in source factories. The American

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<sup>9</sup> For a general review see Lance Campa and Tashia Hinchliffe-Darricarrere, "Enforcing International Labor Rights Through Corporate Codes of Conduct", *Columbia Journal of Transnational Law* 33 (1995)

Apparel Manufacturers Association and the National Retail Federation had also developed codes of conduct.

In most cases the codes are a corporate response to consumer concerns and activist pressures about labour standards. Widely publicized reports of poor labor conditions in source factories and the accompanying bad publicity led Wal-Mart, The Gap, Liz Claiborne, Nike, JC Penney, Talbots, Starbucks, and other major firms to adopt codes. Given the millions of dollars spent on advertising brand names, the risk of having any particular brand “ become synonymous with slave wages, forced overtime, and arbitrary abuse”<sup>10</sup> made it good business practice to take defensive action; and most large retailers and apparel firms have done so. Revelations in 1992-93 that some of the items sold in Wal-Mart stores were produced by children in Bangladeshi factories induced the US’s largest retailer to develop a set of standards for its vendor partners, who contract with manufacturers to produce goods for Wal-Mart. The standards have had some bite. By February 1997 the firm had barred 115 factories from receiving contracts for violation of the company code, and instituted a vendor screening and monitoring process to assure compliance. But this did not guarantee that its consumer goods were in fact produced under good conditions, as investigation by NLC made clear.

Many firms that have received bad publicity and responded with codes of conduct are generally viewed as socially responsible or leading corporations in their area. They and their contractors are probably not the worst violators of decent labor conditions. Activists target these firms because the firms have good reputations which can be sullied and because their management is likely to respond in a positive manner to information about poor working conditions overseas and consumer pressure. There is no point in pressuring Sleazo or RatFink Inc about practices in their operations. They have no

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<sup>10</sup> Nike CEO Phillip Knight, NYT, p D1 and D5, May 13, 1998.

reputation to lose and, if pressured, will simply re-open with some other name, SleazFink or Ratto.

At this writing there have been two major reviews of corporate codes. In 1996 the Investor Responsibility Research Center collected 121 codes of company policies from major US retailers and S&P 500 companies. The IRC data show wide variation in the issues covered by corporate codes, in the level of standards and in modes of monitoring or enforcement. The most frequent labor issues covered relate to worker health and safety (76), discrimination (69) and environmental protection (67). The least frequent were the right to organize or bargain collectively (12), overtime hours and pay (12). Surprisingly, only 45 codes referred to what has become the prime issue in international labor standards, child labor.

In 1996-97 the US DOL examined codes of conduct in 45 top retailers and apparel manufacturers and their implementation in some 74 apparel-producing plants in less developed countries. The DOL reports make it clear that implementation is easier when US firms wholly own the operation or contract through their own buyers for products rather than through middleman buyers with a long procurement/production chain. On average, the codes seem to have had some limited impact on the factories. While most factory managers interviewed by DOL knew about them, 1/3rd had never heard of codes; just 20 percent received any training in how to implement them; and just 20 percent posted the codes in their factory. Most important, relatively few workers were aware of them and local NGOs and governments were generally not fully informed about codes. While it is difficult to gage the benefits that the plans may have brought to workers absent some comparison group of plants that did not operate under corporate codes of conduct, or a careful before/after comparison of these plants, the tone of the DOL reports is that the codes have had some impact on behavior, but that there remain major problems in monitoring and enforcement.

If corporate codes were “the answer” to the standards problem, one would expect firms to eagerly publicize the names of the specific factories that make their products and invite independent observers to visit them. Few firms do this. Most refuse to provide the names of producers in less advanced countries. The latest NLC campaign in fact asks for just one thing: transparency in the production chain. Come on, NEO. If Sleazo has really cleaned up its act as you say, why refuse to tell us the location of Sleazo’s plant? Why battle against independent monitors?

### **Public Sector**

The governments of advanced and less developed countries and international agencies have responded to citizen pressures against low labor standards with diverse programs. The major US and UK programs have taken the form of government sponsored partnerships among major participants in the “market for standards”. The ILO has championed elimination of the worst forms of child labor. Underlying at least some government initiatives has been the fear that concern over standards could threaten world trade. The abortive Harkins Bill forbidding imports of products made by children into the U.S. probably did more to energize Bangladesh to begin dealing with its child labor problem than anything else.

### **The White House Apparel Partnership; the UK Ethical Trade Initiative**

In 1996 the Clinton Administration sought to organize concern over sweatshop production sparked by the Kathie Lee Gifford affair by bringing together major apparel companies, unions, and human rights groups in the White House Apparel Partnership. In Nov 1998 the companies and some NGOs reached a preliminary agreement to develop a Fair Labor Association that would accredit independent external monitors and develop a reporting system on compliance with company codes. The Association would require companies to undertake internal monitoring and submit some supplier factories to

external monitoring. But two major participants refused to participate in the Association. The primary representative of the religious community, the Interfaith Center on Corporate Responsibility, troubled over the refusal of participating companies to commit to paying a living wage and the failure of the agreement to provide for sufficient independent monitoring. The primary representatives of unions, UNITE and the Retail, Wholesale and Department Store Union, also withdrew, noting that the agreement did nothing to protect workers who wanted to unionize, and gave firms veto power of the governance of the Fair Labor Association.

So who came out on top from this initiative? The Association seems well suited for firms that want to make marginal improvements in conditions while maintaining low wages and control over its work force. It gives these firms a defense against activist publicity that may have threatened their sales. One signatory to the Partnership is Nike, which had taken a pummeling in public relations from its use of child labour and working conditions. Nike had paid former ambassador to the U.N. Andrew Young to make a whirlwind tour of its facilities and approve of the company efforts. When this did not assuage concerns, it hired Ernst & Young to do a more thorough study, which found many unsafe conditions in a major Vietnamese plant. Nike has since developed a code that pledges to end child labor, to allow for independent auditors to inspect factories, and to apply OSHA air quality standards in its LDC factories. By joining the Partnership and Association, Nike has potentially protected itself from further activist bad publicity. It is officially a good guy.

In Jan 1998 a group of companies, unions, and NGOs formed a non-profit organization, the Ethical Trading Institute supported in part by the UK government, to work out ways to promote fundamental human rights in employment and decent working conditions. Like US retailers and apparel firms, the companies involved in the ETI deal with thousands of agents, middlemen, contractors and

subcontractors in low income countries. The ETI seeks to follow corporate codes of conduct with action - monitoring working conditions and working with suppliers to improve them to improve the lives of workers. At this writing it has not developed formal commitments for companies and other members to meet, raising the possibility that the partnership may break down when it comes to moving from words to action as did the US effort. But British firms and unions are more accustomed to dealing with unions in a partnership arrangement, so that the groups may be able to work together successfully. The ETI has, however, equivocated on whether it expects consumers to pay higher prices for products made under better conditions -- the key condition for harnessing consumer sentiment to improve matters in less developed countries.<sup>11</sup>

### **International agencies and LDC governments**

In 1992 the ILO established its International Programme on the Elimination of Child Labor (IPEC). Recognizing that many children are working because they lack alternative opportunities, the ILO has taken a judicious stand toward child labour in general. It targets “intolerable forms of child labour” (bonded labour, commercial sexual exploitation, domestic service, hazardous agricultural work, work in dangerous jobs) and seeks to provide them with better alternatives, such as schooling. ILO-IPEC began to operate in six countries, Brazil, India, Indonesia, Kenya, Thailand, and Turkey, and has since expanded to 23 other countries. Initial funding came from Germany, but includes 16 countries. The ILO operates by assisting national governments and societies. It offers the carrot of technical aid and some financial support but has no stick with which to get countries to take action. It invariably insists that programmes have a strong rehabilitative component so that action in one

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<sup>11</sup> The ETI website poses the question: Will the process inevitably lead to higher prices for the consumer? but offers no clear answer.

sector -- usually sweatshop export production -- does not drive child labour into more hazardous and worse jobs.

The ILO-IPEC programme has moved the child labour issue from the back burner of international discourse to the front of discussion. It has motivated some less advanced countries that had accepted child labour as a part of life to take some steps to reduce it, and helped develop collaborative work among various players in the standards market -- governments, employers associations, and unions who constitute the core ILO constituency -- and NGOs. For the most part, the issue is not one of legislation: most countries have reasonable labour codes regulating child labour and other workplace standards, though they may not have signed up for the ILO Convention. The issue is implementation, enforcement, and the creation of fruitful alternatives for the children. The ILO has sought to increase the role of labour inspections in enforcing laws on child labour and has encouraged the development of educational programs in various countries. It has pioneered programs to provide schooling for child carpet weavers in Pakistan, and provided support for educational activity for child workers in a variety of other countries.

The key to any successful attack on child labour lies, however, not in having government inspectors demand that factories fire child workers but in moving the children into education while compensating them or their families for the loss of income that often contributed to survival. Here, the ILO working with other groups ranging from UNICEF to employers federations to activist NGOs has demonstrated that it is possible to eliminate child labour in some areas, such as production of soccer balls in Pakistan, or garments in Bangladesh, from work in factories into special education programmes, while paying compensation to them and their families to maintain living standards. In the case of the soccer balls, the major global companies have pledged to buy balls only from local

manufacturers who permit the ILO to check production and to give alternative income to the families to replace the earnings of children.

This all sounds very good -- the “toothless” ILO having a real impact -- until, as the Wall Street brokers say, we look at the numbers. In 1996-97 the ILO had \$20 million for its war on child labour. If I were in a rhetorical mood, I would compare this to spending on some consumer luxury item, or in endorsements to a few famous sports figures; to Michael Eisner’s annual salary, or the daily return on Bill Gates’ wealth; or the cost of a few advanced fighter planes, or the money the IMF wasted trying to prop up the corrupt Russian economy. But economists are not rhetoricians or PC lawyers or ... heaven forbid ... sociologists. So make your own assessment of how much good \$20 million dollars can accomplish in the current global economy.

To be sure, small expenditures can catalyze other resources and the actions of other players, and any social programme that has a positive benefit-cost ratio merits support and expansion. While there has been no experimental verification that ILO-IPEC has indeed “paid” for itself in terms of improving the well-being of a substantial of children per dollar spent, you can multiply \$43 million by any reasonable benefit-cost ratio and you still get ... something modest.

### **bottom line on the six approaches**

In sum, organizing the market for labor standards to improve living standards in less developed countries cannot be done by any single group. Consumer/activists can bring the issue of labor standards to public attention and pressure firms to respond. Firms can try to impose corporate codes of conduct on subcontractors. And NGOs or unions in less developed countries can help provide on the ground monitoring. The ILO can improve the capability of local governments and devise model programs for moving children from work to education and help countries and private groups fund a small

number of such programs.

The missing element in all of this is the activity of the workers in the factories themselves, organized into trade unions or some other collective group to represent their own interests. Few companies in less developed countries desire unions at their work places, for fear that they will raise pay and reduce profits. In the current world scene it is hard to imagine a burst of unionism in the less developed world that would greatly alter the distribution of the benefits of growth and globalisation between them and multinationals, capital, and consumers in the advanced countries.

### **III. DO STANDARDS DO GOOD?**

Say, the world community did indeed establish an effective mechanism for pressuring firms to improve labor standards, at least in the products sold on world markets. This would make consumers in advanced countries feel good. The handwoven rug you bought was not produced by children, the blouse your partner bought was made in Honduras by 17 year olds rather than 13 year olds, and your Nike Shoes were produced in factories where everyone is over 18. But if the firms simply fired the children, they are probably worse off than they would be making products for the export market. More broadly, some types and levels of standards – for instance a world minimum wage or occupational health and safety standards that require massive capital spending – could readily price the poorest countries out of the global market, reducing overall GDP.

The fear that inappropriate standards will harm the very people they are meant to help is often raised by opponents of standards and defenders of the activities of multinational corporations. But the fear is a valid one. If the market for standards was organized so that consumers spent more on products made under better conditions, the problem of harm would largely disappear. Consumers would pay an extra 5 cents for their soccer ball, and the children who had worked making the balls would

receive a stipend to go to school. But standards imposed through labels, boycotts or codes of conduct that do not address costs and alternative, will depress the demand for work by the affected group and can cause them more harm than good. At present that is how many see standards as operating.. “No child labour” or “Pay a living wage” are great slogans but by themselves are no guarantee that the living conditions of the affected children or workers will be better, and can make them worse off.

To assess whether any given set of standards does more good or harm, we must take account of: the cost of meeting the standards, which will affect levels of production; and the next best alternatives to workers who might lose their jobs if standards raise costs.

I am unaware of any careful assessment of the costs of meeting various standards, but would expect costs to vary greatly. Consider the following complaints about working conditions in factories in less developed countries (Oxfam) :

Dark, crowded, hot, noisy workplaces.

No emergency exits or fire extinguishers

Inadequate or no time to go to the toilet

No canteen or place to eat

Abusive supervisors who strike young workers

Below minimum wage payments

Workers have no contracts

Compulsory overtime

Sexual or other harassment of workers

Late or short wage payments

Some of these problems concern the process of fair treatment and are likely to add little to

the cost of production. Providing emergency exits or lights in a workplace or fire extinguishers or giving workers security from sexual or other harassment by supervisors or the right to go to the toilet are not major capital items, and thus should be relatively inexpensive to provide. Other standards may cost the producer considerably. To provide more space for workers, or a canteen, may require expansion of the facility or reduction in operating machines.

A sensible strategy for raising standards might be to start with the least expensive items regarding decent treatment of workers, then to move to more expensive standards. Some standards have little cost if they are raised throughout a sector. As long as all competitors face the same increase in cost, they remain on the same level playing field.

The one standard that has the potential for most improving the well-being of workers -- forming a trade union -- is highly contentious since it threatens to change the balance of power within factories and countries. The abstract right to form a union is not an expense item, but if workers exercise the right, labor costs are sure to rise. And freedom of association may risk the stability of non-democratic regimes and thus have a high cost to those regimes, if not to employers. A natural place for the international community to demand enforcement of this right is in export processing zones, which obtain other cost advantages.

The issue of the next best alternative available to workers is a huge one, which I have touched upon already in discussions of child labour. Without programs to provide sustenance and schooling for children, many would be forced to live on the street, some would fall prey to prostitution, some might find crime the only way to make a living, others might die from disease. Recognizing this problem, the National Labor Committee campaigns for higher wages to children working in Haiti rather than a ban on child labour, and the ILO's International Program on the Elimination of Child Labor has worked to

create better alternatives for young workers. Going beyond children, the problem is that the pressure to raise standards is in most cases limited to export manufacturing, which generally offers higher wages and work conditions than in most other sectors in a low income economy. Thus, it is highly likely that adult workers displaced from the export sector will suffer a decline in living conditions. But this does not by itself mean that such a program does more harm than good. If the demand for labour in the export sector is relatively inelastic with respect to labour costs, increases in standards that raise costs will increase the amount of revenue (benefits) going to workers as a whole, though some will suffer. Only if the demand has elasticity greater than unity will workers in general lose from a costly increase in labor standards or higher wages. Studies in advanced countries have found relatively low elasticities of demand for low skill minimum wage workers. But elasticities are likely to be higher in traded goods production since there are many potential producing countries. This gives less scope for improvements in standards that raise costs in some countries or for some producers but not for others.

But there is a flipside to the fact that pressure for raising standards focuses on traded goods. One of the key propositions in trade theory is that changes in the price of goods on world markets have multiplier effects on wages (see table 5). If labour costs are 20% of the cost of production of a good and the price of the good falls by 5% on world markets and if capital is completely mobile, the wages of workers must fall by 25% for a firm to maintain production ( $.20 \times 25\% = 5\%$ ). The change in wages accompanying a given change in prices is larger the smaller labor's share of cost.

Since labor costs in less developed countries constitute a relatively modest share of the retail price of most products the implication is that an increase in price from consumers willing to pay for higher standards can have a huge multiplier effect on the well-being of workers. If you pay an

extra 50 cents on \$5.00 t-shirt in which labor costs are, say, 20 percent of the retail price, and if that money goes to improve the conditions of workers, you will have provided funds for a 50 percent increase in expenditures on labor ( $.50 / (.20 \times \$5.00)$ ). Thus, there is a substantial margin for significantly increasing the wages/work conditions of workers in export sectors through modest increases in the price of goods paid by consumers who want to improve standards.

### III. CONCLUSION: STANDARDS AS A WEDGE

How much good can we legitimately expect to come from international concern over labour standards?

Assume that the Invisible Hand suddenly appeared before you and gave you the following three choices.

1. To increase the well-being of workers in poor countries, you could
  - a) Improve labor standards in the poorest countries in the world to levels that the ILO, NLC, and various activist groups would approve; OR
  - b) Forgive the debts of these countries and restructure the world financial system to limit the burden and risk on poor countries from the volatile flow of capital.
2. To reduce the danger that unscrupulous firms will exploit workers in low income countries, you could
  - a) Bring the monitoring and enforcement of corporate codes of conduct and domestic labour laws up to acceptable levels; OR
  - b) Reduce speculative flows of short term capital from poor countries to the West and stop IMF programs that require depressions and real wage cuts to cover the cost of financial disorder.
3. To improve the living standard of children in poor countries, you could

a) Generate rapid economic growth fueled in part by exports of low wage products to advanced countries and imports of high wage products from those countries; OR

b) Eliminate child labor in traded goods sectors with programs that guaranteed that the children would go to school and their families be recompensed for the loss of income

The answers to these questions are clear. Without gainsaying the positive contribution that improved labor standards can make to world well-being, the problem of global poverty and poor labor conditions **cannot** be resolved through international labor standards. As Wal-Mart stated in a 1998 response to the National Labor Committee, “The problems outlined by the National Labor Committee (regarding conditions in Wal-Mart factories in China and elsewhere that produced Kathie Lee Gifford items) transcend Wal-Mart, Kathie Lee and modern garment industry).<sup>12</sup>

What is necessary is rapid economic growth. Given a choice between, say 8% annual growth and compliance with labor standards, most less developed countries would rightfully choose the former. Happily, countries do not face such a choice. Economic studies find that income inequality is negatively related to economic growth (see the review by Benabou), which at least suggests that appropriately applied standards are more likely to raise rather than lower growth rates. But the point remains. Growth is the long term cure to the problems of less developed countries. And the greatest threat to growth is global financial crisis.

Imagine that in next year or so the global financial system, creaking under bad bank loans in Japan, Russia’s default, and the East Asian financial crisis, goes belly-up. Another big speculative hedge fund collapses, Brazil devalues its currency and capital flees, the Chinese banking system collapses, Bill Gates gets sick, whatever.

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<sup>12</sup> Wal-Mart Press Release, Wal-Mart Responds to the National Labor Committee, March 18, 1998.

How the major players in the world economy deal with such a crisis will affect the well-being of workers around the world far more than any conceivable improvement in labor standards. The prime ministers, presidents, finance ministers, central bankers of the major economies will convene meetings to decide how to apportion the cost of collapse and to develop a new more secure system for global trade and finance. Who will be at the table deciding on the rules of the game?

Representatives of the workers in less developed countries who will foot the bill for the blunders of their leaders and the international banking community? Workers in advanced countries whose taxes will bail out bankrupt banks and financial institutions? Or the same finance ministers and bankers and IMF bureaucrats who neither foresaw nor managed to prevent the crisis? Whose voice will be heard loudest and whose interests will be best represented -- bankers and financiers, or workers and taxpayers?

We all know the answer to this, and the likely outcome.

Government bailouts of insolvent banks, greater protection of investors' rights, with perhaps some grudging limitation on short term capital flows and debt restructuring. A bailout of the financial sector by taxes paid by the normal citizen. Greater transparency in financial flows, so investors will have a better idea of the risks investment banks and funds are taking with their money. Perhaps even the reappearance of the Multinational Agreement on Investing as a necessary component for re-establishing a stable global financial order.

We also know what will be missing from such a new world economic system. Greater transparency in labor standards. Enhanced protection for workers to form trade unions to defend their interests. Shifts in the burden of adjustment for crisis from labor to capital. Regulation of financial sectors to limit the harm that speculative runs can bring to ordinary citizens.

Of course, it is possible that the finance ministers and bankers will put the concerns of workers first and the financial community second. But I wouldn't bet on it. If only capital is at the table devising the rules of the game, the rules will be set to benefit capital. To turn the Invisible Hand questionnaire from fantasy to reality, representatives and advocates of labor must be at the table that set the rules of any new world financial system.

Is there any issue or way in which this might occur?

The only possible issue which might have sufficient "legs" to bring labor to the table determining the rules of the game is labor standards. The demand for some minimal level of rights to workers around the world resonates with many people for whom discussions of debt restructuring and international finance are arcane, boring, abstract economics.

In sum, critics of labor standards are right that improved standards in export industries cannot do all that much to make life better for workers in low income countries. But campaigns for labor standards just might be the wedge for bringing workers concerns directly into discussions of how we run global trade and finance, and that could make a big difference.

**EXHIBIT 1:**

**How Much Would You Pay for a T-Shirt Made by Workers Treated  
Well in a Decent Workplace?**

**DESIGN A:**

|                                                                         |                |
|-------------------------------------------------------------------------|----------------|
| <b>% WHO CARE ABOUT CONDITIONS<br/>CLOTHING IS MADE AT ...</b>          | <b>70%</b>     |
| <b>% WHO WOULD NOT BUY IF MADE<br/>UNDER POOR CONDITIONS</b>            | <b>80%</b>     |
| <b>% WILLING TO PAY MORE IF CLOTHING<br/>MADE UNDER GOOD CONDITIONS</b> | <b>80%</b>     |
| <b>AVERAGE PREMIUM ...</b>                                              | <b>8 to 9%</b> |

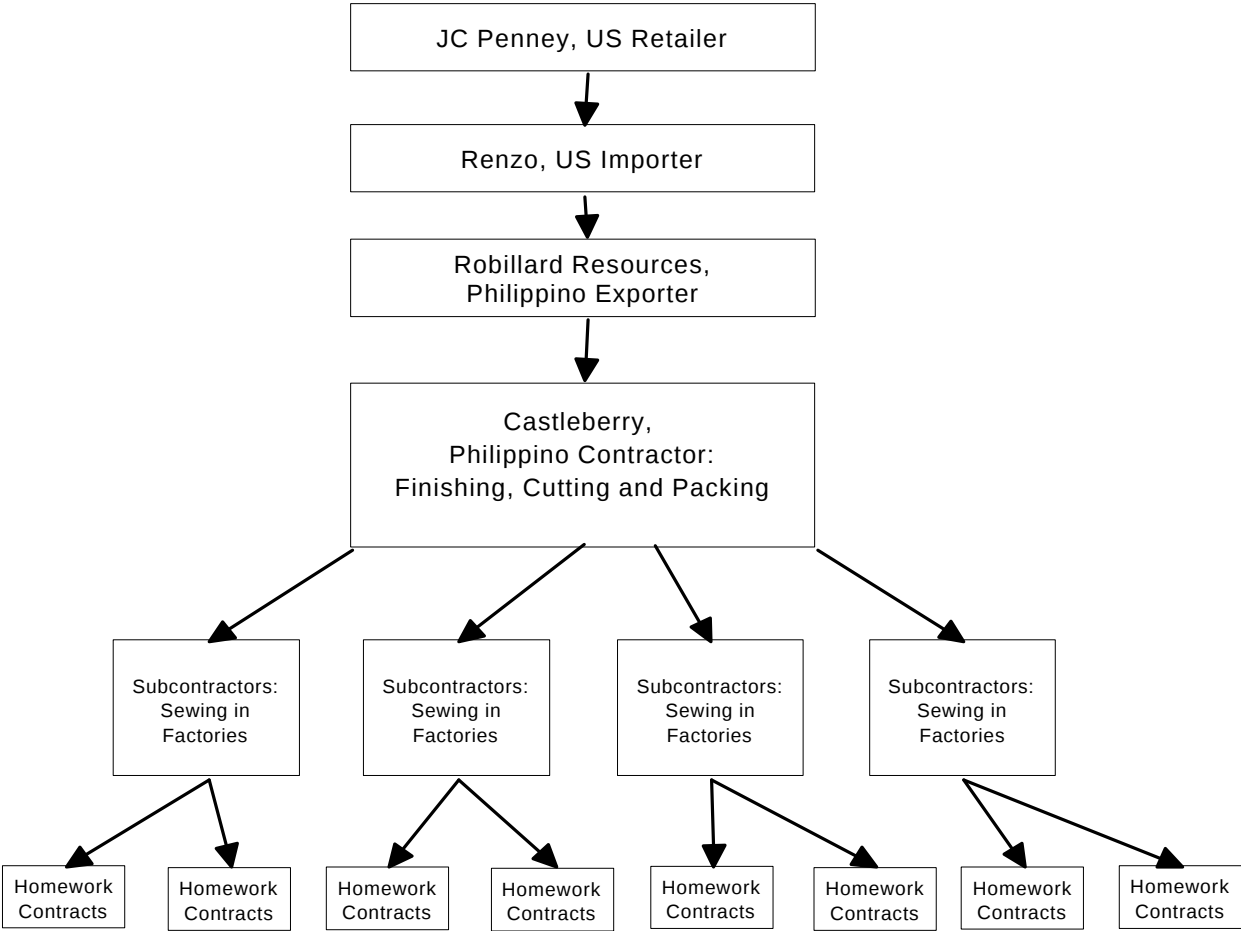
**DESIGN B:**

|                                                                                                                                  |               |
|----------------------------------------------------------------------------------------------------------------------------------|---------------|
| <b>WOULD YOU BUY A T-SHIRT FOR \$10<br/>(going rate for T-shirts of this quality)<br/>IF were made under poor conditions ...</b> | <b>50%</b>    |
| <b>HOW MUCH WOULD YOU PAY:<br/>IF were made under poor conditions ...</b>                                                        | <b>\$6.60</b> |

**EXHIBIT 2:**  
**The Experimental Evidence**

| <b>Game</b>               | <b>OECONOMICUS</b>                                     | <b>ACTUAL</b>                                              |
|---------------------------|--------------------------------------------------------|------------------------------------------------------------|
| <b>Prisoners' Dilemma</b> | <b>Always Defect</b>                                   | <b>Often Cooperate</b>                                     |
| <b>Ultimatum Game</b>     | <b>Boss takes almost all<br/>Workers accept crumbs</b> | <b>Reject<br/>highly uneven<br/>sharing</b>                |
|                           |                                                        | <b>Most Prefer Smaller<br/>Amount Fairly Shared</b>        |
| <b>Dictator Game</b>      | <b>Dictator takes all</b>                              | <b>Most people give<br/>moderate amount to<br/>partner</b> |

EXHIBIT 3:  
THE CHAIN OF PRODUCTION: RETAIL TO FACTORY



## **EXHIBIT 4:**

### **List of Some Private Activist Groups**

Investor Responsibility Research Center ([www.irrc.org](http://www.irrc.org))

Interfaith Center on Corporate Responsibility

National Labor Committee ([www.nlcnet.org](http://www.nlcnet.org)))

Ethical Trading Initiative ([www.ethicaltrade.org](http://www.ethicaltrade.org))

Clean Clothes Campaign ([www.cleanclothes.org](http://www.cleanclothes.org))

Oxfam's Clothes Code Campaign

([www.oneworld.org/oxfam/campaign/clothes](http://www.oneworld.org/oxfam/campaign/clothes))

Hearts and Minds ([www.heartsandminds.org](http://www.heartsandminds.org))

Vietnam labor Watch ([www.saigon.com/nike](http://www.saigon.com/nike))

Campaign for Labor Rights ([www.compugraph.com](http://www.compugraph.com))

National Consumers League ([www.nationconsumersleague.org](http://www.nationconsumersleague.org))

child labor coalition

Free the Children ([www.freethechildren.org](http://www.freethechildren.org))

Human rights watch ([gopher://gopher.humanrights.org:5000](http://gopher://gopher.humanrights.org:5000) )

Human Rights for Workers: ([ourworld.compuserve.com/homepages/hrw](http://ourworld.compuserve.com/homepages/hrw) Global

March Against Child Labor([www.globalmarch.org](http://www.globalmarch.org)):

UNITE union Stop Sweatshops Campaign ([www.uniteunion.org](http://www.uniteunion.org))

### **EXHIBIT 5:**

#### **The Multiplier Effect of Consumer Willingness to Pay More for Better Labor Standards on Labor Expenditures in LDCs**

|                            |     |     |      |
|----------------------------|-----|-----|------|
| Labor's Share of Cost      | .20 | .10 | .05  |
| Increased Price paid for   |     |     |      |
| Better conditions          | 5%  | 5%  | 5%   |
| Increased Expenditures for |     |     |      |
| wages/work conditions      | 25% | 59% | 100% |