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Labor Standards: Where do they belong on the International  
Trade Agenda?

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**ABSTRACT****Labor Standards: Where Do they belong on the International Trade Agenda****Drusilla K. Brown**  
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Recently, universal labor standards have become the focus of intense international debate. This paper analyzes the arguments concerning the value of coordinating labor standards internationally, the arena in which international labor standards ought to be established and the instruments that can be used constructively to bring about compliance. We examine the analytical underpinnings of universal rules; the evidence on whether labor practices in developing countries have adverse consequences for workers in industrialized countries; and the question of whether labor standards should be introduced into the negotiations of the World Trade Organization (WTO) or remain in the purview of the ILO.

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During the past decade, universal labor standards have become the focus of intense debate among policymakers, international agencies, nongovernmental organizations, college campus activists and the general public. Tension over labor standards has sometimes erupted into violent conflict between police and demonstrators, most recently during the Spring 2001 Conference of the Americas in Quebec.

Labor rights activists argue that the nations of the world ought to be able to agree on some set of universally accepted human rights regarding working conditions that would apply in all nations. In addition, trade with countries in which labor is poorly protected may create an incentive to lower wages in industrialized countries and weaken existing labor law in order to maintain competitiveness in international trade. As a remedy, some proponents seek to protect the interests of labor by incorporating labor rights into international trade law.

Opponents of internationally established labor standards respond that the regulation of labor markets, as a matter of national sovereignty, should remain primarily in the domain of domestic policy and should not be a topic in international trade

negotiations. The promulgation of standards internationally ought to be delegated to the International Labour Organization (ILO) and advanced exclusively through dialogue, monitoring and technical advice.

Our purpose here is to analyze the arguments concerning the value of coordinating labor standards internationally, the arena in which international labor standards ought to be established and the instruments that can be used constructively to bring about compliance. We will examine the analytical underpinnings of universal rules for labor rights; the evidence on whether labor practices in developing countries have adverse consequences for workers in industrialized countries; and the question of whether labor standards should be introduced formally into the negotiations of the World Trade Organization (WTO) or remain primarily in the purview of the ILO.

#### Labor Standards Defined: Rights, Outcomes, Efficiency

The regulation of labor markets originally emerged before the fourteenth century in Europe with laws generally written to serve the interests of the elite rather than to protect labor.<sup>1</sup> However, with the onset of the industrial revolution, social activists began advocating for labor protections that might

mitigate the more brutal aspects of industrialization. Engerman (2001) marks the beginning of the modern labor rights movement with the English Factory Act of 1802. This act regulates the working conditions of pauper apprentices, establishing a twelve-hour day, prohibiting night work and providing for basic academic and religious training.

From its inception, the debate over labor rights addressed the legitimate right of the government to intrude upon market outcomes and the free choices of workers. Thus, most of the legislation in Europe and North America throughout the 19<sup>th</sup> century focused only on regulating the working conditions of women and children with the intention of offsetting their weak bargaining power with employers. Legislation typically controlled the length of the workday and night-work and prohibited the employment of women in hazardous conditions such as underground mines.

A second thread common to our current debate concerned the importance of international coordination of labor law in order to mitigate the effects of labor protections on trade competitiveness.<sup>2</sup> The drive to coordinate labor practices internationally began during the second half of the 19<sup>th</sup> century. However, success was limited largely to the prohibition of production and importation of white phosphorous matches and night work by women.

The international labor rights agenda broadened dramatically at the end of World War I with the creation of the International Labour Organization. The ILO was established in 1919 as an offshoot of the League of Nations and originally had 44 member countries from Europe, Asia, Africa and Latin America. Initially, discussions in the ILO focused on the eradication of slavery and all forms of forced labor. However, a broader labor rights agenda also included the rights to freedom of association and collective bargaining, nondiscrimination in employment, and the elimination of child labor (ILO, 1999).

As part of building an international consensus on labor standards, the ILO promulgates certain "Conventions" and "Recommendation" which member nations may choose to ratify. The early Conventions adopted between 1919 and 1939 included a long list of labor market practices targeted for international standards. For example, Convention 1 establishes the 8-hour day/48-hour workweek and Convention 5 establishes a minimum work age of 14 years<sup>3</sup>. Additional Conventions and Recommendations pertained to wages, occupational health and safety, retirement compensation, severance pay, survivor's benefits, etc.

#### The Critique of International Labor Standards

In the face of the lengthy list of labor standards

contemplated by the ILO, critics of international labor standards point out the unfairness of attempting to establish standards in all of these areas without regard for the level of economic development and cultural norms. While most countries may be willing to embrace the broad caveat-filled language typical of ILO Conventions, that does not imply that we will be able to agree on specific language pertaining to labor standards that would then be subject to trade disciplines in the World Trade Organization.

For example, there is strong empirical evidence that the optimal length of the workweek is negatively correlated with a nation's level of income; that is, high-income countries have a shorter workweek than many low-income countries. See, for example, Table 1, which reports on typical workweeks, wages and labor costs for a select group of countries for manufacturing, agriculture and wearing apparel. Note, for example, that in Costa Rica a typical worker in manufacturing earned \$1.54/hour and worked 49 hours a week in 1999. Some textile and wearing apparel workers earning less than \$1/hour worked 50 or more hours per week. By contrast, a typical manufacturing worker in the United States earned \$13.91/hour and worked 41.7 hours a week in 1999. Similarly, a suitable minimum wage cannot be set uniformly since its effects will depend critically on how high it is relative to the productivity of less-skilled labor.

Child labor practices, which receive the most intensive scrutiny in the public discussions, clearly depend on the level of economic development and for many families the income earned by their children is a matter of the family's survival. Krueger (1997) finds a very strong negative correlation between child labor force participation and per capita GDP. Children 14 years and younger are not completely withdrawn from the labor force until GDP approaches \$5000 per capita.<sup>4</sup>

Virtually every country in the world attempts to regulate child labor by setting minimum educational requirements and minimum age of employment, though with limited success. Regulations along with child labor force participation rates for a select group of countries are reported in Table 2. For countries in the poorest parts of the world, more than 40 percent of children aged 5-14 work. This is the case even though the legal minimum age of work is typically 14 years old or higher and in no case is the minimum work age less than 12 years.

#### Core Labor Standards as Basic Human Rights

There have been several responses to the concerns raised by the labor standards critics. First, even if a global minimum wage applying across all countries seems nonsensical, there are still certain "core standards" that should be imposed universally

because they are arguably independent of national income and reflect natural rights or broadly held values. A second line of argument holds that certain basic labor standards will have positive economic effects and can be justified on these grounds.

Cast in these terms, the discussion of core labor standards is closely related to the on-going debate in political science and philosophy over the notion of natural rights. Some prefer to avoid the language of "rights," but instead argue that something of a consensus has emerged on a broader set of values that are derived from the notion of individual freedom (Maskus, 1997).

Such rights-based or value-based language appears in the charters and declarations of several international organizations that include nearly all countries in the world in their membership. For example, The ILO Conventions pertaining to core labor standards, listed in Table 3, have been ratified by well over 100 countries and similar United Nations covenants have been ratified by more than 120 countries. Furthermore, The 1998 ILO Declaration on Fundamental Principles at Work<sup>5</sup> binds all 175 ILO members and states that

" ... all Members, even if they have not ratified the Conventions in question, have an obligation arising from the very fact of membership in the Organization,

to respect, to promote and to realize, in good faith and in accordance with the Constitution, the Principles concerning the fundamental rights which are the subject of those Conventions, namely:

1. freedom of association and the effective recognition of the right to collective bargaining,
2. the elimination of all forms of forced or compulsory labor,
3. the effective abolition of child labor, and
4. the elimination of discrimination in respect of employment and occupation.

Thus, proponents argue that the ILO and UN language can be viewed as a near universally accepted set of humanitarian principles concerning the treatment of labor (Eddy, 1997).

Of course, the fact that an ILO document refers to "fundamental rights" does not end the discussion. Bhagwati (1995) has been a prominent voice among those arguing that in the area of labor standards, there is little universal agreement. We have a near-universal consensus only in favor of prohibiting forced labor.<sup>6</sup> On other issues, like the appropriate rules to regulate collective bargaining or child labor or discrimination, we have a mixture of good intentions, some blood-curdling stories about

undoubted abuses in extreme cases, and great uncertainty over what the appropriate labor standard should be.

Some statements about labor standards may be attractive general goals, but they vary too much across countries to be defined as rights. Even the United States, which has been a driving force behind the recent international labor standards initiative has not ratified any of the ILO Conventions pertaining to nondiscrimination, forced labor or the right to free association and collective bargaining, as can be seen from Table 3. Similarly, the debate over what constitutes "the elimination of discrimination" has proceeded for decades inconclusively. At this point there appears little closure on the issue.

#### Labor Process Standards

To avoid the intellectual quagmire of natural rights, other organizing principles have been proposed. For example, Aggarwal (1995) distinguishes labor market standards that are focused on outcomes from those that are focused on processes. Outcome-related standards, like a minimum wage, will always depend on levels of productivity and economic development and, thus, are poor candidates for international standards. By contrast, the core labor standards listed in the 1998 ILO Declaration are largely process-related; that is, they concern the organization of the

labor market without specifying any particular market outcome. If we adopt the "process" approach, the question becomes what labor standards should be regulated and how?

An OECD (1996) report isolates labor standards that reflect near universally held values and/or play a role in supporting the efficient function of labor markets. According to this view, standards such as freedom of association, the right to collective bargaining, prohibition of forced labor, the principle of nondiscrimination and prohibition of "exploitative" child labor can be imposed without regard to the degree of development and can actually promote economic growth.

While it would be convenient if efficiency-enhancing labor standards could be linked to humanitarian values, these connections are often ambiguous and controversial. Consider first the prohibition against forced labor. The consensus against slavery or labor contracts that lead to slave-like conditions is one point on which there is virtually no debate. Although it is possible to make an efficiency argument supporting the prohibition of forced labor, e.g., Swinnerton (1997), humanitarian concerns typically dwarf any discussion of efficiency.

The grey area concerns bonded labor contracts prohibited under ILO Convention 105. As noted by Singh (2001), the act of choosing to be bonded may be voluntary but once bonded the worker

is no longer free. Genicot (2000) emphasizes the role of capital market failure in bonded labor contracts. Extremely poor workers frequently have no access to formal capital markets and, so, are forced to offer their own labor as collateral to obtain a loan.

Such arrangements may be mutually agreed upon by the worker and the employer, at least *ex ante*. Nevertheless, banning such contracts may be justified if they result from limited information or rationality on the part of the worker.

Genicot further argues that the legality of bonded labor contracts may actually inhibit the development of formal capital markets. He points out that a bank may be unwilling to extend a loan if the worker has the option of obtaining a second loan by bonding his labor. Presumably, the bondholder has greater power to enforce the loan agreement than the bank, thereby raising the default risk for the bank. In such cases, outlawing bonded labor contracts can actually improve the options for the worker by lowering the default risk for formal credit institutions.

Standard efficiency arguments are also weakened when we are constrained by political feasibility. Take, for example, discrimination in employment. Discrimination discourages workers from entering the job to which they are best suited, thereby lowering the value of output. However, Rodrik (1999) offers a striking example in which discrimination was Pareto-improving for

political economy reasons.

Mauritius set out on a development strategy that depended on operating an export-processing zone. To generate a consensus in support of the export-oriented development strategy, the interests of those benefiting from long-standing protection had to be preserved. This was accomplished by following a two-part development strategy: protection for existing industries that hired males was continued, while the export-processing zones employed females. Rodrik argues that the segmentation of the labor force along gender lines was critical to the policy's success. Male workers and import-competing producers continued to produce under the same conditions as before the introduction of the export-promotion plan, while women and capital owners in the export-processing zones had new opportunities opened to them. In Rodrik's words (p. 21): "New profit opportunities were created at the margin, while leaving old opportunities undisturbed." Thus, the Pareto-improving step was rendered politically feasible by segmenting the labor market along gender lines. Dealing with entrenched cultural patterns that have favored one group over another may sometimes lead to advocacy of policies - either preserving some of the benefits to the favored group or assuring benefits to the disfavored group - that would not pass a strict non-discrimination test.

The expected outcome of collective bargaining is similarly uncertain. As argued by Freeman (1994), unionism has two faces. In many cases, a union can improve dispute resolution, provide a channel of information from worker to employer, and coordinate the differing views among workers concerning the tradeoff between working conditions and wages (for a view of unions along these lines, see Stiglitz, 2000, Piore, 1994, and Marshall, 1994). However, if the union behaves like a monopoly in an otherwise competitive market, favoring the interests of a small elite at the expense of a large group of excluded workers, then the efficiency effects are negative (Bhagwati, 1995; Srinivasan, 1997).

Finally, the OECD (1996) report seeks to include the prohibition of "exploitative" child labor as a core standard. Indeed, the specter of small children working long hours in appalling conditions motivate most analysts to find some analytical basis on which to at least circumscribe labor practices concerning children.

Bonded child labor is frequently put forward as the most egregious and offensive form of exploitative child labor. Children delivered into bonded servitude are sometimes clothed, housed and fed by their employer and they may receive only a very small wage. The excess product generated by the child's work that is not devoted to the child's support is paid to the parent who

receives a lump sum at the time the child is delivered into servitude. That is, the child must be subsidizing the standard of living of the rest of the family and thus is exploited in this sense (Brown, Deardorff and Stern, 2001).

Although the OECD (1996) report focuses on "exploitative" child labor, it is possible to make an argument for banning child labor more broadly defined on both equity and efficiency grounds.<sup>7</sup>

Basu and Van (1998) analyze the case of families who put their children to work only when the adult wage is below some critical level at which the family's survival is threatened. When child labor decisions depend on the adult wage in this manner, two labor market equilibria may emerge.

In the low-wage child-labor equilibrium, both children and their parents work because the adult wage is below the critical level at which children are withdrawn from the labor market. A ban on child labor that requires parents to withdraw their children from the labor force contracts the supply of labor and may give rise to an equilibrium adult wage above the critical level at which children no longer work. The ban on child labor is effective when it redistributes income from capital to labor in such a way as to alter the family's child-labor decisions.

Although much attention is focused on poverty as the root cause of child labor, Baland and Robinson (2000) refocus on the

role of capital market failure. Presumably, poor families analyze the trade-off between work and schooling in part by comparing the present discounted value of an education to the income from current work. It is arguably the case that the relative return to education is as high or higher for a poor child than for children generally. However, poor parents may still choose to put their child to work if they cannot borrow against their educated child's future income.<sup>8</sup> In this situation, a ban on child labor may be part of a constructive strategy for improving the efficiency of the labor market when combined with a program that provides poor families access to capital markets or otherwise repairs the capital market failure.<sup>9</sup>

Taking steps to reduce forced labor, child labor, and discriminatory behavior, or to support free association and collective bargaining will often have a mixture of effects. Realizing the potential efficiency, equity and humanitarian benefits of core standards may depend on first correcting ancillary market or political failures. Further, we cannot make a general statement that universal labor standards derived from commonly held moral values will always produce positive economic outcomes. The effect on economic performance and the lives of workers and their families of legally imposed labor market constraints of the sort contemplated by labor rights activists

cannot be presumed to be positive, but instead must be empirically investigated on a country-by-country basis.

## Divergent Labor Standards, Trade and Wages of Unskilled Workers in High-Income Countries

While humanitarian concerns have played a prominent role in the debate over international labor standards, a second motivation rests on the view that trade with low-wage countries has increased unemployment and slowed the growth in wages of unskilled workers in high-income countries over the past three decades. To the extent that low labor cost in developing countries is the result of poorly protected core labor rights, trade based on low wages is sometimes seen as unfair or illegitimate.

As a matter of theory, poorly protected worker rights in one country can assuredly lower the wages in their trade partner. According to the Stolper-Samuelson (1941) Theorem, international trade between a high-wage and low-wage country will lower the return to unskilled labor in the high-wage country. But to what extent is the decline in the return to unskilled labor in the United States in the last few decades the result of international trade with low-wage countries? Further, to what extent is such trade the consequence of low labor standards?

Has Trade Lowered the Return to Unskilled Labor in the United States over the Past Two Decades?

There appear to be two primary candidates driving the rise in inequality between skilled and unskilled labor in the United States in recent decades. Skill-biased technical change, presumably associated with the new information and communications technologies, would shift up the demand for skilled workers. However, labor rights activists focus on the expansion of international trade with low-wage economies which tended to reduce the demand for low-skilled labor in the United States.

A number of pieces of evidence suggest that an important shift toward skill-biased technological change has indeed occurred. For example, the relative supply of skilled labor did expand throughout the 1980s even as the relative wage of skilled labor increased, which suggests that firms were moving up along the skilled-labor supply curve, paying higher wages and adopting a more skill-intensive technique of production (Bound and Johnson, 1992). Similarly, throughout the 1980s, U.S. manufacturing consistently substituted toward skilled labor in spite of its rising costs (Lawrence and Slaughter, 1993). Such a pattern of behavior is cost-minimizing only if there has been a technological change rendering skilled labor relatively more productive. The

greater demand for skilled labor seems to have occurred more as a broad-based shift within many sectors of the economy rather than arising only in certain labor-intensive sectors. Such evidence is consistent with skill-biased technological change that drives up the demand for skill in all sectors (Berman, Bound and Griliches, 1994). Finally, there is little evidence that the relative price of labor-intensive goods fell during the 1980s, as one would expect if imports from low-income countries were undercutting less-skilled U.S. labor (Leamer, 1996).

Nevertheless, a number of economists continue to believe that international trade is responsible, at least in part, for the recent decline in the relative wages of unskilled workers in the United States. As one example, Borjas, Freeman and Katz (1992) calculate the factor supplies embodied in U.S. international trade and immigration. They find that for 1985-1986, trade and immigration implicitly increased the supply of workers with a skill level equivalent to a high school dropout in the United States by 27 percent, whereas the comparable number for college graduates was 9 percent. They use a wage equation to relate the implicit change in relative factor supplies to a change in relative wages and conclude that trade and immigration gave rise to a 2 percent increase in the college graduate wage premium which was 20 percent of the total change in the college premium during

the period.<sup>10</sup>

Choosing between skill-biased technology and trade as explanations for the rise in income inequality is further complicated by the reality that these factors may be intertwined; that is, technological improvements may both increase the demand for skilled labor and also increase imports from low-wage countries by making it easier to manage far-flung supply chains.

The controversy over trade and the distribution of income continues.<sup>11</sup> However, at this point, the bulk of the evidence supports the argument that skill-biased technological change is more important than trade as an explanation of wage inequality in the United States, although rising levels of trade with low-income countries may have played a secondary role.

Do National Labor Standards Alter Exports, Competitiveness or Comparative Advantage?

With regard to the issue of international labor standards, the question is whether poorly protected labor rights have played a role in determining comparative advantage and driving exports from developing countries.

Several studies have examined a simple correlation between the existence and/or observance of core labor standards and various measures of trade performance. For example, Mah (1997)

analyzes the trade performance of 45 developing countries and finds that each country's export share of GDP is strongly negatively correlated with rights to nondiscrimination, negatively correlated with freedom-of-association rights and weakly negatively correlated with the right to organize and collective bargaining.

However, to gauge the marginal contribution of core labor standards, one must compare each country's trade performance against a baseline expectation as to what such a country should be trading given its factor endowments and other determinants of trade. Rodrik (1996) provides an excellent example of how such analysis can be undertaken.

He first considers the impact of core labor standards on labor costs per worker in manufacturing. He does this by calculating a regression using labor cost as the dependent variable and per capita income and various measures of labor standards as the independent variables. In this framework, per capita income is being used as a proxy for productivity in the economy. Labor standards are measured in a variety of ways: total number of ILO conventions ratified; number of ILO conventions ratified pertaining to labor standards; Freedom House indicators of civil liberties and political rights; statutory hours worked; days of paid annual leave; the unionization rate; and an indicator

of child labor.

Rodrik finds that for the period 1985-1988, labor costs are overwhelmingly determined by labor productivity. However, the number of ILO conventions ratified, Freedom House indicators of democracy and the index of child labor are large and statistically significant, with laws regulating child labor playing a particularly important role in determining labor costs.

Rodrik then turns to the determinants of comparative advantage in labor-intensive goods. He uses the fraction of textiles and clothing exports in total exports as a proxy for measuring comparative advantage in labor-intensive goods. As a theoretical matter, comparative advantage is primarily determined by factor endowments. Therefore, the comparative advantage variable is regressed on the independent variables of population-to-land ratio (a measure of the labor endowment), average years of schooling in the population over 25 (a measure of the stock of human capital) and the labor standards variables. The population and human capital variables have the expected signs and are statistically significant. However, generally the labor standards variables, while having the expected sign, are not statistically significant. The lone exception is statutory hours worked. The longer the workweek, the stronger is the comparative advantage in textiles and clothing.

Overall, the link from low labor standards in low-income countries to the wage of unskilled workers in industrialized countries is not especially strong. Increased global trade is at most a secondary cause of income inequality in high-income countries and labor standards are at most a secondary determinant of wages in low-income countries. Moreover, this evidence begs the question as to whether externally-imposed labor standards will actually affect labor market practices in developing countries (Brown, 2000). Some evidence on this question is discussed below.

#### Competition between Labor Standards and the Risk of a Race to the Bottom

Proponents of international coordination of core labor standards further argue that, in the absence of coordination, each country might lower its own standards in an attempt to be more attractive to foreign investment or to gain a competitive advantage over foreign exporters. The possibility of a prisoner's dilemma outcome arises, in which each country has an individual incentive to adopt low labor standards but all nations could benefit from a coordinated choice of higher labor standards.

This scenario raises several questions. How powerful is this

incentive to diminish labor standards? Must core labor standards be harmonized according to a universal guideline or will some more limited coordination be more effective? Should the responsibility of promulgating standards and monitoring labor practices remain with the ILO or should the trade disciplines of the WTO be brought to bear on countries with low labor standards?

#### The Race to the Bottom

Those most concerned with a prisoner's dilemma in labor protections couch their arguments in terms of a "race to the bottom" in which governments may be pressured to loosen labor protections so as not to hamper domestic firms that are competing in the international arena. This line of argument implies that international trade and labor standards are inextricably linked and, therefore, should be negotiated simultaneously within the WTO.

To understand the political economy of this race to the bottom, consider in the spirit of Brown, Deardorff and Stern (1996), the situation of a country that wishes to impose new labor standards on an import-competing sector of the economy. For a small country, the price of the good is fixed on world markets. Consequently, the cost of the labor standard must be borne solely by domestic producers, who have no power to pass the cost of the

regulation on to consumers. However, if all countries impose the new labor standard, global supply for the product declines, allowing firms in this sector worldwide to raise their price. In this case, consumers end up bearing some of the cost. Thus, with coordination, the political objection to the labor standards legislation by domestic producers will be less intense, enhancing the chances of passage.

It is important to note for the purposes of the following discussion that this country pays a price for relying on international coordination to discipline the domestic political process. Harmonization is effective in transferring some of the cost of the labor standard from the producer to the consumer precisely because it raises the international price of the imported good. In other words, this country suffers a deterioration in its terms of trade with harmonization, i.e., higher prices for its imports and lower prices for its exports.

#### International Trade and Some Surprising Incentives for Higher Labor Standards

At first blush the forces driving a race to the bottom in international standards may seem obvious. However, all countries have an incentive to at least consider the efficiency properties of their labor market policies. We need to consider, then, how

international trade alters the political and economic incentives to pursue efficiency-enhancing domestic policies, such as labor standards (Srinivasan, 1998). As it turns out, trade provides at least some incentives for both high-income and low-income countries to choose *higher* labor standards.

Consider first standards-setting in a high-income country. Bagwell and Staiger (1998) analyze a situation in which a government's rationale for establishing labor standards is, at least in part, driven by the true social benefits and costs of such standards. For example, the decision to raise the minimum age of employment by one year reflects an attempt to balance the social benefits of greater educational attainment and the social cost of the foregone production of young workers.

In this situation, when a high-income economy opens to trade, goods formerly produced by inexperienced and low-skilled young workers can now be replaced with low-priced imports. Thus, opening to trade creates an incentive, because of the reduced opportunity cost, to *tighten* rather than *relax* labor standards in the high-income country.

Next, consider the effect that international trade has on the incentives to set labor standards in developing countries. Brown, Deardorff and Stern (1996) point out that low-income countries are, typically, labor abundant. They make the plausible

assumption that higher labor standards are "labor using," which means that a tightening of world labor standards will contract the world supply of labor. Wages worldwide rise, pushing up the price of labor-intensive goods exported by developing countries. The change in the terms of trade serves the interests of the labor abundant developing countries at the expense of industrialized countries that are physical and human capital abundant. Therefore, developing countries, as a group, have an incentive to *over-protect* labor.

This analysis does not suggest that labor standards in developing countries will be higher than in industrialized countries, but only that developing countries with market power in international trade might have higher-than-expected labor standards given their level of economic development. More importantly, when labor standards are used in this way to gain a strategic advantage over the terms of trade, the policy is welfare-reducing from a world point of view. A low-income country that uses labor standards for strategic purposes is surrendering efficiency in order to bring about higher export prices. However, from a world point-of-view, the terms-of-trade effects are zero-sum. The terms-of-trade gain for the labor-abundant country comes at the expense of their labor-scarce trade partners. Thus, on balance, the efficiency effect is negative.

## The Race to the Bottom Revisited

Given the conflicting incentives, where can we find a race to the bottom that is broadly consistent with optimizing behavior on the part of governments?

Bagwell and Staiger (1999) point out that lower labor standards may be used to gain a strategic advantage in international trade or to accomplish domestic political objectives when tariffs are also being used to restrict trade. Labor standards, like tariffs, have implications for the international terms of trade and for the well-being of import-competing firms and, thus, are policy substitutes.

For example, an import tariff provides relief to import-competing producers from the pressure of foreign imports by raising the landed price of imports. A reduction in labor standards similarly provides relief by lowering labor cost for import-competing producers. Both policies expand production by import-competing firms, which has the additional effect of lowering the demand for imports. If the country has international market power, the contraction in the demand for imports will also reduce the world price of imports, giving rise to a terms-of-trade improvement.

When countries remove tariffs and other barriers to trade in

the context of international trade negotiations, they give up the policy tools normally used to turn the terms of trade to their advantage and to protect their import-competing producers. These protectionist urges are thus deflected onto domestic policies such as labor standards. Consequently, some mechanism for controlling subsequent competition in domestic policies is necessary if WTO members are to realize the full benefits of trade liberalization.

#### Labor Standards in International Negotiations

The strategic interaction between tariffs and labor standards raises the question of whether or how labor standards might be included in the negotiations of the WTO. A recent review of trade law by the OECD (1996) considered various ways of trying to link labor standards to existing WTO rules.<sup>12</sup> However, the OECD report found that in each case, either low labor standards do not meet the technical requirements of the article and/or the WTO does not provide for an enforcement mechanism. As a consequence, some revision to the WTO charter will be required if low labor standards are to be addressed directly.

Opponents of a "social clause" in the WTO warn of a morass that will emerge if governments attempt to negotiate trade and domestic policy simultaneously. Concerns for domestic autonomy,

to say nothing of complexity, could bring the WTO process to its knees. However, because of the strategic interaction between tariffs and labor standards discussed in the previous section, the "benign neglect" of labor standards in the WTO is also a potential source of inefficient bargaining over trade policy (Bagwell and Staiger, 1998).

Remarkably, Bagwell and Staiger find a clever device for implicitly drawing domestic policies into the WTO framework without having to negotiate over domestic policies directly. As they argue in this symposium, when governments negotiate over tariffs in the WTO, they are implicitly making a commitment to a particular level of market access. This is the case because, under GATT Article XXIII, any country in the WTO is entitled to "right of redress" for changes in domestic policy that systematically erode market access commitments even if no explicit GATT rule has been violated. Such a "non-violation" complaint entitles the aggrieved party either to compensation in the form of other tariff concessions to "rebalance" market access commitments or the complaining partner may withdraw equivalent concessions of its own.

In the context of labor standards, any country that attempts to undue its market access commitments made in a round of WTO negotiations may be required to provide additional trade

concessions to restore the originally agreed-upon market access commitments. As a consequence, no government has the ability to pass the cost or benefit of their labor standards onto the rest of the world or achieve a strategic advantage by altering their labor standards.

Of course, a change in labor standards policy may expand, as well as contract, market access. Thus, in order to achieve symmetry, GATT Article XXIII would have to be amended to allow countries that *expand* market access as a consequence of changes in domestic policy to subsequently *retract* some tariff concessions that restore the original market access commitments.

We can gain an intuitive feel for the Bagwell-Staiger mechanism by returning to the race to the bottom presented above.

Recall that some governments have a political economy incentive to seek stricter labor standards internationally to offset the cost of domestic labor standards for their import-competing producers. An internationally coordinated labor standard could provide relief to domestic producers, since it reduces worldwide production of the labor-intensive good, thereby raising its price on the world market. However, under the tariff negotiating scenario envisioned by Bagwell and Staiger, a country that raises its labor standards, thereby increasing import demand, would be entitled to a tariff *increase* that returns market access to the

originally agreed-upon level.

Note that a high-income country will prefer the Bagwell-Staiger mechanism to the strategy of harmonizing labor standards internationally. Both provide relief to domestic producers by raising the landed price of imports. However, harmonization entails a deterioration in the terms of trade and requires all countries to agree upon a single standard. By contrast, the Bagwell-Staiger mechanism does not alter the terms of trade and leaves all countries with the option of setting their labor standards in the manner that serves their own economic and domestic political interests.

The essential feature of the Bagwell-Staiger mechanism is that it requires each country to neutralize the international economic repercussions of its domestic policy decisions. As a consequence, countries are not tempted to sacrifice socially desirable labor market policies in order to achieve zero-sum terms-of-trade gains. Perhaps more importantly, each government is also given the ability to offset some of the distributional effects of efficiency-enhancing domestic policies. By internalizing to each country all of the external effects of domestic policy, legislators are free to choose optimizing domestic policies without regard for their strategic consequences for international trade.

## Labor Protections and Humanitarian Concerns

The analysis to this point has probably not been particularly satisfying for those motivated by humanitarian concerns. It is morally meaningless to prohibit the domestic production of goods by our own children if the end result is simply to import goods produced by illiterate children in a neighboring country. A similar argument can also be made, albeit in a lower tone, about goods produced by workers who receive low wages or work long hours.

While it is undoubtedly the case that consumers in high-income countries are genuinely concerned with the welfare of foreign workers, it is not at all clear that these concerns can be constructively addressed in the WTO by applying trade disciplines.

To understand the role that the WTO might play in mediating humanitarian concerns with the process of production, it is important to distinguish between two different forms in which these moral concerns might manifest themselves.

First, moral distaste may be a private good. For example, a consumer might prefer not to consume goods produced by children or under poor working conditions. In this case, consumers ought to have an opportunity to avoid goods produced in this manner,

provided that they are willing to pay the additional cost of production. In some cases, this might be accomplished by attaching a product label detailing the conditions under which the good was produced (Freeman, 1994). But one can also make a case that countries that wish to do so should be allowed to include a broad definition of immoral working conditions and, acting as a country, refuse to import such goods.

However, this particular moral stance focuses only on alleviating the bad feeling consumers have knowing they have consumed a good produced under unpleasant circumstances. The welfare of the foreign workers themselves is not necessarily at issue. But if consumers in high-income countries can exhaust their moral commitments simply by avoiding consumption of goods produced in ways that they dislike contemplating, without regard for the welfare of the workers involved, then the humanitarian argument begins to lose some of its moral gravity. If, by contrast, humanitarian and moral concerns focus on the welfare of the workers themselves, rather than on the discomfort of the consumer, then the ability of trade sanctions imposed through the WTO to address these concerns is highly limited.

In fact, trade sanctions in the face of low labor standards are as likely or even more likely to harm workers as they are to improve working conditions. Maskus (1997) provides a detailed

discussion of this point, which I draw upon throughout this section.

Consider the problem of child labor in the case of a small open economy in which the export sector is adult labor-intensive, the import sector is capital-intensive, and a nontraded intermediate input to the export sector is produced using child labor. The child's labor supply is increasing in the child's wage and decreasing in the adult wage. The marginal child worker is the youngest, since the opportunity cost in terms of foregone education falls as the child ages.

In this setting, a foreign tax imposed on goods produced by children can lead to the social optimum in the sense of internalizing the external effect of child work on the well-being of western consumers. Those children no longer working who receive an education are also better off. However, if, as a consequence of the tax, the newly unemployed children live in a household with lower income, less nutrition, and otherwise diminished life alternatives, the trade sanction has probably been counter-productive. Children who continue to work after the imposition of the tax are definitely worse off, since the firms who employ children have to pay a tax. In a small open economy, a tax must lower the after-tax wage of the working child.

A similar type of analysis can be applied to discrimination

in employment. Suppose, for example, that the supply of female workers is upward-sloping but there is a legally mandated ceiling on the wages paid to female workers in the export sector. A foreign tariff imposed as a sanction against the offending practice will lower the demand for the offending country's exports. By implication, the demand for female labor in the export sector also declines. Since the equilibrium wage for female workers is now lower than before the sanctions were imposed, firms will find it less costly than before to engage in discrimination, thus making discrimination more likely. Women, of course, are made worse off in the process relative to male workers since both their employment and wages have declined.

The foreign tariff will only be successful if the government responds to the threat of sanctions by eliminating the discriminatory practice. However, the threat itself lacks credibility in view of the fact that the tariff harms precisely the group of workers who are already victimized. A threat with such adverse consequences could hardly be credible.

The threat of sanctions will be particularly ineffective if the targeted country simply lacks the resources to respond to the threat. For example, Rogers and Swinnerton (1999) estimate that if GDP per worker falls below \$5020, families are so poor that they cannot survive without contributions to family income from

children. Thus, no matter how intense the demand for a reduction in child labor, child labor practices will continue.

Furthermore, trade sanctions do little to address the underlying market failure that gives rise to offending labor practices. For example, capital market failure arguably lies at the heart of the most egregious forms of child labor exploitation. If parents had access to capital markets, they would school their children while transferring wealth from the future to the present by borrowing against their own future income or the future income of their children (Baland and Robinson, 2000). However, lacking collateral and facing other capital market pathologies, the only device parents have available to them is to put their children to work. The end result, of course, is inadequate human capital formation.

Nor does it appear that legislating labor practices is likely to be particularly effective when standards are not sensitive to local community conditions. For example, Krueger (1996) examines the relationship between mandatory education and the actual age at which children leave school. In 1947, the United Kingdom raised the age at which children could leave school from 14 years to 15.

In 1973 the age was raised again from 15 to 16 years. In both cases, the modal age at which students left school adjusted with the law. By contrast, in Brazil, 80 percent of students leave

school before the age of 13, even though school attendance is mandatory through age 14. In Mexico and Portugal, 25 percent of students leave school before the legal age. More generally, none of the developing countries studied showed a spike in leaving school at the compulsory age for doing so.

The decline in child labor in the United States between 1880 and 1910 suggests a similar pattern (Moehling, 1999). In 1900, twelve states had a minimum age law prohibiting work by children under the age of 14 years. By 1910, 32 states had enacted similar legislation. However, a review of the censuses taken in 1880, 1900 and 1910 suggest that the legislation had little effect on the incidence of child labor.

More broadly, the difficulty in enforcing agreed-upon labor standards has plagued the ILO since its inception. Many countries have ratified ILO Conventions pertaining to both core and other labor practices, but have ultimately lacked the intention or the resources to change their labor market conditions.

For example, many countries that have ratified ILO Conventions pertaining to the right to organize and collective bargaining maintain tight political control over union activity (OECD, 1996). The main union federations in Jordan, Kenya, Singapore and Taiwan are closely linked with the ruling parties.

More extremely, China, Egypt, Iran, Kuwait, Syria and Tanzania

effectively permit only a single union structure and the right to strike is severely circumscribed in many countries.

Thus, while international pressure can lead to the passage of stricter labor law, it is unclear to what extent the newly enacted legislation will change the realities of the labor market in low-income countries. If trade sanctions are actually employed in pursuit of higher labor standards, the effect will often be to hurt precisely those who are the focus of humanitarian concerns. Of course there are some cases in which sanctions by the international community can be brought to bear against some more egregious violations of broadly held humanitarian values. However, the routine use of trade sanctions or the threat of sanctions imposed through the WTO does not seem an especially promising mechanism for helping workers in low-income countries.

#### International Enforcement of Labor Standards

The weight of the argumentation above militates against direct negotiation over labor standards in the WTO, leaving the ILO as the main forum for discussion. Labor rights activists nevertheless argue in favor of some link between the ILO and the WTO on labor issues in order to provide the ILO with enforcement

power beyond its current practice of monitoring and providing members with advice and technical support.

Countries who have ratified ILO Conventions are obligated to regularly report on their compliance activities. In addition, ILO Article 24 allows employer's and worker's organizations to report to the ILO on a state's compliance and under ILO Article 26 another member of the ILO can bring evidence of a state's failure to comply with ratified Conventions. Moreover, Freedom-of-Association complaints can be brought even against countries that have not ratified Conventions 87 and 98. In cases where problems exist with compliance, the ILO begins a consultative process with the Member government, providing technical support and drawing press attention to the matter.

While the ILO may be effective in promoting discussion between workers and Member governments, it has none of the remedies available to members of the WTO. For this reason, linkage between the ILO and the WTO has been suggested as a way of transferring some enforcement power on trade policy to labor standards.

Indeed, it is possible to link two separate issues in a single agreement and, through that linkage, improve enforcement of both issues. Spagnolo (1999) considers the case in which two governments are attempting to cooperate over two separate policy

issues. For our purposes, these two policy issues can be viewed as tariffs and labor standards. Both policy issues are characterized by a prisoner's dilemma; that is, both countries would gain if they could find a sustainable mechanism to cooperate on lower tariffs and higher labor standards, but an inferior outcome emerges in the absence of cooperation.

In a repeated prisoner's dilemma game, cooperation can be self-enforcing if the benefit of defecting in any round of the game is smaller than the cost of the punishment in all succeeding rounds. Thus, one strategy for sustaining cooperation in a repeated prisoner's dilemma game is a "trigger" strategy: cooperate as long as the other party cooperates, but make clear that if the other party ever defects, then there will be no future cooperative behavior. When policy issues become linked in an international agreement, defection on either tariff or labor standards commitments will cause the entire agreement to collapse. Employing linkage to raise the cost of defecting from either tariff or labor standards commitments should help to sustain compliance on both dimensions.

It is important to realize though that linking trade and labor standards could slow the process of trade liberalization. Limao (2000) considers a case in which the international community has found it relatively easy to achieve a nearly-optimal agreement

on tariffs but has had greater difficulty finding a self-enforcing agreement on labor standards. If tariffs and labor standards are linked together, the likely agreement would consist of less trade liberalization but tighter labor standards than would have occurred in a partitioned agreement. Nevertheless, world welfare is higher than in the absence of linkage because the gains from improving the relatively inadequate labor standards are larger than the losses from raising the already close-to-optimal tariff levels.

However, as with most things in economics, the outcome depends on the underlying assumptions. Limao (2000) points out that linkage can become counterproductive in the face of a powerful lobby, which advocates in favor of producers in the import-competing sector. In this scenario, defection on the tariff agreement by raising tariffs makes the import-competing sector larger. The larger is the import-competing sector the greater the gain in producer surplus from subsequently relaxing labor standards. That is, when it comes to cheating, cheating in labor standards and cheating in tariffs are complements when producer surplus in the import-competing sector plays an important role in the political process. The consequent increase in the returns to cheating makes defection on a linked agreement more attractive when compared to two separate agreements. Thus, in this

case, the enforcement power of two separate agreements can be destroyed by linkage.

## Conclusion

There is clearly a trend in global trade talks to extend coverage beyond traditional tariffs, quotas and subsidies. During the Uruguay Round of Multilateral Trade Negotiations, the purview of the GATT process extended well past debate over tariffs to include issues previously relegated to the domestic agenda, such as intellectual property rights, competition policy, and investment regulations. In each case, the argument is that trade policies and domestic policies need to be negotiated simultaneously if all policy tools are to be set optimally.

Labor standards have proved to be one of the most contentious of the domestic policies considered for introduction into the WTO. In spite of the "trade-relatedness" of labor market practices, ultimately, the case for international labor standards mediated by the WTO is problematic.

For those whose goal is to protect the wages of low-skilled workers in high-income countries from import competition, it seems unlikely that trade is the primary factor that has caused the stagnant wages of low-skilled workers in recent decades. Nor does

it appear that harmonizing labor standards is a powerful tool for improving the distribution of income in industrialized countries.

For those concerned with a race to the bottom in labor standards, there is a strong case that efficiency can be achieved without negotiating over labor standards directly. As long as countries are required to adhere to market access commitments made in a round of tariff negotiations, any subsequent change in domestic policy that erodes that commitment must be offset with additional tariff concessions. If GATT Article XXIII is interpreted and enforced in this way, it can be used to short-circuit any motivation for setting labor standards strategically.

For those motivated by humanitarian concern over the plight of workers in low-income countries, it is an uncomfortable reality that trade sanctions leveled against countries with poor labor practices may well hurt the very workers who are the intended beneficiaries. Moreover, it is by no means clear that attempts to use trade sanctions to enforce labor standards will strengthen either trade or labor standards, at least not in a world of strong political lobbies.

Heterogeneous labor standards across the world are a legitimate source of policy concern. But it seems unlikely that the appropriate policy response is to seek a single set of universal labor rules.



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<sup>1</sup> See Engerman (2001) for a discussion of the history of international labor standards.

<sup>2</sup> See in particular the 1818 writings of Robert Owen (Engerman, 2001).

<sup>3</sup> Convention 5 excludes children working with family members.

<sup>4</sup> Not only do families depend on the income earned by their children for survival, in some traditional households, children are bonded to finance a dowry or funeral ceremony.

<sup>5</sup> Specifics concerning the ILO and ILO Conventions can be found at ILO.org.

6. Portes (1994) offers a four-part taxonomy of labor standards: basic rights, which include the rights against the use of child labor, involuntary servitude, physical coercion and discrimination; civic rights, including free association, collective representation and expression of grievances; survival rights, including a living wage, accident compensation and a limited work-week; and security rights, which protect against arbitrary dismissal and provide for retirement compensation and survivors' compensation.

<sup>7</sup> See Basu (1999) for a review of the literature concerning child labor.

<sup>8</sup> In fact, there is considerable evidence that the presence of household assets lowers the probability of child labor above and beyond their impact on family income. See Psacharopoulos (1994) for a discussion.

<sup>9</sup> See Brown (2001) for a review of policies that combine education and capital market reform.

10. The factor content approach relies on certain underlying assumptions that are controversial. For critiques, see Panagariya

(2000), Bhagwati and Dehejia (1994) and Leamer (2000). For a defense of the approach, see Krugman (2000).

11. For discussions of the state of the literature on trade and wages, readers are referred to the "Symposium on Income Inequality and Trade" in the Summer 1995 issue of this journal, with articles by Richard B. Freeman, J. David Richardson, and Adrian Wood. More recently, see Cline (1997), Slaughter and Swagel (1997), Panagariya (2000).

12. Specifically, some possible sources of linkage from labor standards to trade in the WTO, based on the articles of the original GATT, include: the prohibition on dumping products at less than normal value (GATT Article VI); the prohibition on export subsidies (GATT Article XVI); the prohibition on goods produced by prison labor (GATT Article XX(e)); the Nullification and Impairment Provision (GATT Article XXIII); the Opt-Out Provision (GATT Article XXXV); and the Trade Policy Review Mechanism. See OECD (1996) for a detailed discussion.

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