

## **Running on Parallel Tracks? Analysing the Effects of Linking Labour Standards to International Trade**

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### **ABSTRACT**

The purpose of this paper is to review the arguments for and against the linking of labour standards with international trade agendas. Efforts in linking labour standards and trade negotiations in the Western Hemisphere and ASEAN region are highlighted. The study provides a survey of the arguments, both, advocating for and opposing against such linkages. Empirical evidences from past studies found that ratification of labour standards are not related to trade performances. The advocates of the linkage proposed that it would protect the rights of workers in developing countries, while, the opposing parties argued that it is a form of disguised protectionism for developed countries. This paper concludes that a paradigm shift is required to bring both international trade negotiations and labour standard practices together. Recommendations for future study are also provided.

**Keywords:** *Globalization, international trade, labours standards.*

### **Introduction**

As the world undergoes rapid liberalization in trade through increasing exposure to global market forces and competition, it transforms itself into a level playing field for businesses. Globalization was supposed to increase the competitiveness of each country, speed up economic growth and reduce the income gap between the developed countries and the developing countries. As global economic integration has increased—the result of reduced tariffs, dismantling of barriers to capital flows, lower transportation and communication costs, and other factors—many classes of unskilled and semiskilled labor have become more readily substitutable across national boundaries. Globalization, however, has been perceived negatively as it has been viewed to be forging ahead at the expense of the poor, the environment and worker's rights. As restrictions to trade are dismantled, developing safeguards against potentially negative social ramifications of international trade has become more urgent (Flanagan & Gould, 2003). Similarly, issues related to non-trade legislation and policies, such as workers' rights (Peterman, 2001), cross-border movement of goods and services and foreign direct investment flow (Sengerberger, 1990) have come under scrutiny. This is so because issues such as differing labour standards can act as non-tariff barriers to free movement of capital, goods and services (Rodrik, 1996).

Labour carries with it two different aspects. First, from its inception, capitalist enterprises have always treated labour as commodity to be bought and sold at the labour market. Second, workers on the other hand have sought to emphasize its human face- that such commodity cannot be reduced to numbers and statistical figures to be manipulated by the enterprises. The common belief is that more needs to be done if workers conditions are to be improved. If the deterioration of workers' conditions is the result of free trade, then free trade must be reined in and one such method is the imposition of labour standards. In the past decade, labour

standards have become the focus of intense debate among policymakers, international agencies, non-governmental organizations and the general public. Labour right activists argue that countries should be able to agree on universally acceptable human rights principles related to working conditions.

This article attempts to evaluate the arguments concerning the value of introducing and imposing labour standards into the negotiations of the World Trade Negotiations (WTO), since such interaction is likely to be more complex than generally assumed. The relationship between international trade and labour standards needs to be explored from different angles and perspectives in order to understand such complexities. Many economists clearly agree that the improvement of core labour standards is a legitimate objective. However, they frequently consider that the introduction of these standards in trade agreements would be counter-productive; as such an institutional innovation would impede imports from countries having a comparative advantage and, consequently, would slow down their economic growth and social development (Granger & Siroen, 2006).

### **Contribution of the Study**

The paper provides an insight with regard to the inclusion of labour standards in trade agendas for both developing and developed countries. The study also provides examples of how recognition of interplay between international trade and labour standards can contribute to a fair sharing of the gains of globalization and improvement and protection of human rights, resulting from the enforcement of labour standards.

### **Background of Study**

Grandi (2009) opined that the relationship between trade agreements and labour standards is closely linked to the spectacular global changes in the means of productions and labour, through trade liberalization and free movement of capital. The process has a continuous and daily impact on the labour and employment, transforming economies and with it societies across the world.

According to Stern and Terrell (2003) the interaction of labour standards and international trade has become a key issue in the relations between the advanced industrialized and developing countries. Proponents of the international enforcements of labour standards present two lines of arguments. First, organized labour and social activists in the United States and other industrialized countries argue that “unfair” labour practices and conditions exists in many developing countries trading partners and need to be offset by appropriate trading policy. Second, social activists argue that workers in developing countries are subject to exploitative and abusive working conditions, and that their wages are suppressed. Therefore it is difficult for one developing country to fully protect basic worker rights and decent working conditions if others at similar wage levels undercut them. Trade agreements that include protection for labor rights can improve upon the outcomes that any single developing country could achieve. Bilateral trade agreements that include labor protections can produce important improvements in outcomes for the developing country party to the agreement, since the increased access to a rich country market and tariff reductions can offset incentives for producers or buyers to go to other countries that allow labor rights violations but have lesser market access (Polanski, 2003). The proposed solution is for United States and other industrialized countries to take steps to ensure that labour standards are enforced through

mechanisms such as the World Trade Organization (WTO) and bilateral and regional trade agreements.

International Organizations of Employers (hereon to be known as IOE) (2006) stated that the use of labour standards to impact on international trade policies have been around since last century. For instance, at the time of the founding of the International Labour Organization (ILO) in 1919 and the revitalization of the multilateral system following Second World War, concerted efforts were made to integrate the two concepts. In more recent times the last major effort to link the two domains was at the WTO Ministerial Meeting in Singapore 1995. The 1998 ILO Declaration on Fundamental Principles and Rights at Work adopted a parameter of minimum labour principles. These standards were based on basic human rights to be respected in the workplace and there is a widespread consensus that the core labour standards can act as a basis of minimum standards in the workplace, regardless of the level of development of a given country.

However, the broader issue of trade and labour standards still evokes strong views, for instance, governments of developing countries are against such linkages while the governments of developed countries are somewhat divided. Trade unions in developed countries favour such a link, while employers have consistently been against linkages of any kind (IOE, 2006).

### **Definition of Labour Standards**

The term “labour standards” has been used to refer to a wide range of employment laws, regulations and practices including the right to form and join a trade union, the right to collective bargaining, prohibitions on child labour, minimum wages, overtime rates, limitations on hours worked per week, health and safety regulations and prohibitions on forced and slave labour (Brown, 2000).

Though there are several different taxonomies used to categorize labor standards. This paper adopts the definition according to the 1998 ILO Declaration on Fundamental Principles and Rights at Work, which states labour standards as: (1) Freedom of association and the effective recognition of the right to collective bargaining;(2) The elimination of all forms of forced or compulsory labour;(3) The effective abolition of child labour; and (4) The elimination of discrimination in respect of employment and occupation.

The abovementioned definition takes into account the establishment of universal core labour standards that is typically justified on both humanitarian grounds and notions of fair competition in international trade, where, the proponents focus on the harsh working conditions of children, adults and the weak protection of workers’ rights.

### **Current Effort in Linking Labour Standards and Trade**

The efforts to link trade with the rights of workers have taken many different forms. Nkowani (2009) reported that due to WTO refusal to integrate labour standards in its negotiations has led the member states concluding separate trade agreements that integrate workers’ rights such as the generalized system of preferences (GSP) programs and free trade agreements (FTAs). This leads to a proliferation of national (in the case of the USGSP) or regional (in the case of the European Union (EU) GSP) initiatives that seek to measure a beneficiary country’s labour standards compliance by their domestic yardstick. For instance, the USA has included labour standards in the FTAs that it has ratified with Chile and Singapore (July 2003), Australia (June

2004), Morocco (July 2004), Central America and Dominican Republic (June 2005), Bahrain (September 2005) and Oman (June 2006) (Onida, 2008). Kimberly and Richard (2003) also reported other developments in linking trade and labour standards can also be found in the changing conditions set for loans by World Bank and International Monetary Fund (IMF).

### **Labour Standards in ASEAN Region**

According to the Organization for Economic Cooperation and Development (OECD) (2000), there are eight fundamental International Labor Organization Conventions that form the basis of consensus among the ILO's constituents. These include: (1) prohibition of forced labor (ILO Convention No. 29 and 105); (2) freedom of association and protection of the rights to organize and to collective bargaining (No. 87 and 98); (3) equal remuneration for men and women for work of equal value (No. 100); (4) nondiscrimination in employment and occupation (No. 111); and (5) minimum age of employment of children and abolition of the worst forms of child labor (No. 138 and 182).

The ratification of ILO's core labour standards varies considerably, only three ASEAN countries- Cambodia, Indonesia and the Philippines- have ratified all eight. Malaysia, Singapore, Thailand and Vietnam have each ratified five. Laos has ratified only three and Myanmar only two (both before the military takeover in 1962). Brunei has yet to ratify any, having joined ILO only in January 2007. Despite this important progress, there are still shortcomings with regard to enforcement of the standards in some member countries of ASEAN. For example in Indonesia, there are still restrictions with regard to freedom of association, collective bargaining and child labour remains a serious problem. Government policy in Malaysia has inhibited the formation of national unions in the electronics sector, Malaysia's largest industry, with 150,000 workers, because the Government has accorded the companies in the sector with 'pioneer status' (Gupwell & Gupta, 2009).

### **Empirical Evidence of Linkages**

According to Brown (2000) the relationship between the observance of certain core labor standards and international trade performance has been explored empirically by several authors. It is relatively straightforward to perform a simple correlation between measures of core labor standards, their observance and various measures of trade performance. However, this type of analysis tells us little as to the role that core labor standards are playing in determining trade performance. In order 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. Many country characteristics play a role in constructing the expected baseline trade performance. Factor endowments along with other factors including (perhaps) core labor standards, are central to the determination of both the pattern of trade and the volume of trade. Establishing the baseline for each country is a challenge but crucial to obtaining quality evidence.

Mah (1997) analyzes the trade performance of 45 developing countries that are not members of the OECD. In this study, export value as a fraction of GDP is regressed on measures of freedom-of association rights, the right to organize, the right to collective bargaining, prohibitions against forced labor and discrimination in employment and the real interest rate. The labor rights variables are merely a binary index of whether or not a country has ratified the relevant ILO conventions. Mah (1997) finds that each country's export share of GDP is negatively correlated with freedom-of association rights and strongly negatively correlated

with rights to non-discrimination. Exports are also negatively correlated with the right to organize and collective bargaining. The result implies that the ratification of labour standards as embedded in the ILO Conventions does not affect the export performance of both either the richer or poorer group of countries involved in the study. The findings in the study by Mah (1997) is consistent with OECD's (1996) findings in both OECD and non-OECD countries which found that the ratification of core labour standards and trade performances are not related.

Rama and Tabellini (1997) provide an excellent analysis of the relationship between goods market imperfections and labor market standards. In their analysis, product market distortions and labor market distortions are jointly determined. For example, labor market distortions such as a minimum wage are determined as an optimal response to barriers to product competition. In Brown's (2000) view, removing distortions in the goods markets will give rise to an endogenous liberalizing adjustment to labor standards in the factor markets. Thus, suggesting that the problem lies not with the labour standards or the lack of it, but rather the goods market imperfections.

Kuruvilla (1996) carefully documents the connection between export-oriented industrialisation policy and labour relations practices; such union activities, collective bargaining and cost containment policies; in Singapore, Malaysia, the Philippines and India. In each case, labor practices are negatively correlated with a successful stage-one export promotion strategy. Brown (2000) who has surveyed the relevant empirical evidence on wages and trade in the industrialized countries found that there is a preponderance of evidence suggesting, for the US at least, that trade was not the major reason for the observed widening of the skilled/unskilled wage differential. The literature suggests that biased technical change rather than trade may have increased the demand for skilled workers, thus widening the US wage gap. This further suggests that, since imports from developing countries account for a relatively small proportion of total industrialized country imports, trade may more generally have a limited impact on the wages of unskilled workers in the industrialized countries.

Brown (2000) noted, however, that the studies undertaken thus far consider only the economic impact of endogenously determined labor standards. These are standards set within the political and economic context of each country. Therefore, they may or may not provide evidence of the economic consequences of imposing labor standards exogenously, as would be the case if labour standards were imposed as a matter of international law.

### **Debate For and Against Linkages**

IOE (2006) in their report states that the case against linkages could be summed up in two main arguments. First, that market-based economic policies, including openness to international trade and investment, offer superior policy settings for lifting the pace and breadth of economic development in developing countries and are the best means of enhancing labour practices in those countries. Second, the advocates of trade/labour linkages are merely pushing a thinly disguised protectionist agenda and are seeking to deny developing countries the opportunity to realize their competitive and comparative economic and trade advantages and that if restrictions were to be placed on developing countries ability to export their goods then, sadly, it would be the most vulnerable in society that would pay the heaviest price.

At the multilateral level it has been argued that any efforts to formally link trade and international labour standards within international economic law would inevitably encounter a number of substantive legal problems. Prominent amongst these would be the coherence and content of the different legal streams, the different forums (labour standards are the domain of the ILO, while trade law is that of the WTO) and the appropriate forum to receive complaints (again, the ILO or the WTO). The WTO's dispute settlement mechanism was created solely to deal with trade disputes, primarily through the withdrawal of measures that are inconsistent with WTO agreements. The inclusion of labour standards within the WTO *per se*, or as a judicial matter within the WTO's dispute settlement mechanism, would be likely to place excessive strains on WTO members, potentially to the extent of jeopardizing their own commitment to, and membership of, the multilateral rules-based trading system (IOE, 2006).

Brown (2000) writing on a review of trade law by the OECD in an attempt to find ways to link labour standards to existing WTO rules, found that in each case either the low labour standards do not meet the technical requirement of the legislation or WTO does not provide for an enforcement mechanism. Bagwell and Steiger (2000) state that the opponents of the linkages between labour standards and trade warned of the difficulties that will emerge, namely concerns for domestic autonomy, if governments attempt to negotiate trade and domestic policy simultaneously. In the context of labour standards, any country that attempts to undo 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 labour standards onto the rest of the world or to achieve a strategic advantage by altering its labour standards. Critics of international labour standards point out the unfairness of attempting to establish these standards worldwide 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 the same countries will be able to agree on specific language pertaining to labour standards that would then be subject to trade disciplines in the WTO (Brown,2001).

Eric and Nina (2005) point out the sub-standard conditions of workers on tobacco or tea farms in Malawi, children working in sugar plantations in the West Indies and bare foot workers making designer shoes to be sold in the London High Street shops, where, these are not just cheap labour but also cheap human rights. Only that the abuser is possibly a transnational corporation that is bringing foreign direct investment to the country. Therefore, in the case of international trade there need to be a balance between economic and moral legitimacy (Nkowane, 2009).

Proponents of international coordination of core labour standards argue that, in the absence of coordination, each country might lower its own standards to be more attractive to foreign investments or to gain competitive advantage over foreign exporters. An example of this situation is, where, the governments of a developing country may be pressured to loosen labour protections, and so, domestic firms will not be shackled when competing in the international arena (Brown, 2001).

Some favour linking trade with labour standards because it would provide labour enforcement under ILO with a stronger authority that would complement a weak enforcement mechanism under the ILO. However at the procedural level, by including labour standards within the WTO mechanism, will involve the issue of "standing". Standing in the WTO means that only governments can file complaints to the WTO, whereas, under the ILO only trade unions, NGOs and social movement organizations are given the rights to be complainants. The other

relates to the WTO dispute resolution system since WTO places blame on the government and not the offending transnational corporations. It is said that while WTO is investigating the complaint, the offending enterprise can easily avoid trade sanctions and relocate to another country. While this would be an easy task for small firms it would be harder to replicate by a larger firms as it would involve relocation of major investments in technology, personnel and intellectual property rights (Nkowni, 2009).

Countries, too, have an incentive to overprotect their labour. With harmonization of labour standards, wages worldwide will increase, pushing up the price of labour-intensive goods exported by developing countries. Therefore, the change in terms of trade serves the interests of the labour abundant developing countries at the expense of industrialized countries that are physical and human capital abundant (Brown et al., 1996). This analysis does not suggest that labour 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 labour standards given their level of economic development. When labour standards are used to gain strategic advantage over the terms of trade, the outcome will be a welfare-reducing policy where a low-income country surrenders efficiency to bring about higher export prices (Brown, 2001).

### **Implications**

McCrudden and Davies (2000) are of the opinion that even if the theoretical conflict between labour rights and trade can be minimized or eliminated, approaches designed to link trade to the observance of rights may fall foul of WTO rules. The most worrying aspect of this is the conflict between purely domestic laws and WTO rules, where, some regulatory measures may have the effect of making it more difficult for market penetration to take place (McCrudden, 1999). Currently, this effect is more theoretical than immediate, but with the increasing number of complaints to the WTO, and the greater extent to which internal regulatory measures are being challenged, it is reasonable to expect that in time, challenges to national labour law may increase.

However, the question remains that whether there is any reason for global promotion and enforcement of labor standards. In fact, in countries where democracy and social institutions are strong, they are beginning to promote good labor standards as a competitive advantage in attracting multinational corporations with strong brand identities and an interest in “reputation insurance” (Elliot, 2003).

Another rationale for giving higher priority to global labor standards is that political support for the current system of global economic governance is increasingly undermined by the perception that it is unbalanced. Rules protecting trade, capital flows, and intellectual property have progressed much further and faster than rules to protect workers or the environment. If this lack of public enthusiasm in developed countries for multilateral rules and reciprocal negotiations on integration further erodes political support for the international trade system, it is developing countries that will suffer most. Chau and Kanbur (2000) have developed a theoretical model showing how a “race to the bottom from the bottom” can develop, particularly among small countries that cannot affect their terms of trade. This should not be interpreted as meaning that higher labor standards undermine comparative advantage and Chau and Kanbur (2000) note that this dynamic depends on a variety of factors and is not inevitable. For example, Costa Rica, when faced with increasing competition in traditional low-wage sectors, advertised its political stability and high literacy rates to attract foreign investment in electronics and other higher valued-added sectors. In other words, Costa Rica

chose to opt out of the race to the bottom and was able to do so. Cross-country studies also do not show that countries that have low labor standards necessarily grow faster and most show a negative correlation between the level of labor standards and inward foreign direct investment (Rodrik 1996; Morici & Schulz 2001).

### **Conclusion and Recommendation for Future Study**

There is clearly a trend in global trade talks to extend coverage beyond traditional tariffs, quotas and subsidies. Labour 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, the case for international labor standards mediated by the WTO is ultimately 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. 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. 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.

While worldwide harmonized labour standards which is integrated with trade concerns seems to be an ideal system but it is highly unlikely that the proper response is to seek a single set of universal labour rules. It is evident that the assumption taken by most parties as highlighted in this article is that the linkage between trade and labour standards is undesirable, but it is an assumption that must be challenged. The parties involved must also look at the possible benefits that could be derived from such linkage, therefore, a system should be developed where linkage would do more good than harm to the people it intended to protect.

The paper discovers that labour standards and labour rights, in particular, are indeed increasingly present on the socio-economic and political agendas in different regions. It is hereby proposed that future studies should look at the extent of ratifications and enforcement of labour standards at the regional level. Since, the regional level represents a more ideal socio-economic, political and cultural reality as compared to a global platform.

In sum, if the parties involved are desirous that labour standards and international trade agendas run on parallel tracks and at the same speed, they need to shift their attention from sanctions to pressuring governments to adopt concrete, real plans of action for raising labor standards and to provide the financial resources to implement them.

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