Inter-American Development Bank
Banco Interamericano de Desarrollo

Office of the Chief Economist
Working paper #380

Does Latin American & Caribbean unemployment depend on Asian labour standards?

By
Patrick Belser

Institute of Development Studies
University of Sussex

Banco Interamericano de Desarrollo
Oficina del Economista Jefe
Documento de Trabajo #380
August 1998

Paper for the Inter-American Development Bank Seminar:
"Mercado de trabajo: entre la solidaridad y la lealtad".

I am greatly indebted to Adrian Wood and Eliane Darbellay.

Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577

The Office of the Chief Economist (OCE) publishes the *Latin American Economic Policies Newsletter*, as well as working paper series and books, on diverse economic issues. To obtain a complete list of OCE publications, and to read or download them, please visit our Web Site at: http:\\www.iadb.org\oce\32.htm

Introduction

Many Latin American nations have recently implemented liberal trade regimes, often as part of a larger set of market-oriented reforms, and have abandoned their industrialisation policies based on import-substitution. In the 1980s, Chile, Mexico and Bolivia where among the continent's first nations to slash tariff rates and virtually eliminate quantitative restrictions on imports. They were followed little later by many others, including Argentina, Brazil, Colombia, Jamaica, Peru, Uruguay, Venezuela and Trinidad & Tobago. All these countries are now much more exposed to international competition than ever before.

In the context of this new openness to trade, discussions about the international "harmonisation" of a minimum set of labour standards have moved to the forefront of the Latin American policy agenda. There is indeed a growing feeling among many government officials that the continent's high unemployment partly results from "unfair" trade practices abroad. In particular, it is alleged that many East Asian nations deliberately restrict labour rights in order to gain a special competitive advantage, stimulate exports and attract inflows of foreign direct investment. This is why governments in Argentina, Chile or Uruguay have decided to provide some support for a "social clause" in the World Trade Organisation (WTO)[1]. But is this a good idea? Are labour rights really more restricted in export-oriented Asian nations than they are in Latin America? And if yes, are Latin American workers prejudiced by Asia's lower standards? These are the main questions addressed in this paper.

The paper has two objectives. The first, in section 1, is to present a brief description of core international labour standards promoted by the International Labour Organisation (ILO), as well as to provide an overview of the ratification and -when possible- the enforcement of these standards in Asia and Latin America. As pointed out by the OECD Secretariat (OECD, 1996, p.48), it is "difficult to make an overall assessment of the degree of enforcement of core labour standards across countries. Information on this issue is sparse and incomplete. The lack of reliable indicators on enforcement is especially acute regarding child labour, forced labour and non-discrimination in employment". Nevertheless, the evidence that *is* available confirms the intuition that in general the

[1] Such a clause would make it legal for any country to restrict the importation of goods produced by foreign workers whose basic labour rights are not respected.

implementation of labour rights is weaker in Asia -and especially in East Asia- than in Latin America.

The second objective of the paper, in Section 2, is to discuss -and provide some evidence- on possible linkages between labour standards, international trade, and foreign investment. In particular, the paper defends the view that -in theory- there are three plausible ways for weak Asian labour rights to hurt Latin American employment. The first is by increasing Latin American low skilled labour-intensive manufacturing *imports* from Asia; the second is by making Latin American manufacturing *exports* less competitive; and the third is by diverting *foreign investment* away from Latin America. The question of the magnitude of these effects, however, is an empirical matter. And this is why the paper also offers a quick overview of the available -but contradictory and ambiguous- evidence. Finally, policy implications are discussed.

Labour standards and working conditions in Asia and Latin America & Caribbean: a comparative perspective

1.1 Ratification and enforcement of ILO Conventions

The International Labour Organisation (ILO) was created in 1919 by the treaty of Versailles. Its aim is to promote world peace through social justice by encouraging as many countries as possible to ratify and enforce *international labour standards*. These standards - which are designed to establish a minimum level of labour conditions across countries- are codified in 181 "Conventions" that create international legal obligations and which, together, form the so-called "international labour code"[2]. Most Conventions are accompanied by one or more non-binding "Recommendations".

In principle, once international labour standards are ratified they become part of individual countries' set of *domestic* labour rules and laws that are generally written into labour codes or industrial relations acts (Plant, 1994; OECD, 1996). It is thus only insofar as ILO Conventions find a way into countries' national law books that they become part of the normative framework which effectively regulates working conditions and industrial relations. It is important to remember this basic observation because what ultimately determines the economic effects of labour standards is not the ratification of treaties but the implementation of the principles that they embody. This link between the ratification of ILO Conventions and the improvement in labour conditions can be broken in at least two ways: first, labour standards may be quickly adopted but poorly enforced, so that workers in many countries may face bad labour conditions even though the country has ratified many ILO Conventions. This is a widespread problem, especially since there is no mechanism that allows the ILO to take any sanctions. Second, it is possible that workers in a country with few ILO ratifications, like for example the U.S. (which has ratified only 15 out of the 181 Conventions), enjoy decent labour conditions anyway, either because the country has good *domestic* labour regulations or simply because the country is in an advanced stage of economic development.

[2] International labour standards are classified by the ILO itself into no less than 14 categories: basic human rights, employment policy, social policy, human resources development, social security, labour administration, labour relations, conditions of work, employment of women, employment of children and young persons, older workers, migrant workers, indigenous and tribal people, workers in non-metropolitan territories, and particular occupational sectors

1.2 Core international standards and human rights

Recent studies on the globalisation of the world economy have discussed whether free trade should be conditional upon the harmonisation of a certain number of labour standards (see, for example, Bhagwati and Hudec, 1996 or OECD, 1996). Such studies have generally emphasised the distinction between *core* and *non-core* labour standards, reflecting the growing consensus that what should be discussed at the multilateral level, if anything, is the harmonisation of the former type of standards (Langille, 1997; Maskus, 1997). According to the OECD (1996) and to the Declaration of the World Social Summit in Copenhagen, 1995, the minimum set of core -or fundamental- labour rights includes the following principles:

1) the right to freedom of association and collective bargaining
2) the prohibition of exploitative forms of child labour
3) the prohibition of forced labour
4) the prohibition of discrimination in employment and remuneration

All these rights relate, although sometimes imperfectly, to seven fundamental ILO Conventions (see table 1) which, in turn, overlap with principles of Human Rights expressed in the International Covenant on Civil and Political Rights (CPR) and in the International Covenant on Economic, Social and Cultural Rights (ESCR), both adopted by the U.N. General Assembly in 1966[3]. It is often argued that -since human rights are universal- such core labour standards should be enforced throughout the world independently of political, economic, social or cultural factors. It is also sometimes assumed that the respect for these core standards will "pave the way" for the establishment of better working conditions and wages (OECD, 1996).

Table 1: core ILO Conventions

[3] Article 6 of the ESCR indicates that work must be freely chosen; article 7 prohibits discrimination in employment and remuneration, and also recognises to everyone the right to enjoy conditions of work that are just, safe and healthy, with reasonable working hours and periodic holidays; article 8 guarantees the right to form and join trade unions, and to exercise the right to strike in conformity with national laws; article 10 states that children should be protected from economic and social exploitation, and that countries should adopt minimum working age laws.

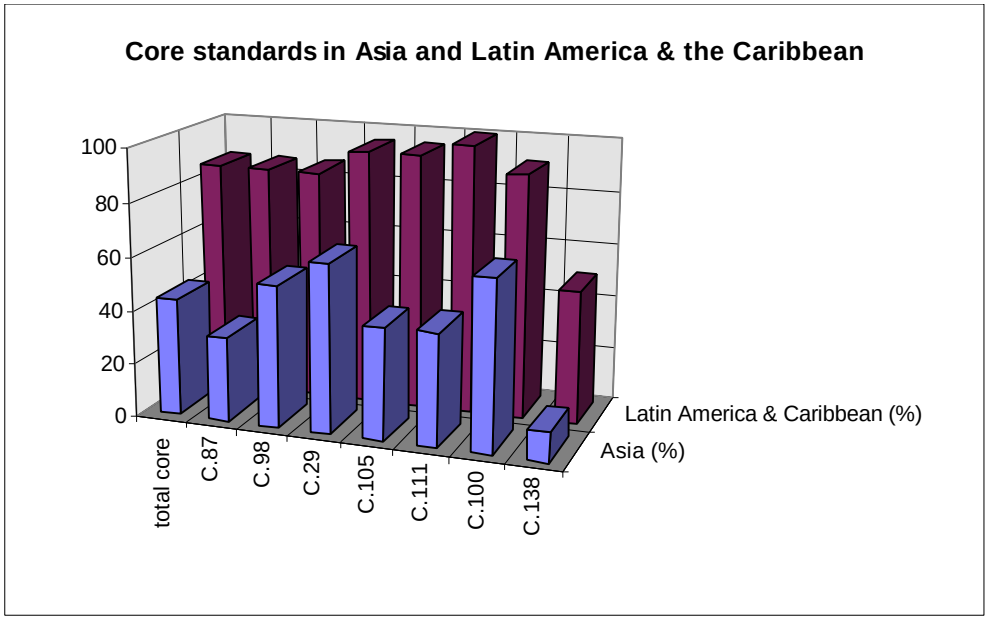
Principle	Main Conventions	Number of Ratifications (by 01.06.1998)
1) Freedom of Association and Protection of the Right to Organise and Collective bargaining	Convention 87 (1948) and Convention 98 (1949)	121 137
2) Minimum Working Age	Convention 138 (1973)	62
3) Prohibition of Forced Labour	Convention 29 (1930) and Convention 105 (1951)	146 130
4) Rights to Equal Remuneration and Prohibition of Discrimination in Employment and Occupation	Convention 100 (1951) and Convention 111 (1958)	137 130

Source: ILO (1998)

Figure 1 (below) shows that Latin American & Caribbean countries have -on average- ratified a much higher proportion of all of the 7 core ILO Conventions than Asian countries. Asian countries (excluding Japan and Central Asia) have on average ratified only 3 out of the 7 core ILO Conventions (44%), compared to an average of 6 out of 7 for Latin American & Caribbean countries (86%). A more detailed picture of the Asian ratification pattern (shown in figure 2) indicates that the East Asian region[4] -which comprises most of the continent's export-oriented nations- has a very low scorecard (36%), while South Asia[5] performs slightly better (60%). Finally, as illustrated in figure 3, the significant difference between the two continents also appears in the ratification rate of *noncore* ILO standards. Latin American & Caribbean countries have basically ratified about 3 times as many ILO Conventions as Asian countries: 52.5 per nation instead of 17.8. The first impression we thus get is that Latin American & Caribbean nations seem to care more about core labour standards than Asian countries. However, as pointed out above, this impression could be misleading. In principle ILO Conventions could be poorly implemented in Venezuela or in the Dominican Republic -which have both ratified 100% of core Conventions- and labour conditions in Korea and China -which have ratified only one Convention- may be better as its low ratification rate suggests. More detailed evidence is therefore offered in the follwing sub-sections.

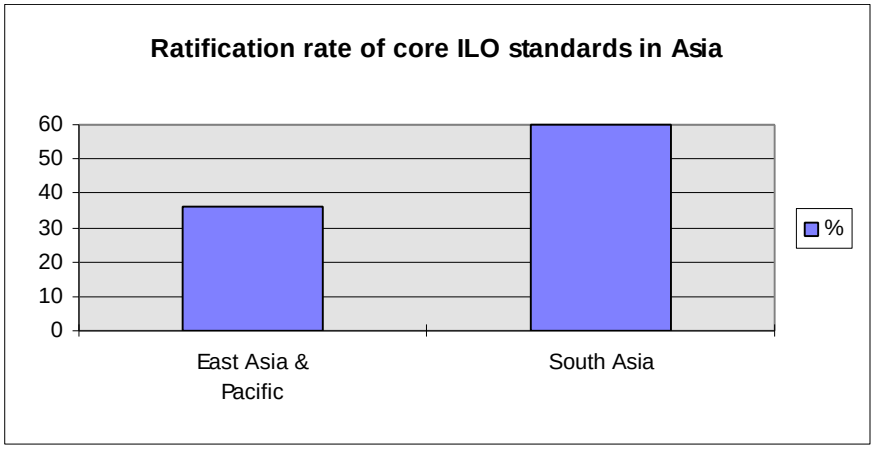
[4] Cambodia, China, Indonesia, Korean Republic, Lao, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Singapore, Thailand, and Vietnam.
[5] Afghanistan, Bangladesh, India, Nepal, Pakistan, and Sri Lanka.

Figure 1



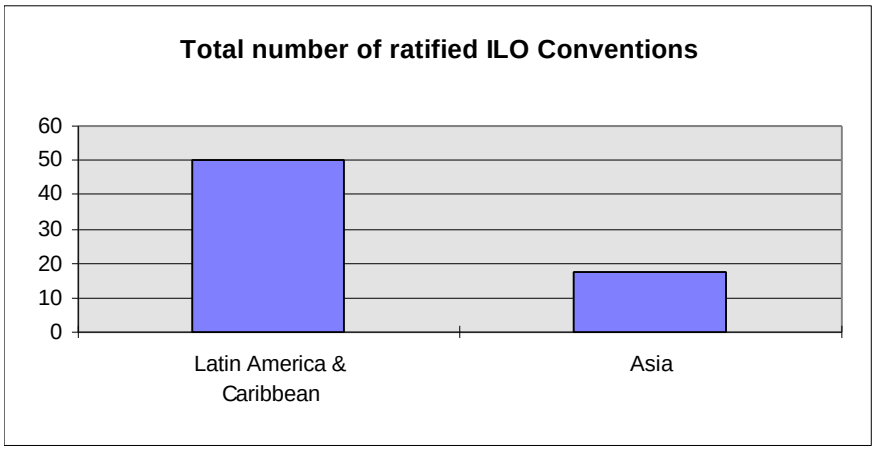
Source: ILO (1998)

Figure 2



Source: ILO (1998)

Figure 3



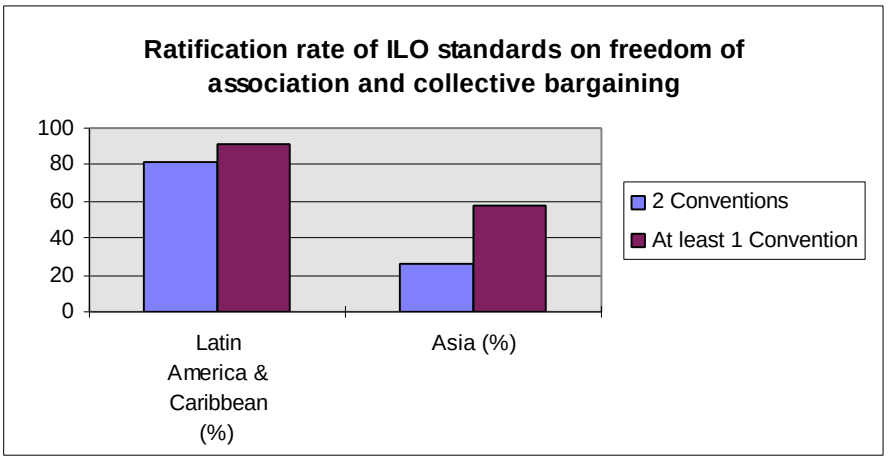
Source: ILO (1998)

1.3 Collective bargaining

Conventions 87 and 98 respectively establish the principles of freedom of association, and of the right to organise and to bargain collectively. Convention 87 guarantees the right for all workers and employers -except members of the armed forces and the police- "to establish and join organisations of their own choosing without previous authorisation" (Article 1). It prohibits "public authorities" from interfering with the right of these organisations "to draw up their own constitutions and rules, to elect their representatives in full freedom, to organise their administration and activities and to formulate their programmes" (Article 2). Even though not directly mentioned, the right to strike has been considered as implicitly covered by this Convention. Convention 98 refers to the horizontal relationship between workers and employers. It stipulates that "workers shall enjoy adequate protection against acts of anti-union discrimination" by employers, like for example the dismissal of union members or any other interference. The two Conventions are thus complementary.

Figure 4 shows the striking ratification pattern for these two ILO Conventions. We observe that 82% of all Latin America & Caribbean countries have ratified both of them, and that 91% of those countries have ratified at least one of the two. This compares very favourably with Asia, where only 26.3% of nations have ratified both Conventions and 58% have ratified one.

Figure 4

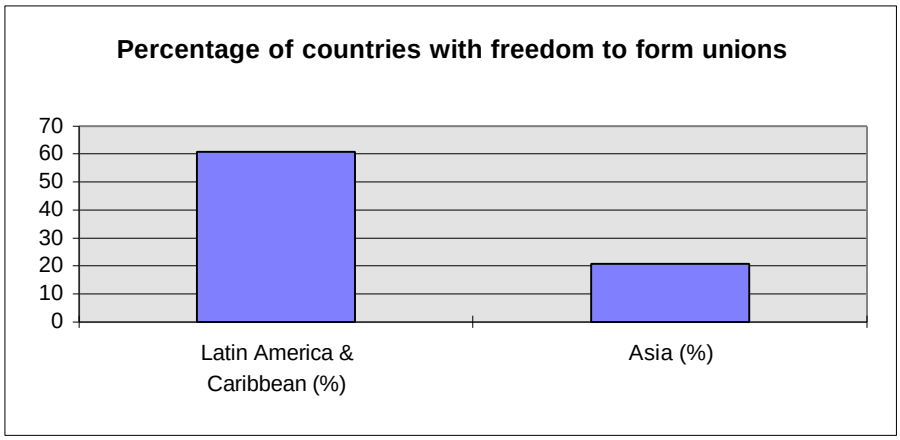


Source: ILO (1998)

As illustrated in figure 5, these differences are not just on paper! They quite strongly reflect the reality of industrial relations in the two regions (even though they somewhat distort the picture in a favourable way for Latin American countries). According to information by the OECD (1996), it is possible to establish more or less independent unions or workers' organisations in 61% of all Latin American & Caribbean countries but only in 21% of Asian countries. This finding confirms the World Bank's view according to which, in East Asia, there is "an active government role in repressing labour organisations" and "although complete bans have been rare, governments have employed extensive definitions of essential industries or services in which organising is banned (often including export processing zones), instituted onerous provisions for union registration, provided weak (or no) protection for union organisers and, in some cases, have been guilty of the most serious human rights abuses against independent labour leaders" (1995c, p.26).

As for Latin America, -where, it has to be pointed out, the situation is still far from perfect- the association between the ratification of ILO Conventions and the practice of industrial relations has clearly improved over time. In many countries, the right to establish free unions is a by-product of the recent democratisation process of the political system and of Constitutional changes that occurred in the 1980s and 1990s. Before these changes, Latin American States typically displayed a high degree of protection for the individual worker, but repressive attitudes towards unions - perceived as communist or anarchist threats (see Bronstein, 1995).

Figure 5



Source: OECD (1996)

1.4 Child labour

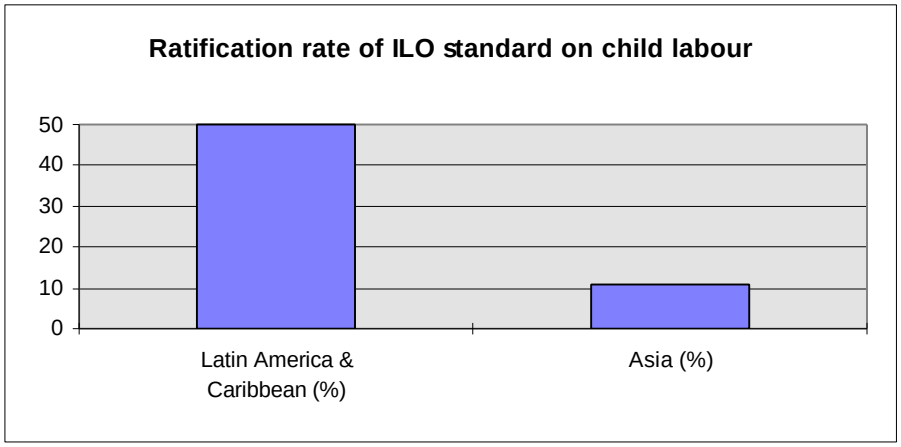
The objective of Convention 138 is to eliminate child labour. It requires signatory parties to set a minimum age for employment that is no lower than the age for completing compulsory schooling. As a general rule, this minimum age should be no lower than 15 -or 14 in developing countries. But for "light work" the age can be lowered to respectively 13 and 12. On the other hand, for hazardous work likely to jeopardise the "health, safety or morals" of young persons the minimum age is generally 18. Convention 138 allows some exceptions for activities which raise special practical problems of application like family undertaking. Note that there is currently no international consensus on whether this ILO Convention really embodies a fundamental labour right. In particular, it is pointed out that the Convention does not distinguish between "exploitative" and "non-exploitative" forms of child labour. This is why the ILO has drafted in 1998 a new Convention focusing on the elimination of "intolerable forms" of child labour. The definitive version of this new Convention should be opened to ratification in 1999, after approval by the 87th International Labour Conference.

Regional differences in the ratification of Convention 138 on child labour are very spectacular. As shown in figure 6, about 50% of Latin American & Caribbean countries have ratified Convention 138 compared with only 11% of Asian countries. However, according to the ILO (1996), national laws in both regions tend to be quite similar. Indeed, even though only few

Asian countries have ratified Convention 138 -often judged too complex and difficult to implement in detail- many governments have adopted restrictions on child labour at the national level. But how well are these laws enforced?

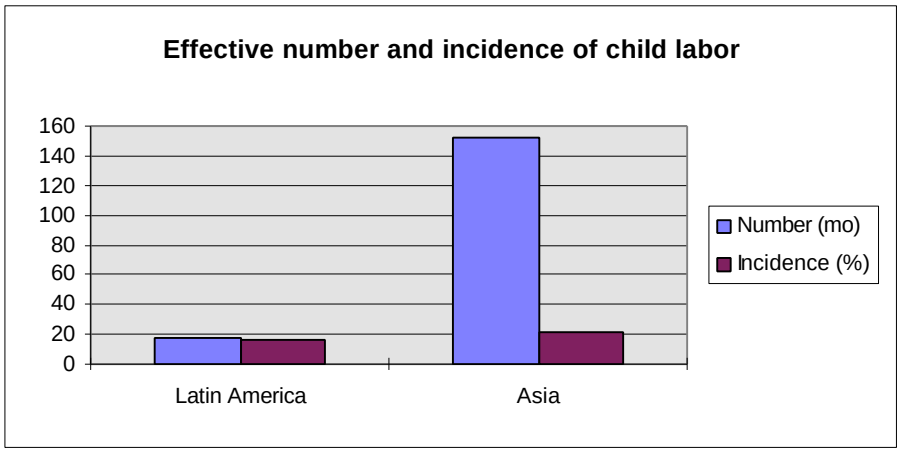
According to the ILO's latest data, there are throughout the world 250 million children between 5 and 14 years old who work -half of which do so full-time. Out of these 250 million, 152.5 million work in Asia and 17.5 million in Latin America. This means that that 61% of the world's working children are found in Asia, compared to 7% in Latin America & the Caribbean (figure 7). This difference in absolute numbers is massive. It reflects to a large extent demographic factors: there are about 10 times more children in Asia than in Latin America. And when comparing child labour *incidence* -the share of child workers as a proportion of a country's total number of children- the difference is somewhat less compelling. Indeed, child labour incidence is only about 30% higher in Asia than in Latin America: 21.1% instead of 16.5%.

Figure 6



Source: ILO (1998)

Figure 7



Source: ILO (1996)

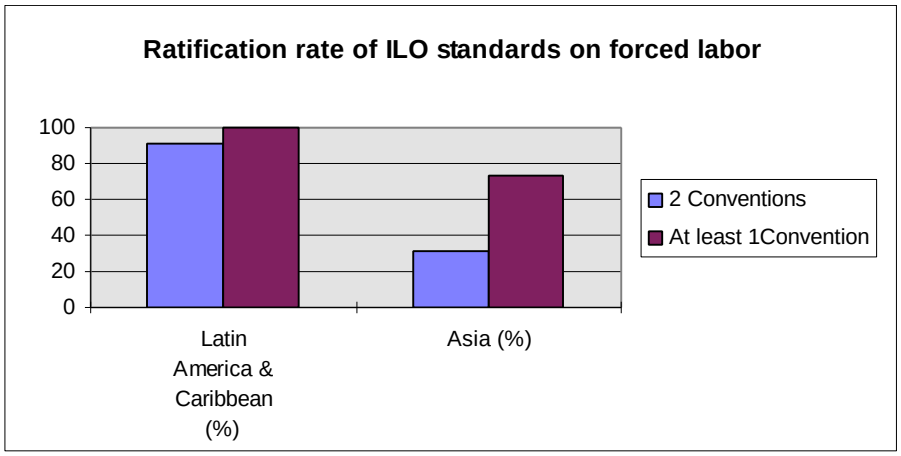
2.5 Forced labour

Conventions 29 and 105 are about the elimination of all forms of forced labour. Convention 29 prohibits labour "exacted from any person under the menace of any penalty, and for which the said person has not offered himself voluntarily" (Article 2), and it stipulates an obligation for State authorities to punish any improper behaviour. The Convention also prohibits prison labour when prisoners are "hired" or "placed at the disposal of private individuals, companies or associations". There is nothing wrong, however, with minor community work, military service, or with prison labour that is carried out "under the supervision and control of a public authority". Convention 105 is about the suppression of politically motivated forced labour, as found in many former Latin American military regimes or socialist countries ("gulags"). It prohibits forced work "as a means of political coercion or education or as a punishment for holding or expressing political views"; "as a method of mobilising and using labour for purposes of economic development"; "as a means of labour discipline"; "as a punishment for having participated in strikes"; and "as a means of racial, social, national or religious discrimination" (Article 1).

Figure 8 shows that in Latin America & the Caribbean 91% of countries have ratified both these Conventions related to the prohibition of forced labour and all countries have ratified at least one of them, compared to only respectively 31.5% and 73% of Asian countries. There is no systematic evidence on the scale of forced labour in the two regions. Anecdotal evidence suggests however that child slavery is more widespread in Asia than in Latin America & the Caribbean. Based on the cases reported to the ILO "Committee of Experts on the Application of Conventions

and Recommendations", the ILO itself considers that "child slavery (...) has long been reported from South and South-East Asia and West Africa, and despite vigorous official denial of its existence it is both common and well-documented" (ILO, 1996, p.15).

Figure 8



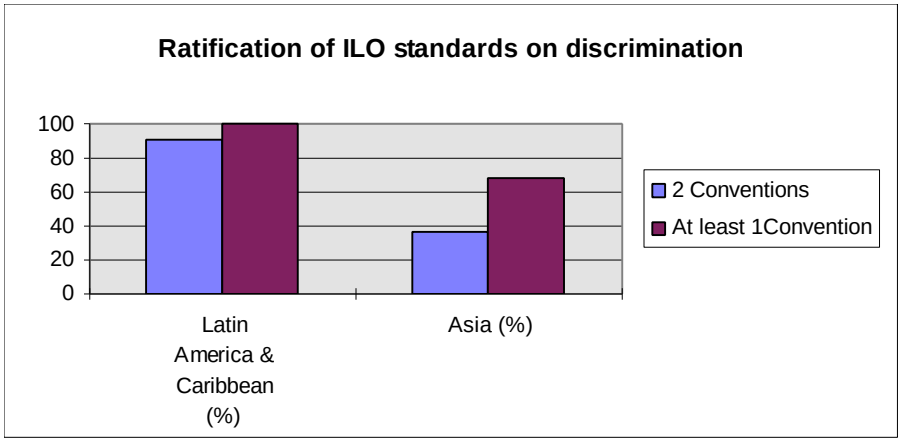
Source: ILO (1998)

2.6 Discrimination

Convention 100 and Convention 111 are about the elimination of *discrimination* in wages and employment. Conventions 100 is very simple and clear. It stipulates an obligation for member countries to ensure that men and women who perform work of equal value receive equal remuneration (Article 2). Convention 111 goes one step further and requires members to "promote" equal occupational and employment opportunities for all individuals, whatever "race, colour, sex, religion, political opinion, national extraction or social origin" (Article 1).

Here again, 91% of Latin American & Caribbean countries have ratified both Conventions and all nations have ratified at least one, compared respectively to 37% and 68% of Asian countries. There is no evidence to confirm that -in practice- discriminations are more frequent in Asian than in Latin American labour markets. According to UNDP (1995) estimates, average wages of women relative to men seem to be relatively similar in both regions. However, women's participation in industry is almost twice as high in Asia (37% of all hours worked) as it is in Latin America (20% of all hours worked), indicating that any possible systematic gender-based discrimination might occur on a larger scale in Asia (UNDP, 1995).

Figure 8



Source: ILO (1998)

Does Asia's weak enforcement of core standards hurt Latin American & Caribbean employment?

2.1 The controversy about the links between trade and labour standards

The tentative evidence presented above indicates that -as a rough generalisation- fundamental labour rights are better guaranteed in Latin American & the Caribbean than in Asian countries. This is unfortunate for the many Asian men, women and children who suffer from the denial of these rights. Is it also -albeit for different reasons- unfortunate for Latin American & Caribbean workers? Does East Asia's weak enforcement of labour rights -given the growing integration of the world economy- hurt working men and women in Kingston, La Paz or Mexico City? The answer to this question depends on whether -and how- labour standards interact with international trade and with foreign investment flows.

Economic research in this area is still rather scarce and controversial. The first major study on the subject was undertaken by the OECD Secretariat in June 1994 and published two years later (OECD, 1996). Its main finding is that core labour standards have a positive effect on economic efficiency and development, but that they have *no* effect whatsoever on international trade or foreign investment. All developing countries are thus invited to respect workers' basic human rights, and Latin American countries are -implicitly- summoned not to care about Asian labour standards and to keep the "social clause" issue out of the WTO. A similar recommendation emerges from a World Bank Policy Research Working Paper (Maskus, 1997).

Such conclusions, however, fly in the face of an old intuition according to which labour standards -and especially the right to collective bargaining (with all its implications)- have at least *some* effect on international trade. The ILO Constitution states that "...the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries" (quoted in Sengenberger, 1994). Similarly, the 1947 Havana Charter of the International Trade Organisation (ITO) -which was intended to replace the General Agreement on Tariffs and Trade (GATT) but was never ratified by the U.S. Congress- declared that "unfair labour conditions, particularly in production for export, create difficulties in international trade" (quoted in Rodrik, 1995).

Even though resource endowment and technology are clearly the most important determinants of trade, it is widely recognised that government policies *can* modify comparative advantage (see, for example, Markusen et al., 1995). Thus, as pointed out by the OECD itself, it is far from unreasonable to assume that the denial of core standards can be used to "prolong or strengthen an existing comparative advantage, and, in some instances, create a new one" (OECD, 1996, p.97). The following sections defend the view that there are three plausible ways for low Asian standards to hurt employment mainly for low skilled workers in Latin America & the Caribbean. The first is by increasing Latin American *imports* from Asia; the second is by making Latin American manufacturing *exports* less competitive in third markets; and the third is by diverting *foreign investment* away from Latin America.

2.2 Latin American imports from East Asia

Because of rich endowment in land and natural resources, Latin America's comparative advantage is in processed and unprocessed primary goods, while East Asia's advantage is in basic manufactures. This is at least the impression one gets when looking at trade data for the two regions. It is indeed a fact of life that Latin American exports tend to include a higher share of processed and unprocessed primary goods relative to manufactures than East Asian exports (Wood and Berge, 1997). How, then, would one expect restrictions on labour rights in Asia to affect bilateral trade between the two regions? The answer is simple. Insofar as such restriction reduce labour costs -and thus production costs- they will lead to an increase in Latin American imports of the now cheaper basic manufactures from Asia (Rodrik, 1995). And as a result, some mainly low skilled Latin American workers will lose their jobs. On the other hand, however, we would also expect a corresponding increase in Latin American exports of processed and unprocessed primary goods towards Asia -and the creation of new employment opportunities in that sector. Overall, low East Asian standards can thus be seen as just another source of trade creation.

Between 1980 and 1994, Latin American imports from East Asia have indeed been multiplied by 8, so that nowadays nearly 10% of all Latin American imports come from East Asia compared with 3.1% in 1980 (UNCTAD, 1996). The main reason for this increase is certainly a reduction in trade barriers among the two regions. But part of this trade expansion may also be due to Asia's low standards. Few trade economists dispute this possibility. What they argue, however, is that such an increase in bilateral trade -whether due to differences in the enforcement of labour

rights or anything else- is *beneficial* for Latin America (see for example Krugman, 1997 or Rodrik, 1995). Traditional gains from trade arise irrespective of the source of trade. Latin America gets an extra opportunity to allocate its resources more efficiently and consumers enjoy a higher purchasing power; they can buy cheap Asian goods instead of more expensive domestic substitutes. But what about employment?

To be sure to reap the gains from trade, countries must fulfil a certain number of conditions which are rarely met in Latin America. In particular, there must be a flexible labour market that is ready to re-absorb workers displaced from import-competing sectors, for example in the expanding primary processing industry. Unfortunately, both the notorious rigidity of the Latin American labour market, and the fact that primary processing is less labour-intensive than basic manufacturing (Owens and Wood, 1997) make such a happy end unlikely. The growing bilateral trade -partly due to Asia's low standards- may thus very well increase unemployment in Latin America[6]. And, if such is the case, the traditional gains from trade must be balanced against the losses associated with the non-utilisati on of a part of the country's human resources.

3.3 Latin American exports to third markets

North-South manufacturing trade models generally consider that the North has a comparative advantage in technology and skill-intensive products, while the South has an advantage in low skilled labour-intensive goods (see for example Wood, 1994). In such a framework both East Asia and Latin America are generally considered as part of the South. Indeed, apart from land and natural resources, the two regions have similar factor endowments: most workers have only a basic level of education but a fairly-well developed infrastructure (Wood, 1997a). Thus, *within* the manufacturing sector both regions tend to specialize in the same kind of low skilled labour-intensive products (textiles, clothing, footwear, electronics, etc...). In Argentina and Colombia, for example, these products of medium and low skill intensity account for about 80% of *manufacturing* exports (Londero and Teitel, 1996). The implication is that -as globalization proceeds- one would expect both region to expand their exports of labour-intensive manufactures to the North -providing many new job opportunities for the low skilled in the formal sector and reducing unemployment.

[6] According to Krugman (1997), this is a second-best argument in the sense that it would be more efficient for Latin American countries to remove the source of their labour market rigidity than to reduce trade with East Asia.

In 1990, however, Latin American countries exported only 11.6% of all manufacturing exports by developing countries, compared to 82.7% by Asian countries (Page, 1994). This means that, in export markets, Latin American firms have been "outperformed" by Asian companies. There are certainly many reasons for this. But it is conceivable that the weaker enforcement of labour rights in East Asia is one of them. Indeed, by allowing Asian companies to enjoy "artificially" low production costs, it is possible that low standards -just like a currency devaluation- have induced third countries to import more of their labour-intensive manufactures from Asia rather than Latin America. This is very unfortunate for at least two reasons. First, because it reduces Latin America's real income and makes it hard for the continent to follow the World Bank's advice to diversify its exports away from natural resources into basic manufactures (World Bank, 1995a). Second, because it reduces demand for Latin American low skilled workers, and thus -given the continent's already mentionned labour market rigidity- increases unemployment and the size of the urban informal sector.

It is essential, at this stage, to notice that the suppression of labour rights in a group of developing countries increases the competitiveness of that group's exports only at the expense of nations with a *similar* export structure. Indeed, exported goods must be substitutable. This means that OECD firms -which tend to specialise in a more technology and skill-intensive brand of manufactures- are *not* affected by Asian labour standards in the same way than Latin American countries are. The only way weak Asian labour rights affect OECD countries is by reducing the price of its imports, improving its terms of trade. This points to the fact that the *South-South* dimension of the international trade and labour standards issue is even more thorny than the *North-South* dimension of the question.

2.4 Foreign direct investment, the race to the bottom, and export processing zones

Since the end of the 1980s, FDI *flows* to developing countries have increased impressively. According to the World Bank (1996), developing countries' share of global FDI has risen from 12% in 1990 to 38% in 1995. This is because new technologies and cheaper transports have led to the spread of *vertical integration* in manufacturing; affiliates of multinational companies are no more only replicas of the parent companies, producing for the local market, but are increasingly becoming a specialised part of the multinationals' production chain. In other words, OECD firms are shifting their low skilled labour-intensive activities -especially assembly work- to poor countries where

labour costs are low. Such a "delocalisation" of part of the production process is designed to reduce costs and keep multinationals competitive in world markets. A well-known example is the assembly-based investment of U.S. companies in Mexican maquiladoras. Most of vertical integration is concentrated in traditional manufactures like textiles, garments and electronics. But, more recently, delocalisation has also gained importance in high-tech electronics industries, like semiconductors.

Such mobile -or "footloose"- industries can be readily competed for by many developing countries and the slightest advantage can be determinant in attracting them. In recent years, most of the dramatic increase in the flow of foreign direct investment to developing countries has been directed towards Asian and not Latin American countries. Asia's share of such flows has moved up from form 15.3% in 1980 to 56.4% in 1994, while Latin American countries' share has fallen during the same time from 71.9% to less than 25% (De Mello, 1997). Here again, there are certainly many reasons for this trend. But one of these may be that multinationals tend to set up affiliates in countries where labour standards -and therefore production costs- are lower, increasing the rate of returns to investment. In other words, the absence of labour rights may divert foreign investment -and employment creation for low skilled workers- away from Latin America. As a result these nations will also enjoy less of the benefits generally associated with foreign investment, among which technology transfers, improvement of workers' skills and management techniques, increased demand for domestic inputs, and higher tax revenues (Maskus, 1997).

Note that it is often feared that that international competition for capital could trigger a "race to the bottom" among developing countries, which is a situation where nations compete for foreign investment by restricting labour rights. It is true that any country which has a pre-existing tendency to attract little capital might have an incentive to lower its labour standards (Krugman, 1997). International harmonisation of labour standards would be useful to make sure that such an outcome is avoided. Especially since the simple *fear* by governments that high standards may discourage foreign investment may lead to the decision to restrict labour rights (Wilson, 1994).

This is especially true in *Export Processing Zones* (EPZ), which now exist all over the developing world. Such special zones are clearly major actors in the intra-South competition for foreign investment. In 1990, about 50% of multinational companies' total employment in developing countries were located in EPZs, providing typically between 60% and 80% of jobs within such regions (OECD, 1996). In EPZs, restrictions of collective bargaining rights are frequent and most of

the work is performed by non-unionised women (Maskus, 1997 and OECD, 1996). Moreover, when labour laws are not restricted governments often fail to enforce them properly. This however seems to be as true in Latin America and Caribbean countries as it is in Asia. However, the overall impact of such practices may be of more consequence in Asia -where 64% of world-wide EPZ employment is located (OECD, 1996) and where EPZs account for much of the manufacturing export growth.

2.5 Empirical evidence

The above sections have explained how in principle Latin America may suffer from low East Asian labour standards. But in the end, the extent to which international differences in labour standards affect the competitive position of nations is an empirical issue, on which much more research is certainly needed to reach a consensus. This section presents a quick overview of the main -generally contradictory- evidence available so far.

● *Does the implementation of labour standards increase unit labour costs*[7]*?* This is a critical question for if standards do not affect labour costs -and thus production costs- there is no reason why they should have any effect on trade or foreign investment. Available evidence is ambiguous. Rodrik (1995), using cross-country analysis with data on labour costs for 40 countries (and controlling for productivity), finds that labour costs tend to increase *significantly* as standards become more stringent. Rama (1995) also uncovers a positive -though small- association between a country's number of ILO ratifications and the annual growth rate of labour costs in the manufacturing sector. As for Seguino (1997), she contends that in Korea the average female wage is typically about half the average male wage. Assuming that 20% of this wage difference reflects gender-based discrimination -as seems to be the case in the U.S. (see Filer et al., 1996)- it is possible to infer as a very rough approximation that gender-discrimination reduces employers' labour costs by about 10%. This may have an important impact on production costs, especially when considering that in Korea all the largest export-oriented industries are female dominated: they form 72.9% of all apparel employees, 62.5% of all textiles employees, and 52.6% of electronics employees (Seguino, 1997)!

The OECD (1996), on the other hand, finds no correlation at all between freedom of association and labour costs. This last result is, however, rather surprising. It is indeed well established that -within countries- unionised workers receive higher wages than non-unionised

[7] "unit labour costs" are labour costs per unit of production

workers, and that as a result of collective bargaining average unit labour costs in low skilled labour-intensive activities typically increase by about 5%-15% (Filer et al., 1996). Such activities are precisely the ones that account for most of developing countries' exports. As for child labour, the ILO (1996) contends that in it generates a labour cost savings (as a share of the product's final price) of about 5% for bangles and 5% to 10% for carpets.

● *Do labour standards affect trade patterns and export performance?* An increase in unit labour costs should in principle translate into an increase in the price of a country's goods on international markets -unless there is a corresponding currency depreciation. Thus, if labour standards affect labour costs, they should also affect trade flows. But here again evidence is contradictory. The OECD (1996) finds that no clear relationship exists between labour standards and sectoral trade patterns or export performance (i.e. the share of manufacturing exports in world trade). Indeed, consistently with its findings that standards have no effect on labour costs, the OECD finds that prices of U.S. textile imports from developing countries are rather uniform. This, so the OECD, suggests that differences in the degree of freedom of association plays little role in the determination of export prices and thus export performance. According to the Secretariat of the Paris-based institution, most of the low to medium-income countries have exhibited export dynamism irrespective of their level of core labour standards. It recognises that some countries where freedom of association has recently been strengthened (Argentina, Korea, and Taipei) have suffered a loss in export competitiveness, but reckons that this was mainly due to labour shortages and currency appreciation -both of which pushed up manufacturing labour costs in the 1980s. Other studies contradict the OECD's view.

Mah (1997), for example, shows that the ratification of ILO core Conventions -apart from the Conventions on forced labour- worsens *developing* countries' export performance (as proxied by the value of exports/GDP). In such countries, he finds that it is especially the ratification of the Conventions on freedom of association and non-discrimination that *strongly* deteriorates export competitiveness. By contrast, the negative effect of ILO Conventions on exports is not found in developed countries. Presumably this is because they are specialised in skill and technology-intensive products -in which the share of labour cost in production cost is much lower than in labour-intensive sectors and in which competition is based on product differentiation rather than on pure price competitiveness. Similarly, Rodrik (1995) finds that -even though not very strong- his empirical results are supportive of the hypothesis that low standards can help create a comparative

advantage in labour-intensive goods such as textiles and clothing. In accordance with Mah's results, he finds that this is mainly true for countries with a GDP/capita smaller than 6,000 U.S dollars.

● *Do labour standards affect the location of foreign investment?* Here evidence is made of 2 pieces. First, there is some evidence that labour *costs* determine the location of multinationals within the developing world. Indeed, empirical research confirms the intuition that labour costs are a statistically significant determinant of foreign investment -especially in labour-intensive and export-oriented industries (for a quick summary of the literature on the determinants of foreign investment to low-income countries see ODI, 1997). This is confirmed in two recent studies by Brainard and Riker (1997a and 1997b). They find that *within* multinationals labour demand in each affiliate is related to the cost and demand conditions of other affiliates owned by the same firm. For example a 10% fall in Mexican labour costs typically leads U.S. multinationals to reduce their Malaysian workforce by 1.6%. In the electronics industry, in particular, a 10% decline in wages in one developing country leads to an 3.7% employment increase in the affiliate located in that country, and a 6.3% fall in employment in affiliates located in other developing countries. These results suggest that it is indeed the case that workers in developing countries compete with each other to perform labour-intensive work, and that standards -insofar as they affect labour costs- have the power to shift employment from one developing country to another.

Second, some (few) studies have tried to assess directly the effect of labour standards on foreign investment flows. Here the evidence is not only very scarce but also once again ambiguous. The OECD (1996) finds that empirical evidence on the links between FDI and core labour standards "remains open to different interpretations" and concludes that "while core labour standards may not be systematically absent from investment decisions of OECD investors in favour of non-OECD destinations, aggregate FDI data suggests that core labour standards are not primary factors in the majority of investment decisions of OECD companies (...). In these circumstances, host countries may be able to enforce core labour standards without risking negative repercussions on FDI flows" (pp.123-124). The problem, unfortunately, is that the OECD study fails to distinguish between two types of foreign investment: local-market oriented investment within OECD countries (which still represents the majority of FDI flows), and cost-saving North-South investment (discussed above). Rodrik (1996), when restricting the sample to developing countries, finds a weak but positive relationship between low labour standards and inflows of foreign investment and concludes that labour standards do affect foreign investment (p.21). Here again, much more research is certainly needed to settle the debate.

2.6 A "social clause" in the World Trade Organisation (WTO) ?

For the sake of the argument, let's assume three things: a) low Asian labour standards do have an effect on trade and foreign investment flows; b) this is bad for Latin American nations because it increases unemployment among low skilled workers. How, then, could Latin American countries convince East-Asia's export-oriented nations to ratify *and* enforce more of the ILO's core Conventions? The first option, as always, is to apply diplomatic pressure and use the force of persuasion. A second option -which would need to be carefully assessed and whose evaluation is outside the scope of this paper- is to provide (or continue to provide) support for the introduction of a "social clause" in the World Trade Organisation.

Such a "social clause" would make it possible to restrict imports of goods produced abroad under conditions that violate the principles embodied in core ILO standards. As pointed out by Maskus (1997), there are three main routes for introducing labour standards in the WTO. The first is an expansion of Article XX which states a few general exemptions to the basic rule of non-discrimination. Article XX(e), in particular, permits WTO members to unilaterally ban imports made by prison labour. It would in principle be easy to extend this possibility to goods made by bonded children, discriminated women, or by workers who are unable to bargain collectively. A second route would be to extend the interpretation of Article VI so as to treat the lack of respect for basic labour rights in export sectors or in EPZs as a form of "export subsidisation" or "social dumping" to which countries could respond in the same way as they respond to other forms of "dumping": through countervailing duties (Rodrik, 1995; Charnovitz, 1992). Finally, the third route would be to negotiate a separate multilateral agreement that would make it compulsory for WTO members to enforce basic labour rights. In case the agreement is violated any WTO member could invoke Article XXIII and call for the suspension of trade benefits.

Of course, the introduction of a social clause in the WTO is very controversial, and many counter-arguments have been advanced. The first problem with a "social clause" is its possibly discriminatory use. Indeed, the threat of trade restrictions is very much an instrument of power politics in international relations. And as such, a "social clause" -if opened to unilateral action- can be expected to be used mainly by powerful nations to induce weaker countries to implement better standards. Even though most countries would certainly be quick to act against Fiji, there is little perspective for action against China. Such a problem could be avoided only if it is agreed that the

suspension of trade benefits has to be decided multilaterally at the end of an agreed dispute-settlement process. The second problem -pointed out by many governments in developing countries- is that the "social clause" could in principle be "hijacked" by import competing lobbies. Such groups would make use of a "social clause" with the unique intention to raise tariffs against export-oriented countries and destroy their comparative advantage. In the words of Bhagwati (1994, p.60): "blue protectionism is breaking out, masked behind a moral facade". But one must be careful not to exaggerate this danger. Intelligently implemented, a social clause could probably avoid such an outcome. As pointed out by Freeman (1996, p.14), this protectionist argument is a little bit a "red herring" in this debate. Finally, the third problem is that such a clause may be used against Latin American countries themselves in case their own enforcement of standards is judged unsatisfying. Indeed not all of the continent's nations enforce core labour rights in an entirely satisfactory way. The case of Uruguay provides a nice illustration of the problem. Indeed, while the Uruguayan trade minister supports the introduction of labour standards in the WTO, the OECD Secretariat (1996) considers that it is impossible to establish independent workers' organisation in that country. If the OECD conclusion is still true today, pressing for a social clause is really a shot in one's own foot since Uruguay may be the first country against which the new "social clause" might be used. .

In any case, the introduction of such a clause in the WTO would require the negotiation of a new legal framework, unanimously approved by member countries. Given the strong opposition by many Asian countries[8] as well as by some industrialised countries[9] it is unlikely that such a clause be adopted soon. So far the only step forward was made during the 1994 Marrakech Ministerial meeting, where a commitment for further deliberation on this issue within the WTO was agreed on. During the 1996 Ministerial Conference in Singapore, however, Ministers have affirmed their support for core standards but have ruled out further work on this issue in the WTO. They have also rejected the use of trade measures to enforce labour rights. But ignoring the issue will presumably not make it go away.

Concluding Remarks

This paper has discussed the issue of Asia's "unfair" competition to Latin America, based on the observation that fundamental labour rights are better enforced in the Latin America. This is

[8] In particular: Indonesia, Japan, Malaysia, Thailand, Philippines, HongKong, India, and Pakistan

obviously a very big generalisation. Some Latin American & Caribbean countries still have a long way to go before labour rights can be considered as appropriately guaranteed. According to the OECD (1996), it is for example impossible to establish free unions in Bolivia, Colombia, Guatemala, Haiti, Honduras, Panama, or Uruguay. There is no apparent reason why the denial of the right to freedom of association and collective bargaining in those countries should not also be considered as "unfair competition" to Latin American countries or -indeed- to Asian countries with higher standards.

This being said, the connection between labour standards, trade, foreign investment and employment is one of the most controversial issues in academia. And there is no doubt that much more research is needed, especially on the *South-South* dimension of this issue. This is because there is a strong likelihood that labour standards differences divert trade and foreign investment mainly *among developing countries*. And if there is a danger of a "race to the bottom" it is thus probably mainly within the South. This is somewhat ironical since -in the terms of Bhagwati (1994, p.57)- the issue is currently "resurrecting the North-South divide that afflicted the world economy in the late 1970s". Indeed, most of the public debate and much of the research has so far focused on the role of labour standards in trade and investment flows between industrialised countries and the developing world. This reflects the presumption that the North is the main victim of the South's low labour standards. But this is almost surely wrong. The countries that suffer the most from the weak enforcement of core labour rights in China or Indonesia are almost certainly other developing countries with higher standards. These are the countries which should find it in their interest to support some form of international harmonisation of labour standards.

[9] Among others: Australia, New Zealand, Great Britain, Germany and Spain

Bibliography

Bartolomei de la Cruz H., and Euzéby A. (1997). *L'Organisation Internationale du Travail*. Presses Universitaires de France, Que Sais-Je?, Paris.

Belser P. (1996), "North-South Integration and Labor Markets: Can a Social Clause Protect OECD Workers", University of Sussex, unpublished.

Belser P. (1997). "Globalization, Consumers and Working Conditions", *Background paper for the Human Development Report 1998*, UNDP, New York.

Bhagwati J. (1994). "A View from Academia", in Swinnerton K. and Schoepfle G., eds., *International Labor Standards and Global Economic Integration: Proceedings of a Symposium*, Washignton, DC., U.S. Department of Labor, Bureau of International Labor Affairs.

Bhagwati J. and Hudec R. (1996), eds., *Fair Trade and Harmonization*, MIT Press, Cambridge, Massachusetts.

Bhagwati J. (1996), "The Demands to Reduce Domestic Diversity among Trading Nations", in Bhagwati J. and Hudec R., eds., *Fair Trade and Harmonization*, MIT Press, Cambridge, Massachusetts

Brainard L. and Riker D. (1997), "Are U.S. Multinationals Exporting U.S. Jobs?", *NBER Working Paper No. 5958*, National Bureau of Economic Research, Cambridge, Massachusetts.

Brainard L. and Riker D. (1997b), "U.S. Multinationals and Competition from Low Wage Countries", *NBER Working Paper No. 5959*, National Bureau of Economic Research, Cambridge, Massachusetts.

Bronstein A. (1995). "Societal Change and Industrial Relations in Latin America: Trends and Prospects", *International Labour Review*, vol. 134, No.2.

Brown D., Deardorff A., and Stern R. (1996). "International Labor Standards and Trade: A Theoretical Analysis", in Bhagwati J. and Hudec R., eds., *Fair Trade and Harmonization*, MIT Press, Cambridge, Massachusetts.

Charnovitz S. (1992). "Environmental and Labour Standards in Trade", The World Economy 15 (3), pp. 335-56, 1992

Charnovitz S. (1997). "Recent Developments in the Trade and Labor Standards Debate", Yale University, unpublished.

De Mello Jr, L. (1997), "Foreign Direct Investment in Developing Countries and Growth: A Selective Survey", *The Journal of Development Studies*, Vol.34, No.1, October.

Ehrenberg R. (1994). *Labor Markets and Integrating National Economies*, The Brookings Institution, Washington, DC.

Filer R., Hamermesh D., and Rees A. (1996). *The Economics of Work and Pay*, Sixth edition, Harper Colins, New York.

Freeman R. (1993), "Labor Market Institutions and Polices: Help or Hindrance to Economic Development" in Summers L. and Shah S., eds., *Proceedings of the World Bank Annual Conference on Development Economics 1992*, The World Bank, Washington, DC., 1993.

Freeman R. (1994). "A Hard-Headed Look at Labor Standards", in Swinnerton K. and Schoepfle G., eds., *International Labor Standards and Global Economic Integration: Proceedings of a Symposium*, Washignton, DC., U.S. Department of Labor, Bureau of International Labor Affairs.

Freeman R. (1996). "International Labor Standards and World Trade: Friends or Foes?", Institute for International Economics, Conference on WTO, 1996.

International Finance Corporation (1994), "Exporting to Industrial Countries: Prospects for Businesses in Developing Countries", *Discusion Paper 8*, Economics Department, Washington D.C.

International Labour Organization (1996). *Child Labour: Targetting the Intolerable*. International Labour Office, Geneva.

International Labour Organization (1998). *Liste des Ratifications par Convention et par Pays. Rapport III (Partie 2)*. International Labour Office, Geneva.

Krueger A.B. (1997), "International Labor Standards and Trade", in Bruno M., and Pleskovic B., eds., *Annual World Bank Conference on Development Economics 1996*, The World Bank, Washington, DC.

Krugman P. (1997), "What Should Trade Negotiators Negotiate About?", *Journal of Economic Literature*, Vol.XXXV, March.

Langille B. (1994), "Labour Standards in the Globalized Economy and the Free Trade/Fair Trade Debate" in Sengenberger W. and Campbell D., eds., *International Labour Standards and Economic Interdependence*, International Labor Office, Geneva, 1994.

Langille B. (1997). "Eight Ways to Think About International Labour Standards", Paper presented at the Graduate Institute of International Studies, Geneva.

Londero E. and Teitel S. (1996). "Industrialisation and the Factor Content of Latin American Exports of Manufactures", *Journal of Development Studies*, 32(4); pp.581-601

Mah J. (1997). "Core Labour Standards and Export Performance in Developing Countries", *World Economy*, September.

Markusen J., Melvin J., Kaempfer W., and Maskus K. (1995), *International Trade: Theory and Evidence*, McGraw-Hill, New York.

Maskus K (1997). "Should Core Labor Standards be Imposed Through International Trade Policy", *Policy Research Working Paper 1817*, The World Bank, Washington, DC.

OECD (1996). *Trade, Employment and Labour Standards: a Study of Core Worker's Rights and International Trade*, Paris.

ODI (Overseas Development Institute) (1989), "Labour Standards or Double Standards? Worker Rights and Trade Policy", Briefing Paper.

ODI (Overseas Development Institute) (1997), "Foreign Direct Investment Flows to Low-Income Countries: A Review of the Evidence", Briefing Paper (3), September.

Owens T. and Wood A. (1997). "Export-Oriented Industrialization Through Primary Processing?", *World Development*, Vol.25, No.9, pp.1453

Page S. (1994). *How Developing Countries Trade; The Institutional Constraints*, Overseas Development Institute, Routledge, London.

Plant R. (1994), *Labor Standards and Structural Adjustment*, International Labor Office, Geneva.

Primo Braga C., Noguès J., and Rajapatirana (1997), "Latin America and the Caribbean in the World Economy" in *Poceedings of the Annual World Bank Conference on Development in Latin America and the Caribbean 1995: The Challenges of Reform*, World Bank, Washington D.C.

Rama M. (1995), "Do Labor Market Policies and Institutions Matter? The Adjustment Experience in Latin America and the Caribbean", *Labour Review of Labour Economics and Industrial Relations*, Special Issue.

Reich R. (1994). "Keynote Address" in Swinnerton K. and Schoepfle G., eds., *International Labor Standards and Global Economic Integration: Proceedings of a Symposium*, Washington, DC., U.S. Department of Labor, Bureau of International Labor Affairs.

Todaro M. (1997). *Economic Development*. 6th edition, Longman, New York

Rodrik D. (1995). "Labour Standards and International Trade: Moving Beyond the Rhetoric", first draft, Columbia University, unpublished.

Seguino S. (1997). "Gender Wage Inequality and Export-Led Growth in South Korea", *The Journal of Development Studies*, Vol 34, No.2, December.

Sengenberger W. (1994), "Labour Standards: An institutional Framework fro Restructuring and Development, in Sengenberger W. and Campbell D., eds., *Creating Economic Opportunities. The Role of Labour Standards in Industrial Restructuring*, International Institute for Labour Studies, Geneva

United Nations Development Programme (1995). *Human Development Report*, New York, Oxford University Press.

UNCTAD (1996), *Handbook of Trade and Development Statistics*, Geneva.

Wilson, J.D., "Capital Mobility and Environmental Standards: Is There a Theoretical Basis for a Race to the Bottom", in Bhagwati J. and Hudec R., eds., *Fair Trade and Harmonization*, MIT Press, Cambridge, Massachusetts, 1996

Wood A. (1994) *North-South Trade, Employment and Inequality; Changing Fortunes in a Skill-driven World*, Clarendon Press, Oxford.

Wood A. (1995). "How Trade Hurt Unskilled Workers", *Journal of Economic Perspectives*, vol 8 no 3, Summer.

Wood A. (1997). "Openness and Wage Inequality in Developing Countries: The Latin American Challenge to East Asian Conventional Wisdom", *World Bank Economic Review*, vol. 11. No.1.

Wood A. and Berge K. (1997). "Exporting Manufactures: Human Resources, Natural Resources, and Trade Policy", *The Journal of Development Studies*, vol.34, No.1, October

World Bank (1995a), *World Development Report 1995: Workers in an Integrating World*, Oxford University Press, New York.

World Bank (1995b), "Labor and Economic Reforms in Latin America and The Caribbean", *Regional Perspectives on World Development Report 1995*, Washington DC.

World Bank (1995c), "Involving Workers in East Asia's Growth", *Regional Perspectives on World Development Report 1995*, Washington DC.

World Bank (1996), *World Debt Tables*, vol. 1, Washington D.C.