In Defense of Globalization

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Wages and Labor Standards at Stake?

Marx was famously wrong when he predicted the progressive immiseration of the proletariat.[1] The real wages and living conditions of the working classes improved over the span of the nineteenth century, reducing the squalor that has been captured for posterity by social critics such as Chadwick and Hegel and by writers such as Dickens.[2] Marx got the effects of accumulation under capitalism wrong: it can, and often will, raise wages by increasing the demand for labor. But the improvement in working conditions was a result of social legislation such as the Factory Acts of England, which paved the way for the protection of workers.

Anti-globalizers fear that Marx is striking again: that, thanks to globalization, his prediction of falling wages is finally coming to pass. Labor unions in rich countries fear that trade with poor countries with low wages will drive down the real wages of their own workers and produce paupers in their midst. They also sense a threat to their labor standards, achieved through well over a century of anguish and agitation, as trade with poor countries with lower standards intensifies and some multinationals are seen to move to these low-standards locations, "taking jobs away." The resulting pressure to lower standards produces in this view a race to the bottom as these rich countries abandon their high standards to ensure competitiveness.

These fears appear plausible, no doubt about it. Yet the facts strongly suggest that they are not supported by evidence. Most studies of the real wages of workers assign to trade at best a small fraction of the decline in real wages in the 1980s and much of the 1990s. I will argue here the stronger proposition that trade has actually helped the workers, not just harmed them insignificantly, by moderating the decline that was

instead caused by technical change that economized on the use of unskilled labor.

At the same time, there is no evidence for a race to the bottom. The reality is that political pressures have developed instead for imposing higher standards, whether appropriate or not, on the poor countries. So we witness paradoxically, as is demonstrated in this chapter, what is in fact a race to the top.

Globalization and Workers' Wages

It is certainly possible that closer integration by the richer nations with the poor countries, with a more abundant supply of unskilled labor, will depress the wages of the richer countries' workers. What is the intuition behind this fear? It makes sense to assume that lower prices for labor-intensive goods, among which textiles and shoes are obvious examples, brought about by imports from the poor countries, should translate into lower wages for labor. Therefore, one can legitimately regard trade with poor countries as an *indirect* way in which their impoverished masses will drive down our wages, just as their emigration to our countries will do it *directly*.

As it happens, this parallel between the effects of free immigration and of free trade in goods found an echo in political debates over immigration policy in the last century. It is interesting to recall the fierce debate that broke out in England over the proposed immigration legislation in 1905 that would have created quota restrictions on immigrants in response to the "alien invasion" by Central European Jews of London at the end of the nineteenth century. In that political fracas, the free-traders were also free-immigrationists, while the immigration restrictionists were also trade protectionists.

This intuitive parallel with immigration, which makes trade with poor countries a cause of concern by the labor unions seeking to protect their members' earnings, was also manifest in the firestorm that broke out in the United States over the inclusion of Mexico in NAFTA in the early 1990s. The influx of impoverished Mexicans across the Rio Grande— the so-called peso refugees, many illegal migrants—had already provoked calls to curtail that flow in order to safeguard American workers' wages and working conditions. The prospect of NAFTA raised similar objections: imports from Mexico would also have this adverse impact on American workers.

So while some thought that trade would improve Mexican prosperity and cut down on Mexican emigration to America eventually, many

others, including the labor unions and influential Democrats such as Richard Gephardt and David Bonior, were concerned instead with the immediate pressure on American workers' wages that they expected from NAFTA. And, in a throwback to the English debate at the end of the nineteenth century, some opposed NAFTA and simultaneously proposed tougher immigration control measures.

Available evidence makes it difficult, however, to argue that trade with poor countries has been responsible for the stagnation, perhaps even a decline, in the real wages of workers in the rich countries, particularly in America. Several economists have examined this question, and the overwhelming majority, including Paul Krugman of Princeton (now a fiercely liberal *New York Times* columnist) and Robert Lawrence of Harvard, are agreed that the role of trade with poor countries in depressing wages is small, perhaps even negligible. But even they give too much away. If the evidence is examined somewhat closely, it can be argued that trade with poor countries is likely to have *improved* wages, in the sense that it has moderated the decline that would have occurred due to non-trade-related factors, chiefly labor-saving technical change.

To understand why, remember that this fear follows from the fact that the poor countries export labor-intensive goods such as textiles, garments, shoes, and toys to us. If the prices of these goods fall in trade because of increasing supplies from the poor countries, this will trigger a decline in the reward to unskilled workers: an intuitive effect, as explained earlier, going from lower prices of the goods produced to lower real wages of the workers producing them.[3] Thus the key issue is whether the prices of such goods have actually been falling, triggering the declining real wages.

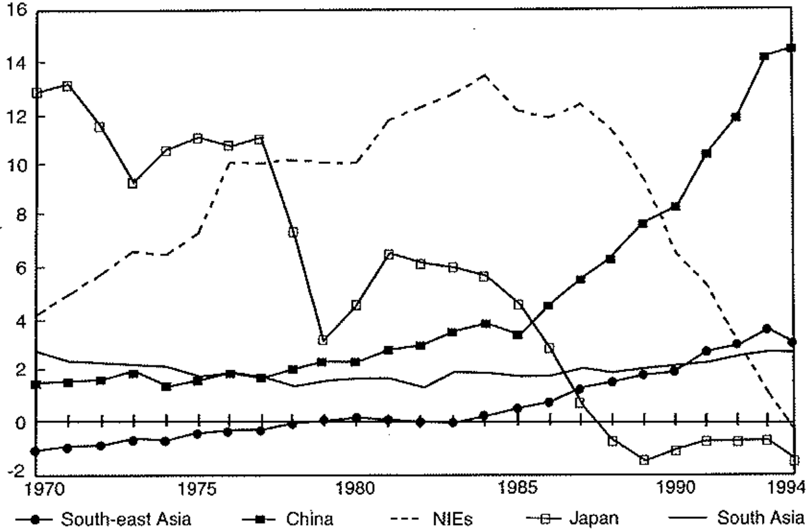
Here the evidence really does not support the assertion. During the 1980s, when the real wages of American workers were stagnant, the prices of the labor-intensive goods as a group actually rose relative to the prices of the set of all other goods in world trade. And their prices actually fell during the 1970s, when American real wages, defined both as compensation per worker and as the less satisfactory average hourly earnings (which do not include non-wage benefits), rose.[4]

What happens to the prices of these goods depends on a host of factors that affect the production and consumption of those goods, chiefly in the poor countries. If their production rises faster than consumption, the effect is to increase exports of these goods. Increased exports, in turn, will reduce the world prices of these goods . The factors that affect production include capital accumulation and technical change. Economists have demonstrated that both these constituents of growth tend to reduce the production and hence the exports of labor-intensive goods.

Capital accumulation increases the supply of capital and therefore creates an extra incentive to producers of capital-intensive goods. Technical change will do the same since it is concentrated in practice in industries producing capital-intensive goods, and technical progress there tends to pull in resources from the less progressive industries that typically produce labor-intensive goods.[5] Therefore, the rapid accumulation of capital and absorption of technology in the Far East and then in the Near East have led to a progressive fall in the relative prices of labor-intensive goods, rather than in their rise, as feared by the unions.

The common mistake is to assume that trade in labor-intensive manufactures will result in exports from one poor country being piled on top of those of another in an endless process that would make them come like gangbusters into the markets of the rich countries, depressing prices and lowering real wages. In truth, because of technical change and capital accumulation in the countries that are growing out of the poor-country ranks (e.g., East Asia in the 1970s and 1980s), the entry of new exports of labor-intensive manufactures by poor countries is offset by the withdrawal of exports of labor-intensive manufactures by the rapidly growing erstwhile poor countries. The latter group of countries become exporters of capital-intensive manufactures and importers of labor-intensive manufactures instead. Therefore, the *net* exports of labor-intensive manufactures to the rich countries grow far less dramatically than if one conjured up the image of everything piling on, burying the rich countries in an avalanche of exports. The fear that the "yellow peril" (as the phenomenon of rapidly expanding exports from Japan was described in the 1930s) would be joined by the "brown peril" and eventually by the "black peril" as poor countries emerged as exporters of labor-intensive manufactures is belied by the fact that the "yellow peril" is *replaced* by the "brown peril," and so forth. International economists have long understood this phenomenon empirically, calling it the phenomenon of ladders of comparative advantage.

This more comforting picture is exactly what the Australian economist Ross Garnaut showed in 1996. Thus in the chart below one can witness how East Asia steadily increased net exports of labor-intensive manufactures in the 1970s while Japan (whose income had been growing rapidly) reduced them. The same pattern repeated itself in the period from 1980 to 1994, when the net exports of East Asian countries (the NICs, newly industrializing countries) declined from over 10 percent of world trade in labor-intensive manufactures to nearly zero, while China went in a crossing diagonal from around 2 percent to over 14 percent. The difference between the two leaves a greatly reduced net impact on what Garnaut calls the "old industrial countries," the rich nations, on average.



Ration of net exports to world imports of labor-intensive manufactures, East and South Asia 1970–94 (%). *Note:* South-east Asia includes ASEAN (including Singapore) and Vietnam; NIEs include Taiwan, Hong Kong, Korea, and Singapore; and South Asia includes India, Pakistan, Bangladesh, and Sri Lanka. *Source:* UN trade data, International Economic DataBank, The Australian National University, prepared by Ross Garnaut.

A recent empirical study by the economists Robert Feenstra and Gordon Hanson examined the effect on real wages of unskilled American workers as a result of outsourcing (i.e., buying components from other producers instead of producing these components oneself) to foreign suppliers of labor-intensive components in U.S. manufacturing during the period 1972–90. This study also concluded that the effect of such imports of labor-intensive goods for producers (rather than as goods for consumers, such as textiles and shoes), much of it also from poor countries, actually *raised* the real wages of the workers.[6]

So the principal cause of worry for the unions and their political allies, that a trade-driven fall in the (relative) prices of labor-intensive manufactures, whether of consumer goods or of outsourced components, will drive down the real wages of workers in rich countries is not compelling. Nor are other trade-related explanations that have been produced for this pessimistic scenario. Thus, for instance, it has been argued that labor-saving technical change, which is the real culprit, is itself induced by international competition faced by labor-intensive industries and the pressure on wages there. But think about it a little. If wages are declining, then induced technical change is likely to bias the search

for technology in a direction that will use *more,* rather than less, of the cheapening labor. But the problem for real wages of the unskilled workers comes from labor-*saving* technical change.

In short, the contention that trade with the poor countries will produce wage declines in our midst is not compelling when examined: the underlying premises do not square with the facts.[7] Moreover, if we shift the focus of our analysis to how protection as presently practiced actually affects workers, we get yet another picture that portrays protection as harmful to workers. Current protection in the United States seems particularly aimed at lower-end consumer goods (such as flip-flops) that have virtually gone out of production in the United States by now and where the net effect on our workers' well-being comes not from the effect on their wages in employment, but overwhelmingly from their role as consumers.

The further findings on this question by Edward Gresser, reported in *Foreign Affairs,* are startling: "Tariff policy, without any deliberate intent, has evolved into something astonishingly tough on the poor. Young single mothers buying cheap clothes and shoes now pay tariffs five to ten times higher than middle-class or rich families pay in elite stores."[8] The removal of these tariffs would destroy this highly differentiated and inegalitarian tariff structure, which undercuts the real incomes of the poorest consumers and therefore of the working class.

Race to the Top, Not to the Bottom

The fear that the labor standards in the rich countries will be corroded by trade with, and investment in, the poor countries bothers workers and unions as much as the fear of an induced decline in wages. They are afraid that, faced with international competition or threats of employers to leave for locations where the standards are lower, employers will successfully manage politically to persuade governments to revise labor (and environmental) standards downward. Again, this seems likely, but does it happen systematically?

It generally does not seem to, at least if you look at recent American experience. Two examples suggest skepticism, if not rejection, of the race-to-the-bottom hypothesis. Take the fiercely competitive garment industry, where the politically active Union of Needletrades, Industrial, and Textile Employees (UNITE) operates. Its former president, Jay Mazur, and the current president, Bruce Raynor, have been strong proponents of the race-to-the-bottom view. But there is no evidence that this competition has led to a decline in labor and safety standards in the garment

district in New York City, for instance. It is true that there are many sweatshops in the garment district. But the causes of these low standards, in violation of legislated standards, are twofold: the appalling lack of enforcement (because of a dearth of inspectors through the 1980s and 1990s) for the industry nationwide, and the presence of illegal immigrants who cannot demand legislated rights because of fear of deportation. In fact, if the degree to which standards actually fall below the legislated standards in these sweatshops has increased in the last two decades, it is surely likely to reflect the increased bipartisan agreement on introducing greater domestic enforcement (including through the use of employer sanctions) against illegal immigrants—an illiberal consensus that included the union movement itself until just recently![9]

As a contribution to the growing NAFTA debate, the General Accounting Office conducted a study of furniture firms faced with tough lead paint regulations in California and their migration across the Rio Grande.[10] The GAO estimated that a small fraction of wood products firms had moved, and concluded that their responses to questions concerning what profit-making factors had induced them to leave for Mexico were quite mixed.[11] Nonetheless, this study was widely cited at the time as evidence suggesting that a race to the bottom in lead paint regulations would follow. But a phone interview with the South Coast Air Quality Management District, southern California's agency responsible for regulation of air quality, elicited the response that emission control standards for paint coatings and solvents had "never been relaxed."[12] Evidently, the widely held perception that California's strict lead paint restrictions would induce furniture firms to cross the Rio Grande had led to no downward revision of these restrictions.

But there is little doubt that during the Reagan and first Bush administrations the Republican view that regulation had gone too far created in the public mind the fear of a race to the bottom. As scholars of the subject have noted, if you wished to deregulate for reasons that had nothing do with international competition (e.g., if cost-benefit analysis implied there was too much regulation, or if there was an ideological preference for deregulation), the smart thing nonetheless was to say that you were suffering from competition from rivals elsewhere who were less regulated.

President George H. W. Bush created in 1989 a Council on Competitiveness.[13] The council, which was headed by Vice President Dan Quayle, was intended to continue the work of the Council on Regulatory Relief, a task force that had been chaired by Bush during the Reagan administration.

The history of this council awaits careful research. But available materials indicate that its major deregulatory efforts appear to have been justified in cost-benefit terms rather than on grounds of improved competitiveness. Cost-benefit arguments were used in its many brushes with the Environmental Protection Agency on issues such as the burning of lead batteries and the softening of development restrictions on wetlands. It is hard to find significant examples where the council successfully reduced environmental or labor standards by invoking improved international competitiveness as a key reason.[14]

Recall also that if one is concerned about the decline in labor standards that might follow from the downward trend in the United States over more than a quarter century in the degree of unionization of the labor force, down by now to less than 10 percent in the private sector, globalization has not had much to do with it. It has far more to do with the draconian Taft-Hartley anti-labor legislation that goes back half a century. Under that legislation, the ability to use the strike as a weapon was seriously curtailed: sympathetic strikes by unions outside the industry were restricted, and the ability to hire replacement workers (scabs) was protected. This crippling of the right to strike, many union activists conclude, led to ineffective unions, as a union without adequate ability to strike is almost like a tiger without teeth.[15]

The political scientist Daniel Denzer, himself no captive of corporate interests nor a foe of unionism, wrote recently, in an influential article in *Foreign Policy*, that the public use of the phrase "race to the bottom" was a popular rhetorical device with negligible basis in fact.[16] Indeed, in a recent article in *Foreign Affairs*, Robert Ross and Anita Chan abandon the notion that the North suffers from a race to the bottom because of competition from the South, and try to shift focus to the notion of a race to the bottom within the South itself, producing no real evidence in support of such an intra-poor-countries race to the bottom either, plausible as it sounds.[17] Nor are they correct in implying that concern with the race to the bottom is now behind us in the rich countries. If only it were true!

Economists have also tried to get at this question from another angle. They have asked if there is evidence that multinationals are partial to investing in poor countries that have weak protection of workers' rights to unionize and to enjoy a safe workplace. Consider first, however, whether lower wages (as distinct from lower worker standards) are a magnet for investors. One needs to be careful and not just look at wages; they must be adjusted for labor productivity differences because lower wages may simply reflect lower productivity. The studies that do this adjustment, though they are focused not on poor countries but rather on investment flows among the rich countries or among different states within the United States, show that (productivity-adjusted) wages do matter to corporations that are considering where to invest.

But evidence also suggests that this is only one of many factors determining location decisions by multinationals.[18] The question of interest here, however, is whether the other factors affecting the locational decision of the firms include lower worker standards. Interestingly, cross-sectional analysis—that is, analysis of a number of countries at one point in time—of the outward investment by U.S. corporations shows that the greater the extent to which ILO workers' rights conventions are ratified by a country, the greater its share of U.S. investment tends to be.[19] Of course, the United States has in truth a better record on workers' rights, no matter how defined, than China; but China has ratified more conventions than the United States because the U.S. political and legal scene requires that ratifications lead to real obligations, whereas in China it does not. So ratifications are not a good guide to what protections exist for workers in reality. Analysts at the ILO have also found that higher unionization rates are associated with higher investment inflows, whereas fewer episodes of repression of rights of collective bargaining and association also go with higher inflows.[20] In fact, much of the other international evidence on whether the location of multinationals reflects attraction to the absence of high standards and particularly on whether multinationals use technology that is less environmentally friendly in locations where there are lower environmental standards, also shows that this is not a significant issue.[21]

In short, the evidence suggests that multinationals, generally speaking, do not go streaking to where labor rights are ignored or flouted. If true, this suggests a lack of empirical support for the notion that multinationals, by moving to where workers' rights are violated, encourage their violation by the poor governments seeking to attract those companies.

Why, then, is the race to the bottom, so easy to imagine and dread, not the dragon it is feared to be by the anti-globalization activists? For two reasons, one having to do with the economic behavior of multinationals in poor countries and the other, much the more important, relating to the political behavior of the unions and their allies in rich countries. The former (discussed at great length in Chapter 12 alongside several critiques of multinationals) is simply that just because lower standards exist in the poor countries, it does not follow that multinationals will take advantage of them. The gains to be made by doing so can be outweighed by several economic factors. Take just reputational effects. The multinationals, which account for an overwhelming percentage of direct foreign investment in the poor countries, cannot afford to be seen to dump dangerous effluents into the waters or into the air or treat their workers badly. With incipient or even full-blown democracies in many poor countries, with the growth of NGOs, with CNN

and the BBC everywhere, the ability of multinationals to do something legal but offensive in terms of widely shared morality is seriously diminished. The reputational consequences of profiting from host-country laxity are sufficiently serious today to outweigh for many multinationals the extra profits that might be made by the "taking advantage" strategy.[22] Whether this means that legislative safeguards are not important is of course another matter, one of appropriate governance, which I turn to in Chapter 17.

Much the more important reason why a race to the bottom has not occurred lies instead in the fact that the effects of pressures from trade and outgoing investments on our standards are simply not substantial enough to undo the gains we have made after decades of political action. Our institutions are simply too strong to permit this. The unions, even though weaker than they were, and the environmental groups, which are stronger than ever, are politically active, not ciphers, and the Democratic Party sees them as core constituencies. Anytime rollbacks of regulations are sought on any grounds, the pro-regulatory bulbs light up and the political activists go to work. This is seen in energetic agitations against rolling back regulations on wetlands, on cutting down forests, and on the ability of unions to finance electoral campaigns of pro-union candidates for Congress and the presidency from general union dues. And while the anti-regulatory forces are abundantly financed by business lobbies such as the Chamber of Commerce and associations for specific industries such as logging, this is matched by two advantages that favor the pro-regulatory groups: their cause resonates with the public as socially responsible, and they substitute their labor for the capital they are short on, ringing doorbells, using the Internet, and working the political circuit with fervor and energy. On issues such as the rights of labor and the protection of the environment, the labor-intensive strategy has been demonstrated to be the more effective one in analysis of California referendums on such issues.

So American standards remain generally unaffected by the race to the bottom. But, paradoxically, the politics then shifts to a race to the top. Worried about international competition from producers in poor countries who have lower standards, the unions then turn to *raising* standards in these countries. Seen as a political ploy to moderate competition from rival suppliers abroad, this can be described as a form of "export protectionism" or "intrusionism," where you virtually force the exporters into accepting measures that raise their cost of production and hence cut down on their competitiveness. This is, in fact, what importing countries do when, not desiring to resort to import protection, they get the exporting countries instead to adopt export restraints (ironically called "voluntary" export restrictions), as was done, for example, when the Japanese

were persuaded to limit exports of their cars to the United States to 2.2 million units in the early 1980s or face the imposition of import barriers. That export restraints are ways of reducing trade as much as import barriers are is best seen through analogy. Faced with a charging beast, you may hold it by its horns, much as import restraints do in trade, or you may reach behind the beast and catch it by its tail to break the charge, much as export restraints and forced raising of standards and hence of production costs in exporting countries do.

What is remarkable about this political process, where our lobbying groups seek to capture our all-too-powerful government to push for higher standards abroad, is that it is couched in the potent language of fair trade. They argue that we should not have to compete with, and lose to, others with lower standards. In short, we want to be virtuous but not have to pay for it! To see the morally unattractive nature of this position, consider what would happen if the United States were a closed economy. Suppose then that we raise our labor standards and ask polluters to pay. In that case, the industries that use a lot of labor and the polluting industries will contract. This is only the flip side of our labor and environmental policy choices. But when it comes to an international economy, the labor and environmental lobbies want to have the higher standards *and* not to lose the industries! In their frantic desire, they are willing to walk over the exporting countries and force on them standards that may not be appropriate or may be different from what would be desirable from their own perspective, which is often democratically determined. It is not surprising, therefore, that this political posturing by our labor and environmental groups is occasionally seen in poor countries, including by some unions and environmental NGOs there, as a kind of neo-imperialism![23]

In fact, the politics of protectionism can manifest itself in the domestic setting of the high standards themselves. Cynics go to the length of arguing that where high standards are imposed on traded goods, such as air bags in cars (as distinct from standards on how cars are produced), and are automatically extended to imported cars, the motives may be precisely to reduce the competitiveness of rivals abroad. This is because it may be more expensive for foreign car manufacturers to retool themselves for air bags.

Different Reasons for Seeking Higher Standards Elsewhere

But if it is not a race to the bottom but a race to the top (with the goal of moderating competition) that we observe, and if the poor countries

generally resist this race, which they see as a dagger aimed at their export competitiveness, there are still other, moral and altruistic (rather than egoistical or self-serving competition-reducing) reasons that higher standards are sometimes sought abroad by some in the rich countries.

First, for some standards, the issue is simply one of morality, not competitiveness. If, say, goods are produced anywhere with child labor, I may not want to consume them, no matter that they are cheaper when produced in the poor countries, because I believe that they are immorally produced. Thus I may refuse to sup with the devil even though the consequence is that I miss a free meal! My position here is *not* that I am seeking with my action to produce higher standards abroad. I may well believe that my action will have absolutely no effect whatsoever on the use of child labor abroad. Yet I abstain from participating in consuming goods that use child labor, to satisfy my own conscience.

If this is the moral argument, then all it can imply is that I should have the ability in the marketplace to choose goods made without the use of child labor. This suggests that if sufficient numbers of people who think like me are willing to pay more for their principles, then positive labeling will become feasible. The Germans helped to develop the label Rugmark, which goes to firms producing rugs without the use of child labor. The new organic product label in the United States is yet another example. Somewhat differently, firms may advertise, and get a reputation for, their goodness in certain respects, catering to the moral preferences of their intended customers; this is what Ben & Jerry's does in its production of ice cream, as does the Body Shop chain of personal care product stores.

The advantage of this, as against negative labeling where goods are marked "made with child labor," is that negative lists bring with them many difficulties. They can tar a wide range of behaviors, of greatly varying degrees of offensiveness, with the same brush. The mere accusation that child labor is used, without addressing questions such as how the children are treated, whether they work just a few hours and then are escorted to school, and so on, makes it unlikely that an informed moral choice will be made. Further, a negative list would be enormously expensive and administratively difficult for poor countries to administer. Indeed, often the exports from these countries are in primitive bottles and packages where the labels would be harder to affix and may not be fully legible, whereas positive labels are more likely to be applicable to better-endowed and better-equipped firms.

But the moral argument also takes a more common form: the standards are often sought to be extended to poor nations on grounds of altruism. Thus one may take the position that, even if no trade with

Mars or outflow of investment to it could occur and hence no race to the bottom need be feared, green men from Mars should not put green children to work. One's motive may entirely be interplanetary empathy and concern for children everywhere. There is undoubtedly some of this sentiment underlying the demand for standards to be raised in the poor countries. Often the policy recommended to bring this about is the use of sanctions, chiefly trade sanctions inserted through what is now called "linkage" of standards with trade liberalization and inclusion of standards in trade treaties and trade institutions. The inadvisability of such sanctions, and the use of more efficacious non-coercive methods to advance standards worldwide are considered in Chapter 17.