Chapter 8

International Trade and Labor and Environmental Standards
Chapter Objectives

• Discuss the remaining obstacles to international economic integration: national laws, regulations, and standards

• Analyze the relationship between trade flows and labor standards, and between trade and environmental standards

• Examine the usefulness of utilizing trade measures, such as sanctions, to enforce certain standards
Introduction: Income and Standards

• Since the end of World War II, many of the formal barriers to trade have been removed.

• However, unfettered flow of trade and deepening integration are still hampered by differences in:
  – National laws and regulations
  – National technical, health and safety, environmental, labor standards, etc.

-These are often adopted for domestic reasons without consideration of the effects on trade.
Setting Standards: Harmonization, Mutual Recognition, or Separate?

• Most trade agreements and WTO commitments allow for the combination of:
  – **Harmonization of standards**: Two or more countries adopt a common set of standards
  – **Mutual recognition of standards**: Countries maintain their own standards, but accept the standards of others as valid and sufficient
  – **Separate standards**: Countries maintain their own standards and refuse to recognize the standards of others
Setting Standards: Harmonization, Mutual Recognition, or Separate? (cont.)

• No general rule determines which way of dealing with the differences in standards is best for international trade

• Each of the three mechanisms has advantages and disadvantages
  - Harmonization of technical standards, for example, leads to a larger market and greater efficiency, but may also freeze inferior standards into place
However, differences in labor and environmental standards, in particular, have generated concerns:

- **High-income** countries often fear that laxer standards in other countries induce domestic firms to (1) adopt lower standards to remain internationally competitive; or (2) move to countries with lax standards.

- Countries are feared to engage in a *race to the bottom*—adoption of the lowest level of standards possible in order to attract foreign firms.
### Table 8.1 Income and Population by World Bank Categories, 2007

<table>
<thead>
<tr>
<th>Income Category</th>
<th>Number of Countries</th>
<th>Population (Millions)</th>
<th>Average Income per Person (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>49</td>
<td>1,295.8</td>
<td>574</td>
</tr>
<tr>
<td>Lower middle</td>
<td>54</td>
<td>3,434.5</td>
<td>1,905</td>
</tr>
<tr>
<td>Upper middle</td>
<td>41</td>
<td>823.7</td>
<td>7,106</td>
</tr>
<tr>
<td>High</td>
<td>65</td>
<td>1,056.3</td>
<td>37,571</td>
</tr>
</tbody>
</table>

Most of the world’s population lives in countries classified as low- or lower-middle-income.

*Source: World Bank, World Development Indicators.*
**Table 8.2 Income Levels, Society and the Environment**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Low</td>
<td>126.4</td>
<td>68</td>
<td>0.6</td>
<td>−10.5</td>
</tr>
<tr>
<td>Lower middle</td>
<td>49.9</td>
<td>88</td>
<td>2.8</td>
<td>−2.5</td>
</tr>
<tr>
<td>Upper middle</td>
<td>24.2</td>
<td>95</td>
<td>5.5</td>
<td>−3.3</td>
</tr>
<tr>
<td>High</td>
<td>7.1</td>
<td>100</td>
<td>12.6</td>
<td>+1.1</td>
</tr>
</tbody>
</table>

Some conditions improve with income growth, some worsen, and some vary widely.

*Source: World Bank, World Development Indicators.*
Labor Standards

- The U.S. and many other countries today want labor and environmental standards be included in any future trade agreements
  - U.S. trade agreements with Canada and Mexico (the North American Free Trade Agreement, NAFTA) and with Jordan address labor and the environment: each country must enforce its own standards or face monetary fines
  - Labor and environmental activists see fines as inadequate to enforce standards and prohibit the race to the bottom, demanding the use of trade sanctions
Defining Labor Standards

• The **International Labor Organization (ILO)** proposed **eight core labor standards in four basic areas:**
  
  – Freedom of association and recognition of the right to collective bargaining
  – Elimination of all forms of forced labor
  – Effective abolition of child labor
  – Elimination of discrimination in employment and occupations

• These standards were later revised by the **Organization for Economic Cooperation and Development (OECD)**
Defining Labor Standards (cont.)

- The four areas of standards are widely agreed upon, but also ambiguous: what is meant by “exploitation”?
- Many potential labor standards are contentious: universal minimum wage level, limits on the number of work hours, workplace health and safety, etc.
  
  - Low-income countries are reluctant to pay much higher minimum wages: higher wages would reduce firm profits, and result in closing down of production and a rise in unemployment
Figure 8.1 Child Labor, 5-14 Age Group, 2004 (Millions)
Figure 8.2 Percent of Children Working, 5-14 Age Group
Labor Standards and Trade

- **Low- and high-income countries** face very different sets of economic constraints; harmonization of labor standards is thus difficult.

- Should one country, then, use trade sanctions to enforce certain labor standards in another?
  - Labor activists often favor the use of trade barriers to enforce standards.
  - Trade economists think such barriers are ineffective as an enforcement mechanism and only spur protectionism, deadweight losses, and other economic inefficiencies.
Labor Standards and Trade (cont.)

- Economists express four concerns over the use of trade measures to enforce standards:
  1. **Effectiveness**: (a) only large countries or coalitions of countries can use trade barriers successfully to enforce standards, since small countries do not have a large enough impact on global demand; (b) use of sanctions could be counterproductive for boosting working conditions: improved enforcement in the target country may cause producers to shift to the unregulated and uninspected informal economy.
2. Hazy borderline between protectionism and concern: special interests sometimes use the issue of foreign labor standards in order to attain their real goal, protection against foreign competition.

- Producers in a high-income country with scarcity of cheap, unskilled labor may seek sanctions against a low-income country in order to counter the competition posed by the low-income country producers with abundant supplies of cheap labor.
3. **The specific content of labor standards**: there is no international agreement on the specific content and language of labor standards
   - Justifying the specific goal of sanctions to the international community is thus difficult, and may lead to conflict in international economic relations

4. **The potential to set off a trade war**: the use of sanctions is discriminatory and thus an infraction of WTO rules
   - Sanctions may cause retaliation from the targeted country, thus further hurting international trade rules
Evidence on Low Standards as a Predatory Practice

• Low standards are generally not an effective mechanism to enhance competitiveness and attract foreign investment

1. In theory, countries cannot simultaneously capture markets (run a trade surplus) and attract foreign investment: trade surplus implies capital outflows, not inflows

2. There is very little evidence that countries that lower labor standards succeed in obtaining a comparative advantage in a new line of production
3. Low labor standards are not a successful means to attract foreign investment: low labor standards are correlated with unskilled, illiterate labor force and lack of economic development (poor roads, ports, telecommunications point of contention in international trade, schools, and sanitation)

   - Low labor costs are thus more than offset by the costs implied by a lack of development
Trade and the Environment: Transboundary and Non-Transboundary Effects

• There is considerable overlap in the debates on labor and environmental standards
  – Proponents of including environmental standards in trade agreements believe sanctions should be used to enforce such standards
  – Critics of sanctions have concerns about the ineffectiveness of sanctions, the hazy borderline between protectionism and environmental concerns, the lack of international definitions of environmental standards, and the potential for trade wars
Non-Transboundary and Transboundary Effects

- Three arguments by proponents of trade barriers to enforce environmental standards are:
  1) Without adequate enforcement of standards, countries engage in an \textit{environmental race to the bottom} to boost industrial competitiveness
  2) Lack of enforcement of standards in developing countries induce dirty rich country industries to “export pollution” and thus create \textit{pollution havens}
  3) Poor enforcement leads to environmental problems that spill over to another country
Environmental Race to the Bottom

• Is there an environmental race to the bottom?
  – Although high environmental standards reduce industrial competitiveness, they raise national well-being and lead to economically optimal levels of production, making nation better off
  – Most countries have adopted tougher environmental standards over time. In order for race to the bottom to occur, sectional interests would have to be politically powerful
Pollution Havens

• Do pollution havens attract foreign firms?
  – Some dirty industries did move in the 1970s from high-income countries to low-income ones
  – However, there is no evidence that any country competes successfully for investment on the basis of lax environmental standards
  – As a result, individual firms cannot move to escape the environmental regulations of a high-standards country
Transboundary Environmental Problems

• Do environmental spill overs occur?
  – Transboundary spill over effects are frequent
  – However, a successful use of sanctions to counter them is possible only by a large country or a coalition of countries, and may lead to trade wars
Alternatives to Trade Measures

• As long as there are large income gaps between countries, differences in labor and environmental standards are unlikely to disappear
• Seeking enforcement of standards through sanctions, however, is often futile and harms international trade
• How, then, to enjoy the benefits from world trade while resolving the conflicts over standards?
Alternatives to Trade Measures (cont.)

• There are three ways of enforcing sanctions without hurting international trade
  – Labels for exports
  – Requiring home country standards
  – Increasing international negotiations

• Let’s examine the usefulness of each of these in detail…
Labels for Exports

- **Labeling**: A certification process whereby a label is attached on an exported good to indicate to consumers that the good was produced under humane and environmentally sound conditions.
  - The method is already in place in some instances: Cambodian textile exports to the U.S., Starbucks coffee imports, etc.
  - **Problems**: (1) Many countries resist labeling as an infringement of their sovereignty and (2) consumers must be convinced the label provides accurate information.
• **Requiring home country standards**: High-standard countries can require their firms to follow home country standards when operating abroad

  – Pros: impedes the race to the bottom; avoids the problem of high-income countries’ dictating standards
  – Cons: addresses only firms of high-standard countries
    - Low-country producers are not affected
    - A high-standard country firm may outsource production to a low-standard country producer
Increasing International Negotiations

- **Increasing international negotiations**: Using either existing international organizations or creating new agreements and organizations
  - ILO could be given a greater role and start, for example, publicizing lack of compliance with labor standards
  - New agreements and organizations could be created to address environmental issues
    - The WTO is not an environmental organization; however, it allows international environmental agreements to develop their own enforcement mechanism
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