

**The Effects of Multinational Production on Wages and
Working Conditions in Developing Countries**

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I. Introduction

This paper is designed to assess the empirical evidence on the effects of multinational production on wages and working conditions in developing countries. It is motivated by the controversies that have emerged especially in the past decade or so concerning whether or not multinational firms in developing countries are exploiting their workers by paying low wages and subjecting them to coercive, abusive, and unhealthy and unsafe conditions in the workplace. Thus, in Section II, we address the efforts and programs of social activist groups and universities and colleges involved in the “Anti-Sweatshop” Campaign in the United States, the social accountability of multinational firms, and the role of such international institutions as the International Labor Organization (ILO) and World Trade Organization (WTO) in dealing with labor standards and trade. We then turn in Section III to consider the conceptual aspects of the effects of foreign direct investment (FDI) on wages in host countries and the effects of outsourcing and subcontracting by multinational firms. In Section IV, we review the empirical evidence on multinational firm wages in developing countries, and the relationship between foreign direct investment (FDI) and labor rights. Conclusions presented in Section V.

II. Political Economy Issues

As mentioned, our paper has been motivated by the controversies as to whether multinational firms are exploiting and mistreating their workers. In this connection, Moran (2002) has stressed the importance of distinguishing low-wage, relatively unskilled labor-intensive industries such as apparel and footwear from

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industries that employ more highly skilled workers and produce relatively more skill-intensive products such as electronics and automotive products. Many social activists and activist organizations that are critical of multinational wages and working conditions in developing countries do not make this distinction. Rather, much of the criticism by social activists in the United States especially has been directed at multinational operations in the apparel and footwear industries that are allegedly producing under “sweatshop” conditions in which workers are being exploited by means of low wages and subjected to undesirable working conditions.¹ We turn next accordingly to consider the salient anti-sweatshop issues.

The Anti-Sweatshop Campaign in the United States

Elliot and Freeman (2001, pp. 15-16) note that:

“Sweatshops have characterized apparel production since industrial revolution days, and so too have campaigns to improve labor conditions in the industry. ...Many of the issues are the same, but a major difference between anti-sweatshop campaigns at the turn of the 21st century and those at the turn of the 20th century is that sweatshops then were largely local whereas today they are found mostly in poor developing countries. This means that U.S.-based activists cannot lobby the U.S. government to improve labor standards. Instead they must target U.S.-based corporations who operate or source in developing countries or pressure the world trading community to demand changes in less developed countries.”

Elliot and Freeman (2001, pp. 48-49) provide a timeline of U.S. anti-sweatshop activities from 1990 to spring 2000,² and a list of transnational labor rights activist organizations (Appendix Exhibit A). As they note (pp. 16-17), during this period, multinationals such as Levi Strauss, The Gap, Phillips-VanHeusen, and others were singled out for condoning undesirable labor practices. And Wal-Mart, a major retailer, was cited as selling clothing made by child labor in Bangladesh and Honduras. Many of

¹ Graham (2000, pp. 101-102) has noted that products originating in the footwear, apparel, toy-making, and sporting goods industries combined accounted for less than 10 percent of world merchandise exports in 1997 and less than 7 percent of the stock of U.S. FDI abroad in 1998. He states then: “If indeed sweatshop conditions are concentrated in these industries, they do not represent the greater part of globalized economic activity. And as already noted, not all facilities even in these industries are sweatshops.”

² See also Varley (1998, pp. 12-13).

the firms involved in producing or sourcing abroad have responded to the criticisms by adopting codes of conduct that are designed presumably to guide their operations.³ In 1996, the Clinton Administration established the Apparel Industry Partnership (AIP) to address sweatshop issues globally by bringing together apparel firms, unions, and NGOs by means of a code of conduct and monitoring system that were introduced in April 1997 and that would be applicable to the firms involved. Subsequently, in November 1998, the AIP established the Fair Labor Association (FLA) to implement and monitor the code. Some groups, in particular the Union of Needletrades, Industrial and Textile Employees (UNITE), were critical of the AIP/FLA program, complaining as Elliott and Freeman note (p. 17) that "...the code failed to require payment of a living wage; had weak language with respect to union rights in nondemocratic countries; and had a weak monitoring and verification system." Nonetheless, by fall 2000, 140 colleges and universities had become affiliated with the FLA, and, as of the end of 2001, the number had grown to 192.⁴

It was during this period that student activism on sweatshops took hold at a number of American campuses. A group called Students Against Sweatshops was established at Duke University in August 1997. With assistance from UNITE, the United Students Against Sweatshops (USAS) was established on a national basis in summer 1998. In expressing their dissatisfaction with the FLA, the student members of the USAS orchestrated sit-ins during 1999 at a number of prominent universities and colleges. On October 19, 1999, the USAS announced the creation of the Worker Rights Consortium (WRC) and urged institutions to withdraw from the FLA and join the WRC, which purportedly had a stronger code of conduct, a focus on worker complaints and education on worker rights, and a requirement for disclosure of the name and location of factories producing licensed apparel. As of June 2000, 50 institutions had

³ We have more to say on this below.

⁴ The list of colleges and universities affiliated with the FLA can be found at [www.fairlabor.org/htm/affiliates/university.html].

become affiliated with the WRC. The number had grown to 92 as of December 13, 2001, and 49 of these institutions continued to remain affiliated with the FLA.⁵

Elliott and Freeman (2001, p. 18) note that a number of additional organizations were created that formulated codes of conduct and mechanisms for monitoring adherence to the codes. These organizations include such U.S. groups as the Social Accountability International, which administers its SA8000 code on a global and multi-industry basis; the Collegiate Licensing Company (CLC); the Worldwide Responsible Apparel Production (WRAP); Verité, which monitors human rights especially; the Europe-based Ethical Trade Initiative; and some NGOs based in developing countries. There are also a number of private monitoring groups, including PriceWaterhouseCoopers (PWC) and Ernst and Young. In addition, many American academic institutions have established codes of conduct,⁶ although they depend for the most part on the monitoring to be carried out by the FLA or WRC.⁷ It is of interest therefore to compare the main features of the FLA and WRC.

Comparison of the FLA and WRC

As noted above, the FLA was established in 1998 as an outgrowth of the Apparel Industry Partnership (AIP) sponsored by the Clinton Administration. Its focus is on improving working conditions in the global apparel industry.⁸ In considering the relative merits and membership in the FLA and WRC, the University of Michigan Advisory Committee on Labor Standards and Human Rights (2000, pp. 30-33) noted for example the following positive features of the FLA: (1) the FLA membership includes most of the largest apparel producers, is well funded, may be cost effective in avoiding the proliferation of codes of conduct and monitoring, and may provide economies of scale in coordinating its membership and

⁵ The list of institutions affiliated with the WRC can be found at [www.workersrights.org/as.asp].

⁶ See, for example, the University of Michigan code of conduct in University of Michigan Advisory Committee on Labor Standards and Human Rights (2000, pp. 7-8).

⁷ It is noteworthy that the University of Chicago decided against joining either organization. According to the *University of Chicago Magazine* (2000), they opted to rely on Barnes & Noble, which operates the University bookstore locations, to require that all merchandise sold complies with FLA standards.

⁸ The code of conduct of the FLA is reproduced in Appendix 1 below and can be found at www.fairlabor.org.

carrying out monitoring; (2) the FLA focuses on the apparel industry as a whole, and its charter gives universities the option to pursue more flexible strategies if so desired. Some of the concerns expressed about the FLA were that it might be dominated by corporate interests that would favor a weak code of conduct on such issues as health and safety, women's rights, compensation, and hours and overtime, and that it would be reluctant to provide public disclosure of factory locations.

With regard to the WRC, the Michigan Advisory Committee Report (2000, pp. 29-31) cited the following attractive features:⁹ (1) emphasis on disclosure, transparency, and public information on conditions in apparel factories; (2) emphasis on the investigation of complaints as a means of focusing attention on factories where problems are reported rather than relying on monitoring per se; (3) commitment to involve workers and their representatives in the development and implementation of WRC policies; (4) insistence on including a living-wage standard in the WRC code of conduct to focus the attention of universities and licensees on wage issues; (5) concentration on university-licensed apparel rather than on the entire apparel industry as a means of enhancing the leverage of universities; and (6) independence from the FLA and other groups as a means of providing a check on the quality and reliability of other monitoring efforts. Some concerns expressed about the WRC were: (1) its adversarial approach towards licensees, with the consequence that licensees may view the WRC with suspicion, make them hesitant in self-reporting their activities, undermine the credibility and legitimacy of the WRC investigation of reported complaints, and disrupt university-business relationships with licensee partners; (2) the WRC objective of educating workers and encouraging them to act on their own rights may compromise the impartial and independent investigation of worker complaints; (3) there may be an over-reliance on complaint investigation insofar as it presumes that workers are aware of their rights and willing to take risks in filing complaints; and (4) that the independence and credibility of the WRC may be compromised because of the presence on its Governing Board of UNITE or other U.S. unions with a

⁹ The code of conduct of the WRC is reproduced in Appendix 2 below and can be found at www.workersrights.org.

documented history of trade protectionism and discouragement of apparel job creation in developing countries.¹⁰

From the perspective of many American colleges and universities, it should be evident from the foregoing discussion that there are some important differences between the FLA and WRC in terms of their objectives and mode of operation. Two issues that stand out are deserving of further comment: (1) the living wage; and (2) conditions of work, including the right of association and collective bargaining.

The Living Wage

As noted in Appendix 1 below, the FLA code relating to wages and benefits is:

“Wages and Benefits. Employers recognize that wages are essential to meeting employees’ basic needs. Employers shall pay employees, as a floor, at least the minimum wage required by local law or the prevailing industry wage, whichever is higher, and shall provide legally mandated benefits.”

As noted in Appendix 2 below, the WRC code relating to wages and benefits is:

“1. Wages and Benefits: Licensees recognize that wages are essential to meeting employees’ basic needs. Licensees shall pay employees, as a floor, wages and benefits which comply with all applicable laws and regulations, and which provide for essential needs and establish a dignified living wage for workers and their families. [A living wage is a “take home” or “net” wage, earned during a country’s legal maximum work week, but not more than 48 hours. A living wage provides the basic needs (housing, energy, nutrition, clothing, health care, education, potable water, childcare, transportation and savings) of an average family unit of employees in the garment manufacturing employment sector of the country.]”

It is evident that the WRC concept of what constitutes a living wage is much more explicit than the FLA basic-needs criterion of the payment of the minimum wage or prevailing industry wage, whichever is higher. As noted by Elliott and Freeman (2001, p. 50), the WRC is apparently willing to

¹⁰ In this regard, it is of interest to note the statement in the *University of Chicago Magazine* (2000):

“It is the WRC’s apparent intention to move beyond a monitoring function to an advocacy role – supporting particular social, political, and environmental positions – that troubles the University administration and faculty.... As ... outlined by the faculty in the 1967 Kalven Committee Report on the University’s Role in Political and Social Action: ‘A university ... is a community but only for the limited, albeit great, purposes of teaching and research. It is not a club, it is not a trade association, it is not a lobby.’”

postpone the implementation of its living-wage standard pending the completion of further research. This is essentially similar to the position of the FLA, which called for a wage study that was carried out by the U.S. Department of Labor (2000) and a request for follow up on this study with possible annual updates.¹¹ In any event, the question at issue is how to define and measure what constitutes a living wage or basic needs and how this relates to the wages that workers are actually receiving.

The information on wages that we will present in Section IV below suggests that there is pervasive evidence that workers employed in multinational firms in developing countries are being paid wages that are on average higher than compared to alternative employment domestically. Of course, these wages are low in absolute terms in comparison with wages of workers in developed countries. Granting this, many observers have argued that workers' wages in developing countries may not be sufficient to satisfy basic needs. Hence the pressure for higher wages.

In this connection, for example, a group of students from the Columbia University School of International and Public Affairs carried out a study in 1999 for the National Labor Committee to calculate a living wage for maquila workers in El Salvador—see Connor et al. (1999). They found that most maquila workers earned the legal monthly minimum wage of 1,260 colones, which was estimated to be barely sufficient to meet basic food requirements. According to the formula used, it was estimated that maquila workers in El Salvador required a living wage of 4,556 colones to cover the basic needs of a family of 4.3 people living on one wage and allowing for 12.5 percent to be saved for the future. It was recommended that the process for setting wages according to a living-wage formula be standardized and multinational firms should adopt industry-wide standards for paying a living wage.

Moran (2002, Ch. 4, pp. 10-12) has pointed out the extraordinary complexities involved in calculating a living wage:

- (1) There is a need to determine the nutritional standards, types of housing, expenditure categories, savings, and provisions for contingencies to be included in the living-wage formula and to make allowance for inter-country differences in purchasing-power-parity and macroeconomic conditions.

¹¹ See www.fairlabor.org/html/faqs.html.

- (2) Estimates of family size as a basis for wage adequacy may be arbitrary and discriminatory since average family size may vary, and there may be differences among wage earners depending on their age, gender, and family relationships.

Using South Asia as an example, Srinivasan (2001) also questions the relevance of attempting to calculate and administer a living wage. He notes that:

- (1) in South Asia, over half of the labor force is self employed and the proportion of regularly employed wage-paid workers is small;
- (2) workers employed by multinationals are generally well paid, unionized, have legal protection of their rights, and receive mandated benefits, so that payment of a living wage to these workers may be redundant;
- (3) focusing on paying a living wage to workers employed by multinationals diverts attention from the far more serious and relevant problem of poverty and from the need to promote rapid economic growth to help eradicate poverty; and
- (4) the goal of the living-wage proponents would be better served if they would lobby to eliminate barriers in developed countries on imports of labor-intensive manufactures and other trade barriers more generally, and relax immigration restrictions on unskilled workers. By the same token, efforts should be made in developing countries themselves to eliminate bureaucratic corruption, remove barriers to trade, and dismantle domestic policies that are inimical to the poor.

While living-wage proponents may grant many of the foregoing objections, they commonly argue nonetheless that multinationals can well afford to pay higher wages to workers in developing countries because those wages are typically but a tiny fraction of the selling price of the product. In this connection, some examples noted in Moran (2002, Ch. 4, pp. 15-16) are of interest: in 2000, the piece rate plus benefits of jeans produced in Nicaragua was \$.66 compared to the U.S. retail sales price of \$21.99; in 2000, the unit labor cost, inclusive of benefits, for a ladies jacket made in Hong Kong was \$.84 compared to the U.S. retail price of \$99; in 2001, the unit wage was \$.40 for a sport shoe produced in Indonesia that sold for \$100 in the United States; and, in 2001, Nike reported that the labor cost of Nike shoes was \$2.43 compared to a retail price of \$65.

What are we to make of these comparisons? One can argue that the comparisons are inappropriate because they do not take into account the costs of further processing, transportation, advertising, and distribution. There is also a presumption that the multinational firms may be capturing oligopoly rents because of brand preferences, private labels, and name recognition that they have established. While it is conceivable that some of the largest multinationals may be capturing oligopoly

rents, it is by no means clear how pervasive this is especially for firms competing at the retail level. But suppose for the sake of argument that some multinationals are mandated or may opt to divert some of their profits to pay higher wages to their workers in developing countries. It is by no means clear exactly how this would be this be done and what would prevent the companies from shifting their operations to locations with already higher wages and higher productivity.

The difficulty of paying higher wages is even more pronounced if subcontracting firms were obliged to do so. Thus, as Moran notes (p. 16), in the examples cited above, the local wage bill ranged from 20 percent of the pre-tax profit for the firm producing footwear in Indonesia, 46 percent for the jeans production in Nicaragua, and 250 percent for the Nike shoes. Since subcontracting firms are generally independently owned, mandating higher wages for them in these circumstances would almost surely motivate them to search out less costly production locations.

The view that mandating higher wages for workers in developing countries can be accomplished with minimum disruption to employment within and between countries has been colored by the research finding of Card and Krueger (1995) that increases in the minimum wage in the United States in the early 1990s did not reduce teenage employment. In our judgment, contrary to Card and Krueger, there is reason to believe that labor-intensive manufacturing in developing countries is relatively sensitive to changes in wage levels. This is particularly true for the production of apparel and footwear, which are prototype “footloose” industries. This is borne out for example by the experiences of Japan and the Asian Tigers—Hong Kong, Singapore, South Korea, and Taiwan—insofar as increased labor costs in these countries in the course of their economic expansion from the 1960s onward resulted in a shift of the location of labor-intensive industries to China and Southeast Asia and to some extent to South Asia. Also worth mentioning are the experiences of Mauritius and Madagascar noted by Moran (2002, Ch. 4, p. 9), which suggest that labor-intensive producers were sensitive to changes in relative wage levels in deciding where to expand or contract employment and change the location of production.¹²

¹² See also Cooper (2001) for a journalistic account of the experiences of the two countries.

We conclude therefore that efforts to define and measure the living wage are fraught with insuperable difficulties,¹³ and that it is likely that the imposition of a living wage that exceeds existing market-determined wage levels will result in employment shifts in developing countries that may be detrimental to economic efficiency and welfare.¹⁴

The Right of Association and Collective Bargaining

As noted in Appendix 1 below, the pertinent FLA code is:

“Freedom of Association and Collective Bargaining. Employers shall recognize and respect the right of employees to freedom of association and collective bargaining.”

The pertinent WRC code noted in Appendix 2 is:

“9. Freedom of Association and Collective Bargaining: Licensees shall recognize and respect the right of employees to freedom of association and collective bargaining. No employee shall be subject to harassment, intimidation or retaliation in their efforts to freely associate or bargain collectively. Licensees shall not cooperate with governmental agencies and other organizations that use the power of the State to prevent workers from organizing a union of their choice. Licensees shall allow union organizers free access to employees. Licensees shall recognize the union of the employees’ choice.”

The right of association and collective bargaining is arguably the most contentious of issues in countries with low-wage labor and specialization in labor-intensive industries like apparel and footwear.

¹³ The most comprehensive effort to define and measure the living wage is to be found in U.S. Department of Labor (2000). Their conclusion (p. vi) is: “For the countries considered, there appears to be little conclusive evidence on the extent to which wages and non-wage benefits in the footwear and apparel [industries] meet workers’ basic needs.”

¹⁴ Neumark (2002) has studied the effects of living wage ordinances that have been adopted in many cities across the United States. These ordinances typically mandate a minimum wage floor that is often considerably higher than the traditional minimum wages set by state and federal legislation. Among the most significant findings are the following: (1) living wage ordinances have sizable positive effects on the wages of low-wage workers; (2) employment is reduced among the affected workers; (3) a detectable number of families may be lifted above the poverty line, even allowing for employment reductions; and (4) unionized municipal workers especially may gain from narrow living wage laws covering city contractors. Thus, while there is some evidence that living wages may provide some assistance to the worker poor, Neumark notes that such ordinances may not be the best policy for helping the urban poor and that a range of other issues need to be addressed, including budget implications, the incidence of the measures, effects on taxes and local development, the provision of city services, productivity, compliance and enforcement, and equity and overall economic welfare. While there is need for more evidence on how firms respond to higher wages in developing countries, Neumark’s findings would appear to cast doubt on the wisdom of mandating above-market wages in these countries.

As Moran (2002, Ch. 3, p. 14) notes, the problems include: (1) the representation of workers and anti-union discrimination; (2) the right to strike; and (3) the threat to close plants that form unions.

Many employers have initiated worker-management associations designed to foster good relations with employees, and, according to Moran (p. 15), there is evidence for example in the Philippines, Dominican Republic, and Costa Rica of relatively high wages and good treatment of workers. By the same token, there have been allegations and evidence offered of cases of discrimination against workers seeking to organize unions in a number of countries.¹⁵ This has been a problem especially when there already exists a government sponsored or government favored union, or when unions are prohibited by the government. Moreover, workers have been dismissed in some cases for participating in strikes, and replacement workers have been hired. Further, the threat to close plants that form unions has been alleged to occur at times.

There are divergent views on the issues of the right of association and collective bargaining. As our earlier discussion suggests, it can be argued that encouragement of unions and collective bargaining may enhance the efficiency of labor markets and increase the productivity of workers, especially when there are monopsonistic employers.¹⁶ There may also be significant political and social spillover effects as democratic institutions and social harmony are strengthened. Further, it may be the case that governments are weak so that there is nobody to protect the workers but the workers themselves. On the other hand, as noted in the above discussion of the living wage, it may be the case in many low-income countries that labor unions are already concentrated in the formal manufacturing sector, and there may be substantial numbers of workers employed in public enterprises. As a consequence, the fostering of unions could be harmful to workers and families in the informal and in the rural/agricultural sectors, where much

¹⁵ A recent example is a strike by about 800 workers making collegiate apparel for Nike in the Korean owned factory, Kukdong International Mexico, located in Atlixco, Mexico, after some of their fellow workers had been fired in connection with their involvement in labor-rights disputes. For more information, see Verité (2001).

¹⁶ See, for example, Freeman (1993).

of the labor force is self employed, often doing “home work” on a piece rate basis, and the numbers of regularly employed wage-paid workers may be limited.¹⁷

The point just made should not be construed as condoning the suppression of unions and worker rights. Rather, the issue is whether the right of association and collective bargaining should be considered to be the prime objective, as emphasized by the WRC, to enhance the welfare of workers in low-income countries. That is, account needs to be taken of the wages and benefits that workers are actually receiving together with the treatment that they are being accorded in the workplace. Thus, as Moran (2002) in particular has stressed, there is considerable evidence suggesting that market forces combined with judicious government policies can provide the basis for enhancing worker welfare in poor countries. There may well be cases in which workers are mistreated in terms of not receiving their rightful wages or are subjected to poor working conditions.¹⁸ In these instances, corrective measures should be taken by government in conformity with domestic law.

The ACIT and SASL Initiatives

We have had occasion in the preceding discussion to review the issues that are pertinent to the Anti-sweatshop Campaign that has focused attention on the wages and working conditions in multinational firm operations in the apparel and footwear industries in low-income countries. Much of this campaign is being played out in the efforts of organizations like the WRC and the FLA to provide codes of conduct and monitoring of firms engaged in the production and marketing of apparel and related items bearing university and college logos.

As mentioned above, the strategy of the WRC and associated student groups has been one of confrontation with university/college administrations in the form of protests and sit-ins that were resolved

¹⁷ In this connection, Srinivasan (1998, p. 239) has remarked: “... where the freedom to form unions has been exercised to a considerable extent, namely in the organized manufacturing and public sectors in poor countries, labor unions have been seen promoting the interests of a small section of the labor force at the expense of many. ... it should be recognized ... that unionized labor often constitutes a small labor aristocracy in poor countries.”

¹⁸ For documentation, see, for example, Business for Social Responsibility Education Fund et al. (2000) and Verité (2000).

in most cases by agreeing to membership in the WRC. At the same time, the FLA has been active in its efforts to engage and induce universities and colleges to become FLA members. As noted above, the FLA had 192 members at the end of 2001. The WRC had 92 members, and 49 of them were also members of the FLA.

Following the failure of the WTO Ministerial Meeting in Seattle in December 1999, Jagdish Bhagwati of Columbia University and Robert M. Stern of the University of Michigan convened a group of academic international trade economists and lawyers that met in January 2000 at the Georgetown University Law Center. The objective of the meeting was an effort to review what had happened in Seattle and the role that academic trade specialists might play in bringing their expertise to bear on the important issues of trade policy and engaging the attention of policy makers and the public. After the Georgetown meeting, it was decided to establish the Academic Consortium on International Trade (ACIT) with the foregoing objectives in mind. An ACIT Steering Committee was established and comprised: Robert E. Baldwin, University of Wisconsin; Jagdish Bhagwati, Columbia University; Alan V. Deardorff, University of Michigan; Arvind Panagariya, University of Maryland; T. N. Srinivasan, Yale University; and Robert M. Stern, University of Michigan, as Head of the Steering Committee. An ACIT website [www.Fordschool.umich.edu/rsie/acit] was created as a repository for academic papers, reports, policy statements, and news articles dealing with trade policy and related issues.

One of the most contentious issues at the Seattle Ministerial Meeting was that of trade and labor standards. This is a topic that most of the members of the ACIT Steering Committee had addressed individually and jointly in their published theoretical and policy-oriented writings. These writings explored the analytical complexities, political economy, empirical evidence, and the policies of national governments and international organizations involving trade and labor standards. The ACIT group concluded that much of the social activism in the United States regarding labor standards was motivated by protectionist considerations especially on the part of organized labor. The interests of low-income, developing countries were seen therefore to be especially at risk, particularly if efforts were made to

mandate higher labor standards, including higher wages, by means of trade sanctions or other pressures on low-income countries.

It was with these concerns in mind that the ACIT Steering Committee decided to address the decisions taken by university and college administrators to design codes of conduct on their own and/or to become affiliated especially with the WRC to deal with issues of sweatshop labor. The ACIT Steering Committee prepared a letter that was sent in September 2000 to around 600 university and college presidents, stating that the actions taken or to be taken on sweatshop issues at many institutions were possibly not well informed and therefore ill advised. This letter is reproduced below in Appendix 3 and is available on the ACIT website and in Broad (2002, pp. 222-23). It was first circulated to academic trade specialists and other members of the academic community, and some 352 (primarily) economists and other academics indicated that they wished to be signatories of the letter. The list of signatories is available on the ACIT website.

It is noteworthy that only a small number of university presidents or administrators acknowledged receipt of the letter. These included Columbia, Duke, UC-Berkeley, Harvard, and some smaller institutions. But what is perhaps more significant is that the ACIT letter received considerable press and media coverage, much of which can be found on the ACIT website.

It stands to reason that some members of the academic community would take issue with the position expressed in the ACIT letter. Thus, a group calling itself Scholars Against Sweatshop Labor (SASL) was formed, and they prepared a letter that was endorsed by 434 signatories (73 percent economists) and thereafter sent in October 2001 to more than 1,600 university and college presidents. The SASL letter is reproduced in Appendix 4 below and in Broad (2002, pp. 224-27). It is also available together with the list of signatories on the SASL website [www.umass.edu/per/sasl/]. There is also a link to the SASL website on the ACIT website. There are several points in the SASL letter that are worthy of comment:

?? Are colleges and universities making decisions about codes of conduct without adequate consultation?

SASL assertion: “Colleges and universities that have adopted codes of conduct have generally done so after careful consultation with appropriate faculty and/or outsider experts.”

Evaluation: The SASL ignores the fact that the adoption of a code of conduct at many institutions was in response to campus sit-ins and protests, and that there was not a broad representation of alternative views and faculty expertise and campus-wide student involvement.

?? **Worldwide Consultation and Monitoring**

SASL assertion: “... the three organizations (WRC, FLA, and Social Accountability International) bring different strengths to the task of establishing and monitoring effective labor standards worldwide. Ongoing cooperation and competition between these groups should also raise the general performance standard for all three.”

Evaluation: As we have noted in our earlier discussion, the primary focus of the WRC on workers rights and collective bargaining and a living wage, the influence of protectionist labor unions, and the adversarial approach to the business community may serve to limit the effectiveness of the WRC.

?? **Wages, Labor Costs, and Employment Opportunities in the Global Garment Industry**

SASL assertion: “While caution is clearly needed in setting minimum decent standards for workplace conditions, workers rights, and wage levels, there is still no reason to assume that a country or region that sets reasonable standards must experience job losses.”

Evaluation: The fact remains that workers in low-income developing countries are generally being paid wages that are higher than in alternative employment. Mandatory increased wages and more stringent labor standards may improve the position of some workers in the affected industries, but it is almost certain to disadvantage other workers not covered by the mandated changes and may induce firms to seek out lower cost production locations.

In our judgment, many of the points raised in the ACIT letter remain valid and have apparently been accepted in the SASL statement. We remain critical, however, of the SASL statement on the grounds that it: (1) glosses over the ways in which the Anti-sweatshop Campaign led by student activists has intimidated the administrations of many academic institutions; (2) apparently accepts the objectives and operation of the WRC; and (3) downplays the possibly detrimental effects of labor-market interventions in low-income countries. The question remains then as to what the most effective ways may be to address the issues of multinational wages and working conditions in developing countries. One way that we favor and will now consider is the provision of voluntary codes of conduct designed to promote the social accountability of multinationals.

Social Accountability of Multinational Firms

Having just reviewed the issues involved in the Anti-Sweatshop Campaign and the efforts of activist organizations and academic institutions in the United States to address these issues, we now focus on the options that multinational firms may choose to pursue on matters of their social accountability. In this connection, it might be argued, with externalities aside, that in a competitive environment all that matters to a firm is profit maximization and, to society, the resultant optimal allocation of resources and increased consumer welfare. In this context, competitive firms need not concern themselves with their social accountability, although questions might arise about the distribution of income. But when there are market failures, including the possible exercise of market power by imperfectly competitive firms, there will be grounds for intervention designed to achieve the social optimum.

Market failures aside, it appears to us that the thrust of the Anti-Sweatshop Campaign and other antiglobalization activities represent an effort primarily to alter the distribution of income between rich and poor countries. Under the circumstances, if there is a desire to reduce international income and related inequalities, the optimal policy is to provide direct income transfers and technical assistance from the rich to the poor countries. Furthermore, maintaining and extending open markets for the imports from developing countries will be similarly beneficial. It will be suboptimal therefore in terms of resource misallocation if multinational firms are mandated or pressured by interest groups to effect income transfers in the guise of higher wages to workers in developing countries.

If the preceding reasoning is accepted, it might be argued that the Anti-Sweatshop Campaign aimed at multinationals is misdirected.¹⁹ The evidence to be presented in Section IV below generally bears this out. Nonetheless, multinational firms have come under increased scrutiny by activist organizations for their alleged violations of social norms especially in low-wage, labor-intensive industries. It is essential therefore for multinational firms to devise modes of response to allegations of

¹⁹ This has led Graham (2000) to entitle his book, *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises*.

the mistreatment of workers to ward off consumer reactions that may be detrimental to their sales and profitability. This is especially the case for firms whose image in the eyes of consumers is derived from a recognized brand name or private label.

As already mentioned, it has become commonplace especially for large multinationals to devise codes of conduct. Thus, as noted in Moran (2002, Ch. 5, p. 5), the Organization for Economic Cooperation and Development (OECD) had 246 corporate codes in its inventory in the year 2000 covering a variety of industries.²⁰ This included (p. 7) 37 firms in the textile and apparel industry, 25 of which were U.S. firms. It is one thing for a firm to have a written code of conduct. What is needed to complement such codes is a monitoring or certification system that is designed to assure code compliance. This is of course what the FLA is intended to do for the apparel industry and both it and the WRC for university/college suppliers. As we have noted earlier, there are several additional nongovernmental organizations that have been established to carry out monitoring and certification, and there are a number of private monitoring groups as well.

Moran (2002, Ch. 5, p. 9) notes that: “movement toward meeting the prerequisites for credibility and legitimacy [in monitoring and certification] has not been smooth.” Some of the issues that have proven troublesome include: circumscribing the availability of information on plant locations on confidentiality grounds; the use of business and auditing firms to conduct inspections; public disclosure of alleged code violations and efforts at remediation; and comprehensiveness of scheduling of monitoring and follow up.²¹ It is no doubt too much to expect that a system of monitoring and compliance will be perfect. Nonetheless, as Moran (p. 12) has concluded: “There has ... been considerable movement, albeit

²⁰ See also Varley (1998, pp. 505-94) for the texts of a subset of 46 (out of a total of 121) codes of conduct collected for a variety of multinational firms. The Investor Responsibility Research Center (IRRC) has posted profiles of these 46 firms and eight others on its website [www.irrc.org]. We should mention as well UN Secretary General Kofi Annan’s Global Compact, which has been signed onto and endorsed by many multinational firms and a number of labor unions and NGOs.

²¹ See Varley (1998, esp. Ch. 11 and 12) for a discussion entitled “Corporations Grapple with Codes of Conduct” and “The Compliance Conundrum.”

contentious movement, toward meeting the conditions needed to create a credible ‘voluntary’ system for certifying plants that comply with good worker standards and identifying plants that do not.”

If this judgment is correct, it suggests that many multinational firms have found it in their interests to devote resources as a kind of insurance against the possibility of unfavorable publicity regarding their operations that could prove damaging to them in the eyes of consumers and thereby reduce their sales and profitability.²² By the same token and apart from the issues of code monitoring and compliance, it should be recognized, as Moran (2002) has stressed in his study *Beyond Sweatshops*, that the improvement of wages and working conditions is an ongoing process as economies evolve, bringing about endogenous changes in the structure and composition of output and conditions of employment, including a movement towards more technologically advanced industries. For this to happen, as already mentioned, it is necessary for governments to adopt domestic policies that will enhance economic efficiency and welfare and thereby provide the basis for improvements in workers’ skills and the conditions of work.

The Role of the International Labor Organization (ILO) and the World Trade Organization (WTO)

We have focused thus far on the efforts and issues involving the design of codes of conduct, monitoring, and compliance applicable to multinational firm operations in these countries. These various issues have also been addressed at the multilateral level, and there has been a continuing debate on whether or not and how to deal with trade and labor standards in the ILO and WTO.

²² Bhagwati (2001) argues that: “... the truly, indeed the only, compelling reason for corporations to assume social responsibility is that it is the right thing to do. For, in so doing, they will *accelerate* the social good that their economic activities promote, and for which there is now much evidence.” Ruggie (2002), who served as an advisor to UN Secretary-General Kofi Annan in helping to develop the Global Compact, notes that the Global Compact is based on a learning approach to induce corporate change rather than a regulatory arrangement involving a legally binding code of conduct with explicit performance criteria and independent monitoring of company compliance. Ruggie notes further that the Global Compact comprises a network form of organization that comprises the UN, business, labor, and civil society organizations. The hope is that the Global Compact will assist companies in internalizing the relevant principles of social policies embodied in the Global Compact and thereby induce the companies to shape their business practices accordingly. Whether or not this objective can be attained, Ruggie concludes, will depend on the viability of the inter-organizational networks being developed.

The crux of the argument is that the ILO is an international organization that was established around 80 years ago for the purpose of improving labor conditions in its member countries. The ILO mandate is carried out by specifying conventions covering a variety of labor issues and conditions of work to which member countries agree to adhere. These conventions include the so-called core labor standards, which cover forced labor, freedom of association, the right of collective bargaining, equal pay for men and women, discrimination in the workplace, the minimum age of employment, and ban on the most egregious types of child labor. These core and other labor standards have been incorporated in various forms into most of the codes of conduct of NGOs, colleges and universities, and multinational firms. The modus operandi of the ILO is to monitor member-country compliance with the various conventions, call attention to departures from the conventions, and provide technical and financial assistance for developing countries to help them upgrade their labor standards. The ILO thus functions as a clearing house to provide information on labor issues and as a facilitator to improve labor conditions. It carries out its mandate without the use of or threat of sanctions against non-complying member countries.

The WTO is an international organization whose main purpose is to design and implement rules governing the conduct of international trade among its member countries. In contrast to the ILO, the WTO does have sanctioning authority that permits member countries to impose trade restrictions in cases in which trading partners are found via the WTO dispute settlement process to be in violation of particular WTO rules. The trade sanctions can remain in place until such time as the violation is corrected by a change in policy. As tariffs have been increasingly reduced in periodic multilateral trade negotiations, there have been efforts to probe more deeply into the domestic nontariff regulatory policies of member countries that may impede trade. It is in this context that proposals have been made to link labor standards and trade on the grounds that countries with allegedly low labor standards may have an unfair advantage in their trade that is detrimental to their trading partners. In Brown, Deardorff, and Stern (2002), we have explored the pros and cons of linking trade and labor standards in the WTO. In the final analysis, we oppose such linkage on the grounds that it may be subject to capture by protectionist

interests in the developed countries and be detrimental therefore to the trade and welfare of developing countries. In our judgment, issues of labor standards should continue to be the responsibility of the ILO.

This concern about protectionist influence relates as well to the Anti-Sweatshop Campaign discussed earlier, especially in view of the support that UNITE and other organizations with a protectionist orientation have provided to activist organizations such as the WRC. Of course, there are many activist organizations that are motivated by concerns over human rights and international inequalities in the distribution of income. In our view, while these concerns are commendable, they are for the most part misdirected against the operations of multinational firms. There is a real danger therefore that well-intentioned efforts to raise the wages and working conditions of workers in developing countries may work to the detriment of these workers and their families. Instead of focusing on codes of conduct, monitoring, and compliance, society would be better served if efforts were directed by activist groups and universities/colleges to the reduction or removal of existing trade barriers and domestic impediments to economic efficiency in both developed and developing countries.

III. Conceptual Considerations

In this section we review what economic theory has to say about the effects of FDI and multinational firms on wages and working conditions in host countries. We begin with a brief discussion of the motivations for FDI and multinational firm activity. One lesson here is that multinationals exist for a variety of reasons and perform a variety of functions, so that we cannot identify them with any single activity whose effects we should explore. Rather, we need to consider them in several roles, each of which may have different implications for wages and working conditions.

We look broadly at four such roles. The first is as a conveyor of additional capital to the host country, either as an addition to the world's capital stock or in place of capital that would otherwise be in the source country. For this purpose, we address the question in the context of the general equilibrium models with perfect competition that are familiar in international trade theory. Second, we consider the possibility that FDI carries with it, instead of or in addition to capital, technologies that may be superior

to those previously available, technologies that may also “spill over” to domestic workers and/or firms in the host country. Again, FDI as a source of improved technology can be analyzed in the context of perfectly competitive general equilibrium trade models. Third, we acknowledge that, even with unchanged capital and technology, multinational production may involve different sets of production activities than simpler national firms, and we look at how the choice of activities may matter for labor markets. This may happen, for example, within multinationals that use their parent-firm location to provide headquarters support for activities in subsidiaries abroad, or more generally it may involve production processes that are fragmented across countries, even to be done in different unaffiliated firms through subcontracting. Fourth and finally, we note that, because of their size, multinationals may have the power to set prices and/or wages to a degree that perfectly competitive firms could not. We examine several ways that their price-setting behavior could matter for wages, including monopsony pricing of labor, efficiency wages, and rent sharing.

Throughout this section we focus for convenience only on wages, rather than explicitly considering the full package of wages, other compensation, and the hours and working conditions that firms ask of and provide to their workers. In practice, of course, all of these are determined together, either in the competitive interactions of firms and workers, or in negotiation between them. In general, therefore, when we say that an event such as FDI raises or lowers wages, one should think here of the whole package of wages and working conditions as improving or worsening to an extent that is determined by these interactions.²³

Motivations for FDI

FDI consists of the acquisition of physical capital in another, “host” country, usually in the form of a production facility or a retail establishment owned at least in part by a parent firm in the home, or

²³ Lim (2001, p. 41) notes that “higher wages are usually correlated with better labor standards.”

“source,” country.²⁴ When done among developed countries, FDI often takes the form of acquisition of an existing facility, but most FDI into developing countries is “greenfield” investment – that is, newly constructed establishments – which therefore add to the physical capital of the host country.²⁵ Strictly speaking, such capital need not be financed from the home country, and it therefore need not in any sense be a movement of capital from the home country to the host country, although in practice it is often interpreted that way. For our purpose, however, of examining the effects of FDI on the host country, this distinction is not important. What matters is primarily the fact of, and the nature of, the addition to capital in the host country.

FDI also often carries with it a technology that may not have been previously available in the host country. That, as well as the additional possibility that such technology may spread to workers and firms outside the foreign-owned establishment, is something we will consider in a later subsection. To start, we will focus only on the role played in the host country by the additional capital.

To some extent, that role may depend on the motivation for the FDI itself. Broadly speaking, there are two types of FDI: that intended to serve the host-country market and that intended to produce for export. Obviously, there exists some FDI that serves both purposes, but if so, one purpose is usually dominant and the other incidental. The distinction can be important because the firms that engage in FDI usually have alternative means available for achieving either of these objectives, and their choice of FDI is an indication of market conditions that favor FDI over these other means.²⁶

In the case of serving the host-country market, the alternatives are to export the product from the home country or, especially in the case of services, to franchise or otherwise license its production by a local firm in the host country. Since the firm’s competitive advantage originated with production in its home country, the choice of FDI instead of these alternatives indicates that there must be extra costs

²⁴ It should be noted that FDI may span a variety of industries, including extractive, manufacturing, and service industries. The literature tends to focus especially on FDI in manufacturing, but our discussion is intended to encompass FDI covering the range of different industries.

²⁵ See Graham (2000, p. 85).

²⁶ The points made here and in the next two paragraphs draw on Moran (2002).

associated with them. For exports, these extra costs include transport costs, tariffs, and other trade barriers; for licensing, they include costs of controlling quality or protecting technology. In both cases, FDI is likely to be a higher-cost method of producing the product than the alternative, chosen only because these other costs are even higher. This second-best nature of FDI in such cases may undermine the benefits that one would otherwise expect from freely functioning markets. For example, “tariff-jumping” FDI may involve production that is so inefficient that it lowers the welfare of the host country. Likewise, concerns about control of technology may induce firms to use only outmoded machines for serving a host-country market.

In the case of FDI for export, the alternatives are, first, not to involve the host country at all, producing either at home or in a third country, and second, again, the possibility of licensing production by a host-country firm. Here there is no reason to produce in the host country at all unless it can be done for lower cost (or higher quality), so the presumption is that the host country offers an advantage in the form of cheaper and/or higher quality inputs, such as labor or some natural resource. The decision to own the facility rather than license it could, again, reflect distrust of local firms that outweighs the cost advantage that local firms presumably have based on familiarity with host-country conditions. However, it may be more likely, since the local market is now less important, that the firm can achieve cost or quality advantages itself by using its own personnel. The result here is a presumption that FDI for export will reduce the cost of providing the product to the home or to the world market, and we would expect this cost reduction to be beneficial, at least from a global perspective.

What is it that allows a multinational to achieve such a cost reduction that a local firm, unaffiliated with the multinational, could not? The answer may only be that the multinational has better access to capital, which is why we start by considering the effects of capital flows on wages. Or the multinational may have a technology that is not available in the developing country, or even outside the multinational itself, as we examine second. But a third possibility is that the multinational produces an input in one country, perhaps the source-country location of the parent firm, that contributes to the productivity of other activities that it performs in the host country. One or both of these activities may

also have the nature of a public good, expanding productivity of multiple affiliates in multiple countries, but that is not essential for our concern here with effects on host-country labor markets. What is important is that the multinational provides the motivation for locating a fragment of its production activity in the source country, an activity that without the multinational would not be viable. This fragmentation is the third source of cost reduction that we examine below.

Effects of International Capital Flows

The simplest story one can tell about FDI is in a one-sector model. Suppose that all countries produce the same good, using inputs of capital and labor in a neoclassical, constant-returns-to-scale, production function: $X=F(KL)$, where X is output and K and L are factor inputs of capital and labor respectively. FDI from abroad then increases a host country's capital stock and raises its output. With competitive factor markets paying factors the value of their marginal products, the increased capital stock will raise the marginal product of labor and thus its wage. There is no possibility here of FDI hurting the host country's labor, and if the amount of FDI is large enough to matter at all, it will surely help it. Of course, the flip side of this is in the source country where, if the FDI entails a drop in the capital stock there, the opposite occurs. But that is not our concern here.

One need not go far to find a different theoretical answer, however. In standard Heckscher-Ohlin (HO) trade theory, with two sectors producing two goods in each of two countries, the factor price equalization (FPE) theorem tells us that an increase in the capital stock of a country will leave both factor prices unchanged in either of two circumstances.²⁷ First, if the host country is small so that any change in its outputs will not affect world prices, then an increase in its capital stock, whatever its source, will leave its factor prices unchanged as long as the country continues to produce both goods. And second, even if the host country is large, if the increase in its capital stock matches an equal decline in the capital of

²⁷ It is this implication of the FPE theorem that causes Leamer and Levinsohn (1995) to rename it the factor-price-insensitivity theorem.

another country, as it would if FDI actually moves capital from place to place, then if that other country also produces both goods both before and after the change, factor prices will again stay the same.

Considering the obvious importance of international trade in the world today, one might think that this two-sector HO model ought easily to be preferred over the one-sector model and that we should forget about FDI affecting wages. But the case just considered is actually very special, and there are many other possibilities within the general HO framework that do not yield this result.

First, the simple specific factors model with mobile labor and two kinds of immobile capital (which can be thought of as a three-factor, two-good case of the general HO model) has the property that an increase in either capital stock raises the wage even in a small country. Second, with specialization, the HO model behaves much more like the one-sector model, with each country producing a single, albeit different, good. Third, without complete specialization but with multiple “cones of diversification,”²⁸ a movement of capital from a capital-abundant to a labor-abundant cone will cause prices of goods to change and internationally unequal factor prices to move closer together. In this last case, far different on its face from the one-sector model, FDI again causes the wage to rise in the host country and to fall in the source country, with opposite changes in returns to capital.

Perhaps the richest variant of the HO model for use in describing developing countries is a two-factor (capital and labor) model with many cones of diversification. In this model, FDI that raises the capital stock of an initially poor, small country will cause it to grow from cone to cone, with the wage remaining constant as it advances within a cone, but then rising as it moves up to the next cone. This sort of progress, which has been explored theoretically by Krueger (1977) and Deardorff (2000) and has been documented empirically by Moran (2002), may offer the best hope for developing countries to escape

²⁸ This refers to the property of HO models with more goods than factors that equilibria can involve FPE for groups of countries whose factor endowments lie within a cone-shaped subset of factor space. If there is only one such cone, then all countries either completely specialize (and are thus outside the cone) or share common factor prices. If there are multiple cones, then countries whose factor endowments are within the same cone (and thus are in that sense similar in their factor endowments) diversify and share a common set of factor prices, but they have different factor prices than countries in another cone. A popular model of trade between developed and developing countries has two such cones, with capital-abundant developed countries in one and capital-scarce developing countries in the other.

poverty if they can accumulate capital (or skill, although this is outside these simple models), either on their own or with the help of FDI.

So far we have considered models with only two factors, capital and labor. Equally important is the distinction between skilled and unskilled labor, but to address this along with capital flows requires allowing for three factors of production. This opens up more possibilities than we can consider here, and we therefore look only at a single case, but it is one that seems particularly appropriate for today's world.

The model is another variant of the HO model, this one introduced by Feenstra and Hanson (FH) (1996). They assumed a continuum of goods, each produced with capital and a fixed-coefficient aggregate of skilled and unskilled labor. The skill/unskill intensities varied along the continuum, while the shares of capital versus aggregate labor did not. In their equilibrium, factor endowments differed between their two countries, North and South, sufficiently that factor prices were unequal and each country produced a different range of goods – i.e., they were in different cones. In particular, FH assumed that the return to capital was higher in South than in North, and that the ratio of the skilled wage to the unskilled wage was also higher in South than in North.²⁹

They used this model to derive a result that is very relevant here. When capital moves from North to South, it expands the range of goods that can be produced in South and contracts it in North. The goods whose production location moves are the least skill-intensive previously produced in North, and they become the most skill-intensive now produced in South. As a result, the average skill intensity of production rises in both countries. This also raises the relative demand for skilled labor in both, causing the skilled wage to rise in both places and the unskilled wage to fall. This is the first sign we get, in theory, of FDI causing a fall in any wage in the host country. It does so because, rather than moving into producing the goods that use the cheapest factor in that less developed country – unskilled labor – FDI instead expands production of relatively skill-intensive products there. As we will see in our look at the empirical evidence below, this is exactly what a great deal of FDI into developing countries actually

²⁹ This is nicely consistent with having both wages realistically lower in South than in North, although they also allowed international differences in technology that could lead to this result.

does. Why does it do this? In the FH model it happens because production of the least skill-intensive goods is already, in the initial equilibrium, being done exclusively in the South. In those industries, there is nothing to move. So if capital is going to move to South at all, in order to take advantage of the higher return to capital there, it must do so to produce something else, and more skill-intensive goods are all that are available.

This is an interesting result that strikes us as important, and we will hark back to it frequently later in the paper. However, there is a qualification that Feenstra and Hanson do not mention. Theirs is a two-country model, with both countries of significant size. We are often concerned, not with a massive flow of capital from the developed to the developing world, but rather with the flows into particular developing countries that might better be viewed as small. What effects would FDI have into a small country that is embedded in what is otherwise the FH framework? The answer is that it would not affect relative wages in the small country at all.

The reason is essentially that a small developing country in the FH framework is within the cone of diversification of the South, and its factor prices are constrained by those of the South as well. Not that there will be FPE. The small country will be able to specialize completely in the only one of the continuum of goods that fully employs its skilled and unskilled labor, and thus the FPE theorem does not apply. However, to keep producers from shifting to any other good in the continuum within the cone, the ratio of the skilled wage to the unskilled wage must remain the same as in all of the other countries of the larger South.³⁰ As a result, as FDI expands the capital stock of the small country, wages of both skilled and unskilled labor rise in the same proportion, while the return to capital falls.

All of the theoretical results discussed so far are collected in Table 1, which shows the direction of change in the real wage of labor in the host country due to capital-inflow FDI. Each of the models

³⁰ This can be seen in the FH model by differentiating the (log of the) cost function with respect to the index of the good, z in the FH notation. This derivative depends on the factor prices only through the ratio of the two wages, q_i/w_i . If a small country had a wage ratio differing from that of the larger South at the z that can fully employ its two kinds of labor, then its cost function would cut South's from above or below, and firms would seek to produce only goods of higher or lower z . Labor markets would not both clear.

considered is identified by the number of sectors and factors that it assumes. Also indicated is whether the host country is diversified or specialized into production of a single good and whether, where relevant, the world equilibrium has two cones of diversification. Results are reported for both the case of a small country, which takes prices as given from a much larger world economy of the sort indicated, and for a two-country model. In the latter case, the FDI is assumed to take the form of an increase in the capital stock in the host country and an equal decline in the capital of the source country.

The results, clearly, are somewhat varied, in that there are several cases where wages do not change and even one where a particular wage – that of unskilled labor – falls. However, most of the cases show labor earning a higher wage as a result of an inflow of FDI, and we regard this as the normal case, in the absence of knowledge that circumstances are otherwise.³¹

Effects of Technology Flows

It is arguably the case that multinationals who engage in FDI possess technologies that others do not, particularly other firms in their host countries. They must, after all, have some sort of advantage in order to overcome the disadvantage of operating in an unfamiliar environment. And if this is the case, then FDI is not fully captured by the simple inflow of capital considered above. Indeed, some FDI may actually involve no addition to a host country's capital stock at all, if the capital already exists and is simply acquired by the multinational through merger or acquisition. In that case, FDI may consist purely of the introduction of an improved technology into the host country.

This is not necessarily technology transfer, if the secrets of the technology remain with the acquiring firm and its source-country personnel. But the technology will still be applied to factors in the host country, and it will increase the output that they produce, even if the advantage would be lost if the firm pulled out. Thus we can model this as an improvement in technology and ask its effects. If

³¹ It is not inevitable that even some labor must gain. For example, in a one-sector model with three factors – labor, capital, and land – if capital is complementary with land and a substitute for labor, a rise in the capital stock could reduce the wage of all labor.

technology transfer does take place, willingly on the part of the firm or otherwise, then these effects will be just that much larger and longer lasting.

Graham (2000, Appendix A) argues that an improvement in technology must raise wages. After all, he says, technology raises productivity, and workers are paid their marginal product, which will be larger as a result of the improved technology. However, this ignores the interaction of supply and demand. A competitive industry with an improved technology will expand output and employment until the value of labor's marginal product equals its wage, but this could happen in several ways: by a fall in the price of the good, as output expands relative to demand; by a fall in the marginal product of labor, as employment expands relative to other factors such as capital; and by a rise in the wage, as workers are induced to leave other industries or to give up leisure. Only the third of these mechanisms entails an increase in the wage, and it will not happen at all in some contexts, such as that of FPE. Thus there really is no assurance that an improvement in technology due to FDI will raise the host country wage at all. It will depend on the circumstances, just as did the effect of a capital inflow above.

Consider first a single multinational firm that brings an improved technology into a host country. Will it pay a higher wage than what prevails in the local market? It may, for any of several reasons that we will discuss below, but the increased marginal product of labor is not one of those reasons. If the marginal-revenue product of labor is initially higher than the prevailing wage, then the firm will expand its use of labor to the point where this would not be true for an additional unit of labor. But even then it has no reason, on account of the technology alone, to pay more than the market wage. This argument applies as well to larger numbers of firms as long as they do not alter the technology of all firms operating in the sector – a case we consider next. Of course, with more firms expanding employment, the effect on the market wage itself may become significant, the wage rising as labor is pulled up its supply curve, but if this happens it is due to the expanded demand for labor, independently of whether its cause was an improvement in technology.

Suppose next that FDI brings to a host country an improved technology for a whole sector of the economy, either because multinationals themselves take over the whole sector or because spillovers of the

technology raise productivity in local firms as well. Like the case of an increased capital stock above, several possibilities arise depending on country size and patterns of specialization. In the simplest case of a one-sector economy, the effect of technology depends on its factor bias. Hicks-neutral improvement will raise all factor prices in the same proportion, while improvement that is biased toward one factor or another will raise one factor price more than another and may even cause one factor price to fall. Thus it is possible, if the new technology is biased strongly enough away from using labor, for it to reduce the wage, although this seems an unlikely outcome.

With multiple sectors, on the other hand, as has been discussed at length in the “trade and wages” literature, the effects of a technological improvement on wages depend on the relative factor intensity of the sector in which it occurs.³² In a small, two-sector, diversified economy, for example, improvement in the capital-intensive sector will lower the wage, while improvement in the labor-intensive sector will raise it. With more sectors and multiple cones, it is again the factor intensity of the sector where technological change takes place that matters for factor prices, though here it is factor intensity relative to other sectors in the same cone, not relative to all sectors. All of these theoretical results are summarized in Table 2.

Fragmentation

So far we have treated multinationals as providing capital and/or technology to developing countries and then using it within the same industries that already exist, either there or in the source countries. In fact, an increasing amount of multinational firm activity involves changes in the organization of production so that portions of a previously integrated activity can be done elsewhere. This phenomenon, which has gone under many different names, we will here call “fragmentation.” It may take the form of a source-country firm building a subsidiary abroad to perform some of the functions that it once did at home, such as making particular parts for its product or completing particular steps in its production process. Or it may take the form of subcontracting such activities to local firms in the host country, to which it provides

³² See Krugman (2000) and the references cited therein.

detailed specifications and even fragments of its technology. In both cases, this activity may be included in what is often called “outsourcing.” And in both cases too, it may or may not be accompanied by an increase in the host-country capital stock or by an improvement in technology. What is distinctive about fragmentation is that a portion of the activity that was previously done in the source country now becomes possible to do in the host country instead. Fragmentation may not require any expansion of the multinational firm’s direct operations, and it therefore may not be recorded as FDI, but it is nonetheless the existence of the multinational firm that makes it possible.

By the same token, it is often the potential for fragmentation that makes a multinational firm possible, or at least provides the economies that make multinational firms more efficient than national ones. It is not unusual for some fragments of a firm’s activities to serve the needs of multiple other fragments, creating a form of economies of scale. For example, research and development need only be done once for all of the subsidiaries of a multinational firm. Indeed, it is this feature of many multinationals that Markusen (1984) and Helpman (1984) used as the basis for their seminal models of multinationals.³³ For our purposes here, it is what a multinational does and not so much why it does it that is important. Once a fragment of production is located in a host country, it matters little for that country’s labor market whether it is there because of multiplant economies or for some other reason.

Fragmentation is both motivated and constrained by the same things that matter for international trade in general. A fragment of a production process will be moved abroad only if it can be done there more cheaply, which means that fragmentation is responsive to the same determinants of comparative advantage as any other trade. In particular, it is likely to occur only if factor prices differ across countries. Even then, it will not occur if the extra costs that are associated with fragmentation outweigh the gain from lower cost of the activity itself. These extra costs may include transportation, communication, and other costs needed to coordinate the activity with what is still being done in the home country.

³³ See also references cited in Carr et al. (2001) for more extensive modeling of multinational firms based on this assumption.

Both the causes and the effects of fragmentation in general equilibrium have been examined by Deardorff (2001a,b), among others. There is some tendency for fragmentation, like trade more generally, to cause internationally unequal factor prices to move closer together. However, no general conclusion in this regard seems to be possible, and the effects of any particular instance of fragmentation may do this, or its opposite, depending on the factor intensities of the fragments.

Thus, to take a not implausible example similar to the movement of capital studied by Feenstra and Hanson (1996), suppose that an industry has previously functioned entirely within a developed country where the relative wage of skilled labor is relatively low. Now it becomes possible to split off a portion of that production process, one that is less skill-intensive than the industry as a whole. In the absence of factor price equalization, this fragment of production will cost less in the developing country, to which it will now move if the cost savings more than covers any increased cost of transportation, communication, etc. How it will affect factor prices there, however, depends on just how unskilled-labor-intensive it is. If it is more skill-intensive than the average of existing production there – as it may well be, since all activities in the developing country are less skill intensive than those at home – then it will put upward pressure on the relative wage of skilled labor in the developing country. Since this relative wage was already higher than in the developed country, this particular example of fragmentation may be moving the two countries' factor prices further apart.³⁴ Of course, this is just one example, and fragmentation could equally well cause an even less skill-intensive fragment to be outsourced, in which case the effect on factor prices would be the reverse. The lesson is only that anything can happen, depending on factor intensities of fragments relative to factor endowments of the country. And there seems to be no reason to expect any one pattern of these factor intensities more than any other.

³⁴ What happens to factor prices in the other country depends on the factor intensities of the industry before and after fragmentation occurs, relative to factor endowments there. See Deardorff (2001a).

Imperfect Competition

We have assumed so far that firms engaged in FDI are perfectly competitive in all markets. Since these are multinational firms, large almost by definition, many would undoubtedly question this assumption. In fact we believe that the assumption is not that bad in many cases, since even large, multinational firms face considerable competition, both from others like themselves and from smaller actual and potential entrants. But it is surely worth asking whether market power can cause a firm engaging in FDI to pay wages higher or lower than we would expect from perfect competitors.

Imperfect competition can take many forms, of course, and there probably exist market structures that will yield just about any theoretical result that one wants to get. We won't play that game, but will merely assume that the firms we consider have some market power. That is, they face market prices that depend on the quantities they buy or sell, and we ask how this matters. Formally, our firms are now monopolists or monopsonists, or perhaps monopolistic competitors without our considering effects on entry.

The most obvious place for market power to matter for wages is in the labor market itself. Suppose that FDI creates a monopsonist buyer of labor in the host country. If it faces an upward-sloping supply curve of labor, such a firm will employ less labor and pay lower wages than it would under perfect competition, since it recognizes that the wage needed to elicit an additional unit of labor must be paid to all employees. Does this mean that such FDI actually lowers wages? Probably not, since the labor supply curve reflects whatever residual options the workers have, such as subsistence farming, and without the FDI the wage from these other sources would be no better, and perhaps even lower. However, it is not difficult to construct a scenario in which monopsonist FDI lowers wages. Suppose that prior to the FDI labor was employed by a competitive local industry with a more primitive and therefore lower-productivity technology than the multinational possesses. If the FDI, due to its superior technology, displaces those local firms, and if the resulting monopsonist multinational pays less than workers' (now higher) marginal product because of its market power, then wages might go down. This is only a possibility, of course; wages might just as well rise. It depends on the parameters of the problem.

Monopsony in labor markets is possible, and historically it may even have been quite common. But today's multinationals often tend to be attracted especially to urban areas where they must compete in labor markets with many other firms, so monopsony today is arguably less of a concern.

More obviously, many multinationals appear to have market power in output markets. One thinks immediately of prominent brands like Nike and McDonalds, but they are hardly alone. In fact, a great deal of production by and for multinationals is of inputs that are produced by many competing firms, so we would not regard market power in output markets as the norm. But it surely exists.

Suppose, then, that FDI is undertaken by a multinational firm that is a monopoly as a seller of its product, either to the world market or to the local, host-country market. How will this firm's behavior differ from that of a perfect competitor? The answer, of course, is that it will produce a smaller quantity and charge a higher price than a perfect competitor, meaning that its price will be above its marginal cost of production. On its face, this says nothing about the wages this firm will pay, and in fact, since we have now assumed no market power in the labor market, it will simply pay the market wage.

What is notable, however, is that, unlike a perfect competitor, this firm does not pay a wage that is equal to the value of its labor's marginal product. Instead, its wage is equal to its marginal revenue product, taking into account that the output of an additional worker would have to be sold on the product market by charging a lower price on all inframarginal units. Put simply, because the monopolist charges a monopoly price for its product, the value of what a worker produces at the margin, valued at the monopoly price, is higher than the wage. Of course there are many reasons why the market price of a Nike shoe is much higher than the cost of the labor that produces it, including payments to many other inputs in both production and distribution, but the fact that the shoe is sold for a monopoly price contributes to this. This does not mean that Nike's market power in the shoe market has permitted it to pay a lower wage to labor; it has not. But it does contribute to the perception that Nike could afford to pay its workers more. And indeed it could, if it were somehow willing or compelled to accept a smaller monopoly profit.

Under the heading of imperfect competition, we should also consider the possibility that labor markets may depart from the perfectly competitive norm on the supply side, rather than (or as well as) on the demand side. That is, labor markets may be unionized, or they might have the potential for being unionized if multinational firms were not present. Here is perhaps the clearest case we can see for FDI and multinational firms to reduce wages, since any market power that workers may be able to acquire by organizing is bound to be diminished if the firms that they bargain with have the option, as multinationals, of producing elsewhere. Unions are in fact notoriously weak in developing countries, and they were already weak, in most cases, before the arrival of multinational firms. But as these countries' incomes rise, it is plausible that unions would gain in strength, and that they would gain faster, other things equal, if multinational firms were not present. Other things would not be equal, however, and without FDI the growth of income that permits the growth of unions might not occur.

The presence of unions matters in another way, however, when it is combined with product market power by the employers. Bargaining over wages will result in workers sharing a part of the firm's monopoly profits, as discussed and documented by Katz and Summers (1989).³⁵ If a multinational has greater profit than a domestic employer, then it may well pay higher wages for this reason, offsetting the effects of its greater bargaining power.

Payment of Above-Market Wages

Except for this last-mentioned possibility of bilateral monopoly involving a multinational and a union, the theories we have considered so far do not allow for or explain a phenomenon that we will see below to be quite common: that multinational firms pay higher wages than do local, host-country firms. To a partial extent, this phenomenon is an artifact of the data. If multinational firms draw on different parts of the labor market than average local firms, then they may pay higher wages just because on average they require different sorts of workers, in terms of education, skill, or location. However, the evidence below will show that multinationals continue to pay higher wages than local firms even after accounting for

³⁵ See also Budd et al. (2002) and references cited therein.

these effects and several others. Standard competitive models, and even most familiar models of imperfect competition, do not explain this. Nor does the suggestion, often made, that workers are somehow more productive in multinational firms, since as we have seen in looking at the role of technology, this does not provide a valid theoretical reason for firms to pay higher wages than are needed to attract their workers.

Relatively standard explanations for this behavior do exist, however, in the macroeconomic literature on efficiency wages that was developed to explain both downward wage rigidity and unemployment. There are several versions of this theory, summarized for example in Yellen (1984), all of them providing reasons why workers will become more productive or efficient as a result of being paid more. That is, in efficiency wage theory, the high wage is not the result of higher productivity, but its cause.

The simplest and apparently oldest version of efficiency wage theory applies best to developing countries, where market wages may be insufficient to sustain workers' health. Firms may therefore pay higher than the market wage in order to improve the health of their workers and thus their productivity. Other versions of the theory depend on somewhat more complex modeling of interactions between firms and workers. They can be summarized by saying that firms pay higher than market wages in order to: (1) reduce shirking (or elicit greater effort); (2) reduce turnover and the costs of retraining; (3) attract and retain the most able and productive workers from a heterogeneous workforce; and (4) improve worker morale in a context where social pressures can make workers more productive.

An alternative explanation for payment of above-market wages is possible in precisely the context that anti-globalization protest is serving to create. In the preceding section, we discussed the Anti-Sweatshop Campaign and other public pressures that have been brought to bear on multinationals for allegedly mistreating their workers. This pressure may well be creating a reluctance on the part of at least the most visible multinationals to be seen providing wages and working conditions that could become a source of embarrassment and lost sales, even when these are at levels generally prevailing in local markets. In response to that pressure, then, they may pay above equilibrium wages even when they do

not expect this to improve the productivity of their workers. It is unlikely that much of the empirical evidence for high wages by multinationals could be due to this, since the data mostly predate the anti-globalization movement. However, it is plausible that multinationals may currently be responding to that pressure, and that future studies of wages paid by multinationals will reflect that.

In all of these stories, it is clear that the workers who receive the above-market wages are better off than those who do not (although in the case of efficiency wages this gain may be partially offset by any extra effort that they provide in return). And if FDI expands employment in firms that pay above-market wages, a larger number of workers will enjoy these benefits. However, it is not necessarily clear that all workers, on average, are better off. The efficiency wage models, in particular, were developed in part to help explain unemployment. Indeed it is likely that above-market wages, whatever their cause, will be accompanied by increased unemployment of workers who are waiting and hoping to get these desirable jobs.

Years ago, Harris and Todaro (1970) proposed a model in which a given above-equilibrium wage was paid in the urban sector of an economy, inducing migration from the rural sector and urban unemployment to the point that the expected wage of these migrants equaled the lower rural wage. This expected wage included not only the high wage of employed workers, weighted by the probability of employment, but also the zero wage of the unemployed weighted by the probability of not finding a job. This same model could be applied within an urban sector, where certain firms pay higher than market wages for any of the reasons we have discussed. They too will attract a larger pool of workers than they can employ, workers who will accept either unemployment or lower-than-market wages in return for the chance of eventually getting one of these high paid jobs. In equilibrium workers as a group, both employed and unemployed, are not better off than those who continue to work elsewhere in the economy for the market wage. And of course there is the additional unhappy consequence of greater inequality among workers, some of whom have these high paying jobs and others of whom do not.

In this framework, the market offers potential workers the same expected wage that they can earn somewhere else, far from the high-wage sector. Therefore, simply adding more firms that pay above-

market wages may not change that equilibrium expected wage. Instead, although the market looks close up very different from the usual competitive model, the underlying forces that will change average wages economy-wide will be the same forces of supply and demand that we have discussed earlier.

In the case of efficiency wages, the firms get something in return for their higher wages that they could not necessarily get elsewhere – higher productivity from their employees – and that together with the low market wage, to which the wage premium is added, is what attracts them to produce in these countries in the first place. But when above-market wages are being paid for other reasons, such as pressures from NGOs, enforcement of minimum wage laws, or even fear of government sanctions, the benefit of avoiding public censure may be obtained as well by producing somewhere else rather than by paying higher wages in poor countries. Whatever may be the level of wages and working conditions that will satisfy a critical public, firms may choose to produce in countries where that level is already the equilibrium due to workers' higher productivity. If so, then an additional effect of the pressure to pay higher wages will be a loss of employment in low-wage countries.

Leamer (1999) has provided an account of wage differentials that differs somewhat from the efficiency wage story, although it too rests on the degree of effort exerted by workers. His model has the advantage of being amenable to general equilibrium analysis. In his model, "effort" determines total factor productivity in a two-sector, two-factor context that is otherwise that of the HO model. Since the return to effort is, in effect, higher in the more capital-intensive sector, equilibrium has that sector paying higher wages and requiring greater effort from its workers than the labor-intensive sector. This model has a long list of striking implications, only one of which need concern us here.

In Leamer's effort model, an increase in a country's capital stock, which could (but need not) be due to FDI, has remarkably different implications in closed and open economies. In a closed economy, increased capital lowers the relative price of the capital-intensive good. This lowers the return to effort and leads to a reduction in effort levels in both sectors. In a small open economy, on the other hand, increased capital may, in one type of equilibrium, leave factor prices and effort levels unchanged, through

a variant of FPE. But, in another type of equilibrium, it may lead instead to new production of capital-intensive goods, thus creating higher-effort, higher-wage jobs.

All of the cases we have considered in this theoretical overview – capital flow, technology flow, and fragmentation – have failed to yield unambiguous conclusions about the effects of FDI and multinational firms on equilibrium wages in host countries. Even when we examined reasons for multinationals to pay above-equilibrium wages, there was no assurance that they would do so. There seems to be a presumption, at least in the case of capital flows, that FDI will raise at least some wages, but even this is not certain, and it becomes even less so when we recognize other forms of multinational activity such as fragmentation. It is therefore an empirical question whether the actual operations of multinationals have raised or lowered wages in developing countries. It is to that empirical question that we now turn.

IV. Effects on Wages and Working Conditions: What are the Facts?

In this section, we review the evidence on wages and working conditions associated with multinationals. We first consider the effects on wages and thereafter the relationship between FDI and labor rights broadly conceived.

Foreign Ownership and Wages

The published evidence on the effects of foreign ownership on wages in developing countries is based on ad hoc observations and surveys as well as a number of studies using econometric methods.

Lim (2001, pp. 39-40) provides a useful summary of some evidence that foreign-owned and subcontracting firms in manufacturing industries tend to pay higher wages than domestic firms:³⁶

³⁶ See also Kristof and WuDunn (2000). Much of the available information evidently refers to wages in manufacturing. It would be useful accordingly to obtain information on wages paid by foreign-owned and subcontracting industries in extractive industries such as mining and in service industries in different developing countries.

- ?? Affiliates of U.S. multinational enterprises pay a wage premium that ranges from 40 percent in high-income countries to 100 percent, or double the local average in low-income countries.³⁷ Graham (2000)
- ?? Workers in foreign-owned and subcontracting apparel and footwear factories in Vietnam rank in the top 20 percent of the population by household expenditure. Glewwe (2000)
- ?? In Nike subcontractor factories in June/July 2000, annual wages were \$670 compared with an average minimum wage of \$134. In Indonesia, annual wages were \$720 compared with an average annual minimum of \$241. Lim (2000)
- ?? In Bangladesh, legal minimum wages in export processing zones were 40 percent higher than the national minimum for unskilled workers, 15 percent higher for semi-skilled workers, and 50 percent higher for skilled workers. Panos (1999)
- ?? In Mexico, firms with between 40 and 80 percent of their total sales going to exports paid wages that were, at the low end, 11 percent higher than the wages of non-export oriented firms; for companies with export sales above 80 percent, wages were between 58 and 67 percent higher. Lukacs (2000)
- ?? In Shanghai, a survey of 48 U.S.-based companies found that respondents paid an average hourly wage of \$5.25, excluding benefits and bonuses, or about \$10,900 per year. At a jointly-owned GM factory in Shanghai, workers earned \$4.59 an hour, including benefits; this is about three times higher than wages for comparable work at a non-U.S. factory in Shanghai. Lukacs (2000)

According to a report on Nike contract factories in Vietnam and Indonesia by students from The Amos Tuck School at Dartmouth College, Calzini et al. (1997, p. 2):

- ?? For factory workers living on their own, Nike contract factory wages allow workers to generate discretionary income in excess of basic expenditures such as food, housing, and transportation.
- ?? For workers living in extended-family households, Nike contract factory wages are used to augment total household income to raise overall living standards.
- ?? Nike contract factory workers consistently earn wages at or above government-mandated minimum wage levels.
- ?? Given the employment opportunities available, Nike contract factories offer an economically attractive alternative for entry-level workers. Nike contract factory jobs provide workers a consistent stream of income in contrast to common alternatives such as farming or shop-keeping. There are significantly more applicants than factory positions available.

³⁷ It may be noted further, according to OECD (2001, Fig. 8) that compensation per employee of firms under foreign control in the OECD countries was substantially higher than the average for national firms.

?? In Indonesia, non-cash benefits provided help to offset recurring expenses for food, housing, and transportation.

?? In Vietnam, overtime wages are perceived by workers to be an attractive means to supplement base income levels.

Moran (2002, Ch. 1, 2) provides extensive evidence on wages and related benefits of FDI and foreign-originated subcontracting in low-skill and low-wage sectors in developing countries as follows:

?? The ILO (1998) finds, based on worker surveys, that wages paid in export-processing zones (EPZs) are higher than in the villages from which workers are typically recruited.

?? The U.S. Department of Labor (2000) finds that footwear and apparel manufacturers in selected countries pay higher wages and offer better working conditions than those available in agriculture.

?? The International Youth Foundation (2000) surveyed three footwear and two apparel factories in Thailand and found that 72 percent found their wages to be “fair” and 60 percent were able to accumulate savings.

?? Bhattacharya (1998) reports that garment workers in Bangladesh earn 25 percent more than the country’s average per capita income.

?? Razafindrakoto and Roubaud (1995, p. 226) find that EPZ workers in Madagascar earned 15-20 percent more than the average worker in the rest of the economy even after controlling for education level, extent of professional experience, and tenure in employment.

?? Workers in the Philippine EPZ reported themselves to be better off after finding employment in the EPZ during the 1990s. As reported by the World Bank (1998, Appendix C), 47 percent of workers earned enough to have some savings as compared to 9 percent before employment in the zone. In addition, employees received social security, medical care, paid vacation, sick leave, maternity leave, and other employee benefits.

Let us next consider some econometric-based evidence on the wage effects of multinationals. The earliest evidence grew out of a literature examining the role of FDI in transmitting technology internationally. The impact of FDI on wages was used as an indication that technological know-how raises labor productivity. For example, Aitken, Harrison, and Lipsey (1996) explored the impact of foreign ownership in Mexico, Venezuela and the United States. They found that the presence of foreign ownership significantly raises wages within the plant in all three countries, but the impact spills over into locally-owned plants only in the United States.

For all three countries, manufacturing survey data were analyzed. In the case of Mexico, 2,113 plants were surveyed concerning factor usage, sales, equity ownership, and input and output prices. Data were also available on industry and location. For Venezuela, data were available on foreign ownership, assets, employment, input costs, and location for all plants employing more than 50 workers. The log of the industry/region average wage was regressed on the proportion of employment in foreign-owned firms within the industry-region, a measure of the capital stock, royalty payments, and average output and input prices. Aitken et al. found that a 10 percent increase in the share of foreign investment in regional/industry employment raised wages on the order of 2.5 percent in Mexico and Venezuela. However, when the analysis was restricted to domestic-owned firms, the foreign investment variable was insignificant.

The empirical analysis was then performed at the plant level, incorporating information on plant size and age. As with the industry-level analysis, the extent of foreign ownership raised wages of both skilled and unskilled workers, with the impact on skilled workers about 50 percent higher than for unskilled workers. However, as will be seen in the case for Indonesia noted below, about one third of the wage-premium paid by foreign-owned firms was accounted for by larger plant size.

In order to identify the source of the FDI wage premium, Aitken et al. analyzed a cross-section of firms for Venezuela and the United States in 1987 and Mexico in 1990. They took as a point of departure that foreign-owned firms in all three countries paid about 30 percent more than domestic firms for both skilled and unskilled labor. Controlling for industrial sector, they first found that this accounted for a significant portion of the FDI wage premium. That is, foreign firms tended to locate in higher-paying sectors of the economy. For the United States, industry effects accounted for about half of the premium. In Mexico the figure was two-thirds and for Venezuela the figure was one-third. They then considered location. In the case of the United States, foreign-owned firms actually tended to locate in low-wage regions. As a consequence, controlling for region made the FDI wage premium larger. However, foreign affiliates were located in high wage regions of Venezuela and Mexico. Nevertheless, even after controlling for region, foreign-owned firms paid more than domestic firms. Finally, Aitken et al.

controlled for plant size and capital intensity. Foreign-owned firms tended to operate larger facilities, giving rise to economies of scale that may raise wages. However, as with location and industry, the foreign ownership variable retained some explanatory power. Unfortunately, Aitken et al. did not report regression results in which they controlled for industry, location, plant size, and capital intensity simultaneously. As a consequence, it is not possible to tell whether foreign ownership serves as a proxy for the omitted variables in each equation. Nevertheless, the Aitken et al. results support the view that foreign-owned firms pay premium wages.

Further supporting evidence is found by Feenstra and Hanson (1997) in their study of the impact of foreign owned capital on the skilled-labor wage premium in Mexico for the period 1975-1988. They found in particular that foreign capital impacts the demand for skilled labor disproportionately. FDI constitutes a significant and growing portion of the capital stock in Mexico. In 1987, FDI accounted for 13.7 percent of total fixed investment in Mexico, a level sufficient to affect the demand for labor. A surge in investment in the border region occurred following liberalization measures enacted by Mexico between 1982 and 1985. Rules prohibiting majority foreign ownership were relaxed, and the average tariffs were lowered from 23.5 to 11.8 percent. In the immediate aftermath, the share of FDI in total investment in Mexico rose nearly six-fold. At the same time, the wages of skilled and unskilled workers began to diverge after nearly 20 years of convergence.

In order to test whether FDI in the maquiladoras contributed to the growing wage disparity in Mexico during the 1980s, Feenstra and Hanson analyzed labor-market census data for nine 2-digit ISIC categories in 32 states for the three periods, 1975-1980, 1980-1985, and 1985-1988. The nonproduction wage bill as a fraction of the total wage bill was regressed on a measure of alternative wages for skilled and unskilled workers, the state's domestic capital stock, and the ratio of maquiladoras in a state to the number of domestically-owned establishments. They found that the fraction of establishments that are foreign-owned significantly raised the relative return to skilled labor. Between 1985 and 1988, FDI accounted for 52.4 percent of the increase in the wage share of nonproduction workers in the border region.

Although Feenstra and Hanson's results are informative, they focus primarily on the impact that foreign ownership has on the demand for labor in local factor markets, thereby providing little evidence on the specific labor practices of multinational firms. The evidence presented above supports the view that multinational firms are improving the lives of at least some workers by raising overall labor demand. However, in order to respond to some of the challenges raised by the issue of sweatshop labor, we might also want to know whether foreign-owned firms play a positive role by altering industry characteristics or by paying above-market wages.

To this end, Lipsey and Sjöholm (2001) analyzed the wages paid by foreign-owned plants in Indonesia.³⁸ They were specifically interested in whether foreign-owned firms pay more for local workers than domestic firms and, if so, why. Can the difference be attributed to plant characteristics, worker characteristics, or industry characteristics? Further, do the labor practices of multinationals affect the wages paid by local firms? Lipsey and Sjöholm analyzed survey evidence for all plants in Indonesia that had more than 20 employees. In 1996, 19,911 plant managers responded to the survey, providing data on value-added, energy inputs, location, and labor characteristics for blue collar and white-collar workers.

Lipsey and Sjöholm used the plant-level data to estimate a standard wage equation. The log of the average plant-level wage was regressed on average education level (as measured by proportion of workers with primary, junior, senior, and university education), plant characteristics including size, proportion of workers that are female, energy inputs, other inputs, and binary variables for foreign ownership, government ownership, sector, and location.

Three separate wage equations were estimated. First, Lipsey and Sjöholm controlled only for ownership and education level. They found that foreign-owned firms paid 33 percent more for blue-collar workers and 70 percent more for white-collar workers than locally owned firms. So the next question was, what is it about foreign-owned firms that produces the premium? When the region and sector dummy variables were added to the regression equation, the premium fell to 25 percent for blue-collar

³⁸ Hill (1990) and Manning (1998) also find that foreign firms pay higher wages than domestic firms in Indonesia.

workers and 50 percent more for white-collar workers. Finally, controlling for plant size, energy inputs per worker, other inputs per worker and the proportion of employees that is female, the foreign-ownership premium fell to 12 percent for blue-collar and 22 percent for white-collar workers. So, about one-third of the foreign-ownership premium for labor of a specific quality was accounted for by region and industry, one-third by inputs and plant size, leaving one-third of the premium unexplained. Thus, foreign-owned firms are raising wages for blue-collar and white-collar workers above and beyond the impact of increased productivity associated with more inputs per worker and a more efficient scale of production.

Lipsey and Sjöholm suggested several reasons why foreign-owned firms might pay a higher wage for the same quality of labor and in the same industrial setting. One possibility, of course, is that they are responding to social pressure to combat desperately poor working conditions. However, foreign-owned firms may have less knowledge of the local market, want to invest in the skills of their employees, or fear the loss of competitive advantage to locally-owned firms. Alternatively, workers may prefer domestic-owned firms, requiring foreign firms to pay a premium.

Lipsey and Sjöholm also considered whether the presence of FDI raises the wages in domestically-owned plants. They regressed the log of wages in domestically-owned plants on worker, plant, and industry characteristics, but also included a variable indicating the proportion of industry value-added produced in foreign-owned plants. In contrast to the results obtained by Aitken et al. in the case of Mexico and Venezuela, the presence of foreign owned firms in an industry significantly affected the wages paid by domestically owned firms in Indonesia. This was the case whether industries were defined at the 2-, 3- or 5-digit level.

Given these findings that foreign-owned firms pay higher wages even after controlling for scale, worker quality, industry, age of facility, inputs and industry and regional characteristics, one might wonder whether firms are motivated by humanitarian concerns or public pressure. Similarly, foreign-owned firms could be more likely to conform with laws regulating minimum wages, overtime pay, and benefits. However, if humanitarian concern or public and legal pressure are the motivating factors, we might expect that the impact would be most pronounced for the most poorly paid workers. However, this

is not the case. That is, the largest bonus for working with foreign capital apparently accrues to skilled/white-collar workers. Thus, while foreign capital may raise wages on average, it may also tend to worsen the distribution of income.

Alternatively, it has been suggested (as discussed above) that foreign firms pay premium wages for unobservable characteristics such as intelligence, flexibility or discipline. Employees who reveal these capabilities after they are hired are likely to be retained with higher-than-average compensation.

However, it is important to note first that there is considerable evidence that the HDI wage premium is a consequence of total factor and labor productivity gains associated with foreign ownership. In this connection, a positive correlation between productivity gains and foreign ownership was found by: Aitken and Harrison (1993) for Venezuela; Haddad and Harrison (1993) for Morocco; Harrison (1993) for Cote d'Ivoire; and Luttmer and Oks (1993) for Mexico.

Furthermore, Budd and Slaughter (2000) and Budd, Konings, and Slaughter (2001) present evidence that multinationals share profits with local and foreign workers. They find, in particular, that affiliate wages are positively correlated with parent profits. They argue that such profit sharing is profit-maximizing in a model in which both workers and firms are risk-averse. Profit sharing will also emerge if wages are set in a bargaining framework in which the firm's ability to pay depends positively on profitability.

Foreign Direct Investment and Labor Rights

In addition to the controversy about the effects of multinationals on wages, it is often argued that they are attracted to markets where worker rights are poorly protected. That is, multinationals are alleged to seek out havens safe from union activism, and there is no shortage of governments willing to accommodate the interests of foreign capital. The allegation stems in part from the view that foreign firms have lower labor costs in locations with weak labor protections. Indeed, several studies find that FDI is attracted to regions with low labor cost after controlling for productivity.

Studies of the role of labor costs in foreign investment decisions provide ambiguous evidence, with some studies finding a positive correlation and others a negative correlation. (See for example: Schneider and Frey (1985); Jun and Singh (1997); Wheeler and Moody (1992); Billington (1999); Cooke and Noble (1999); and Head, Ries, and Swenson (1999)). However, these studies all suffer from the weakness that they do not control for labor productivity. As a consequence, studies that find a positive correlation between wages and FDI, without controlling for productivity, suffer from the weakness that wages are probably a proxy for productivity rather than labor costs.

In contrast, Culem (1988), in an analysis of bilateral FDI flows among a selection of industrialized countries between 1969 and 1982, found that FDI was significantly adversely affected by high labor costs once output per worker was introduced as an explanatory variable. Similarly, Friedman, Gerlowski and Silberman (1992) found that the allocation of FDI across individual states in the United States between 1977 and 1988 was significantly affected by the relative labor costs of individual states, after controlling for state-level labor productivity.

However, in a recent survey of managers of transnational corporations reported by Hatem (1997), several other factors were considerably more important than labor cost when selecting a site for FDI. Market size, political and social stability, labor quality, the legal and regulatory environment, and infrastructure were all rated as more important than the cost of labor. Labor rights that promote political stability and enhance labor quality may in fact make a particular location attractive to foreign investors.

For this reason, it is useful to separate the role that worker rights play in raising labor costs relative to labor productivity from those that improve the efficient functioning of a production facility. For example, Head, Ries, and Swenson (1999) found that the unionization rate in a U.S. state lowered the inflow of Japanese investment. Cooke and Noble (1999) found similar adverse effects of unionization in developing countries. However, Friedman, Gerlowski and Silberman (1992) found that Japanese firms were more likely to locate a plant in a state with a high unionization rate after controlling for wages and productivity. Thus, it seems, that as long as the union does not raise wages above worker productivity, Japanese firms appear to believe that unions play a positive role in the plant.

Of course, worker rights are not limited to collective bargaining. The empirical evidence on worker rights more broadly defined is unambiguous. No matter how worker rights are defined, foreign investors are *not* attracted to countries with poorly protected worker rights. Similarly, political and social stability have a positive impact on the choices of foreign investors.

Cooke and Noble (1999) found that U.S. outward FDI was positively correlated with the number of ILO conventions ratified. OECD (2000) found that FDI was positively correlated with the right to establish free unions, the right to strike, the right to collective bargaining, and protection of union members. Rodrik (1996) found that U.S. outward FDI between 1982 and 1989 was positively correlated with a Freedom House democracy index but was deterred by a high index of child labor. This was the case even though countries with a high democracy index and a low child-labor index had higher labor costs.

The work on FDI and worker rights has been criticized on two accounts. Martin and Maskus (2001) in particular note the problems with relying on ILO conventions ratified and the Freedom House indicators of democracy. Furthermore, the studies listed above did not control for other determinants of FDI. Kucera (2001) has attempted to improve on the existing literature on worker rights and labor costs by using multiple definitions of each type of worker rights.

Following Rodrik, Kucera first regressed the log of wages per employee on value added per employee, GDP per capita, manufacturing share of GDP, the urbanization rate, and multiple measures of freedom of association and collective bargaining, child labor, forced labor, and gender inequality. Data were for the period 1992-97 in 88 countries. First, like Rodrik (1999), Kucera found that wages were positively correlated with all of the measures of political freedom. Surprisingly, the unionization rate had an insignificant negative impact on wages. However, other measures of free association and collective bargaining rights had a positive impact on wages. These measures may be more interesting since they are based on observed rights violations. The evidence on child labor and wages was quite curious. First, wages were positively correlated with labor-force-participation rates for 10-14 year olds. The coefficient on the secondary non-enrollment rate was also positive. Kucera noted that it is difficult to interpret such

results. Finally, in countries where the female proportion of the labor force was higher than average, wages were lower than average. However, this effect was not generally statistically significant.

Kucera then turned to estimate the impact of worker rights on FDI. Each country's share of FDI inflows was regressed on wages relative to value-added in manufacturing, population, per capita GDP, international trade's share of GDP, exchange rate growth, urbanization, literacy, and the measures of worker rights. He found several very interesting results:

- (1) FDI is attracted to countries with a higher civil liberties index even though labor costs are higher. A one unit increase in the civil-liberties index, controlling for wages, is associated with an 18.5 percent increase in FDI flows. When the negative impact of increased wages in democracies is factored in, a one-unit increase in the civil-liberties index raises FDI inflows by 14.3 percent. So even though democracies pay higher wages for a given level of worker productivity, they still provide an attractive location for foreign investors.
- (2) Unionization rates are positively correlated with FDI, controlling for wages relative to labor productivity in equations that also include regional dummies.
- (3) FDI is higher in countries with fewer episodes in which rights to free association and collective bargaining are repressed.
- (4) FDI is negatively correlated with labor-force participation rates for 10-15 year olds. Otherwise results are mixed and not statistically significant.
- (5) Measures of gender discrimination are not statistically significant.

In short, there is no solid evidence that countries with poorly protected worker rights attract FDI. If anything, investors prefer locations in which workers and the public more generally function in a stable environment in which civil liberties are well established and enforced.

V. Conclusions

The popular press is rife with anecdotes about foreign workers who labor for multinational firms for low wages and for excruciating long hours under horrific conditions in low-income countries to produce goods for Western consumers. This negative impression that multinationals are exploiting and mistreating their workers is reinforced by calculations that labor costs are typically a tiny fraction of the retail-selling price of the goods being produced, and that the multinationals therefore can and should pay higher wages to their workers.

It is true that, as a theoretical matter, multinationals can have an array of positive and negative impacts on host-country workers. However, as an empirical matter, the anecdotal evidence notwithstanding, there is virtually no careful and systematic evidence demonstrating that, as a generality, multinational firms adversely affect their workers, provide incentives to worsen working conditions, pay lower wages than in alternative employment, or repress worker rights. In fact, the opposite appears to be the case. Foreign ownership raises wages both by raising labor productivity and expanding the scale of production, and, in the process, improving the conditions of work. Furthermore, there appears to be some evidence that foreign-owned firms make use of aspects of labor organizations and democratic institutions that improve the efficiency characteristics of their factory operations.

It is undoubtedly the case that public pressure can and ought to be brought to bear on some multinational firms and their suppliers who are abusing social norms to the detriment of their workers. But great care needs to be exercised since, generally, measures that are punitive or provide firms an incentive to alter the location of production are unwarranted and may adversely affect the very workers they are intended to benefit.

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| Model (sectors ? factors) | Small Country ^a | Two-Country Model ^b |
|---|----------------------------|--------------------------------|
| One-sector (1 ? 2) | + | + |
| HO (2 ? 2) diversified | 0 | 0 |
| HO (2 ? 2) specialized | + | + |
| Specific Factors (2 ? 3) | + | + |
| HO (3+ ? 2) two-cone, diversified | 0 | + |
| Feenstra-Hanson (? ? 3) two-cone, diversified | Skilled labor | + |
| | Unskilled labor | + |

^aThe small country is defined by facing world prices that are fixed independently of what it produces.

^bIn the two-country model, FDI here takes the form of an increase in the capital stock of the host country and an equal decrease in the capital stock of the other country.

| Model (sectors ? factors) | Nature of technology change | Effect on wage |
|-----------------------------------|-------------------------------------|----------------|
| One-sector (1 ? 2) | Neutral | + |
| | Labor using | + |
| | Labor saving | + or - |
| HO (2 ? 2) diversified | In labor-intensive sector | + |
| | In capital-intensive sector | - |
| HO (3+ ? 2) two-cone, diversified | In labor-intensive sector of cone | + |
| | In capital-intensive sector of cone | - |

Appendix 1

The Fair Labor Association

Workplace Code of Conduct

The Apparel Industry Partnership has addressed issues related to the eradication of sweatshops in the United States and abroad. On the basis of this examination, the Partnership has formulated the following set of standards defining decent and humane working conditions. The Partnership believes that consumers can have confidence that products that are manufactured in compliance with these standards are not produced under exploitative or inhumane conditions.

Forced Labor. There shall not be any use of forced labor, whether in the form of prison labor, indentured labor, bonded labor or otherwise.

Child Labor. No person shall be employed at an age younger than 15 (or 14 where the law of the country of manufacture^{*} allows) or younger than the age for completing compulsory education in the country of manufacture where such age is higher than 15.

Harassment or Abuse. Every employee shall be treated with respect and dignity. No employee shall be subject to any physical, sexual, psychological or verbal harassment or abuse.

Nondiscrimination. No person shall be subject to any discrimination in employment, including hiring, salary, benefits, advancement, discipline, termination or retirement, on the basis of gender, race, religion, age, disability, sexual orientation, nationality, political opinion, or social or ethnic origin.

Health and Safety. Employers shall provide a safe and healthy working environment to prevent accidents and injury to health arising out of, linked with, or occurring in the course of work or as a result of the operation of employer facilities.

Freedom of Association and Collective Bargaining. Employers shall recognize and respect the right of employees to freedom of association and collective bargaining.

Wages and Benefits. Employers recognize that wages are essential to meeting employees' basic needs. Employers shall pay employees, as a floor, at least the minimum wage required by local law or the prevailing industry wage, whichever is higher, and shall provide legally mandated benefits.

Hours of Work. Except in extraordinary business circumstances, employees shall (i) not be required to work more than the lesser of (a) 48 hours per week and 12 hours overtime or (b) the limits on regular and overtime hours allowed by the law of the country of manufacture or, where the laws of such country do not limit the hours of work, the regular work week in such country plus 12 hours overtime and (ii) be entitled to at least one day off in every seven day period.

Overtime Compensation. In addition to their compensation for regular hours of work, employees shall be compensated for overtime hours at such premium rate as is legally required in the country of

* All references to local law throughout this Code shall include regulations implemented in accordance with applicable local law.

manufacture or, in those countries where such laws do not exist, at a rate at least equal to their regular hourly compensation rate.

* * *

Any Company that determines to adopt the Workplace Code of Conduct shall, in addition to complying with all applicable laws of the country of manufacture, comply with and support the Workplace Code of Conduct in accordance with the attached Principles of Monitoring and shall apply the higher standard in cases of differences or conflicts. Any Company that determines to adopt the Workplace Code of Conduct also shall require its licensees and contractors and, in the case of a retailer, its suppliers to comply with applicable local laws and with this Code in accordance with the attached Principles of Monitoring and to apply the higher standard in cases of differences or conflicts.

Source: www.fairlabor.org

Appendix 2

The Worker Rights Consortium

Model Code of Conduct

Member schools may adopt this code as the standard they will require of licensees. The Worker Rights Consortium will use this code of conduct as the basis for its investigations.

I. Introduction

- A. The Universities participating in the Worker Rights Consortium are each committed to conducting their business affairs in a socially responsible and ethical manner consistent with their respective educational, research and/or service missions, and to protecting and preserving the global environment.
- B. While the Consortium and the Member Institutions believe that Licensees share this commitment, the Consortium and the Member Institutions have adopted the following Code of Conduct (the “Code”) which requires that all Licensees, at a minimum, adhere to the principles set forth in the Code.
- C. Throughout the Code the term “Licensee” shall include all persons or entities which have entered into a written “License Agreement” with the University manufacture “Licensed Articles” (as that term is defined in the License Agreement) bearing the names, trademarks and/or images of one or more Member Institutions. The term “Licensee” shall for purposes of the Code, and unless otherwise specified in the Code, encompass all of Licensees’ contractors, subcontractors or manufacturers which produce, assemble or package finished Licensed Articles for the consumer.

II. Notice

- A. The principles set forth in the Code shall apply to all Licensees.
- B. As a condition of being permitted to produce and/or sell Licensed Articles, Licensees must comply with the Code. Licensees are required to adhere to the Code within six (6) months of notification of the Code and as required in applicable license agreements.

III. Standards

- A. Licensees agree to operate work places and contract with companies whose work places adhere to the standards and practices described below. The University prefers that Licensees exceed these standards.
- B. Legal Compliance: Licensees must comply with all applicable legal requirements of the country(ies) of manufacture in conducting business related to or involving the production or sale of Licensed Articles. Where there are differences or conflicts with the Code and the laws of the country(ies) of manufacture, the higher standard shall prevail, subject to the considerations stated in Section VI.
- C. Employment Standards: Licensees shall comply with the following standards:

1. *Wages and Benefits*: Licensees recognize that wages are essential to meeting employees' basic needs. Licensees shall pay employees, as a floor, wages and benefits which comply with all applicable laws and regulations, and which provide for essential needs and establish a dignified living wage for workers and their families. [A living wage is a "take home" or "net" wage, earned during a country's legal maximum work week, but not more than 48 hours. A living wage provides for the basic needs (housing, energy, nutrition, clothing, health care, education, potable water, childcare, transportation and savings) of an average family unit of employees in the garment manufacturing employment sector of the country divided by the average number of adult wage earners in the family unit of employees in the garment manufacturing employment sector of the country.]
2. *Working Hours*: Hourly and/or quota-based wage employees shall (i) not be required to work more than the lesser of (a) 48 hours per week or (b) the limits on regular hours allowed by the law of the country of manufacture, and (ii) be entitled to at least one day off in every seven day period, as well as holidays and vacations.
3. *Overtime Compensation*: All overtime hours must be worked voluntarily by employees. In addition to their compensation for regular hours of work, hourly and/or quota-based wage employees shall be compensated for overtime hours at such a premium rate as is legally required in the country of manufacture or, in those countries where such laws do not exist, at a rate at least one and one-half their regular hourly compensation rate.
4. *Child Labor*: Licensees shall not employ any person at an age younger than 15 (or 14, where, consistent with International Labor Organization practices for developing countries, the law of the country of manufacture allows such exception). Where the age for completing compulsory education is higher than the standard for the minimum age of employment stated above, the higher age for completing compulsory education shall apply to this section. Licensees agree to consult with governmental, human rights, and nongovernmental organizations, and to take reasonable steps as evaluated by the University to minimize the negative impact on children released from employment as a result of implementation or enforcement of the Code.
5. *Forced Labor*: There shall not be any use of forced prison labor, indentured labor, bonded labor or other forced labor.
6. *Health and Safety*: Licensees shall provide a safe and healthy working environment to prevent accidents and injury to health arising out of, linked with, or occurring in the course of work or as a result of the operation of Licensee facilities. In addition, Licensees must comply with the following provisions:
 - a. The Licensee shall ensure that its direct operations and those of any subcontractors comply with all workplace safety and health regulations established by the national government where the production facility is located, or with Title 29 CFR of the Federal Code of Regulations, enforced by Federal OSHA (Occupational Safety and Health Administration), whichever regulation is more health protective for a given hazard.
 - b. The Licensee shall ensure that its direct operations and subcontractors comply with all health and safety conventions of the International Labor Organization (ILO) ratified and adopted by the country in which the production facility is located.
7. *Nondiscrimination*: No person shall be subject to any discrimination in employment, including hiring, salary, benefits, advancement, discipline, termination or retirement, on the basis of gender,

race, religion, age, disability, sexual orientation, nationality, political opinion, or social or ethnic origin.

8. *Harassment or Abuse*: Every employee shall be treated with dignity and respect. No employee shall be subject to any physical, sexual, psychological, or verbal harassment or abuse. Licensees will not use or tolerate any form of corporal punishment.
9. *Freedom of Association and Collective Bargaining*: Licensees shall recognize and respect the right of employees to freedom of association and collective bargaining. No employee shall be subject to harassment, intimidation or retaliation in their efforts to freely associate or bargain collectively. Licensees shall not cooperate with governmental agencies and other organizations that use the power of the State to prevent workers from organizing a union of their choice. Licensees shall allow union organizers free access to employees. Licensees shall recognize the union of the employees' choice.

10. *Women's Rights*

- a. Women workers will receive equal remuneration, including benefits; equal treatment; equal evaluation of the quality of their work; and equal opportunity to fill all positions open to male workers.
- b. Pregnancy tests will not be a condition of employment, nor will they be demanded of employees.
- c. Workers who take maternity leave will not face dismissal nor threat of dismissal, loss of seniority or deduction of wages, and will be able to return to their former employment at the same rate of pay and benefits.
- d. Workers will not be forced or pressured to use contraception.
- e. Workers will not be exposed to hazards, including glues and solvents, that may endanger their safety, including their reproductive health.
- f. Licensees shall provide appropriate services and accommodation to women workers in connection with pregnancy.

IV. Compliance and Disclosure: Licensees (for themselves and on behalf of their contractors, subcontractors, or manufacturers) shall disclose to the Worker Rights Consortium, the University, and the public the information set forth in Sections A, B, and C below.

- A. Upon execution and renewal of the License Agreement and upon the selection of any new manufacturing facility which produces Licensed Articles, the company names, contacts, addresses, phone numbers, e-mail addresses, and nature of the business association for all such facilities which produce Licensed Articles;
- B. at least sixty (60) days prior to the end of each contract year of the License Agreement, written assurance that (i) Licensees are in compliance with the Code and/or (ii) licensees are taking reasonable steps to remedy non-compliance in facilities found not to be in compliance with the code;
- C. at least sixty (60) days prior to the end of each contract year of the License Agreement, a summary of those steps taken to remedy material violations, and/or difficulties encountered,

during the preceding year in implementing and enforcing the Code at all of Licensees' facilities which produce Licensed Articles.

V. Verification: It shall be the responsibility of Licensees (for themselves and on behalf of their contractors, subcontractors, or manufacturers) to ensure their compliance with the Code. The WRC and its Member Institutions will undertake efforts to determine and clearly define the obligations associated with the development of adequate methods and training for independent external monitoring, as guided by the principles in the founding document of the Consortium.

VI. Labor Standards Environment: In countries where law or practice conflicts with these labor standards, Licensees agree to consult with governmental, human rights, labor and business organizations and to take effective actions as evaluated by the University to achieve full compliance with each of these standards. Licensees further agree to refrain from any actions that would diminish the protections of these labor standards. In addition to all other rights under the Licensing Agreement, the University reserves the right to refuse renewal of Licensing Agreements for goods made in countries where:

- A. progress toward implementation of the employment standards in the Code is no longer being made; and
- B. compliance with the employment standards in the Code is deemed impossible. The University shall make such determinations based upon examination of reports from governmental, human rights, labor and business organizations and after consultation with the relevant Licensees.

VII. Remediation: Remedies herein apply to violations which occur after the Effective Date of the Code.

- A. If a Licensee has failed to self-correct a violation of the Code, the University will consult with the Licensee (for itself and on behalf of its contractors, subcontractors, or manufacturers) to determine appropriate corrective action.
- B. The remedy will, at a minimum, include requiring the licensee to take all steps necessary to correct such violations including, without limitation:
 1. Paying all applicable back wages found due to workers who manufactured the licensed articles.
 2. Reinstatement of any worker found to have been unlawfully dismissed.
- C. If agreement on corrective action is not reached, and/or the action does not result in correction of the violation within a specified reasonable time period, the University reserves the right to
 1. require that the Licensee terminate its relationship with any contractor, subcontractor, or manufacturer that continues to conduct its business in violation of the Code, and/or
 2. terminate its relationship with any Licensee that continues to conduct its business in violation of the Code.
- D. In either event, the University will provide the Licensee with thirty (30) days written notice of termination. In order to ensure the reasonable and consistent application of this provision, the University will seek advice from the Worker Rights Consortium regarding possible corrective measures and invocation of options 1 and 2 above.

Source: www.workersrights.org.

Appendix 3

ACIT Letter

September 25, 2000

Please find below a letter addressed to the presidents of American universities and colleges with regard to the issues raised by the Anti-Sweatshop campaign on American campuses and the decisions that have been taken. In this letter, we urge that the Anti-Sweatshop issues be subjected to more critical analysis and debated and discussed more widely than has been the case to date.

The authors of the letter are economists who are members of the Academic Consortium on International Trade (ACIT). ACIT is a group of academic economists and lawyers who are specialized in international trade policy and international economic law. ACIT's purpose is to prepare and circulate policy statements, letters, and papers dealing with issues of current importance to policy officials, members of the academic community, and other groups and the public. These are posted on the ACIT web site, www.spp.umich.edu/rsie/acit/. The members of the ACIT Steering Committee are listed below, together with signatories of this letter from a number of American academic institutions.

Dear Sir/Madam:

We, the undersigned, are concerned about the process by which decisions are being taken by some academic institutions in the ongoing Anti-Sweatshop campaign to establish Codes of Conduct to be applied to American firms manufacturing apparel with university/college logos in poor countries and about the choice among agencies appointed to monitor the activities of these firms.

We believe that the decisions on these matters by universities and colleges should be made only after careful research, discussion, and debate in a manner appropriate to informed decision-making. However, we often encounter news reports of sit-ins by groups of students in the offices of university/college administrators, after which decisions are often made without seeking the views of scholars in the social sciences, law, and humanities who have long discussed and researched the issues involved or of a broader campus constituency of fellow students and the entire community of faculty members. Furthermore, little attention has been given to whether the views of the Anti-Sweatshop campaign are representative of the views of the governments, non-government organizations (NGOs), and workers in the poor countries that are directly involved in the manufacture and in the export of apparel and related goods.

We recognize the good intentions of the Worker Rights Consortium (WRC) and the Fair Labor Association (FLA), which are the two main anti-sweatshop groups competing for membership commitments by universities and colleges. Both of these groups, however, seem to ignore the well-established fact that multinational corporations (MNCs) commonly pay their workers more on average in comparison to the prevailing market wage for similar workers employed elsewhere in the economy. In cases where subcontracting is involved, workers are generally paid no less than the prevailing market wage. We are concerned therefore that if MNCs are persuaded to pay even more to their apparel workers in response to what the ongoing studies by the anti-sweatshop organizations may conclude are appropriate wage levels, the net result would be shifts in employment that will worsen the collective welfare of the very workers in poor countries who are supposed to be helped. Further information on this and other issues involved in the anti-sweatshop campaign is posted on the ACIT web site.

We are also concerned that the monitoring mechanisms established by both the Worker Rights Consortium and Fair Labor Association may prove uneven and ineffective. Other certifying and monitoring organizations should also be considered, such as the Council on Economic Priorities Accreditation Agency (CEPAA), an international non-government organization with considerable experience in administering a Social Accountability Standard (SA8000). Under SA8000, member companies are required to comply with national and other applicable laws and to respect the principles of worker rights embodied in the pertinent Conventions of the International Labor Organization (ILO), the Universal Declaration of Human Rights, and the United Nations Convention on the Rights of the Child.

In view of the complexity of the broad economic and related issues that the subject of “Social Responsibility” raises, we stress the need for universities and colleges to properly research, debate, discuss, and take decisions on this matter in a manner more appropriate to the fact that they, of all institutions in society, must promote informed decision-making.

ACIT Steering Committee

Robert E. Baldwin, University of Wisconsin
Jagdish Bhagwati, Columbia University
Alan V. Deardorff, University of Michigan
Arvind Panagariya, University of Maryland
T.N. Srinivasan, Yale University
Robert M. Stern, University of Michigan

List of Signatories (attached separately)

Source: www.Fordschool.umich.edu/rsie/acit/

Appendix 4

SCHOLARS AGAINST SWEATSHOP LABOR (SASL)

STATEMENT

October, 2001

SASL Steering Committee

Lourdes Beneria, Cornell University
 James K. Galbraith, U. of Texas-Austin
 Teresa Ghilarducci, Notre Dame University
 Soohaeng Kim, Seoul National University
 Sule Ozler, U. of California-Los Angeles

Robert Pollin, Chair, U. of Massachusetts-
 Amherst
 Dani Rodrik, Harvard University
 Juliet Schor, Boston College
 Ajit Singh, University of Cambridge

A movement by college and university students to oppose sweatshop labor in the production of college logo apparel began in the United States in the mid-1990s. The movement has been highly successful in raising the awareness of students and the broader population about harsh conditions experienced by garment workers throughout the world, including the United States, but most especially less developed countries. The students have read accounts by reputable sources about sweatshops—for example, a 10/2/00 Business Week story titled "A Life of Fines and Beatings," which describes conditions in Chinese factories that make products for Wal-Mart, among other Western companies. The overarching aim of the anti-sweatshop movement is simple: to make a contribution toward eliminating 'lives of fines and beatings' for workers throughout the world, in the same way that previous generations of activists fought to eliminate slave labor, child labor, and the 12-hour workday. The anti-sweatshop movement wants workers worldwide be able to work under decent conditions, exercise basic human rights, and earn at least decent minimum wages.

In response to this student movement, many colleges and universities have adopted "codes of conduct" aimed at improving wages and working conditions for workers producing apparel that carries the logo of their own institutions. We, the undersigned, are broadly supportive of these efforts, even though we acknowledge that we do not have detailed information on the codes established at every institution.

During the past academic year, a group calling itself the "Academic Consortium on International Trade" (ACIT) circulated a letter to Presidents of Colleges and Universities, raising major concerns about these anti-sweatshop activities. As of June 2001, the letter has been signed by 352 economists and other academics, many of them distinguished practitioners in their fields of specialization. This letter is also posted on the ACIT website, <http://www.spp.umich.edu/rsie/acit/>.

The letter raises four basic concerns about the direction of the anti-sweatshop campaigns on college and university campuses:

1. Institutions are establishing codes of conduct without adequate consultation of experts knowledgeable in the relevant fields.
2. The two main organizations engaged in monitoring codes of conduct throughout the world—the Workers Rights Consortium (WRC) and the Fair Labor Association (FLA) may prove ineffective. The ACIT letter proposes that other groups also be considered as monitors, such as Social Accounting International (SAI; formerly known as Council on Economic Priorities Accreditation Agency).
3. Inadequate attention has been paid to whether the views of the anti-sweatshop movement are representative of the views of governments, non-governmental organizations (NGOs) and workers in the developing countries that are directly involved in the apparel industry.
4. Anti-sweatshop activists and the main monitoring organizations do not understand how establishing codes of conduct may actually harm the very low-wage workers in developing countries they are trying to help. In particular, the ACIT letter suggests that forcing businesses in less developed countries to pay higher wages and improve working conditions could reduce the overall availability of jobs in these countries.

We believe that these concerns raised by ACIT are legitimate. At the same time, we believe that the anti-sweatshop movement—and the colleges and universities that have embraced this movement through establishing codes of conduct in college logo apparel production—are taking constructive steps toward improving living and working conditions for millions of poor people throughout the world.

We expand on this conclusion below through addressing the main concerns raised in the ACIT letter.

Are colleges and universities making decisions about codes of conduct without adequate consultation?

Colleges and universities that have adopted codes of conduct have generally done so only after careful consultation with appropriate faculty and/or outside experts. We would be surprised if any institution of higher education were to act otherwise. But the ACIT letter also raises a broader issue: do college and university decision-makers have an adequate foundation of research on which to understand all the issues raised by the anti-sweatshop movement? Of course, scholars have been writing for generations about the most effective ways of alleviating poverty and enhancing conditions in workplaces. At the same time, the anti-sweatshop movement has prompted a new body of research and discussion that is deepening our understanding of the specific issues at hand. Universities have commissioned much of this new research. Links to many of these resources can be found at the SASL website, <http://www.umass.edu/peri/sasl>. No doubt more such work would be beneficial. For now, the anti-sweatshop movement deserves credit for pushing researchers to focus on these issues. With time, these efforts will produce both greater understanding and increasingly effective codes of conduct.

Worldwide Consultation and Monitoring

Establishing and monitoring acceptable codes of conduct for companies operating plants throughout the world are clearly difficult tasks. Achieving adequate levels of compliance will be a long, slow process requiring experimentation, flexibility and learning. Toward that end, ACIT's concern over the quality of monitoring is constructive. But the ACIT letter does not make clear that the three monitoring agencies that it refers to—the Workers Rights Consortium (WRC), Fair Labor Association (FLA), and Social Accountability International (SAI)—offer perspectives that are distinct and

complementary. The WRC governing and advisory boards are comprised of academics, university administrators, labor rights activists and NGOs from developing countries. In other words, the WRC has brought local stakeholders into the center of the monitoring process. This is exactly what the ACIT letter itself recommends. Moreover, the WRC is committed to maintaining transparent procedures for monitoring firms and disclosing the results of their inspections. Unlike the WRC, the Fair Labor Association includes representatives of business prominently on its board, in addition to having NGO and university representatives. The widespread concern voiced by activists over the governance of the FLA is that it gives too much power to businesses to effectively monitor their own behavior. We do not evaluate here the merits of this criticism. But even allowing that there is truth to it, it is still clear that the FLA is on the right track by including business representatives in their formal discussions, since no viable standards will emerge by excluding them. Social Accountability International, as the ACIT letter correctly points out, is more experienced than either the WRC or FLA in implementing monitoring and certification procedures for international businesses. However most of their previous work has been in the area of product quality control rather than social monitoring. In short, the three organizations bring different strengths to the task of establishing and monitoring effective labor standards worldwide. Ongoing cooperation and competition between these groups should also raise the general performance standard for all three.

Wages, Labor Costs, and Employment Opportunities in the Global Garment Industry

The ACIT letter says that multinational corporations "commonly pay their workers more on average in comparison to the prevailing market wage for similar workers employed elsewhere in the economy." While this is true, it does not speak to the situation in which most garments are produced throughout the world—which is by firms subcontracted by multinational corporations, not the MNCs themselves. In implicitly acknowledging this point, ACIT does also state that in the case of subcontracting, workers are "generally paid no less than the prevailing market wage." This is also true, almost by definition. But the prevailing market wage is frequently extremely low for garment workers in less developed countries. In addition, the recent university-sponsored studies as well as an October 2000 report by the International Labor Organization consistently find that serious workplace abuses and violations of workers' rights are occurring in the garment industry throughout the world. Considering simply the "prevailing market wage" in various countries thus tells us little about the working and living conditions of the workers who receive these wages.

The ACIT letter also raises a broader concern about the effort to raise wages and workplace standards for sweatshop workers: that improved labor standards could come at the cost of higher unemployment and a net loss of worker welfare. The aim of the anti-sweatshop movement is obviously not to induce negative unintended consequences such as higher overall unemployment in developing countries, nor to inhibit developing economies from competing successfully in global markets. The anti-sweatshop movement should take particular care that its efforts not produce fewer opportunities for people to get relatively high quality jobs in developing countries such as in some forms of garment production and other manufacturing and organized service sector activities. Even after allowing for the frequent low wages and poor working conditions in these jobs, they are still generally superior to "informal" employment in, for example, much of agriculture or urban street vending.

While caution is clearly needed in setting minimum decent standards for workplace conditions, workers rights, and wage levels, there is still no reason to assume that a country or region that sets reasonable standards must experience job losses. Additional policy measures will also be crucial for enhancing any region's overall employment opportunities and competitiveness. Such initiatives include: measures to expand the overall number of relatively high quality jobs; relief from excessive foreign debt payments; raising worker job satisfaction and productivity and the quality of goods they produce; and improving the capacity to bring final products to retail markets. Moreover, as long as consumers in wealthier countries

are willing to pay somewhat higher retail prices to ensure that garments are produced under non-sweatshop conditions—as recent polling data for the U.S. suggests is the case—the higher revenues within the industry could be used to improve workplace conditions and wages for production-level workers, without creating pressures for manufacturers to reduce their number of employees.

Establishing fair and effective labor market and workplace regulations is always a challenging task. But such regulations remain a cornerstone of any decent society. This has been clear from the historical struggles against slave labor onward. The need for such social protections has only increased in our contemporary era of globalization—contrary to the widespread premise that global economic integration should be synonymous with the dismantling of social protections.

The current anti-sweatshop movement on campuses can point to real achievements toward improving social protections worldwide: it has increased awareness about conditions facing sweatshop workers; and it has stimulated research and thinking as to the most effective ways U.S. academic institutions can contribute toward improving working conditions and living standards for these workers. Of course, both educational and monitoring efforts need to be strengthened, and anti-sweatshop activists need to maintain the open-minded approach they have demonstrated thus far in finding the most effective means of achieving the ends they desire. In this spirit, we broadly endorse the efforts of the anti-sweatshop movement. At the same time, we encourage anti-sweatshop activists to continue to deepen both their own understanding and their educational efforts—to examine conditions facing workers generally in developing countries, including those not employed in sweatshops; and to consider the most effective means of improving these general conditions.

Source: www.umass.edu/peri/sasl/