A hard-headed look at labour standards

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I. Introduction

The concept of labour standards — minimal rules for workplace conditions and outcomes imposed by legal mandate — typically invokes one of two reactions.

To some, standards are an institutional intervention in competitive markets that impairs the workings of the Invisible Hand. Standards, the argument goes, reduce efficiency, increase the cost of labour and lower the employment of those affected, to the benefit of higher-cost competitors. Adherents to this view stress that trade unions in advanced countries lead the fight for domestic or international labour standards not so much to benefit workers in non-union domestic firms or in foreign countries as to limit the ability of those firms/workers to compete in the market-place.

To others, standards lie at the heart of governmental or collectively bargained policies to preserve or raise living conditions and maintain social justice. Societies regulate many things, from food and drugs to security markets, and have developed international conventions to protect endangered species, be they turtles, owls, whales, rhinoceri, or such. Why not apply standards to protect the working lives of our own species? Adherents to this view stress the danger that bad standards will drive out good standards, and thus the need for regulations that affect all

1 In 1994, the United States Government has imposed trade sanctions against Taiwan for the sake of one such set of animals.
firms and countries: "the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries." (Preamble to the ILO Constitution)

These reactions make the argument about labour standards one of a set of running battles between those who believe the unlettered market can do no wrong and those who believe governmental regulations can make things better. If you like standards, trot out the (usual) arguments about market imperfections, externalities, unequal bargaining power, prisoners' dilemma or coordination games, etc. If you don't like standards, trot out the (usual) arguments about the wonders of the Invisible Hand, the ineffectiveness of governments to act in the public interest, rent-seeking, etc. The debate is long on ideology and rhetoric and short on analysis and evidence.

To give the "hard-headed" look at labour standards promised in my title, I step back from the debate to focus on the fact that, merits aside, a sizeable proportion of citizens want some labour standards in their own country and also want some standards in the production of goods imported from other countries, just as they want TVs, doughnuts or perfumes. Treating labour standards as a normal consumer good rather than as something extraneous to the economic system illuminates the underlying demand for standards; directs attention at the market and regulatory mechanisms that can supply standards to meet this demand, at the incidence of the benefits and costs of standards; and provides a vantage point for assessing whether standards should be part of global trade agreements.

II. Standards as an economic commodity

Everyone, or nearly everyone, wants some labour standards. Most countries, including the United States, enact labour standards for their citizens, and nearly every country has ratified some of the Conventions of the International Labour Organization (6,000 ratifications of 174 Conventions at the latest count) [ILO, 1994]. Among the ILO Conventions most commonly ratified are those on forced labour, freedom of association and the right to organize, collective bargaining and discrimination. The United States is a signatory to Conventions on hours worked and occupational health and safety, though it has not signed as many Conventions as other advanced countries. In the European Union (Common Market) all countries save the United Kingdom at this writing accept the Social Charter, with its labour standards.

To evaluate your (mine, society's) demand for standards, consider two T-shirts, identical in quality and with the same cool logo. One was manufactured by... Bosnian Serbs in an "ethnically cleansed" village... political prisoners in a labour camp... sexually harassed women in a free trade zone on a Caribbean island... Chinese convict labour... Indonesians whose efforts to unionize are suppressed by army brutality... Americans in a sweat-shop in New York or North Carolina or Los Angeles... whatever grabs you the most. The other was manufactured by Americans... Indians... Malaysians... Costa Ricans... Canadians... Dominicans... Chinese — name your favorite group — working under normal conditions with or without an independent union, whose employers treat them as human beings under "reasonable" standards, and whose government protects their basic human rights. The products are the same. The price is the same. Which would you buy?

Now, the vendor raises the price. The T-shirt produced by workers under better standards costs... 50 cents, $1.00, $2.00 — fill in the number — more than the T-shirt produced under poorer standards. Which would you buy? At the same price, most consumers would choose the shirt made under better working conditions. Most would pay a modest premium for that shirt. But as the premium rises, the number willing to do so will fall. This gives us the demand curve for labour standards — the additional amount consumers would pay for products made under "decent conditions".

If this example does not convince you that there is genuine consumer demand for labour standards, consider slavery. Announce that the cheaper shirt is made by slave labour, and see what happens: sales will fall; stores carrying slave-produced products will be boycotted, and so on. In biblical days, in ancient Greece, in the early days of the United States, slavery may have been an acceptable form of labour arrangement. But no longer. Most, if not all of us, do not want to be part of a market transaction where the commodity is produced by slave labour, and would pay to avoid such.

Abolition of slave labour is a standard on which nearly everyone agrees. There are other labour conditions about which there is less unanimity: use of prison labour, child labour, hazardous work, freedom of association, hours of work, minimum wages. Some ILO Conventions reflect standards that involve basic human rights. Others may seem trivial or unnecessary interventions in labour contracts, or cost more in terms of reduced flexibility or lost jobs than they are worth in benefits.
Treating standards as a (by-)product for which consumers are willing to pay money parallels Alfred Marshall's treatment of working conditions as a product for which employees are willing to sacrifice pay, through compensating differentials. In *Principles of economics*, Marshall differentiated between the bricklayer, who cares whether he works in a palace or a sewer, and the maker of bricks, who couldn't care less if the bricks are used for the palace or the sewer. The bricklayer's concern creates compensating wage differentials in the job market: lower pay for palace work relative to sewer work [Marshall, 1982]. Consumers' concern with the conditions of production adds a product market dimension to the compensating differential story. The consumer who cares whether the worker makes products in palatial or sewer conditions consumes not only the physical good but the associated work conditions—a "extended product", as it were. This will create compensating price differentials in the product market analogous to compensating wage differentials in the labour market.

There is, however, an important difference between workers' assessments of workplace conditions and consumers' assessments. The bricklayer knows readily if he is in a sewer or in a palace. The consumer, by contrast, has no direct knowledge of the conditions under which a product is produced. For some products, she may rely on the "reputation" of the firm—"Coca Cola is a good company and must have good labour standards". But for generic products, like the T-shirt, and for companies whose names are not household words, the consumer has little, if any, information about the conditions under which the good is produced. How, then, might consumer preferences for standards be expressed in the market?

In principle, one way to determine preferences for labour standards is through *accurate labelling* of the conditions under which products are produced. Tell the consumer the product is made by slaves, convict labour, child labour, workers paid abnormally low wages under sweatshop conditions, and she'll decide whether to buy it or substitute produced under better conditions, depending on the price of the two variants. Consumers will penalize or reward enterprises according to their underlying preference for labour standards, just as workers do so through compensating wage differentials.

But the product market will not produce accurate labelling of standards by itself. Low-standard producers will have an incentive to lie to consumers about the labour conditions in their workplaces. All firms will claim they produce goods under good conditions, and consumers will be unable to express their demand for standards. From these considerations, I conclude that some external labelling organization, private (vide Consumer Reports) or public, would be needed to assure the accuracy of labour conditions labels. But that is the only "extra-market" force needed to produce the desired outcome. A society that gives consumers the information about labour conditions can step aside and let them determine an implicit "price" for labour standards.

Taking the argument a step further, the market price for standards should induce producers to improve conditions for workers. The market share of firms producing under good labour standards will rise when consumers shun products produced under poor standards. Some firms that initially produced under poor standards will find it profitable to improve standards, to avoid having to reduce their price to maintain customers.

This market-oriented way to produce a socially desired level of labour standards may strike some readers as unrealistic. When I presented it to an American union leader, he rejected the notion that people would pay attention to work standard labels. "They'll buy the cheapest product in any case", he said, "so only trade barriers or government restrictions on low-standard workplaces could enforce standards." A similar criticism was made through private correspondence after I presented these ideas at the April 1994 Department of Labour Conference on Standards [Schweiger, 1994].

This criticism underestimates, in my opinion, the extent to which consumers value labour (other) standards of production. As evidence that people will sacrifice money for "standards", I direct attention to: stock market funds that specialize in "good companies"; surveys that show that most Americans wanted to raise the minimum wage in the late 1980s even when they were reminded this would increase the costs of goods [Freeman, 1994]; consumer purchases of politically correct products such as Amazon Forest Crunch Candy at relatively high prices; the 1980s "Sullivan Conventions" on investment in South Africa; the 2 per cent or so of national income that Americans give to charitable causes; consumer boycotts, such as the 1980s' boycott of grapes to support the United...

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2 If firms advertised their standards, knowing that this would increase demand for their product, those with the lowest standards and lowest costs might have bigger advertising budgets, and gain market share.

3 I did not ask if he bought union-label products when such are available in preference to cheaper non-union products; but I do know that AFL-CIO officials fly non-union airlines, go to non-union hotels, and so on, if they find this sufficiently more convenient than patronizing a unionized competitor.
Farmworkers, and the efforts of companies such as Levi Strauss and Reebok International to apply standards in subcontracting arrangements with firms in developing countries. These firms voluntarily reject forced or child labour, set minimum wages and hours of work that are often better than those in the host country’s legislation, and guarantee workers freedom of association.

This criticism also overestimates the shift in demand for a product necessary to induce producers to raise labour standards. In many markets, changes in the behaviour of a small proportion of consumers may yield huge changes in profitability. A loss of 5 or 10 per cent of sales will cut deeply into the profits of retail stores and induce them to drop lines of goods from low-standard producers, pressuring those producers to improve conditions. My guess is that many standards — particularly those associated with decent personnel practices — are relatively inexpensive, and thus likely to respond to modest market pressures.

If I am wrong and consumers are unwilling to pay for a given set of labour standards, that set would have failed the market test. The burden would then fall on the advocates of standards to convince the rest of society that good standards are worth the price just as environmentalists have convinced many consumers that environmentally sound products are worth their price.

In pushing a market approach to labour standards, I do not claim that providing information is necessarily the best way for consumers to “buy” the labour standards they want: a labelling strategy may be hard to implement because of the ease of cheating on labels. I also do not deny that in addition to consumer demand for standards, there is producer demand, for the purpose of raising the costs of competitors. In some cases, moreover, concerned citizens may view some standards as moral imperatives that justify illegal activity: vide the anti-slavery movement in the 1850s, anti-abortion activity in the 1990s, etc. My point is that demand for labour standards is grounded in consumer preferences, and that a positive economic analysis of standards must begin with these preferences.

III. Purchasing (enforcing) standards

Given that consumers want labour standards, the next question is “what mechanism will best enable them to buy the desired amount of standards cum commodity?” In the domestic economy, two mechanisms are available: legal regulations and enforcement thereof, and accurate labelling of goods. As Weitzman [1974] showed in his analysis of quantity versus price regulations, the choice of mechanism is situation-dependent. In some cases, the benefits and costs of directly regulating standards and enforcing such may be more efficacious than a “labelling” strategy. In other cases, the labelling approach may be cost-effective.

In general, societies rely more on legal enactment than informed consumer decisions in establishing labour standards. The United States ended slavery through constitutional amendment. We restrict child labour by law and enforce occupational health and safety standards by government regulators. We outlaw discrimination against workers for reasons of gender, race, disability and the like. In the world economy, ILO Conventions are legal agreements with a status similar to international treaties. One rationale for the use of legal enactment over labelling is the potential ease of mislabelling products. The higher the cost of obtaining accurate information, the less desirable is a market-based labelling strategy for obtaining desired labour standards.

But we should not exaggerate the effectiveness of legal regulation. A substantial number of workers are paid wages below the legal minimum in the United States — a country where laws are generally obeyed. Many workplaces do not follow national health and safety regulations. Some countries sign the ILO Convention on child labour but do little else. The Commission on the Future of Worker-Management Relations in the United States has noted the tendency for the American Congress to pass laws protecting workers but then to fail to provide the money for enforcement. The higher the cost of enforcing a law, the less desirable is a legal-regulation strategy for obtaining desired labour standards. Command and control modes of obtaining desirable conditions have many problems.

My assessment is that society can best obtain the standards it wants through a mixture of legal regulation and consumer information, with some standards more efficiently established through the former and some through the former. Standards governing how the market works, such as those regulating labour contracts and guaranteeing freedom of association, may be more efficaciously set by legal regulation, whereas standards for actual market outcomes, such as wages and hours or occupational health and safety conditions, may possibly be more efficaciously determined through providing consumers with information about those outcomes. The “information revolution” has, in my opinion, created greater opportunity for a labelling-based strategy than in the past.
IV. Who benefits from standards? Who pays?

As with any other commodity, labour standards are costly. Resources must be spent to obtain standards. Someone has to pay for the production of safety, minimum wages, etc. And someone, possibly a different someone, benefits from those standards. A key issue is thus the incidence of benefits and costs of labour standards. Do employers pay for standards because they are legally obligated to provide them? Do the beneficiaries pay through lower wages or employment?

Opponents of standards often argue that the main beneficiaries are workers/firms in high-standard workplaces and that the low-standard workers/firms pay through reduced competitiveness. Proponents of standards argue that the main beneficiaries are the workers in low-standard workplaces or countries. Some labour standards operate like a minimum wage, reducing employment of some low-paid workers while raising the pay of others, including workers with the appropriate cross-elasticity of demand. Other labour standards operate like a payroll tax. If the supply of labour is zero-elastic, workers will pay for the benefit through lower wages. If supply is upward-sloping, the costs will be shared between workers and employers, and eventually consumers, depending on supply and demand elasticities. If workers value a given standard, the supply of labour will shift to the right when it is legally mandated, so that more of the cost will fall on workers.

Analysis of standards as a commodity desired by consumers suggests additional considerations in the incidence of benefits and costs. Consider a situation in which the consumer wants you to work in a safe workplace while you are indifferent. The consumer benefits from the standard and ought, therefore, to pay for it. In a market where standards are set through labelling of conditions, this will be the case. Indeed, consumers who want higher/lower standards will “buy” the amount they want, just as they buy higher/lower quality products. If the worker also benefits from the improved conditions, the consumer and worker will share the costs and benefits.

Legal enactment creates a different situation. If consumers have homogeneous tastes, they would vote to enact a single standard and pay for enforcement through taxes. But consumers are heterogeneous, so that a single standard will force some to buy a higher standard than they want while others buy a lower standard than they want. To the extent that consumers care about their link with products made under substandard conditions, this suggests that, other things being equal, we ought to give preference to an information labelling approach to determining standards.

But to the extent that consumers care about the existence of substandard conditions per se, regardless of whether they buy the goods so produced, legal enactment has an advantage.

These considerations bring to the fore a major issue about consumer preferences for standards: whether they are a private good or a public good. My analysis of differential prices for the extended product treats them as private goods, as does the analysis of compensating differentials in the labour market. If preference for standards goes beyond the commodities the individual consumes to standards in society or the world in general, a public goods analysis is needed.

V. Standards and trade

Establishing labour standards within a country is important, but what makes standards controversial today is growing sentiment for the use of trade to enforce standards across countries, particularly across countries with very different forms of government and levels of GDP per capita. To protectionists, standards offer a rallying cry to preserve or create trade barriers. To those who believe that free trade is the route to economic progress in developing countries, linking trade and non-trade objectives risks blocking the route. To those who care about human rights, trade is one of the few non-military tools for pressuring foreign countries to treat their workers decently and move towards more democratic practices.

I have three points to make about international labour standards.

First, I do not accept the premise of some that bad standards drive out good standards. Any country that wants higher labour standards for itself can have them... if it is willing to pay. A country can pay for standards that increase its cost of production in three ways: through exchange-rate devaluation, with all consumers bearing the burden; through lower wages of workers who gain the benefits; or through taxes on the general public. As a case in point, consider Canada and its major trading partner, the United States. Labour standards and welfare state benefits are higher in Canada than in the US. Does this force lower standards onto Canada? As long as Canada has a separate currency, a tax system and flexible wages, the answer is no: Canadian citizens can buy the standards they wish. Evidence on labour standards and flows of foreign investment in the OECD’s 1994 Employment Outlook supports this analysis for advanced countries. The OECD data shows that foreign direct investment over GDP (an indicator of the attraction of a country
to international capital) is unrelated to whether a country has relatively stringent or flexible regulations on labour standards (see Chart 5.6 in Ch. 5 of the OECD report). The primary determinant of investment flows is the level of wages, as investment has favoured lower-wage OECD countries such as Portugal or Greece compared to higher-wage countries like Switzerland or Sweden. Within the US, with a single currency, states survive in the same economic space with different labour regulations.

Second, international standards must allow for differences in the level of development of countries. Historically, labour standards rose with development. Even the relatively laissez-faire Americans have enacted more laws protecting workers over time, with a burst of legislation in the 1980s (Commission on Worker-Management Relations). The effort of European countries in the 1980s and early 1990s to increase flexibility and reform aspects of the welfare state still leaves Europe with the highest labour standards in the world. Newly industrializing countries such as Korea and Taiwan have introduced higher minimum wages, various social benefits and increased rights of association. The general rule is that the higher national output per capita the higher the standards, at least in some range of variation of GDP. A country with low GDP per capita will not "buy" the same labour standards as an advanced country any more than it buys the same number of cars or telephones.

The International Labour Organization, which sets international labour standards, recognizes that standards must vary with national wealth: "The ILO has always held its standards to be universal, while at the same time accepting the inclusion of flexibility clauses that make allowances for different levels of development ... the ILO's practice has been to set benchmarks that each State is expected to adopt as and when its level of development allows." [ILO, 1994, p. 16].

Allowing for differing national abilities to pay for labour standards raises problems. On the one side, flexible standards may do no more than mirror existing conditions rather than inducing countries to improve conditions. On the other side, consumers and others in advanced countries may apply overly high standards to less developed countries — for instance in the area of child labour. Which standards should be flexible and which should be universal, without exception for levels of development? The distinction between standards that specify processes for determining labour outcomes (freedom of association, use of slave or convict labour) and standards that specify those outcomes (minimum wages, occupational health and safety) offers one rough rule of thumb for answering this question. Many process-related standards can be met without high levels of income and thus might be viewed as fundamental social rights. Nearly all outcome standards, by contrast, depend on the nation's productive capacity, and must be scaled according to that capacity — for instance, by making them relative to income per head.

But this distinction still leaves open some difficult cases. While no one can object to different wage standards or minimum wages across countries, varying health and safety or child labour standards is more problematic. How should one view a multinational that invests in safe machines in an advanced country but in less safe, cheaper machines in a less developed country? Perhaps the firm would not make the investment in the LDC with the more expensive machines. Likely as not, the cheaper machines are safer than those used in the advanced country at a comparable level of development. Is this firm meeting international labour standards or not? And how flexible ought standards to be in the area of child labour? In some LDCs, children may have to work for family economic survival. Better that they work and eat than starve. The multinational which insists that its subcontractors fire all child labour may be doing those children more harm than good. Does the firm, or consumers of its products want to follow local customs to the extent of hiring 8-10-year-olds at subsistence wages? The salience of these concerns to businessmen operating in a global economy was highlighted in a 1993 Harvard Business Review article dealing with the conflict between child labour standards in the West and those in a poor country [Nichols, 1993].

The manager of the ILO's Programme on the Elimination of Child Labour made the following observations in 1994 on this difficult problem: "Abolishing child labour in one sector alone, such as the export sector, cannot eliminate child labour in a country — it may simply push it into other activities, including some more hazardous to children. There is no quick fix in child labour." [Washington Branch of ILO, 1994, p. 9].

Citing cases in which the threat of trade sanctions led employers to dismiss children, who were then forced into more hazardous work in the informal sector, the author of the article drew the following lesson, "What these cases from the garment industry and other export industries

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1 In the OECD listing Canada and the United States are in the same group: countries with relatively flexible regulations on labour standards.
2 Among OECD countries, expenditures on social protection as a share of GDP and indices of labour standards (based upon OECD classification of regulations on working time, fixed-term contracts, employment protection, minimum wages and employee representation rights) show no apparent relation to GDP per capita. The United States, in particular, ranks low in expenditures on social protection or labour standards, while having the highest income per capita. See OECD [1994, tables 5.8 and 5.9].
suggest is the need to transfer children away from the workplace in a planned and phased manner" [ibid., p. 11].

Analysis of standards as a consumer good suggests that the cost of the transfer ought to be borne by consumers in advanced countries. If you are opposed to child labour being used in the products you buy, you ought to be willing to pay a few cents extra for a programme to transfer those children into education or training. Part of the information label on a product ought to specify the amount of the purchase price that goes to such activities. Our demand, as consumers, ought to be that countries/multinationals develop programmes to maintain the living standards of children so they can go to school rather than that firms simply displace the children. If you want better standards in child labour and other areas in poorer countries, you should put your money where your moralizing is.

The third and most controversial issue is whether labour standards should be part of international trade agreements. Ought advanced countries to make standards an issue in world trade negotiations? Unlike trade economists who view any interference with free trade as the work of the Devil, I would be pragmatic in this area. The concerns and issues faced by working people are all too often missing from conferences on the world economy dominated by bankers, finance ministries and multinationals. If trade negotiations are the only way to raise forcefully the standards flag in an international setting, why not? If trade sanctions can improve labour standards, that benefit must be weighed against the cost of lost trade. If trade sanctions can overturn an evil dictatorial regime and save human lives, go for it. Perhaps the standards issue will induce international trading groups to consider innovative ways whereby international trade might be used to finance improvements in standards. As boycotts and sanctions have not in general been successful in altering country behaviour, though, I would proceed cautiously in those directions.

VI. Conclusions

The “take” on standards that I have adopted in this paper — analysing them as part of an extended product desired by consumers — has led me to the following “hard-headed” conclusions:

(a) There is a consumer market-labelling way to establish standards that has some virtues compared to government regulations.

(b) The choice between delivering standards through labelling or regulation depends on the costs of providing information; the costs of enforcing regulations; heterogeneity of consumer preferences for standards; and whether standards are more a private or public good.

(c) Countries can choose their own standards: bad standards need not drive out good standards.

(d) Outcome-related standards depend on the income in a country, but the level of some process-related standards should be independent of the level of income. Consumers in developed countries who want higher standards in LDCs, such as reduced child labour, must be willing to pay for them.

(e) Raising the issue of standards in trade negotiations may force the financial trading community to take standards seriously and develop new ways to improve standards in LDCs.

Perhaps the most radical (conservative?) notion in this essay is that policy-makers should give greater weight to a labelling strategy for determining standards: provide consumers with information about the labour standards under which products are produced, and then trust the market to reward products made with good standards and penalize those made with poor labour standards. I know that you, good reader, would not buy the T-shirt made by workers under poor conditions, and would willingly pay an extra nickel or perhaps a dime if the firm producing it used the money to benefit its impoverished workers, to reduce child labour, or for some other good purpose. I believe that if mechanisms were in place to help us express our demand for higher labour standards, enough other consumers would react similarly that standards would indeed be raised.

Bibliographical references


