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Pros and Cons of Linking Trade and Labor Standards

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ABSTRACT

Pros and Cons of Linking Trade and Labor Standards

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This paper addresses the debate over whether labor standards ought to be linked to trade policy, specifically by being included in the World Trade Organization and becoming subject to trade sanctions. We first try to put the debate into context by reviewing the issues and the events that have led to the current situation. We next turn to the arguments in favor of putting labor standards into the WTO, then address the arguments against doing so. Finally we offer our own advice to developing countries as to the position that they should take in this debate, and how more broadly they should deal with this and other issues in multilateral trade negotiations.

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I. Introduction

Until about ten years ago, international discussions of national economic policies were compartmentalized. International trade policies were the province of the General Agreement on Tariffs and Trade (GATT) and were discussed and negotiated primarily by specialists on trade. Policies involving labor markets, including labor standards, were similarly discussed only among specialists on labor, with international initiatives centered in the International Labor Organization (ILO). Similar compartmentalization existed for intellectual property issues in the World Intellectual Property Organization (WIPO), and also for environmental issues, which unlike the others were spread among several international bodies.

This all began to change in the early 1990s, for several reasons to be mentioned below. Some of this compartmentalization has already disappeared, and more of it seems to be on the way out, as important constituencies now favor integrating the issues under a single institutional framework. Because the successor to the GATT, the World Trade Organization (WTO), is the only international organization with meaningful enforcement powers, it has become the favored place for integrating these diverse policy issues. Intellectual property rights issues have already been taken over by the WTO in the Uruguay Round Agreement on Trade-Related Intellectual

Property Rights (TRIPS). Some advocates of labor and environmental rights have asked that these issues also be taken over by the WTO, and that they be enforced by the same mechanism that it uses for policing trade policies. This paper reviews the arguments for and against such integration in the case of labor standards.

We will first try to put the debate into context by reviewing the issues and the events that have led to the current situation. We will next turn to the arguments in favor of putting labor standards into the WTO, then address the arguments against doing so. Finally we will offer our own advice to developing countries as to the position that they should take in this debate, and how more broadly they should deal with this and other issues in multilateral trade negotiations. We conclude with an epilogue, noting that the linkage issues were not discussed at the November 2001 WTO Ministerial Meeting in Doha, Qatar, but that these issues might well re-emerge under different circumstances in the future.

II. Background and Issues

We are ourselves all specialists in the economics of international trade, and we are therefore much better versed in the history, institutions, and economic case for trade than we are knowledgeable about labor standards. However, precisely because of the debate we will be describing, we have had occasion in recent years to become more familiar with labor issues and to write several joint and individually authored papers on the subject.[1] It is from these perspectives that we will first provide a brief overview of the issues that arise in both trade and labor, and of how they have been dealt with in the world's institutions.

The core problem of international trade policy is that countries and their governments have a variety of incentives to restrict trade, usually imports, and that such restrictions are economically harmful both to other countries and to those within the restricting countries who do not benefit directly from protection. Left to their own devices governments may be unable to resist these incentives, with the result that all countries in the world are made worse off. The incentives may be macroeconomic, as they were in the Great Depression of the 1930s when countries raised tariffs to divert demand from other countries toward themselves. Or they may be microeconomic and political, as is often the case today when countries protect individual industries or groups of workers from import competition.

The GATT was created at the end of World War II to prevent countries from restricting trade for these and other purposes, although it did allow tariffs to be raised in several specified circumstances. One of those circumstances was, as a last resort, if one country violated GATT's rules. After other remedies were exhausted, an offending country could become the target of retaliatory tariffs, the purpose being to provide enforcement of GATT rules. This "dispute settlement mechanism" (DSM) of the GATT was rather weak, for institutional reasons, but these weaknesses were removed in the WTO. A major difference between the WTO and its GATT predecessor is the strength of the WTO DSM, which employs several layers of procedure that lead ultimately, if offending behavior is found and not reversed, to "trade sanctions." That is, the ultimate remedy against a country breaking GATT/WTO rules is for other countries to restrict imports from it by use of increased tariffs.

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[1] See Brown et al. (1996, 1998, 2001a,b), Brown (2000, 2001), and Stern (1999).

Given the understanding that trade restrictions are economically harmful, even to the country that imposes them, this feature of the WTO is somewhat perverse, for it seeks to prevent harmful behavior by use of more of the same. The rationale must be that the sanctions will seldom be used, and that the threat of them will almost always be enough to force eventual compliance with the rules. Experience so far suggests that most WTO cases do not, indeed, result in trade sanctions. However, their use in some recent disputes between the United States and the European Union involving bananas, beef hormones and possibly corporate tax exemptions has been sufficiently disturbing that one may easily wish that some other enforcement mechanism were available. The main reason for the absence of any other mechanism, presumably, is that the GATT and WTO have had jurisdiction only over trade and have had to find their remedies within that jurisdiction. Had the WTO been able, say, to impose monetary fines on countries for breaking its rules, then that would undoubtedly have been preferable.

Turning now to labor standards, here the core problem is to improve the well being of workers around the world. The need arose, or at least was recognized, when workers moved off the land and into factories, where working conditions were often both poor and out of the workers' control. The motivation for improvement was provided in part by humanitarian concern for the workers, and in part by fear of social unrest if the growing number of industrial workers were to give vent to their unhappiness. There was also a perceived need to coordinate improvement in working conditions across countries, so as to avoid undermining the international competitiveness of countries that achieved such improvement by themselves. All of

these concerns contributed to the creation of the ILO in 1919, which today has 175 member states.

The ILO has done many things, including most notably the adoption of a series of Conventions that spell out a long list of labor standards. At the core of this list are eight "Fundamental ILO Conventions" in four areas: freedom of association, abolition of forced labor, equality, and elimination of child labor. Additional conventions address a much wider variety of issues, including basic human rights, conditions of work such as wages and hours, security of employment, and many more.[2]

These conventions have been adopted by many of the member countries, with the notable exception of the United States, which has adopted only a few. However, regardless of whether a member country has adopted a convention, the ILO has relatively little that it can do to enforce adherence to it. Its "enforcement" powers consist primarily of several mechanisms for monitoring and reporting abuses of the standards, but there is little that it can do to a country, even if the country flaunts a standard, except to publicize the fact. The strongest action it can take is to censure a country for noncompliance, and this is hardly ever done. Most would agree that in the vast majority of countries the conventions serve at best as goals that the member countries may be striving to achieve in the future, rather than as descriptions of current practice. This is true even in those countries that have adopted them.

It is this lack of "teeth" in the ILO that has led to interest, on the part of many who wish to advance labor rights, in incorporating them somehow into the WTO. The objective is clear: to be able to apply the WTO enforcement mechanisms, which it already applies to violations of

rules on trade policy, to violations of labor rights as well. Interest in doing this has been advanced by several events.

One of these events was the expansion of GATT and later WTO procedures to deal with what many regarded as domestic policies. As GATT gradually expanded its coverage beyond "border measures" such as import tariffs to other policies that might affect trade, it began to deal with domestic policies such as government procurement and product standards, whose primary purpose may have had nothing to do with trade but whose effects could impinge on trade and on foreign producers. The effect of this expansion was no doubt good for trade, but it blurred the distinction between trade policies and other policies. Some individuals and groups whose interests lay outside of trade, including certainly some environmentalists, began to object strenuously to this expansion of the GATT/WTO onto their turf, and they wished to see its activities curtailed. But others, including advocates of labor rights, saw an opportunity, if they could only harness the procedures of trade policy to their own cause.

A second event contributing to the desire for linkage was the precedent set by the TRIPS Agreement that was negotiated as part of the new WTO. In spite of its name, TRIPS really is not limited to issues involving trade, but instead covers the entire intellectual property regimes of the WTO member countries. It requires specific standards of intellectual property protection (patents, copyrights, trademarks, etc.) that must be enforced in these countries, including in sectors such as pharmaceuticals that some developing countries had previously exempted from such protection. Furthermore, the rules of TRIPS are covered under the same DSM as the rest of the WTO provisions, meaning that trade sanctions can be used for their

[2] See Brown et al. (1996) for more details on ILO conventions.

enforcement, again as a last resort. Since the economic case for TRIPS was questionable,[3] its connection with trade was tenuous, and it was evident in any case that TRIPS was primarily a response to political pressure from multinational enterprises (MNEs) seeking to extend their markets, TRIPS provided both the example and part of the justification for labor interests to extend the WTO to labor standards as well.

Finally and more broadly, the rapid expansion of international trade and investment during the last half of the twentieth century accelerated in the 1990s and contributed to increasing concern over "globalization."[4] This concern has included a wide variety of symptoms and issues on the part of an even wider variety of constituencies. But certainly a major part of it was the perception that globalization had hurt workers, at least in industrialized countries and relative to owners of capital and more valuable skills. Although this perception is only partially justified, according to most careful economic studies that have been done,[5] it is popularly believed and attributed to the increasing political and economic power of corporations, especially MNEs relative to workers. The WTO itself is believed by many to have been created solely for the benefit of corporations, and the example of TRIPS does little to contradict this perception. This too, then, has fed the desire to countervail against the corporate interests within the WTO by bringing labor interests on board as well.

In fact, although it is true that the WTO does serve many corporate interests, and that its creation may well have depended on this fact, it is *not* primarily an agent of corporate control. Instead, the benefits that it provides to the world are spread very broadly and extend

[3] See Deardorff (1990).
[4] See Deardorff and Stern (2002).
[5] See for example Freeman (1995).

especially to the poorest countries and the poorest people within those countries, including labor. What most of the rules of the WTO do, and those of the GATT before it, is to foster international competition, permitting sellers from many countries to compete with domestic sellers in the member countries. This is certainly beneficial for the owners – mostly corporate – of the firms that due to low cost, high quality, or effective strategy are best able to compete with other firms, but it can drive other less able firms, often also corporate, out of business. Lobbyists for protection have always included plenty of corporations seeking to secure their domestic markets, and the WTO is not their friend. Naturally, the corporations who succeed best in an environment of open markets tend to become large and to qualify for the moniker, MNE, or "transnational corporation." But in fact, no matter how large these firms become, as long as open international markets force them to compete with enough others like themselves, none of them has the power that their opponents ascribe to them.

The real beneficiaries of the world trading system that has grown up under the GATT and WTO are ordinary people in all countries. The thriving world economy has naturally created the most visible benefits for those who can afford the most consumption, and this means the populations of the industrialized countries whose standards of living today are unprecedented and owe a great deal to trade, whether they know it or not. But in our view, the most important beneficiaries from the world trading system are probably workers in developing countries, even though they remain (with some exceptions) far poorer than their counterparts abroad.[6]

[6] In this connection, see Brown, Deardorff, and Stern (2002).

Without liberal trade, the United States and its people would have remained well off, just not quite as well off as they are today. The same is probably true of Europe, Japan, and other industrialized countries. But without liberal trade, the pressures of population growth and resource depletion in developing countries would have driven many of them even further into poverty. Instead, trade has permitted wages in many developing countries to rise, albeit far less than we would hope eventually to see.

This could not have happened, very likely, without the GATT. Without it, the rich countries would almost certainly have yielded to the above-mentioned incentives to restrain trade, if not in good times then surely when crises and recession caused them to turn inward, as they did in the 1930s. It was the GATT that prevented this, first by limiting the circumstances under which countries could restrict trade, and second by facilitating successive rounds of negotiations to reduce trade barriers. Successful corporations gained hugely from this process, and it was they who more than anyone else drove the process forward. Indeed, developing countries often resisted the liberalization of trade and even sought exemption from liberalizing themselves, to their own cost as many later learned. But by fostering as much liberalization as it did, and by restraining the rich countries from throwing around their economic weight, the GATT has left most developing countries far better off today than they would otherwise have been.

Those who see the world economy as a contest between capital and labor find this very hard to accept. To them, anything that benefits capital must hurt labor, as though the world economy provides only a certain total of benefit for all and the only question is which group gets it. From that perspective, because they perceive the WTO as promoting the interests of capital,

they either want it destroyed or want labor to be given equal power within it. This is certainly part of the motivation for linking labor rights to trade through formal inclusion in the WTO.

To most economists, this is just not the way the world economy works. Economic benefit arises only from the efficient application of both capital and labor, which together produce the economic pie. The purpose of the WTO is to help make this pie as large as possible, which is best accomplished through the forces of competition in free markets that guide resources into their most productive uses. Incidentally, this same competition also determines how the pie is divided among different groups, including capital and labor, developed and developing, and rich and poor. This division is not what many, including economists, would most like to see. But it is important not to try to alter this division with policies that will so reduce the size of the pie that even the poor will be made worse off. It is from that perspective that economists like ourselves tend to respond to proposals to link trade and labor standards.

It is also the case that linking even seemingly unrelated issues in a round of negotiations can have the added benefit of deepening agreements in both policy dimensions when linkage improves enforcement power. For example, Spagnolo (1999) considers the case in which two governments are attempting to cooperate over two separate policy issues, e.g., tariffs and labor standards. Both of these policy issues are characterized by a prisoner's dilemma; that is, both countries would gain if they could find a sustainable mechanism to cooperate on lower tariffs and higher labor standards, but an inferior outcome emerges in the absence of cooperation.

In a repeated prisoner's dilemma game, cooperation can be self-enforcing if the benefit of defecting in any round of the game is smaller than the cost of lost cooperation in all

succeeding rounds. Thus, one strategy for sustaining cooperation in a repeated prisoner's dilemma game is a trigger strategy: cooperate as long as the other party cooperates, but make clear that if the other party ever defects, then there will be no future cooperative behavior. When policy issues become linked in an international agreement, defection on either tariff or labor standards commitments will cause the entire agreement to collapse. Consequently, defection from a linked agreement results in the loss of benefits from cooperation on *both* tariffs and labor standards. Employing linkage to raise the cost of defecting from either tariff or labor standards commitments should help to sustain compliance in both dimensions.

It is also possible that linking trade and labor standards in a single round of negotiations might produce additional bargaining efficiencies by transferring some enforcement power from the trade dimension to the labor dimension. In this connection, Limao (2000) considers a case in which the international community has found it relatively easy to achieve a nearly optimal agreement on tariffs but has had greater difficulty finding a self-enforcing agreement on labor standards. If tariffs and labor standards are linked together, the likely agreement would consist of less trade liberalization but tighter labor standards than would have occurred in a partitioned agreement. Nevertheless, world welfare is higher than in the absence of linkage because the gains from improving the relatively inadequate labor standards are larger than the losses from raising the already close-to-optimal tariff levels.

III. Arguments in Favor of Linking

Trade Sanctions as an Enforcement Device

The most direct argument for linking labor standards to trade in the WTO should be obvious from the discussion above. Anyone who favors raising the level and enforcement of labor standards around the world would presumably prefer additional tools to make that happen, and trade can provide such a tool. Trade sanctions have long been used to pressure countries to alter their behavior, albeit with mixed success. The hope is that by threatening a country with restriction or taxes on exports, the country would be motivated to avoid that by improving its labor standards. Experience suggests that when such tools are used in a hostile environment, they often fail. But here, by using them within the agreed upon DSM of the WTO to enforce labor standards that many countries have also accepted within the ILO, it seems plausible that compliance might be more forthcoming. If so, then the trade sanctions themselves would seldom actually be applied, and the goal of improving labor standards would be achieved.

Setting Efficient Labor Standards

Implicit in this argument is the belief that countries cannot be trusted to set labor standards optimally for their own populations, and therefore that they need external inducement to do the right thing. Where governments are corrupt and/or non-democratic, this may not be questioned. However, for reasonably well-functioning democracies the case for external pressure must be argued with care. That is, governments have a strong interest in adopting economic policies, including labor standards, that promote economic efficiency.

Inefficient policy-making even in a democracy may occur for a couple of different reasons. First, we might make a political economy argument. Just as with trade policies, labor

policies are also set in response to many conflicting incentives, political and economic. Consequently, the public may be better served by governments that are externally constrained. For example, owners of capital are likely to have disproportionate power compared to labor, and they thus may be able to influence government to set or to enforce weak labor standards. Just as political forces favoring trade protection may be more effectively and beneficially resisted by membership in the GATT/WTO, forces favoring weak labor standards may also be resisted if labor standards are made part of the WTO. Governments may welcome the assistance, even if they cannot say so.

Second, even governments that are able to choose nationally optimal labor standards policies, may still over- or under-regulate labor markets when viewed from the point of view of worldwide economic efficiency. A discrepancy between efficiency and nationally optimal policies will emerge when labor standards alter the volume of trade to such an extent that world prices are disturbed.

For example, a large capital-abundant country, when considering a change in an existing labor standard, may at least consider the domestic costs and benefits of the standard at the margin. In addition, such a country may also consider the impact that the labor standard has on its international terms of trade. A large capital-abundant country may realize that a tightened labor standard may also result in a larger volume of labor-intensive imports that can be purchased on world markets only if the world price of labor-intensive goods also rises. That is, tightened labor standards tend to turn the terms of trade against large capital-abundant countries.

As a consequence, when policy-makers in our hypothetical country consider the economic effects of a tightened labor standard, they require that the domestic benefits exceed the domestic costs by enough to offset the national cost of the deterioration in the terms of trade. However, from a world-efficiency point of view, terms-of-trade effects are zero-sum. That is, terms of trade losses for one country are gains for another, and thus should be ignored in any evaluation of the benefits and costs of the labor standard under consideration. This analysis suggests, then, that large capital-abundant countries may set their labor standards at a point where the marginal benefit exceeds marginal cost, thus under-regulating their labor markets.

Bargaining Inefficiencies in the WTO

In fact, both the political economy and the terms-of-trade externality considerations are a part of a more general argument in favor of incorporating labor standards into the WTO. Bagwell and Staiger (2001) have noted that when we negotiate over border controls and labor standards separately, bargaining inefficiencies are likely to emerge. The inefficiency arises due to the fact that border controls and labor standards can be considered to be policy substitutes. That is, either can be used to accomplish protectionist objectives.

The protectionist content of labor standards has already been alluded to above. Weak labor standards in a capital-abundant country benefit import-competing producers by lowering their labor costs. The consequent increase in domestic production also lowers import demand. Thus, lax labor standards are able in principle to accomplish the twin trade policy goals of

protecting domestic import-competing interests and exercising monopoly control over the terms of trade.

Given the parallels between border controls and labor standards, protectionist urges may be deflected onto labor standards. In a single-dimensional negotiating environment in which we agree to constrain the use of trade policies, governments are motivated to replace inefficient trade policies with inefficient labor policies. That is, following a round of trade negotiations in which trade barriers have been reduced, policy makers may then relax labor standards in order to return the volume of imports closer to their pre-negotiation level. Bargaining efficiency can be achieved only when border controls are negotiated simultaneously with the protectionist content of labor standards, thereby constraining policy makers from replacing protectionist border controls with protectionist labor standards.

Bargaining Complementarities

A fourth and final argument in favor of linking does not necessarily concern whether trade sanctions will be used to enforce labor standards, but rather deals with whether issues of labor standards should be included in a new multilateral round of negotiations under the auspices of the WTO. Developing countries are resisting this, as are most trade economists, while Europeans tend to favor it and in the United States, Republicans and Democrats are divided on the issue. The alternative to including labor standards in a new round is, of course, to leave labor standards as they are now, confined to the ILO.

Arguments against doing this will be discussed in the next section, but an argument in favor needs to be stated here, and it is a simple application of a more general principle. The

principle is that when countries negotiate on multiple issues, all can gain by linking those negotiations. The reason is simple: this permits countries to exchange concessions on one issue for gains on others, thus permitting a more efficient outcome that benefits all. For example, it may be that although developing countries would prefer not to give ground on labor standards, they also are seeking more market access in textiles and clothing than developed countries are willing to provide. If their desire for market access exceeds their unwillingness to raise labor standards, then they may gain by giving up something on labor standards in exchange for market access. Alternatively, if their concern about raising labor standards is the greater, then they might be willing to sacrifice some market access for that.[7] Either way, depending on their preferences, linking the two issues permits them to achieve what they will regard as a better outcome, something that they could not do if negotiations on the two issues were to remain separate.[8]

This is actually a familiar principle for trade specialists, who have long recognized the benefits of negotiating over diverse trade issues within a single round, rather than handling each of them separately. Even when only tariffs were being negotiated, this permitted countries to exchange their own tariff cuts in some sectors for their trading partners' cuts in others. This facilitated the substantial reductions in tariffs that were achieved through the early rounds of negotiation under the GATT. The Tokyo Round extended the scope of negotiations beyond tariffs, although these tradeoffs were hampered by the use of separate codes for each of the

[7] Note that what actually matters is not just one party's relative preferences, but these compared to the relative preferences of the other negotiating party. See Bagwell and Staiger (2001) and Staiger (2001) for a case that can be made that permits WTO member countries to trade off between changes in tariffs and changes in national labor standards as a way of providing secure market access for foreign exporters.
[8] See Horstmann et al. (2000).

new issues, codes that countries could sign onto or not as they chose. The Uruguay Round achieved much more by returning to the all-or-nothing package approach of previous rounds, permitting countries to exchange, say, concessions on agricultural subsidies for concessions on trade in industrial products.

In fact, the principle was most evident on two issues of great importance to developing countries: market access in textiles and clothing, and intellectual property rights. Developing countries eventually accepted the TRIPS agreement, despite what they viewed as its cost to them, as the price to pay for eventual ending of the Multi-Fiber Arrangement (MFA). Of course, this example also illustrates the dangers of accepting tradeoffs of this sort: many developing countries today are unhappy with the deal that they made.

IV. Arguments against Linking

A first argument against linking trade and labor standards is simply to question the efficacy of labor standards themselves. Nobody questions the ultimate desirability of improving conditions for workers. However, one may easily question whether simply imposing better conditions will in fact make all workers better off. The concern is analogous to the traditional economists' argument against a minimum wage, but it applies to all manner of labor standards. If higher standards are imposed, then the cost of hiring labor will rise and fewer workers will be employed. The result will be better conditions for some, but worse for others. Economists will also point out, in this situation, that those who gain would be unable to compensate the losers, even in principle, because the outcome is inefficient. But that may be beside the point, since the harm to the losers in itself may be enough to condemn the policy in most minds.

Of course, this argument applies with different force for different labor standards, depending on the likely numbers of winners and losers, and also on whether labor markets really work this way. Many would accept this argument as applied to a minimum wage in developing countries, and indeed most who favor linking trade and labor standards reject trying to raise wages in developing countries above market levels.

But other labor standards, such as the Fundamental ILO Conventions mentioned above, may be less likely to harm workers, may actually enhance labor market efficiency, or may embody issues of principle that should override simple economic costs and benefits. Thus, freedom of association may be viewed as necessary in order for labor markets to work properly, given what otherwise would be an extreme asymmetry between the market powers of employers and employed. Forced labor, too, is hardly a case of a properly functioning labor market, which ought to have voluntary participation from both sides. Child labor, on the other hand, may be a case of principle, which should be prohibited even if the children and their parents believe that the work makes them better off. For both cases, however, we would plead that enforcement of labor standards not be accepted too uncritically, and that what truly happens to all affected workers (not just those who remain employed) should be taken into account.

Suppose, now, that we accept that certain labor standards do need to be imposed on labor markets. What, then, can be wrong with using trade sanctions to enforce these standards? The answer depends in part on whether the threatened sanctions turn out to be used or not. In any system of sanctions (trade or otherwise), the purpose is to achieve the standards,

not to apply the sanctions. But the system will not likely work unless the sanctions are sometimes applied.

If they are, then the world suffers the costs of distorted trade that we trade economists routinely teach to our students. Is that the only cost of using trade sanctions? If so, then the case against them would be weak, since costs of distorted trade are unlikely to be very large in comparison with the gains that are sought by imposing the labor standards. However, there is a more important cost. That is, trade sanctions, if applied, are likely to hurt most the workers who were intended to benefit from the labor standards. For example, suppose that a country prevents its workers from organizing in its export industries, and that the world responds by restricting those exports. Then these workers, who were presumably already suffering from their lack of union representation, now lose their jobs as well.

All of this assumes that trade sanctions, if permitted, will only be applied where the failure of labor standards justifies their use. However, there is good reason to worry that this will not be the case. Trade sanctions are restrictions on trade, and, when used, they benefit the firms and workers that compete with the restricted imports. We know from long experience that whenever conditions for restricting trade are accepted as legitimate or written into law – as for example in antidumping and countervailing duty statutes – industries become very aggressive and creative in asserting that these conditions have been met. Who could be better placed to identify abuses of labor standards abroad than the domestic competitors of supposedly offending foreign firms? But also, who could have better reason to identify abuses where there are none, since they will then be rewarded with protection? It is this concern, that trade

sanctions will be co-opted for protectionist purposes, that most worries both trade specialists like ourselves and developing country trade negotiators.

It is also this concern about protectionism that makes us doubtful of the alternative argument that trade sanctions will seldom be used, only threatened. If in fact this were the case, then the harm we have ascribed to the sanctions themselves would not arise (although the caveat remains that forcing higher labor standards may be harmful).[9] But the forces of protectionism have shown themselves to be both strong and insistent, sure to exploit any loophole in WTO rules that may be provided. It seems likely that whenever abuses of labor standards are alleged, no amount of response by raising standards will be enough to satisfy those who will seek to exploit the situation by seeking protection. This will include not only those who benefit from the trade sanctions that are applied, but also those who benefit from easier competition with the industries where standards are raised. The prospect that somehow these protectionist interests will drop their case when valid abuses have been corrected seems distinctly unlikely. Trade sanctions are likely to become the norm, not the exception.

These ideas have been formalized by Limao (2000), who points out that linkage of trade and labor standards within a single negotiating environment can enhance the political power of those who seek protection, thereby making it more difficult to sustain a cooperative agreement. He examines the case in which there is a powerful lobby that advocates in favor of producers in the import-competing sector. In such a situation, linkage can destroy enforcement power.

[9] See Srinivasan (1998) and Pahre (1998) for a discussion of how the "hijacking" of the concern for labor standards by protectionist forces may influence the adoption of higher standards and affect the economic welfare of the countries. See also Singh (2001).

Consider, for example, a situation in which a powerful import-competing lobby is affecting trade policy. The lobby may reward policy makers for defecting from an international agreement. Obviously, the larger the import-competing sector, the larger the reward the lobby will be willing to pay for obtaining additional protection on its behalf, because the economic rents reaped from protection are roughly proportional to industry output. In a linked agreement, the lobby calculates the reward that it is willing to pay based on the size of the industry once defection from the international agreement has occurred. Thus, when the lobby calculates its willingness to pay for defection from a labor agreement, it realizes that the defection will also trigger a collapse of the linked trade agreement. As a consequence, the industry base benefiting from relaxed labor standards will be larger than it would have been in the absence of linkage.

A similar consideration applies when calculating the benefits of defection from a trade agreement. In other words, from the point of view of the lobby, there are complementarities between trade and labor standards that increase the payoff from defection. Such complementarities within a linked agreement raise the cost of compliance, making cooperation more difficult to sustain.

V. Advice for Developing Countries

Given these arguments, what position should developing countries take in engaging in multilateral negotiations? Should they continue to resist bringing labor standards into the WTO, or should they not?

On balance, our view is that the dangers of using trade sanctions to enforce labor standards outweigh the benefits, both in terms of likely protectionism and in harm to affected workers. Therefore, we would prefer that labor issues be left out of the WTO. For the same reasons, we concur with the position that most developing countries have taken, arguing against the inclusion of labor standards in the WTO. It is true that by giving up something in labor standards, developing countries might be able to get other benefits that would be worth even more. But experience with TRIPS suggests that they might regret this later on.

However, we also believe that whatever their position on labor standards, the overriding interest of developing countries is in the continued successful functioning of the WTO system. Even though the WTO is not explicitly intended to help developing countries, we believe that it offers them their best protection from being victims of developed country trade policies, for reasons touched on earlier. With that in mind, whatever position developing countries take on labor standards should not get in the way of the ability of the WTO to continue to do its job.

In particular, while developing countries should be advised continue to resist inclusion of labor standards on the multilateral negotiating agenda, circumstances could arise such that the only way to get agreement on a negotiating round would be to permit labor standards to enter it in a small way. Developing countries might accept this and then do their best to deal with the issue in their own interests during the round.

There are several different channels through which labor standards might enter the WTO, some more problematic than others. It has been suggested, for example in OECD (1996), that poorly protected labor standards might constitute dumping under GATT 1994 Article VI, or be interpreted as a subsidy under GATT 1994 Article XVI. But the most direct

approach would be to add poorly protected labor rights to the list of general exceptions articulated in Article XX. However, a complaint under these three articles would likely generate a long, detailed, and potentially intrusive discussion as to what constitutes poorly protected worker rights, and whether harm has been done to domestic interests.

Bagwell and Staiger have alternatively suggested that labor standards be dealt with under the Nullification and Impairment clause. In their conceptualization of international trade negotiations, countries can be thought of as agreeing to a certain level of market access. Changes in domestic policies that reduce that access can then become the basis of a nullification and impairment complaint. They recommend that Article XXIII be amended to require countries that loosen labor standards in their import-competing industries to compensate foreign suppliers with an offsetting tariff reduction that restores the volume of trade to the previously agreed upon level. In order to create symmetry, countries that tighten labor standards in their import-competing industries, which have the effect of expanding import demand, are then also entitled to raise import tariffs to offset the impact on the volume of trade.

The virtue of the Bagwell-Staiger mechanism is that it removes any incentive to alter labor standards so as to gain a strategic advantage internationally. The international trade implications for labor standards would be neutralized by equal and offsetting changes in tariffs. As a consequence, governments become free to consider only the efficiency effects of labor standards and need not be concerned with the implications for international competitiveness.

An additional virtue of the Bagwell-Staiger approach is that it focuses the attention of the WTO on the implications of heterogeneous labor standards on international competitiveness. That is, the Nullification and Impairment clause, as envisioned by Bagwell and Staiger, can be

used to prevent a "race to the bottom" in international labor standards that may otherwise occur if trade policy is largely controlled by import-competing interests.

By contrast, the General Exceptions provision is more likely to be used to focus attention on moral and humanitarian concerns with the nature of production in developing countries. However, as we have discussed above, trade sanctions are not a very attractive device for expressing humanitarian concerns. Trade sanctions are likely to hurt the very people we are trying to help in focusing on worker rights. Furthermore, reliance on the General Exceptions provision requires us to attempt to agree on universally accepted language on worker rights that can be codified in international trade law. Some statements about labor standards may be attractive as general goals, but they vary too much across countries to be defined as rights that should be enforced by trade sanctions.

VI. Epilogue

This paper was initially written prior to the conclusion of the WTO Ministerial Meeting convened in Doha, Qatar, in November 2001 for the purpose of designing the agenda for a new round of multilateral trade negotiations. Following 9/11, the United States and other WTO members had an incentive to downplay the disputes that had led to the failure of the Seattle Ministerial Meeting in December 1999 and to adopt a more cooperative position in launching a new trade round in 2002. It was also the case that the Bush Administration did not favor linking trade and labor standards in the WTO. Thus, for now, the issue of linkage in moot, and the ILO will continue to have the institutional responsibility for the oversight of international labor

standards. But the fact remains that there is continued support for linkage on the part of organized labor, as well by many human and labor rights NGOs in the United States and some other industrialized countries. The issues that we have discussed in this paper may well therefore re-emerge in the future when economic and political conditions change and linkage issues will again be prominent in the policy dialogue.

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