

Capitolo 11

Labor Standards

Alireza Naghavi

Labor Exploitation 1

- **Companies: short-term competitive advantage by abusing worker freedoms**
 - **Malaysia: workers in electronics export sector denied the opportunity of joining trade unions**
 - **Mexico: failure to apply law in the « Maquiladora » free trade zones deprive over 1 million workers (young women) freedom of association**
 - **Turkey: workers in free trade zones denied right to strike**
 - **Lesotho: mainly women workers in export estates producing textile face violation of basic working conditions, police violence, shooting**
 - **Egypt: child labor employed in export sector such as agriculture, textiles, leather, and carpet-making**
 - **China: manufacturing workers powering an economy with no independent voice for higher standards or fair wages, factories in China at some point ran by the army, extensive forced system of labor camps with unpaid labor**

Labor Exploitation 2

- **Multinationals: happy to take advantage, escape high wages, stricter laws, strong unions in the North are happy to take advantage**
- **At least 15 million children working in export production (mining, garment, textile, shoe, agriculture, carpet, football). Short term gain outweighed by long term damage to country's skill base by putting children in factories rather than classrooms. Tomorrow's unskilled and unemployed**
- **Forced labor: a contemporary form of slavery:**
 - **Burma: 160000 working on railways and pipelines linking huge natural gas deposits to consumers; supervised by armed guards (TOTAL)**
 - **Peru: gold mines**
 - **Brazil: vast rural estates**
 - **Pakistan: millions enslaved in different forms of forced labor**

Trade and Labor Standards

- **Interest in minimum standards:**

- A. Protectionist reasons:**

- 1. repressive labor-market practices in South provides artificial advantage to exporting firms.**
- 2. Declining demand for lower-skilled labor in rich nations.**
- 3. downward pressure on labor standards elsewhere, hard for other countries to sustain high levels of labor.**

→ proposals for using trade sanctions to harmonize international standards globally

- B. Altruistic reasons: Consumers in North becoming aware of appalling nature of working conditions in South.**

Justification of Core Labor Standards

1. Reflect shared global vision of morality. Nearly all countries recognize these rights as humane principles within UN declarations; but international ratification of related conventions by ILO far from uniform.

→ while widespread support, much less agreement for minimum international standards

2. Underpin efficient operation of labor markets. Removes constraints on choices facing labor and access of employers to anti-competitive practices so workers employed more efficiently and welfare higher

Arguments Against Labor Standards

*** unions may introduce inefficiencies into economy (distortions in the labor supply) so efficiency gains depends on objectives and practices of labor unions.**

*** with child labor sensible minimum age may vary across countries, may impose constraint on child with limited alternatives. improves educational opportunity and health but maybe rational for poor family for child to work**

Economics and Trade Issues

A. Disutility among Northern consumers when aware of labor conditions in South. Demand for standards rises with income.

B. Artificially low wages contributing to natural comparative advantage low wage nations have in labor-intensive goods in trade. Competition for low-skilled in North → threat to employment and income in North

C. fear that as trade expands with countries with weak standards, competitive pressures placed on higher-standard countries to relax their regulations as multinationals search for competitive locations to produce. low-skilled lose jobs, authorities must lower labor rights to retain employers

International Wage Spillovers?

- **Organized labor interest in high wage countries concerned about effects of limited core labor standards in low wage countries on their own market**
- **Wages not equalized internationally because:**
 - 1. different production technologies and worker productivities and skills.**
 - 2. countries specialize in different goods.**
 - 3. Trade in goods not fully integrated with transport/trade barriers**
 - 4. Monopsony.**
 - 5. labor and capital not fully mobile across countries**
- **controversy about role of trade determining employment and wages in North. relating differences in wages to differences in labor standard that low standards=lower wages=higher exports=lower export prices=lower wages in importing country due to competition**
MAY BE MISLEADING

International Job Spillovers?

- **With relation of standards and investment decisions, link arises from link to labor costs, a variable in decision of investor trying to minimize labor costs. Importance greater the more the production is labor-intensive.**
- **Cost considerations only one among many factors determining investment decision of multinationals. Statically lower standards bring lower costs, but dynamically they work as incentive to raise productivity contributing to long run cost competitiveness).**
- **Also firm value in the long run may go down (stocks fall) when consumers lose confidence by realizing that the multinational is exploiting labor.**
- **Multinationals may on the other hand bring or stimulate standards, growth in host country.**

Calls for Trade Restrictions

- 1. bothered consumers want import ban to sustain standards**
- 2. make govt. abroad enact high standards for fear of losing market access**
- 3. sustain income of low-skilled workers**
- 4. get public support for multilateral trading system → free trade → WTO**

Market Outcomes without Standards: Efficient

- **I. Efficient: relative price reflects supply and demand condition of all goods, services, factors traded in economy. Supply and demand must operate freely:**

- 1. Agents free to choose (utility or profit maximizing decision)**
- 2. Perfect competition (no market power)**
- 3. Perfect information (accurate and complete information).**

Govt. intervention impairs free functioning of market, reduce efficiency, because market outcome endogenous → labor standard endogenous and country-specific (determined by market forces)

Are Market Outcomes without Standards: Inefficient

- **II. Not efficient: market distortions & failures in real world.**
 - 1. No standards can mean no freedom of choice and distorted labor allocation (i.e. forced labor, child labor, discrimination)**
 - 2. Imperfect competition: no standards mean imbalance of market power in the labor market (i.e. monopsony)**
 - 3. Dynamic concerns such as no incentive to increase productivity, invest in education (i.e. lack of long-term investment hurts knowledge accumulation), so market forces alone lead to under-investment in education and training**

Can Labor Standards Improve the Efficiency of Market Outcome?

- 1. Prohibition of forced labor (freedom of choice, enforcement of ILO conventions)**
- 2. Elimination of child labor (preserve human capital)**
- 3. Non-discrimination (reduce distortions to mobility)**
- 4. Freedom of association: (counterbalance market power, give bargaining power) *but unions costly for outsider and unemployed**

Why are Labor Standards not Observed in Parts of the World?

- **I. Public good:**
if willing to pay for “social” content of good, standards no longer public good. Buy good which has preferred characteristic → standards like quality. Pay for “good standards”, no incentive to improve standards without value
- **II. Blocking minority argument:** minority that benefits from no standards has more political power than majority of population and therefore suppresses standards → non-democratic systems.
- **III. Endogeneity argument:** influenced by economic growth. each country determines own rules according to level of development
- **IV. Economic development argument:** tool to improve export, FDI

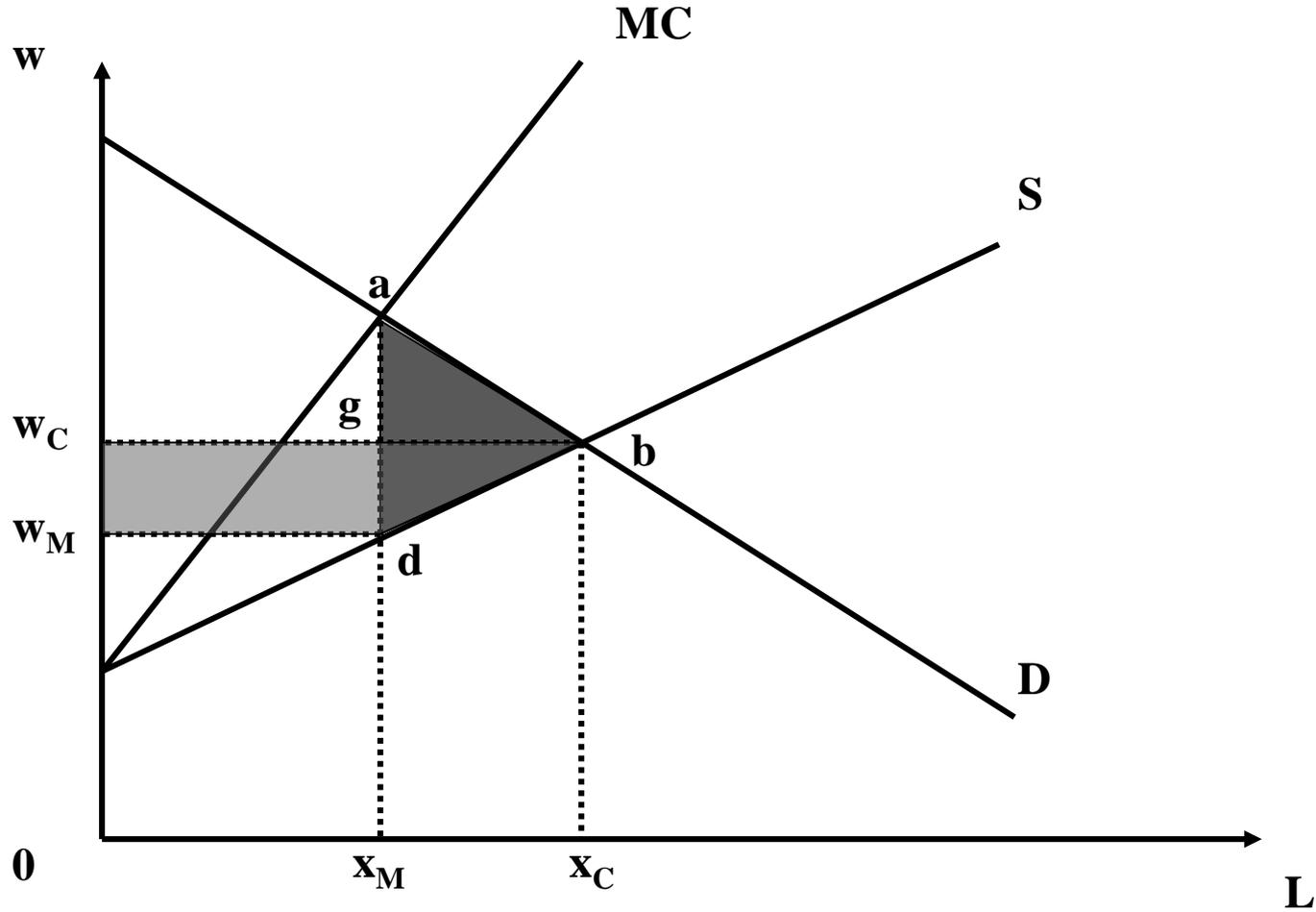
Monopsony Review 1

- **Single buyer, perfectly competitive sellers**
- **Competitive equilibrium is where demand D and supply S intersect resulting in quantity x_C and factor price w_C .**
- **S is upward sloping: to obtain a higher level of production, there must be an increase in wages. (firm has the power of keeping wage down by hiring less)**
- **Not only for new workers, for also for all those already employed**
- **Each marginal labor costs more than the average cost, so MC lies above S .**
- **Profit maximizing employment determined by intersection of D and MC yielding monopsony quantity x_M and wage w_M .**
- **Welfare loss is represented by triangle abd .**

Monopsony Review 2

- **Monopsonist restricts employment below the competitive level, so that from a social welfare perspective too few resources are employed**
- **As a consequence, wages fall below the competitive level**
- **Worker surplus declines by the area $w_C b d w_M$**
- **Firm's profits rises by the difference between rectangle $w_C g d w_M$ and triangle abg**
- **Leaves deadweight social welfare loss as the area abd .**
- **Existence of market distortion (monopsony) supports introducing freedom of association rights**

Monopsony Review 3



Lack of Freedom of Association FA rights in distorted economies 1

- **Introducing labor union in distorted market may raise or lower income**
- **Monopsony where single or collusive firms have market power. Decision on hiring level affects wages. (small market with limited number of firms or govt. barriers to entry of other employers, more common in small nation or countries with protection from domestic competition for workers or government limit on entry & exit of worker or limitation in international labor migration)**

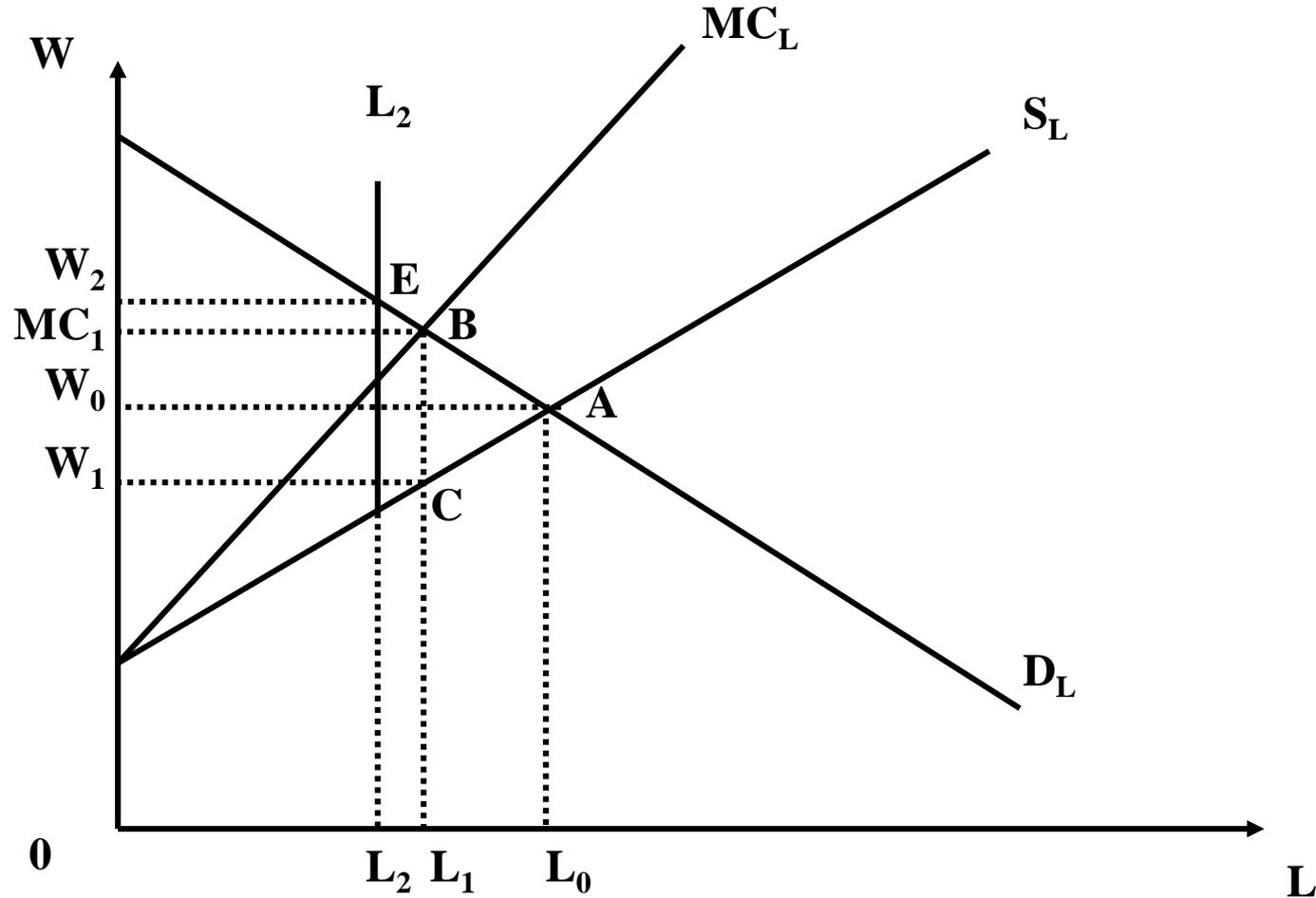
Lack of Freedom of Association FA rights in distorted economies 2

- **Monopsonist labor demand curve DL, faces labor supply curve SL. If employers competitive, employment at A with wage w_0 .**
- **But gains an inframarginal reduction in wage for all workers when it cuts hiring, marginal-cost curve for labor above SL. Max profits by setting labor MC equal to its labor demand curve at B. reduction in hiring results in employment level L1, wage rate w_1 and labor marginal cost MC1.**
- **Markup of marginal cost over wage is: $MC/w=1+1/\eta_L$ where η_L is labor supply elasticity. The more inelastic is labor supply the greater markup.**
- **For fixed output price and capital stock, monopsonist reduces employment below economically efficient point. Workers paid less than marginal revenue product. Measure of inefficiency cost is ABC. Optimal policy is to increase competition in the demand for labor or subsidize employment in this sector**

Lack of Freedom of Association FA rights in distorted economies 3

- **Alternative approach to organize union and bargain. Outcome depends on union's objective. Could bargain for A replicating competitive equilibrium. Efficiency-enhancing. More likely though union restricts employment levels to raise wages. If maintain employment at L1 but bargains for a higher wage, wage set anywhere between w_1 and MC_1 depending on relative bargaining strength of firm and union. This decides the split of rent in labor market but not improve efficiency. If union set higher employment level and therefore a lower maximum wage, economic inefficiency would be reduced.**
- **if union sets a lower employment level, by establishing closed shop limited to those with seniority, would raise wage and increase inefficiency. i.e. limiting employment to L2.**

Monopsony Labor Market and Union Response



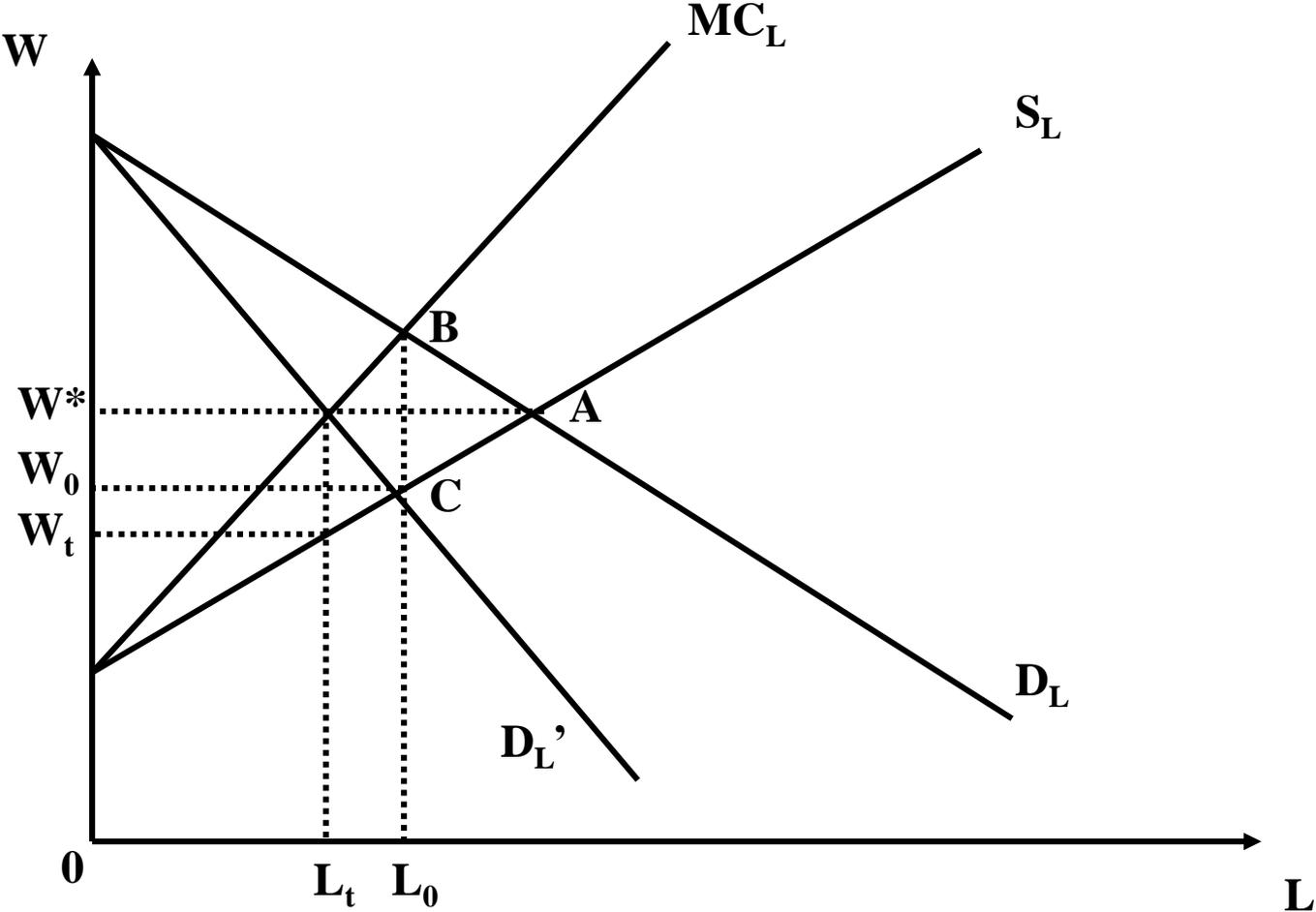
Lack of Freedom of Association Open Economy 1

- **monopsony wage paid lower than free-market wage, but does not result in higher employment, rather below competitive. In product market, output lower than in absence of monopsony.**
- **Concern expressed about absence of labor standards in export sector leading to greater export competitiveness.**
- **Monopsonist drives a wedge between foreign and domestic wage through limiting employment in a localized labor market, even at fixed product price.**

Lack of Freedom of Association Open Economy 2

- **Note that monopsony in small economy can have no impact on international wage. For given price, labor union can raise efficiency by bargaining for higher employment level, expanding export, but could also reduce efficiency**
- **If home economy large in exporting labor-intensive good monopsony in export limits production & export even as it lowers wage. This raises world price of labor-intensive good, raising wages abroad → Union rights can cause foreign wage to decline!**

Monopsony in an Open Economy 1



Monopsony in an Open Economy 2

- **Industry produces export good.**
- **Point A, B, C case of monopsony in free trade.**
- **With no monopsony effective labor supply curve perfectly elastic, wage equal to international wage w^* .**
- **But with monopsony employer chooses to offer lower wage w_0 and less employment L_0 .**

Monopsony in an Open Economy 3

- **Labor demand curve given by labor's marginal value product. Tariff on export to protest lack of labor standards reduces export price, shifts demand curve down to D_L'**
- **Monopsonist chooses yet lower employment, L_t , offers lower wage w_t . → tariffs reduce wages: additional inefficiency**