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Labor Rights in the Age of Global Supply Chains

LAYNA MOSLEY

Labor Shifts

Fourth in a series

Contemporary globalization has provided individuals, businesses, and countries with a range of opportunities. Trade liberalization and trade agreements allow consumers to purchase a broad array of products, manufactured in dozens of countries, at prices much lower than would be possible in economic isolation. Today's consumers, regardless of their place in the income distribution, spend a smaller share of their incomes than previous generations on necessities such as clothing because the relative prices of such goods have declined dramatically with multinational production. Consumers also have gained access to rapidly changing product lines—such as "fast fashion" and new smartphones—as production life cycles have shortened. Similarly, the ability to sell products to customers overseas—facilitated not only by falling trade barriers but also by declines in transportation and communication costs—offers vast opportunities to globally competitive firms and their employees.

Long-term foreign investment from abroad can bring jobs—often higher-paying ones—as well as new production technologies to capital-scarce areas. While we often think of such foreign direct investments as flowing from developed to developing countries, the past decade also has witnessed an inversion of investment flows: developing nations accounted for nearly 40 percent of global long-term investment outflows in 2014, and nearly 30 percent in 2015. While many of the long-term investments made by Brazilian, Chinese, or Indian firms are in the resource or agricultural sectors in low-income countries, today's global economy also includes, for instance, the Chinese purchase of a dormant automotive glass manufacturing plant in Moraine, Ohio, with the promise of employing 2,500 workers at capacity.

While the liberalization of trade and finance produces overall benefits for both rich and poor countries, it does so in uneven ways. Improvements in aggregate incomes and consumption patterns mask the distributional effects of trade and financial openness. The arrival of a multinational firm can pose a competitive threat to domestic firms in the same sector, inhibiting their ability to sell in local markets and hire the best workers.

A more visible issue, spotlighted by the 2016 US presidential campaign's rhetoric on trade, is that workers who are at a comparative disadvantage in the global economy find themselves facing declining real wages, job loss, and long-term unemployment. In developed nations, the material "losers" from trade typically are low-skilled workers, who are unable to make a transition from lower-technology manufacturing jobs to jobs in more skill-intensive firms and industries. Trade likely is to blame for some of this dislocation: recent analyses of the "China shock," caused by China's entry into the World Trade Organization in 2001, suggest that sectors of the US economy that suffered as a result of the arrival of cheaper Chinese products often were still reeling even a decade later.

In his campaign, Donald Trump blamed the struggles of these workers on trade and, specifically, trade agreements such as the North American Free Trade Agreement (NAFTA) or the proposed Trans-Pacific Partnership (TPP). Most economists agree, however, that much of the pain experienced by workers is the result of technological change, such as the increased automation of production.

LAYNA MOSLEY *is a professor of political science at the University of North Carolina at Chapel Hill.*

But even when trade is not to blame, public perceptions often are quite different. The outcome of the June 2016 British referendum favoring an exit from the European Union is another example of voters who are competitively disadvantaged in the global economy demanding that their government put the brakes on integration. Populist rhetoric, often with nativist, anti-immigrant, and anti-refugee undertones, has become more pronounced in the United States and in Europe. While xenophobic cultural views certainly help to explain the Brexit vote and Trump's victory, these events also reflect a sense among some voters that their (or their neighbors') material livelihood is threatened.

In wealthy nations, support for continued economic openness is likely to be bolstered by assisting lower-skilled workers in their transition to skill- and knowledge-based employment, and by developing novel means of reducing youth unemployment and underemployment. Transitional assistance of this sort will by no means be easy or cheap, since it implies a significant investment in education and training and, in the shorter term, in social safety net provisions for those hit hardest by economic liberalization and technological change. Yet such policies could help vulnerable workers in rich countries share in more of the benefits of globalization.

Developing nations suspect that labor rules are merely a means by which rich countries can retain a degree of protectionism.

RACE TO THE BOTTOM?

The dangers of economic globalization also are on display in low- and middle-income countries, albeit in different ways. Some observers worry that governments in developing countries will be unable to defend their interests in the face of pressure from foreign multinational corporations, a concern that has been at the center of recent discussions of the TPP. Investor-state dispute settlement mechanisms, typically found in bilateral investment treaties as well as in many newer trade agreements, allow foreign investors to file claims against governments for arbitration. Such disputes typically involve a claim that a government has changed its policies or practices in ways that reduce the value of the firm's investment and, as such, curtail its property rights.

While the presence of dispute settlement provisions can help encourage inward investment, there is nonetheless a worry that these provisions will give foreign investors greater influence over policy than governments and citizens in host countries. Such concerns also figured prominently in the 2016 debates over the Canada-Europe Trade Agreement (CETA). These concerns persist despite the fact that the most comprehensive database of investor-state disputes, based on cases filed between 1990 and 2014, shows that states win over one-third of arbitrations, and cases are settled before a judgment another third of the time. Investors win an average of 30 to 40 percent of what they demand.

Concerns about investor-state disputes are part of a more general worry that economic globalization puts workers, labor unions, human rights advocates, and developing-country governments at a disadvantage relative to foreign investors. By this logic, the competition to attract and retain foreign investment (and supply-chain subcontracts from foreign firms) will devolve into a "race to the bottom" among governments and firms in developing countries. Governments want to lure foreign investment, which may increase a country's capital stock, create new or better-paying jobs, bring more advanced production methods and technologies, and generate more tax revenues. While not all of these potential effects of foreign direct investment are likely to occur, their attractiveness leads to a fierce competition among governments, in which they lower their labor as well as environmental standards. As a result, even those countries that fail to attract investment will end up providing fewer protections for their workers and natural environments.

Political economists have long debated whether, and under what conditions, such races to the bottom occur. The evidence is decidedly mixed. Government regulations are but one of the factors that influence decisions by multinational corporations on where to locate operations. Firms might also consider labor productivity and skill, access to natural resources, and the security of their property rights. The competition engendered by multinational production could then result in a race to the middle, or even to the top, rather than to the bottom. Indeed, broad cross-national analyses of the relationship between workers' rights and multinational production suggest that, all else being equal, countries that host more foreign direct investment have *greater* respect for the rights of their workers. This finding is consistent with several econometric studies which report that multinationals pay a wage premium relative to domestically owned employers.

When they operate abroad, multinationals typically hire at the top of the labor market; to attract and retain the best workers, they may pay higher wages and offer better working conditions. And multinational firms, desiring efficiency and standardization across their operations, bring their (often better) home-country practices to their foreign affiliates. Additionally, multinationals that produce branded products or must contend with activist shareholders may have additional incentives to avoid the negative publicity that can result from revelations of poor labor practices in their subsidiaries.

Considering global production more generally, standard trade models suggest that, in most developing countries, it is lower-skilled workers who stand to gain from trade: as the abundant factor (relative to capital and skilled labor), these workers are more efficient at producing labor-intensive goods. And when such goods can be sold on world markets, the returns to labor should increase. At the same time, local capital in developing nations stands to lose from economic openness. When it is scarce, local capital can earn high returns, since there are few alternative sources of investment. But liberalization allows for competition from abroad, typically lowering the returns to domestic capitalists.

Of course, this economic story largely ignores the political side of the equation. It assumes that low-skilled workers and capital owners have similar levels of input in the political system and in writing the rules that govern redistribution of the gains from international exchange. In many countries, though, economic elites—the "scarce factors" in models of trade—also hold political power.

In Bangladesh, for instance, the garment sector and its business association have many close ties to the government, which is notorious for its levels of corruption. In the early 2010s, approximately 10 percent of national legislators directly owned garment factories, and many others were connected indirectly to the garment trade. The country's labor laws made it very difficult for unions to form, operate, or bargain collectively, tilting the balance very much in favor of factory owners. While Bangladesh's low wage rates result partly from its endowment of low-skilled labor, they also are due to government repression of workers. Its recent history of deadly factory fires and building collapses is one outcome of this domestic dynamic, in which the gains from economic openness accrue to elites while the dangers are borne by those working in the factories.

Arm's-length production

The case of Bangladesh, perhaps an extreme one in terms of the dangers faced by workers, brings to light three key lessons related to labor and the global economy. First, the specific means by which developing countries engage the global economy matter for how workers fare. Much of today's productive activity occurs through arm's-length, market-based relationships, rather than within a single firm. Lead firms may undertake some stages of the production process via directly owned affiliates abroad, but they frequently outsource many activities. Some of the contractors are themselves large and multinational in ownership and production: Foxconn, for example, is the world's largest electronics contracting manufacturer, with clients including Apple, Blackberry, and Nokia. While Foxconn is based in Taiwan and operates several large factories in China, it also owns facilities in Brazil, Hungary, India, Mexico, and Turkey, among other countries.

Other contracting firms are smaller, often based in a single country. Some are themselves foreign-owned: a South Korean electronics firm may set up a foreign-invested operation in Vietnam, which then supplies a US-based lead firm. Given the complexity of much global production, many steps may exist between the production of an input and its final sale by a lead firm. Indeed, in nearly every economic sector, the number of distinct production stages has increased during the past two decades, as falling communication and transportation costs have enabled firms to organize production in ways that make use of varying locations' comparative advantages.

Multinational corporations and their directly owned affiliates employed an estimated 71 million individuals in 2014, compared with 21 million in 1990. But a far greater number of workers are employed by other firms that subcontract production for multinationals, supply them with natural resources, agricultural products, and manufactured components, or carry out retail distribution and sales on their behalf. Other workers, often at the base of the value chain, work in informal employment settings, but nonetheless produce inputs used in goods that ultimately are traded internationally. Although the exact size of this global value chain–related employment is difficult to gauge, a 2015 International Labor Organization (ILO) analysis came up with an estimate that 20 percent of the world's workers are employed in global supply chains. In developing and emerging economies, these workers are concentrated in manufacturing industries.

For a variety of reasons, supply-chain and subcontracting employment can be more precarious for workers. First, entry into foreign markets through subcontracting, rather than through directly owned production, is more common for activities that are more labor- (rather than capital- or knowledge-) intensive. In such instances, leading global firms are concerned less with protecting the secrets of their production processes, and more with the cost and speed with which components or final products can provided. A focus on cost, coupled with the labor intensity of much supply-chain production, gives developing-country firms incentives to keep wages and standards low, since low overall costs and rapid turnaround are key to winning and keeping subcontracts.

Moreover, even if global firms were interested in improving labor standards throughout their supply chains, the geographically disparate and multilayered nature of many supply chains renders monitoring a challenge. To take perhaps the most visible example, Nike Inc. reports that its athletic apparel, equipment, and footwear are produced in 666 factories worldwide; these facilities are located in 44 countries, and they employ just over one million workers in total. Factories that subcontract for Nike typically produce for other global brands as well. The facilities vary in size; Nike's 170 contractor facilities in China employ an average of 1,245 workers each, while the mean employment of its 42 facilities in Indonesia is 4,729 workers. Vietnam's Nike subcontractors also are relatively large, employing 4,817 workers on average. These patterns—numerous subcontractor facilities, in a range of countries, often producing for numerous global brands—are not unique to footwear and apparel.

At the firm and sector levels, recent analyses find little evidence that supply-chain participation affects wages positively or negatively. Put differently, domestically owned firms that produce for global value chains do not pay significantly different wages than their domestically oriented counterparts. But at the country level, the prevalence of subcontracting activity predicts worse labor-rights outcomes, all else being equal. Human rights and labor rights activists, as well as labor union federations, frequently point to evidence of the poor working conditions experienced by those employed in global brands' supply chains. While activists tend to focus more on factories with connections to Western brands—because naming and shaming tactics may be more effective when deployed against branded products—labor-rights violations are a common feature of contemporary multinational production.

DOMESTIC INTERESTS

The second, related lesson suggested by the case of Bangladesh is that—transnational connections notwithstanding—domestic political interests and institutions play a key role in determining outcomes for workers. Many factors that directly contribute to the status of a country's labor force are internal, including the degree of democracy, the presence of civil conflict, and the level of socioeconomic development. Just as important, domestic interests and institutions interact with international efforts to improve labor-related outcomes. Private regulation, the centerpiece of many corporate social-responsibility efforts, often complements—rather than replaces—public governance.

Along these lines, many activists and intergovernmental organizations have focused on increasing the capacity of governments to protect workers in low- and middle-income countries. These efforts are based on the notion that governments often have the will, but lack the resources, to bring their labor laws in line with internationally agreed, ILO-backed core labor standards; to inspect workplaces and assist firms in remediating labor-rights violations; and to enact adequate health and safety protections. Some efforts therefore have been aimed at enhancing government capacity, while others have prioritized private-sector initiatives—in which firms and industry associations create codes of conduct, inspect facilities for compliance, and raise awareness of corporate social responsibility—as an alternative means of improving working conditions.

But capacity is only part of the story. Political will has a key role to play. In many countries, there is a gap between labor laws and their implementation. Revisions to national labor laws may be "cheap talk"—a means by which governments can appear to respond to external pressure to improve rights, when they have little intention of protecting or enforcing those rights.

Repressing workers can serve the interests of both foreign firms and local elites, who might prefer to avoid political challenges and economic demands from labor unions. Concerns about the extent to which governments like Vietnam's will comply with labor-related conditions of trade agreements may be well placed. Those who want to improve conditions for workers in developing countries must pay attention to politics within those countries.

WEAK LINKS

This brings us to a third lesson from the case of Bangladesh: changing the incentives for governments in developing countries is probably necessary—albeit not sufficient—to achieve sustained improvements for workers. If multinational firms and their home-country governments are willing to link labor and human rights with investment and trade opportunities, and to do so sincerely, then developing-country governments may change their behavior.

For instance, in a recent survey of foreign-invested firms in Vietnam, a colleague and I found that, in exchange for the possibility of gaining access to a global supply-chain contract, firms are willing to make significant improvements in their labor codes. They are notably more willing to do so when the potential lead firm is located in Europe rather than in India. Access to high-value-added markets is important to many firms in developing countries; if such access is conditioned on workers' rights, they are likely to lobby their governments for improvements.

External pressure therefore has a role to play, in conjunction with the efforts of domestic interests and institutions. Lead firms based in countries with higher standards, informed and conscientious consumers (especially those from richer countries), intergovernmental organizations (such as the World Bank and the Better Work Program it runs in a partnership with the ILO), and developed-country governments might all play a part in linking rights with access to supply chains and markets. For such linkages to be effective, they must be sincere, strong, and sustained.

With respect to developed-country governments, sincerity requires that they enforce labor-related provisions in preferential trade agreements or unilateral preference programs (such as the US Generalized System of Preferences scheme). Often, these provisions are included in an agreement to meet the concerns of domestic labor unions or rights activists, and as a means of winning support from legislators. US legislation passed in 1984 requires all preferential trade agreements to ensure that partner countries protect "internationally recognized worker rights." But the legislation does not specify the precise means by which agreements must do so, or which mechanisms should be used to enforce those provisions.

These linkages may not be strong: governments may favor the maintenance of trade and financial relationships over enforcing labor provisions. This is a common criticism of the labor side-agreement that is part of NAFTA. Governments may be particularly unwilling to enforce labor provisions when trade partners are strategically important. For instance, while US labor groups have complained about the government of Georgia's treatment of its workers—it has refused to allow public-sector employees the right to unionize—the US executive branch has been unwilling to revoke Georgia's unilateral trade preferences. One might speculate that this is not only because Georgia is an important source of US manganese imports, but also because Tbilisi has been a key ally in the US war on terror.

> *Competition results in lower prices for consumers, but it also can put workers at risk.*

Even more perniciously, labor safeguards are prone to capture by domestic interest groups. Provisions in trade agreements that purport to protect vulnerable workers abroad may instead be used as a veiled means of protecting weak industries at home. In such instances, developed-country governments might enforce labor-related provisions not in the worst cases of rights violations, but against industries and developing countries that represent the greatest competitive threat. Worries about veiled protectionism are common among developing nations, which suspect that labor conditions are merely a means by which rich countries can retain a degree of protectionism.

The US government sometimes ties market access to labor conditions, but other factors also play a role in its decision-making process. A recent analysis of the US Generalized System of Preferences that I carried out with colleagues indicates that while the US trade representative has been willing in some cases to revoke trade privileges for countries that systematically violate labor rights, this is not always done. Many decisions related to the program's operation reflect competitive, rather than rights-related, considerations.

CONSUMER ETHICS

Consumers and lead firms, especially those based in wealthy destination markets, also can enhance the incentives for developing-country employers and governments to protect workers' rights. The push for corporate social responsibility, which took hold in the late 1990s, is based partly on the assumption that multinational firms are concerned about their reputations (in the eyes of shareholders and/or consumers). Violations of workers' rights in their subsidiaries, or in their supply chains, can harm these reputations. This is a material incentive to improve labor rights outcomes, which can be effective in conjunction with a politically open domestic environment and with other forms of international pressure and advocacy.

Countries that host more foreign direct investment have greater respect for the rights of their workers.

For this incentive-based mechanism to work, it must be possible for firms—as well as for shareholders, consumers, and activists—to observe labor conditions in the supply chain. This is easier in more democratic host economies, where nongovernmental organizations can operate and communicate more freely. It also may be easier with branded (versus private-label or store-brand) goods, which consumers can more easily associate with a lead firm.

Consumer-based routes to labor-rights improvements also require that consumers care about the conditions under which their goods are manufactured. Analyses of consumer behavior in the United States suggest, however, that ethical consumption is quite rare. We might expect that consumers are more attentive in countries with strong domestic protections for labor rights (such as those in Scandinavia, as opposed to the United States). Moreover, other analyses reveal that consumers' willingness to pay for higher standards is greatest when the products are luxury and/or branded rather than mass-market items.

Indeed, consumers are often part of the problem: their demands for newer, less expensive products with short life cycles can increase pressure on supply-chain firms, making violations of workers' rights more likely. In Bangladesh, an October 2016 report by rights advocates noted that structural and fire-safety problems had been found at a large number of facilities, but that firms struggled to finance and complete repairs. The Accord on Building and Fire Safety, an initiative launched in 2014 in response to major industrial accidents in Bangladesh's apparel sector, commits Western brands to bear some repair costs. However, the ILO recently identified a $448 million gap between the cost of necessary repairs and foreign brands' contributions to those repairs.

While inspections revealed safety issues in over 1,000 firms, the Bangladeshi government shut down only 39 firms with such issues. Meanwhile, local firms worry that if they ask brands to contribute more financing, or if they must close temporarily to make repairs, the brands will simply move their orders elsewhere. Nonetheless, the prospects for financing repairs are better for factories with links to Western brands.

More generally, subcontractor factories report feeling squeezed: inspectors and activists pressure them to make safety improvements, but sourcing managers for brands (or brands' subcontractors) push them to produce more goods faster and at lower cost. Firms in Bangladesh compete for orders not only with one another, but with companies in Myanmar, Cambodia, Vietnam, Ethiopia, and other countries. This competition results in lower prices for consumers, but it also can put workers at risk. Many consumers in markets in the global North continue to choose—knowingly or not—fast fashion over the welfare of workers in developing countries.

Even if consumers are largely ignorant of working conditions in global supply chains, lead firms may still have reasons to attend to labor issues. At home, shareholders—especially activist shareholders such as the California Public Employees' Retirement System—may question their behavior overseas. In host countries, lead firms may worry that the spotlight (brought to bear by activists as well as governments) shines more brightly on them: the notion of "the liability of foreignness" implies that multinationals may get away with less than their domestic counterparts.

Again, however, it is more difficult for lead firms to monitor working conditions in suppliers and subcontractors than in directly owned and managed affiliates. So we might expect that it will be easier for lead firms to hold supply-chain partners accountable when their chains are narrower and shallower—with fewer firms at each production stage, and fewer stages. In this sense, the shift by many firms during the past decade to consolidate and concentrate their supply chains bodes well for monitoring labor-related issues. That said, supply-chain contraction also could transfer leverage from lead to supplier firms, in that lead firms may become reliant on inputs from a single supplier. Such reliance likely would reduce the ability of lead firms to cut their production ties in response to labor-rights violations.

FAIR COMPENSATION

Working conditions in many parts of the world are far from ideal. Globalization and technological changes have made it easier to observe instances of forced labor, child labor, unsafe working conditions, and limits on workers' capacity to organize and bargain. In some cases, globalization also can exacerbate such problems. But the sources of poor working conditions are as likely to be domestic as international. Changing the status of workers often requires the reform of political institutions, as well as the adjustment of political leaders' incentives.

For many workers, the alternatives—such as marriage and rural work at a very young age—may be worse than the supply-chain status quo of an urban factory job that provides a modicum of autonomy. The key is to identify the conditions and the tools that allow developing countries to participate in global production networks, while ensuring that they—and workers, labor unions, and advocacy groups within those countries—can express their interests just as loudly as foreign corporations and domestic elites.

For wealthy countries, attending to the status of workers, especially less-skilled workers, requires a recognition that adjustment to technology- and trade-induced pain often is a long-term process. Governments can facilitate this process via investments in education, skills development, and infrastructure. Such investments—which, given historically low interest rates in many rich economies, would be cheaper now than in decades—could help bolster support for economic liberalization and transformation. The postwar compromise in Western nations balanced trade liberalization with protection from market-generated risks by means of strong social-welfare systems and progressive tax policies. Using some of the gains from economic openness—gains enjoyed both by globally competitive firms and by consumers—to compensate those who fare less well can once again be an effective political solution that works for all. ■