

# **TRADING UP: Reversing the Race to the Bottom**

By Joel Richard Paul<sup>1</sup>

## **Summary**

Since the Second World War American leaders have strongly favored open trade and borders for a growing economy. Their support was premised on generally accepted economic theory and postwar experience. But the orthodoxy of free trade has ignored the social costs of trade: displaced manufacturing workers, idled plants, abandoned communities, growing income disparity and the downward pressure on regulatory standards. For three decades while the volume of world trade soared and fortunes were made, it was nearly impossible for anyone who challenged free trade orthodoxy to be taken seriously.

President Trump ran and won on a populist platform opposed to open trade and borders. He tore up free trade agreements, launched a trade war on multiple fronts, threatened U.S. companies that invest abroad and attacked the World Trade Organization (WTO). Trump's assault on globalization has hurt American workers, farmers and consumers, slowed economic growth and isolated the United States. But the damage Mr. Trump has brought has also created an opening for the next administration to reshape U.S. trade relations, reform the world trading system and reverse the regulatory race to the bottom.

U.S. producers that are subject to higher regulatory standards than their foreign competitors face higher costs of production. The "regulatory gap" between U.S. and foreign standards bestows a "constructive comparative advantage" on foreign producers that distorts trade patterns and hurts U.S. industry. Regulatory gaps occur because regulation primarily focuses on the place of production rather than, the place of consumption. To level the playing field for U.S. workers and companies the United States should require that imports conform to certain basic labor and environmental standards.

U.S. free trade agreements [FTAs] have incorporated labor and environmental side agreements, but these agreements have failed in the absence of an enforcement mechanism. The most effective way to enforce labor and environmental standards would be to allow importing countries to impose social dumping duties on imports that do not meet basic agreed-upon standards.

The next administration should reform the WTO Agreement on Article VI to allow importing countries to impose social dumping duties against imports that are produced by workers paid less than fair wages or by unsustainable methods of production. At a minimum the next administration should require that any future trade agreement provides that importing countries can impose social dumping duties on imports that fail to meet basic labor and environmental standards.

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## Introduction

David Ricardo's theory of comparative advantage teaches us that where relative prices differ some countries will gain and none will lose by trading at an intermediate world price. The appeal of Ricardian theory is that it does not matter how small or poor or inefficient a country may be; it can still benefit from exporting whatever good or service it can produce least inefficiently. According to Ricardo, free trade will generate a more efficient allocation of productive resources and lower prices for consumers. Best of all, Ricardo's theory is easily proved arithmetically; on its own terms it is irrefutable. Our world trading system relies on this simple principle as its moral justification.

But like all economic theory, the theory of comparative advantage rests on a sets of assumptions, and the most problematic of its assumptions is that we have perfectly competitive markets: lots of buyers and sellers trading homogenous goods and services in a market with no barriers to entry and perfect knowledge of the prices of each good and service offered. In reality we know that relatively few goods and services are traded in perfectly competitive markets. The world we actually live in is often dominated by cartels, monopolies, oligopolies, and state trading companies buying and selling highly differentiated goods and services protected by intellectual property rights and regulatory barriers. In the real world free trade does not necessarily lead to a more efficient allocation of resources due to market failures and market interference.

To the extent that we practice free trade, we anticipate "creative destruction" – that is, some industries will be destroyed by import competition in order to free up workers, land and capital for use by a more efficient export industry. Creative destruction sounds appealing if workers, like capital, can move easily from one industry to another, but that isn't realistic. Workers may not be located in the right places, and they may be unable to move to new locations. They may not have the requisite skill or knowledge, and they may not have enough time or money to obtain training or education. So labor, unlike capital, is relatively immobile. Workers, like idled plants and abandoned communities, represent "sunk costs," that are not always recoverable when import competition strikes.

Donald Trump's election signaled a radical departure from the open trade policy that the United States has pursued since the Second World War. He rejected the pending Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership, the North American Free Trade Agreement (NAFTA) and the United States-Korea Free Trade Agreement. Trump leveled tariffs against imports of solar panels, washing machines and steel and aluminum products. He kicked off a trade war against China and threatened more tariffs against Mexico and Central American countries if they did not curb immigration to the United States.

The executive's authority to impose tariffs must be delegated by Congress, and there is doubt Congress intended for the president to impose tariffs in this manner. Moreover, these tariffs almost certainly violate both the nondiscriminatory principle of Article I of the General Agreement on Tariffs and Trade (GATT) ("most-favored-nation treatment") and Article II which does not permit countries to raise

negotiated tariff rates (“bound concessions”). But complaints against Trump’s tariffs may never be heard in the WTO since the President’s opposition to the appointment of judges to the WTO Appellate Body threatens to paralyze dispute resolution.

We have reached a critical turning point in the project of globalization begun at Bretton Woods in 1944. Proponents of free trade have too long ignored the social costs of globalization – displacement of workers, growing income disparity, the failure of rural communities and industrial towns, and the environmental degradation from increased exploitation of natural resources and climate change. Around the globe we witness industrial democracies electing authoritarian populist parties with illiberal anti-globalist messages.<sup>2</sup> The failure to address the social costs of trade has put liberal democracy itself at risk. If we are to protect liberal democracy, we must face the genuine concerns of those who feel displaced by free trade. To save globalization, we must transform it.

While the collapsing consensus on globalization poses a threat to liberal democracy, it also offers an opportunity to rewrite the rules for global trade. There are many changes that should be considered. This paper addresses only one of these issues – the problem of regulatory competition or the so-called “race to the bottom.”

As goods and capital are free to move around the globe, producers have naturally sought to produce goods in countries with the lowest cost of production. In advanced industrialized countries regulatory standards often drive up the cost of production causing producers to move production facilities to locations with lower regulatory standards. The risk of capital outflow may also lead some countries to set regulatory standards lower than they might otherwise set them, thus forcing regulatory authorities in advanced countries to compete with regulatory authorities in developing countries to attract capital and jobs.<sup>3</sup> Regulatory competition puts American producers and workers at a disadvantage and creates downward pressure on regulatory standards designed to protect workers, consumers, and the environment.

I will focus on one aspect of the social cost of globalization: how trade holds down labor and environmental standards. Trade agreements and the WTO have failed to provide adequate enforcement for labor and environmental standards. In part, this is because of a traditional reluctance to address processes and production methods (PPMs).<sup>4</sup> The problem of regulatory competition is the consequence of three conditions: the free movement of goods and capital; the relative immobility of labor; and the insistence on regulation at the place of production rather than on the place of consumption.

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<sup>2</sup> E.g., Austrian Freedom Party, the Danish People’s Party, the French National Front, the German Alternative for Deutschland, the Hungarian neo-Nazi Jobbik Party, the Italian Northern League, The Finns Party in Finland, the Netherlands Party for Freedom, the Swiss People’s Party, and the U.K. Independence Party.

<sup>3</sup> See generally, *International Regulatory Competition and Coordination*, William Bratton, Joseph McCahery, Sol Picciotto and Colin Scott, ed.

<sup>4</sup> Steve Charnowitz, “The Law of Environmental PPMs in the WTO: Debunking the Myth of Illegality,” 27 *Yale J. of Int’l Law* (2002). Available at <https://digitalcommons.law.yale.edu/yjil/vol27/iss1/4>.

I propose an alternative approach to enforcing basic labor and environmental standards to create a race to the top for all countries by empowering importing countries to impose social dumping duties on imports that do not meet basic standards.

### **Social dumping**

In April 2013 more than a thousand garment factory workers perished in the fire and collapse of a sweatshop outside Dhaka, Bangladesh. This factory produced millions of dollars' worth of garments for forty retailers around the globe, but it paid average wages of about one dollar per day for long hours in appalling and unsafe conditions. In July that year the city of Detroit, once the proud capital of American technology, declared bankruptcy. Over the last four decades, the well-paid manufacturing jobs that powered Detroit in the last century have migrated to other countries. Stripped of its tax base Detroit has become a hole in the heart of American manufacturing. These two industrial catastrophes are two sides of the same problem – social dumping.

Social dumping occurs when a country imports goods that were produced in sub-standard conditions. When countries like Bangladesh export goods to the United States, they are also exporting social costs like child labor, unsafe working conditions, and environmental degradation. These imports compete against U.S. domestic products that are necessarily more expensive to produce because we require producers to internalize social costs like pollution or labor welfare.

Where workers are not paid fair wages and are denied the right to collectively bargain, where they are forced to work in hazardous or inhumane conditions, or where production facilities do not meet minimal environmental standards, U.S. manufacturers that maintain good labor practices are disadvantaged.

By imposing higher regulatory standards on domestic business than exist for imports, we confer on foreign producers a comparative advantage. This is not the kind of comparative advantage that leads to a more optimal allocation of resources, however. This is an artificially constructed comparative advantage that foreign producers have not earned through greater efficiency. It is simply a result of the fact that U.S. producers and foreign producers are not playing by the same rules.

Differences in the cost of labor are often the most consequential differences in regulatory standards. Table I lists the average hourly compensation costs in a range of trading countries based on data compiled by the Conference Board in 2016.<sup>5</sup> Table I shows, for example, that in 2016 the hourly compensation cost for all manufacturing workers in the Philippines is only 5% of the cost in the United States.<sup>6</sup> In China it is 13%. Clearly, these labor cost differentials are difficult for U.S. manufacturers to overcome. And wages are even lower in countries like Pakistan, Vietnam and Bangladesh, which were not part of the Conference Board's study.

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<sup>5</sup> Hourly compensation costs include all wages, benefits, social insurance, and payroll taxes paid by the employer.

<sup>6</sup> Also, see U.S. Bureau of Labor Statistics, International Comparisons of Hourly Compensation Costs in Manufacturing in 2007, March 2009.

According to the factor price equalization theorem<sup>7</sup>, if there is free trade in goods such that the price of a commodity is equal to two countries, then the cost of labor per unit of output should also equalize. Wages will decline in high-wage countries and rise in low-wage countries until they are equal. To the contrary, we have had a free trade agreement with Mexico for a quarter century, and yet, the cost of labor in Mexico is only 10% of the cost in the United States. The apparent explanation for this anomaly is the regulatory gap in labor standards between the United States and Mexico.

Mexico fears that if it raises labor standards to allow its workers to share in its economic growth, capital will move to other developing countries, like India and the Philippines, with lower wages. Competitive pressures on developing countries lock them into a race to the bottom that hurts workers overseas as it hurts workers in the United States.

Wages paid to manufacturing workers in developing countries is often insufficient to support a family. Statistics for a living wage are often not accessible, difficult to calculate and inconsistent, but one way to approximate how sustainable wages may be in developing economies is to consider the annual purchasing power for wages paid to manufacturing workers in a specific industry.

Table II shows the average hourly wages for the twenty leading exporters of apparel to the United States in 2012, and based on these wage levels, how much goods and services an apparel worker could afford on her annual salary. For example, China is the largest exporter of apparel to the United States, and the average wage of an apparel worker in China was only \$1.94 per hour in 2012. In terms of real purchasing power that's equivalent to paying an American worker \$8,390. It is not even a subsistence wage in China, and it is no wonder that a worker who cannot afford to feed her family cannot be selective about her working conditions either. Apparel workers in Vietnam earn the equivalent of about \$3,250. In Bangladesh the annual purchasing power is the equivalent of only \$1,940 annually, and in Haiti it is even less, \$1,180 annually. These are not living wages.

Table III shows one estimation of a living wage per hour for an average urban family in six of the leading apparel exporting countries as of 2016. It then subtracts the actual hourly wage paid to apparel workers in these countries from the living hourly wage to show the gap in wage levels. In China, for example, apparel workers in 2016 were paid about 24.5% less than a living wage. In Indonesia, apparel workers earned 31.7% less than a living wage, and in the Philippines, workers were paid 95.3% below a living wage.

Of course, it is difficult to calculate a living wage. Exchange rates may distort the living wage, and the standard of living varies considerably from one region to another even within one country. Moreover, workers may have other sources of income, and they often work more than 40-hour weeks. Nevertheless, Tables II and III give a rough approximation of the extent to which wages in these developing countries would need to rise in order to provide workers with a living wage.

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<sup>7</sup> Paul A. Samuelson, *International Trade and the Equalization of Factor Prices*, *Economic Journal*, 163-184 (1948).

U.S. companies and workers cannot compete fairly against workers who are denied basic international labor standards. The regulatory gap disadvantages U.S. producers and confers a constructed comparative advantage on overseas producers. It distorts the pattern of trade, and so long as it persists, it will be difficult to restore support for open trade policies among industrialized democracies.

The International Labor Organization (ILO) 2008 Declaration on Social Justice for Fair Globalization set forth four important strategic objectives for implementing the ILO's mandate. Article I declared that states should develop measures of social protection "which are sustainable and adapted to national circumstances," including *inter alia*, "policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection."<sup>8</sup>

Some Organization of Economic Cooperation and Development (OECD) member governments and trade unions have sought to raise wages and improve working conditions through international agreements. In the WTO many developing countries have spurned efforts to even address labor or environment issues. From the perspective of developing countries any attempt to set minimum labor standards threatens to deny them their perceived comparative advantage from low-wage labor and low environmental standards in order to protect the more highly paid workers in the developed countries. The suspicion of these governments towards legislating any labor standards in the WTO contributed in part to the deadlock in WTO negotiations over the last two decades. In frustration, many countries have turned instead to regional trade agreements as a means of gaining greater access to foreign markets.

### **Regional trade agreements' labor standards are ineffective**

That in turn has meant that there is increased pressure from labor groups to incorporate labor standards into regional trade agreements. The United States, for example, has twenty free trade agreements (FTA's), and most FTA's have included provisions or side agreements mandating minimal labor standards. The first labor side agreement, the North American Agreement on Labor Cooperation (NAALC) was negotiated in connection with the North American Free Trade Agreement (NAFTA) in 1994. The NAALC relies on domestic law and domestic enforcement, and it has been regarded as ineffective for lacking any concrete labor standards or meaningful enforcement mechanisms.<sup>9</sup> Subsequent FTA's, like the U.S.-Jordan FTA and the Central American Free Trade Agreement (CAFTA), have incorporated more specific labor requirements. However, these FTA's have also proved to be ineffective in raising labor standards in the absence of any enforcement mechanism.<sup>10</sup>

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<sup>8</sup> ILO 2008 Declaration on Social Justice for Fair Globalization, Article I(A)(ii).

<sup>9</sup> Michael A. Cabin, *Labor Rights in the Peru Agreement: Can Vague Principles Yield Concrete Change?* 109 Colum. L. Rev. 1047 (2009).

<sup>10</sup> The GAO, for example, concluded in 2009 that Jordan, Singapore, Morocco, and Chile did not enforce labor standards as promised under the FTAs. GAO, *Four Free Trade Agreements GAO Reviewed Have Resulted in Commercial Benefits, but*

The US-Peru Trade Promotion Agreement (TPA) signed in 2006 was the first to incorporate fundamental ILO principles and has become the model for subsequent FTA's with Colombia, Korea, Panama, and Oman. The Peru TPA provided the same dispute resolution mechanism and remedies for labor complaints as it provided for enforcing commercial obligations. The TPA allows the parties to select arbitral panels to hear labor disputes. If a panel report is not implemented, the complaining party has the right to suspend trade concessions under the agreement. And for the first time, the Peru TPA gave workers and labor groups standing to submit a dispute to the opposite party's government. Claims have been filed with the United States on behalf of Peruvian workers for serious denials of labor rights. The U.S. Department of Labor (DOL), however, has declined to bring any of these claims on behalf of Peruvian workers to an arbitration panel.<sup>11</sup> Labor conditions in Peru have deteriorated since the FTA was established in 2007 and widespread labor unrest over the last several years evidence that Peru has not made progress. The DOL has reported that the number of industries using forced labor or child labor has increased since 2007. The failure of the Peru labor agreement is a consequence of a lack of enforcement. Since 2007 not a single complaint has been filed by the USTR against Peru for failing to comply with its FTA labor obligations.

There is widespread agreement that the FTA's have not raised labor standards. The United States has initiated only one complaint under an FTA, and it resulted in the appointment of an arbitral panel against Guatemala in 2011. The U.S. Trade Representative agreed to suspend proceedings against Guatemala in June, 2012, in exchange for a promise that Guatemala would submit monthly progress reports on improving labor conditions.<sup>12</sup> The GAO reported in 2009 that FTA's with Jordan, Singapore, Morocco, and Chile had brought some commercial benefits, but there was scant evidence that any of these governments had improved enforcement of labor standards.<sup>13</sup>

The DOL International Labor Affairs Bureau (ILAB) published a comprehensive report on the CAFTA-DR in 2012 looking at the enforcement capacity of these countries. ILAB found that Costa Rica, the Dominican Republic, El Salvador, Honduras and Nicaragua had increased the number of inspectors and the

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*Challenges on Labor and Environment Remain,*  
[www.gao.gov/new.items/d09439.pdf](http://www.gao.gov/new.items/d09439.pdf).

<sup>11</sup> The Deputy Director of the DOL Office of Trade and Labor Affairs, Timothy J. Wedding, acknowledged that as of 2010 his office had never brought any enforcement actions. Timothy J. Wedding, *The Evolution and Enforcement of Labor Provisions in U.S. Free Trade Agreements*,  
[http://www.americanbar.org/content/dam/aba/administrative/labor\\_law/meetings/2010/2010\\_intl\\_wedding.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/labor_law/meetings/2010/2010_intl_wedding.authcheckdam.pdf).

<sup>12</sup> Office of U.S.T.R., *Guatemala Submission Under CAFTA-DR*, (2012)  
<http://www.ustr.gov/trade-topics/labor/bilateral-and-regional-trade-agreements/guatemala-submission-under-cafta-dr>.

<sup>13</sup> GAO, *Four Free Trade Agreements GAO Reviewed Have Resulted in Commercial Benefits, but Challenges on Labor and Environment Remain*, (2009)  
<http://www.gao.gov/new.items/d09439.pdf>.



size of their labor enforcement budget with \$136 million of U.S. assistance, but that “much work remains to be done.” The report was especially critical of Guatemala for decreasing its inspections and enforcement, and it pointed out that even in countries where the number of inspections had increased, few employers were actually fined for violations. ILAB was also critical of the lack of progress in outlawing child labor and gender discrimination. Most importantly, ILAB concluded that the number of actual cases brought to court and the time required to resolve cases had not improved.<sup>14</sup>

In 2011 ILAB issued reports on the impact of FTA’s on labor standards in the Republic of Korea, Panama, and Colombia. While ILAB concluded that Korea has incorporated fundamental ILO standards, it criticized Korea for bringing criminal “obstruction of business” charges against union organizers and failing to protect temporary workers and migrant worker unions.<sup>15</sup> ILAB found significant improvement in Panama’s labor standards since the election of the populist Democratic Change party in 2009,<sup>16</sup> but ILAB expressed serious concern over the denial of labor rights in Colombia. Although the report acknowledged some recent reforms and proposals by the government, the report found widespread abuse of workers’ rights and violence targeting trade unions, especially teachers. The number of teacher union members murdered has increased since the FTA was ratified, and since the authorities have failed to bring prosecutions, attackers have continued to operate with impunity.<sup>17</sup> In 2017 the DOL Office of Trade and Labor Affairs (OLTA) issued additional reports on labor conditions in Colombia, the Dominican Republic, Guatemala and Peru, but there is little evidence that these reports have resulted in increased compliance.

What is needed is a system of regulation that ensures that all workers are paid at least a fair wage based on local standards in the country of export and that can be enforced by the country of import.<sup>18</sup> But neither the WTO negotiations nor FTA’s have produced an enforceable regime for raising labor standards international trade.<sup>19</sup> Labor standards will only be enforceable if they are imposed

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<sup>14</sup> DOL International Labor Affairs Bureau, *Progress in Implementing Chapter 16 (Labor) and Capacity-Building under CAFTA-DR*, <http://www.dol.gov/ilab/2011-cfta-dr-rpt/2011-CAFTA-DR-REPORT.pdf>. (2012).

<sup>15</sup> DOL International Labor Affairs Bureau, *Republic of Korea Labor Rights Report* (Sept. 2011). [http://www.dol.gov/ilab/media/reports/usfta/southkorea\\_LRR.pdf](http://www.dol.gov/ilab/media/reports/usfta/southkorea_LRR.pdf).

<sup>16</sup> DOL International Labor Affairs Bureau, *Republic of Panama Labor Rights Report* (Sept. 2011). [http://www.dol.gov/ilab/media/reports/usfta/panama\\_LRR.pdf](http://www.dol.gov/ilab/media/reports/usfta/panama_LRR.pdf).

<sup>17</sup> DOL International Labor Affairs Bureau, *Republic of Colombia Labor Rights Report* (Sept. 2011). [http://www.dol.gov/ilab/media/reports/usfta/colombia\\_LRR.pdf](http://www.dol.gov/ilab/media/reports/usfta/colombia_LRR.pdf).

<sup>18</sup> See generally, Joel R. Paul, *Free Trade, Regulatory Competition, and the Autonomous Market Fallacy*, 1 Columbia J. of European L. 29 (1995).

<sup>19</sup> The United States has also tried to legislate labor standards unilaterally by threatening trade retaliation. Section 301 of the Trade Act of 1974, 19 USC 2411, authorizes the U.S. Trade Representative to take action against acts, policies, and practices which deny workers the right of association, the right to organize and bargain collectively, permits forced or compulsory labor, fails to prohibit child labor,



by the importing country rather than by the exporting country. The next section discusses how to make that work within the framework of existing trade law.

### **Level the playing field by imposing duties on social dumping**

Social dumping exploits workers in developing economies, damages the environment, and unfairly disadvantages U.S. businesses. It hurts American companies, costs America jobs, and it holds down American wages.

If all countries were required to enforce fair wage standard, we would improve the living standards and move closer to a level playing field. At the same time, by raising wages overseas, we would stimulate foreign demand for U.S. goods and services and grow the world economy. Obviously, every country has a different cost of living and imposing a global minimum wage would be unfair and distorting. Instead, a fair wage should be determined according to the cost of living in each country to guarantee that workers can afford at least the basic necessities of life.

*First, how should we define a fair wage?*

A fair wage should be adequate to support a household of two full-time wage-earners and two dependents. That means that hourly wages should be high enough to provide the minimum food, shelter, clothing, medical care, education, and retirement savings necessary for a family of four.<sup>20</sup> Obviously, not every household has two dependents or two wage-earners, but on average, this is a good starting point for analysis. Determining a fair wages depends not just on the cost of living, but on cultural differences. Multiple generations may live together in one extended family, and the cost of retirement will vary depending on cultural expectations and life expectancy. The basket of basic goods and services will vary depending on culture and climate. Not every culture consumes meat, relies on automobiles, or requires home heating. Education, retirement benefits, and medical care may be provided by the government. A fair wage must be defined in a way that is relevant to each country.

*Second, who should determine what is a fair wage?*

The government of the country of export is best suited to make an initial determination. Some governments have established a minimum wage, but minimum wages are not necessarily sufficient to meet the basic necessities of life for a family of four. And fair wages will have to be adjusted over time depending on price inflation and changes in government benefits. Once a government determines a fair wage, that wage should be regarded as presumptively fair.

*Third, who should enforce a fair wage?*

Though governments should enforce their own labor laws, often that does not happen. Governments in developing economies lack the infrastructure,

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or fails to provide standards for minimum wages, hours, and occupational safety and health of workers. However, the USTR has not invoked this authority against other countries' labor practices.

<sup>20</sup> For an ILO report detailing different methodologies for determining a fair wage see Richard Anker, *Conditions of Work and Employment Programme: Estimating a living wage: A methodological review*, ILO Work and Employment Series No. 29 (2011). [http://www.ilo.org/wcmsp5/groups/public/---ed\\_protect/---protrav/---travail/documents/publication/wcms\\_162117.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_162117.pdf).

transparency and financial resources to conduct regular inspections and to enforce the rules uniformly. Exporters face steep competition and may be tempted to cut costs by exploiting workers. Since we want a system that is readily enforced and will deter illicit activity, it makes sense to rely on the country of import to enforce labor standards in the country of export.

*Fourth, how could importing countries enforce a fair wage in exporting countries?*

If imports are produced without paying workers a fair wage, the importing country could impose a duty that will raise the price of the import to the price it would have been if the producer had paid a fair wage. By denying producers any incentive for paying their workers less than a fair wage, importing countries would deter violations and raise labor standards. Imposing a duty against social dumping is no different conceptually or practically than imposing a duty against dumping, which countries do regularly under our antidumping duty laws.<sup>21</sup> Every importing country has a domestic statute, an administrative structure, and economic expertise to determine the appropriate margin of dumping and to impose a duty at the border on imports that are being sold at less than a “normal value.” It is only a question of re-defining normal value to take into consideration the fair wage as determined by the government of the exporting country. If we imposed a duty against social dumping, the ITA would determine normal value by using a fair wage to calculate the cost of production, rather than relying on the actual wage, when the actual wage was below the fair wage.

*Fifth, what if there is a disagreement over what is a fair wage?*

Ultimately, it is up to the ITA to determine the normal value in a dumping proceeding and that would include deciding whether the fair wage, as determined by the exporter’s government, was adequate. An import-competing industry could present evidence that the government’s fair wage was not adequate to support the basic necessities of life in the exporting country.

If the ITA determines that an exporter’s government’s fair wage is not adequate and relies instead on a higher value, then the foreign government should have the right to appeal that determination to a bilateral arbitral commission established for this purpose.

To reduce uncertainty it would be useful if the ITA could pre-certify the fair wage as determined by the exporter’s government. Either a foreign government or an exporter should have the opportunity to ask the ITA in advance whether it agrees that the fair value as determined by the exporter’s government really is fair. If the ITA disagrees, then their decision should be appealable to an arbitral commission as above. And of course, the fair wage would have to be adjusted to take into account increases in the annual cost of living.

*Sixth, what if an individual firm pays a fair wage, but other producers do not?*

If the ITA decides to impose a duty against social dumping of widgets from China, an individual Chinese producer that pays fair wages to its workers ought to be allowed to show that it should not be subject to the duty, and the ITA should

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<sup>21</sup> See generally, Section 731 et seq. of the Tariff Act of 1930 as amended, 19 USC 1673.

exempt those imports. This provision would create an incentive for all producers to pay fair wages.

*Seventh, should a complaining party have to prove injury if it is alleging social dumping?*

Often, it is more difficult for a complaining party to prove injury to the ITC than it is to show there is dumping. Injury is admittedly a subjective judgment both about causation, which is often difficult to disaggregate, and about the relative degree of harm suffered or threatened. If a foreign producer is not paying fair wages, it not only harms the foreign worker, but also U.S. workers and firms are disadvantaged when foreign competitors do not play by the same rules. Therefore, if the ITA determines that a foreign producer is not paying a fair wage, the ITC should treat that determination as creating a presumption that the import causes material injury to a U.S. industry. Producers that fail to pay fair wages should bear the burden of showing that they are not causing injury to workers or domestic firms.

### **Sustainability standards**

Environmental regulation may force some companies to close or move jobs overseas. Admittedly, the evidence is mixed. One of the most comprehensive studies of the first fifteen years of impact of the Clean Air Act on U.S. manufacturing jobs showed that U.S. counties with the lowest air quality (“non-attainment” counties) lost 590,000 jobs in pollution-intensive industries and \$75 billion of output relative to counties which met federal air quality standards (“attainment” counties).<sup>22</sup> Other empirical studies suggest that there may be less of an impact on some industries or that the loss of some jobs may result in other job opportunities in pollution abatement.<sup>23</sup> Environment regulation may cause some U.S. firms to move their most pollution-intensive operations offshore to avoid the cost of pollution abatement. A study of offshoring conducted by the Michigan Census Research Data Center found that from 1992-2009 a group of 8,000 U.S. firms subject to environmental regulation reduced their toxic air pollutants in the United States by more than 50% while at the same time cutting the cost of pollution abatement. The study suggests that this was possible by offshoring operations that produce more pollutants to countries like China with lower environmental standards. Indeed, the same study showed that exports for the U.S. market account for about 21% of four major air pollutants emitted by Chinese producers.<sup>24</sup> Not only are these air pollutants damaging to the health of Chinese citizens, but the increasing carbon emissions threaten the health of the whole planet.

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<sup>22</sup> Michael Greenstone, “The Impact of Environmental Regulation on Industrial Activity: Evidence from the 1970 and 1977 Clean Air Act Amendments and the Census of Manufactures,” 110 *J. of Political Economy* 2 (2002) 1175-1219.

<sup>23</sup> E.g., Anna Belova and Richard D. Morgenstern, “Estimating the Job Impacts of Environmental Regulation,” *J. of Benefit-Cost Analysis* 6 (June, 2015), 325-340. See generally, Alana Semuels, “Do Regulations Really Kill Jobs?” *The Atlantic*, Jan. 19, 2017.

<sup>24</sup> Xiaoyang Li and Yue M. Zhou, “Offshoring Pollution while Offshoring Production?” *Strategic Management Journal* 38, 2310-2329 (2017).

It may be difficult for countries to agree on international standards for sustainability for purposes of imposing a social dumping duty. Unlike a fair wage standard, there is no agreed upon criteria for sustainable production. However, to the extent that international agreements now or in the future may set specific goals they could be enforced through a social dumping duty.

One example of an international sustainability standard would be the 2015 Paris Agreement under the U.N. Framework Convention on Climate Change. Under the Paris Framework Convention on Climate Change 185 member states and the European Union representing nearly 90% of world greenhouse gas emissions agreed to voluntary limits on emissions, known as “Intended Nationally Determined Contributions” (INDC’s). If an exporting state fails to meet its INDC, an importing state that has met its INDC could impose on the exporting state’s product a social dumping duty equal to what the product would have cost if the exporting state had met its INDC.

Since it is impractical to calculate the actual cost of the INDC for a specific export, the importing state could instead use a surrogate measurement. One convenient surrogate measure would be a standard amount per ton of carbon. At least forty countries have now imposed some form of carbon tax ranging from a low of \$5 per ton in Chile to \$121 per ton in Switzerland. Under California's AB 32 Global Warming Solutions Act the current price of carbon is around \$17 per ton, and the price is permitted to rise as high as \$40 per ton before the market regulator will release more carbon rights to maintain the price.<sup>25</sup> If states could agree on a carbon tax of \$20-40 per ton, then an importing country could assess an amount of duty based upon the amount of carbon it believes would be released in the production of a good that is not otherwise subject to carbon controls.<sup>26</sup>

While this method may not reflect the actual cost of carbon controls for the exporting state, it would have two positive benefits: First, it would increase compliance with the Paris Framework Convention if importing states could impose a social dumping duty on the products of non-compliant states. Second, it would level the playing field between those states that meet their INDC’s and those that fail to do so.

As future agreements on climate change or other environmental issues set national targets for reducing pollution, these targets could also be enforced through social dumping duties.

### **Arguments against imposing a social dumping duty:**

*First, is it practical for the ITA to determine a social dumping duty?*

Though setting a social dumping duty sounds complicated, in fact, governments routinely make similar calculations about the costs of producing goods overseas when we determine antidumping duties in compliance with the General Agreement on Tariffs and Trade (GATT).

To determine the normal value in an ordinary dumping proceeding ITA starts with the home market price (the price the good is sold for consumption in the

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<sup>25</sup> Brad Plumer and Nadja Popovich, “These Countries have Prices on Carbon. Are they Working?” *The New York Times*, Apr. 2, 2019.

<sup>26</sup> As an example,

exporting country's home market). If the exporting country is not a market economy, or if the good is not sold in the same condition or in sufficient quantity in the home market, then the ITA must "construct" a normal value rather than rely on the home market price.<sup>27</sup> To do so ITA must then decide what costs are reasonable to attribute to production. These determinations are made based on what ITA imagines it would be like to produce the good overseas.<sup>28</sup> So ITA would estimate how much a Chinese worker would actually get paid, and what it might cost to manufacture a particular good in China. By contrast, to determine a social dumping duty ITA would simply rely on the fair wage in China to make this calculation.

If there is a home market price, the ITA does not need to start from scratch and construct a value. It can simply start with the home market price, and adjust it by adding the fair wage as a percentage of the home market price. For example, let's say the home market price for a widget manufactured in China is ten dollars, and 10 percent of the price of each widget represents the cost of wages (one dollar per widget). Assume the Chinese worker is actually paid fifty cents per hour, but the fair wage is seventy-five cents per hour, then the wage cost should be increased by twenty-five cents or 50 percent more than the actual wage. ITA should adjust the home market price by adding 50 percent to the one-dollar cost of wages (or fifty cents). The adjusted normal value would then be \$10.50. This arithmetical calculation would be pretty straightforward for the ITA to apply.

*Second, would the United States be imposing its own standards on other countries?*

The United States would not be applying its own standard; it would be applying the international standard endorsed by the ILO in 2009 – a "minimum living wage." Each country's government would determine for itself a fair wage that is necessary to support a household of two-full-time wage-earners and two dependents with the minimum of food, shelter, clothing, medical care, education, and retirement savings.

The idea that developing countries should be "free" to set wages below that standard is like saying that workers should be "free" to work for less than a minimum wage. Developing economies do not "choose" to have lower living standards for their people. It is the competition among developing countries that drives down labor standards. A social dumping duty would eliminate any financial incentive for these countries to lower their standards. By setting a fair wage standard for imports, the United States could empower developing countries to raise the living condition of their people and stimulate economic demand.

*Third, would a social dumping duty distort the market?*

Imposing a social dumping duty would shrink the wage differential, but it would not eliminate a developing country's comparative advantage. Developing countries will still have lower wages than the United States, and they will have other comparative advantages in production that result from the proximity of producers to natural resources and markets, or the advantages that result from culture, climate, and the innate talents of their own people.

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<sup>27</sup> Section 773 of the Tariff Act of 1930 as amended, 19 USC 1677b.

<sup>28</sup> *Id.*, Section 773(e).

The cost of paying a fair wage would ultimately be borne by consumers. The difference that U.S. consumers would have to pay would be pennies on the dollar. Labor costs typically account for a small percentage of the total cost of goods like apparel, automobiles, or computers. Even for labor-intensive products, like agriculture, the cost of labor is fairly small. In the United States, for example, only about ten percent of the cost of fruits and vegetables pays for the cost of farm workers.<sup>29</sup> It is not just the amount of the social dumping duty, but also the cost of defending against a complaint, that is likely to persuade foreign producers to pay workers fair wages.

*Fourth, would a social dumping duty raises prices for consumers?*

Most economists would agree that depending on the competitiveness of the market for a specific good, all or most of an import duty will be passed on to consumers in the form of higher prices. A social dumping duty on goods produced by low-wage labor is unlikely to have a significant impact on import prices, however, because foreign labor generally adds less than 4% to the final price of most consumer goods. For example, foreign labor costs about 1-3% of the final price of most textile goods. The cost of foreign labor may be higher for some items, such as custom-made furniture, but it is easy to see that even doubling foreign wages would not have a significant impact on the cost that U.S. consumers pay for imports.

The extent to which a carbon import duty would affect domestic prices would obviously depend on the amount of carbon emission and the amount of tax. However, since we are presuming that domestic goods are subject to the same carbon tax, it would not distort the market.

*Finally, would a social dumping duty violate the GATT?*

Article II of the General Agreement on Tariffs and Trade (GATT) binds parties to their tariff concessions, meaning it prohibits parties from raising tariffs subject to certain exceptions, including an antidumping duty applied consistently with Article VI. Article VI of the GATT does not authorize imposing a duty against social dumping.<sup>30</sup> Article VI could be amended to define the normal value to include a fair wage and a carbon tax. Alternatively, if Article VI were not amended, there are two other possibilities within the WTO framework.

First, GATT Article XX(a) creates a general exception from all other GATT obligations for measures “necessary to protect public morals.” One could argue that this exception is broad enough to permit duties against social dumping.<sup>31</sup> There are few decisions by the WTO Appellate Body construing Article XX(a). Some

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<sup>29</sup> Philip Martin, *Calculating the Costs and Benefits*, NY Times, Sept. 30, 2011. <http://www.nytimes.com/roomfordebate/2011/08/17/could-farms-survive-without-illegal-labor/the-costs-and-benefits-of-a-raise-for-field-workers>.

<sup>30</sup> The 1994 Agreement on Article VI (Antidumping Agreement) reaffirms this method of calculating dumping margin and adds more details.

<sup>31</sup> For example, Article XX would justify a ban on the import of goods produced by children. Steve Charnovitz, *The Moral Exception in Trade Policy*, 38 VA. J. of Int'l. L. 689 (1998). The United States has relied on the morals exception to ban pornographic materials and online gambling. See also, Joel Richard Paul, *Cultural Resistance to Global Governance*, 22 Mich. J. of Int'l. L. 1, 33-34 (2000).

commentators have assumed that the public morals exception should be construed narrowly. On the other hand, in a 2005 decision the Appellate Body appeared to take a broader view of the public morals exception when it allowed in principle that the United States could ban internet gambling as a threat to public morals under Article XX(a), though it ultimately found that the United States was acting inconsistently by allowing domestic gambling.<sup>32</sup> More recently, the Appellate Body held that animal welfare was a legitimate reason to restrict imports based on the public morals exception.<sup>33</sup> It is reasonable to argue that if animal welfare justifies an exception from GATT requirements, *a fortiori* human welfare or environmental sustainability should be at least as compelling a justification.

However, even if a measure to protect labor standards were permitted under the public morals exception, the Appellate Body might decide that imposing a social dumping duty unilaterally constituted an “arbitrary or unjustifiable discrimination between countries” or “a disguised restriction on trade” in violation of the chapeau to Article XX. In other decisions, the Appellate Body has insisted that any measures undertaken under Article XX should be negotiated with other parties.<sup>34</sup> In the event that the Appellate Body held against the United States, the United States would be given a reasonable time to repeal the social dumping duty before any sanctions were authorized. The application of Article XX(a) is uncertain at best.

The alternative approach would be for the United States to re-negotiate our FTA’s to provide for social dumping duties. Article XXIV(5) of the GATT allows countries to form FTA’s so long as it does not raise the barriers to trade for other countries. Presumably, if other trade partners agree to a social dumping duty as the price for free access to the U.S. market, there is little reason for countries outside of our free trade area to object.

## **Conclusion**

For three decades proponents of free trade and proponents of labor rights have battled over the promise of globalization and the danger of a race to the bottom. As import competition has increased, the United States has lost manufacturing jobs, and wages have stagnated. U.S. manufacturers cannot compete against exporters who engage in unfair labor practices. At the same time, increased

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<sup>32</sup> Appellate Body Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R (2005).

<sup>33</sup> Appellate Body Report, *EC-Measures Prohibiting the Importation and Marketing of Seal Products*, WT/DS400 and DS401/AB/R (2014).

<sup>34</sup>E.g., *U.S.-Import Prohibition of Certain Shrimp and Shrimp Products*, Appellate Body Report, WT/DS58/AB/R, (1998)(holding that the U.S. ban on certain imported shrimp under Art. XX(g) constituted arbitrary and unjustifiable discrimination because the United States failed to negotiate the ban with exporting countries); *U.S.-Standards for Reformulated and Conventional Gasoline*, Appellate Body Report, WT/DS2/AB/R, (1996) (holding that the rules on reformulated gasoline implementing the Clean Air Act under Article XX(g) constituted unjustifiable discrimination and disguised restriction on trade because the U.S. acted unilaterally).



production in countries with low or no environmental standards is undermining the planet's sustainability.

As a consequence opposition to free trade is growing. But it is still possible for labor and free traders to come together with a new strategy that can improve wages for U.S. and overseas workers, improve sustainability, and forge a new consensus that supports free trade and investment in the future and turns the race to the bottom into a race to the top.

The next President should propose a grand reform of the WTO that would impose social dumping duties to enforce international labor and environmental standards. While the WTO debates such reform, the United States should open negotiations to amend our FTA's to include social dumping duties as the price for access to the U.S. market.

TABLE I <sup>35</sup>

## Average Hourly Compensation Costs and Wages for All Manufacturing Workers in 2016 Relative to Average Compensation Cost in U.S.

	Total cost (U.S. \$)	Wages (U.S. \$)	As % of U.S. total cost
Germany	43.18	33.71	111
<b>United States</b>	<b>39.03</b>	<b>29.65</b>	<b>100</b>
Canada	30.08	23.95	77
Singapore	26.75	N.A.	69
Japan	26.46	21.67	68
South Korea	22.98	18.59	59
Argentina	16.77	N.A.	43
Taiwan	9.82	8.35	25
Poland	8.53	N.A.	22
Brazil	7.98	5.48	20
China*	4.99	4.62	13
Mexico	3.91	2.74	10
Philippines	2.06	N.A.	5
Vietnam*	N.A.	2.38	N.A.
India*	N.A.	1.47	N.A.

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<sup>35</sup> Total compensation includes direct pay, social insurance and benefits. Source: The Conference Board, "International Comparisons of Hourly Compensation Costs in Manufacturing and Sub-manufacturing Industries, 2018," <https://www.conference-board.org/ilcprogram>.

\*Some of the data for these countries is unavailable or unreliable. Sources: Congressional Research Service, Marc Levinson, "U.S. Manufacturing in International Perspective," Feb. 21, 2018, 7-5700, <https://www.crs.gov>; Statistica, "Manufacturing Labor Costs per Hour for China, Vietnam, and Mexico from 2016 to 2020," <https://www.statistica.com>.

**TABLE II<sup>36</sup>**  
**Average Hourly Wages of Apparel Workers in 2012 and Annual Purchasing Power Parity in U.S. Dollars for the 20 Leading Apparel Exporters to the U.S.**

	<b>2012 Hourly Wages in U.S. \$</b>	<b>Annual Purchasing Power Parity in U.S. \$</b>
China	1.94	8,390
Vietnam	0.75	3,250
Indonesia	1.04	4,500
Bangladesh	0.45	1,940
Mexico	3.55	15,390
India	0.83	3,590
Honduras	0.88	3,820
Cambodia	0.51	2,230
El Salvador	1.53	6,640
Pakistan	0.66	2,870
Sri Lanka	1.27	5,520
Nicaragua	0.86	3,730
Guatemala	1.10	4,760
Thailand	1.93	8,360
Philippines	0.96	4,140
Italy	7.48	32,400
Egypt	1.41	6,120
Jordan	1.37	5,930
Peru	2.18	9,440
Haiti	0.27	1,180

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<sup>36</sup> This list is in order of the actual dollar value of imports to the U.S. Sources: Sweat-free Contracting Ordinance; World Bank, Purchasing Power Parity, World Development Indicators Database, Dec. 21, 2012; American Apparel & Footwear Association, U.S. Apparel Imports 2002-2011.

**TABLE III<sup>37</sup>**  
**Estimated Average Family Living Wage per hour for Urban Workers in Leading Apparel Exporting Countries as of 2016 (in U.S. Dollars)**

	<u>Living wage</u>	<u>Actual hourly wage</u>	<u>Hourly wage gap</u>	<u>% gap</u>
CHINA <sup>38</sup>	5.75	4.62	1.13	24.5
VIETNAM <sup>39</sup>	2.35	2.38	0	0
INDONESIA <sup>40</sup>	1.37	1.04	.33	31.7
MEXICO <sup>41</sup>	2.54	2.74	0	0
INDIA <sup>42</sup>	1.72	1.47	.25	17.0
PHILIPPINES <sup>43</sup>	1.88	.96	.92	95.3

<sup>37</sup> Based on a 40-hour workweek and I.R.S. annual exchange rates as available.

<sup>38</sup> Source: Provincial China Analysis-2015 from Global Living Wage found at <https://www.globallivingwage.org/wp-content/uploads/2018/05/Urban> for Suzhou, Shenzhen, Shanghai, Hangzhou, and Chengdu provinces. (Last visited 9/7/19.) Living wages in China varied significantly across provinces from U.S.\$1134 in Shanghai to \$722 in Chengdu province. Calculation based on the average in these five provinces in 2015 of U.S.\$919.72 and 6.489 RMB to the dollar.

<sup>39</sup> Based on an average monthly living wage of 8,250,400 VND. Vietnam Living Wage Family, Trading Economics, <https://tradingeconomics.com/vietnam/living-wage-family> (visited 9/7/19; see also Living Wage Series – Vietnam, WageIndicator Foundation, <https://wageindicator.org/salary/living-wage/vietnam-living-wage-series-december-2018>; 2016 typical family living wage was 5,783,900-8,003,800 VND per month). Based on a 2016 exchange rate of 21,932.421 VND per U.S. dollar found at <https://CEICdata.com>.

<sup>40</sup> Indonesia Living Wage Family, Trading Economics, <https://tradingeconomics.com/indonesia/living-wage-family> (visited 9/7/19; cf. Living Wage Series – Indonesia, WageIndicator Foundation, <https://wageindicator.org/salary/living-wage/indonesia-living-wage-series-january-2018-country-overview>; 2016 family living wage was 1,952,000-2,617,900 IDR per month.) This calculation based on exchange rate of 13,518.58 IDR per U.S. dollar found at <https://exchange-rates.org>.

<sup>41</sup> Mexico Living Wage Family, Trading Economics, <https://tradingeconomics.com/mexico/living-wage-family> (last visited Sept. 7, 2019); see also Living Wage Series – Mexico, Wage Indicator Foundation, <https://wageindicator.org/salary/living-wage/mexico-living-wage-series-december-2018>; 2016 typical monthly family living wage was 5850-7900 MXN).

<sup>42</sup> India Living Wage Family, Trading Economics, <https://tradingeconomics.com/india/living-wage-family> (visited 9/7/19; see also Living Wage Series – India, Wage Indicator Foundation, <https://wageindicator.org/salary/living-wage/india-living-wage-series-december-2018>; 2016 family living wage was 13400-19400 INR per month).

<sup>43</sup> Source: Philippine Statistics Authority, 2015. <https://outsourcaccelerator.com/articles/how-a-usd-300-monthly-salary-supports-decent-living-standards-in-the-philippines>. (last visited 9/9/19).