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TRENDLINES

Measuring Real Wages

Think the Boom Has Left Workers Behind? Think Again

By John M. Berry
Washington Post Staff Writer

At hearings last month, several witnesses and members of Congress complained that while stock prices are climbing and the salaries of many chief executives are soaring, the pay of an average American worker is not growing.

The nation's prosperity "has bypassed a large majority of American workers," David A. Smith, director of the AFL-CIO's public policy department, told the House banking committee. "Despite steadily rising productivity, their real [inflation-adjusted] wages remain 12 percent below the 1973 peak."

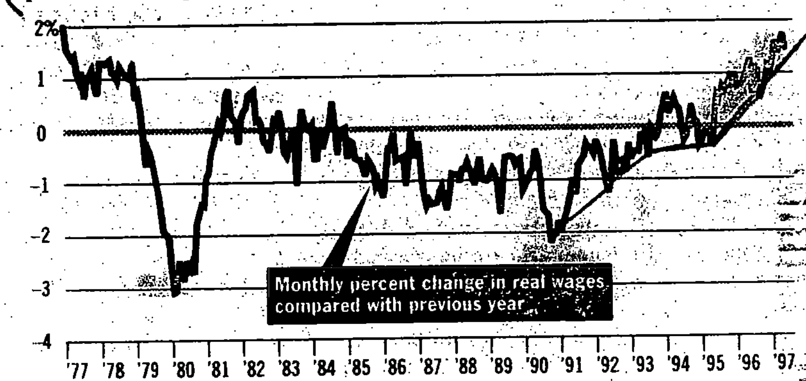
"The average male worker has seen his hourly wage decrease 7 percent in real terms" over the past eight years, Rep. Joseph P. Kennedy II (D-Mass.) asserted to Federal Reserve Chairman Alan Greenspan at another hearing.

While Smith and Kennedy may be citing correctly some measures of real earnings, some economists argue that the picture is not nearly that bleak—particularly if one looks at what is happening now rather than during the 1980s.

For instance, the chart at the right shows a different measure of real earnings, one that shows them rising about 2 percent over the past year, the largest increase since the early 1970s. Bruce Steinberg, chief economist at Merrill Lynch & Co. in New York, believes this rise is the main reason there has been no "worker backlash" against the modest rate of increase in nominal

See TRENDLINES, E8, Col. 3

WHILE THERE IS *a longstanding dispute among economists over how best to measure changes in workers' inflation-adjusted wages, by almost any standard they have been going up for the past two or three years. One approach, using the rise in average hourly earnings adjusted for inflation by the Commerce Department's personal consumption price index, shows an increase of more than 2 percent in the latest 12 months, the strongest gain since the early 1970s. This chart covers private-sector production and non-supervisory workers.*



SOURCE: Merrill Lynch & Co.

THE WASHINGTON POST

Real Wages Look Real Good to Some Analysts

TRENDLINES, From E1

wages—that is, wages before any inflation adjustment.

The chart tracks changes in average hourly earnings of production and non-supervisory workers in private industries—which does not include the value of health insurance or any other benefits—after an inflation adjustment using the Commerce Department's price index for personal consumption expenditures (PCE).

This price index has been going up less rapidly than the more widely known consumer price index of the Labor Department, which is the index most often used for inflation adjustments. Many economists believe the CPI is flawed and overstates inflation somewhat.

Much of the difference in the two indexes stems from the PCE index taking into account how consumers shift the pattern of the things they buy when the price of one item goes up more than that of a substitute.

"Ever since the unemployment rate fell below 6 percent three years ago . . . an ever more noisome crowd of worrywarts insisted that, any day now, labor costs would accelerate" and lead to higher inflation, Steinberg told his firm's clients recently. "The poor downtrodden working class, having been downsized into submission in the early 1990s, would now insist on receiving its just deserts.

"Why hasn't the long-feared wage explosion taken place? What the worker-backlash crowd forgot is that the average worker hasn't had it so good in decades. Real wages are up 2.2 percent during the past year, the strongest gain since the early 1970s and matching the performance of the 1960s.

"Workers are not clamoring for more, because they are already doing better than they have done in a very long time. In other words, because inflation is so low, modest gains in nominal wages are consistent with strong gains in purchasing power."

At the banking committee hearing, Greenspan acknowledged that some workers at the low end of the pay scale had done poorly, but he added: "The true, real wage increase has been going up recently on average."

The Fed chairman also indicated that the strong increase in corporate profits that has contributed to the big run-up in the stock market has not come at the expense of workers.

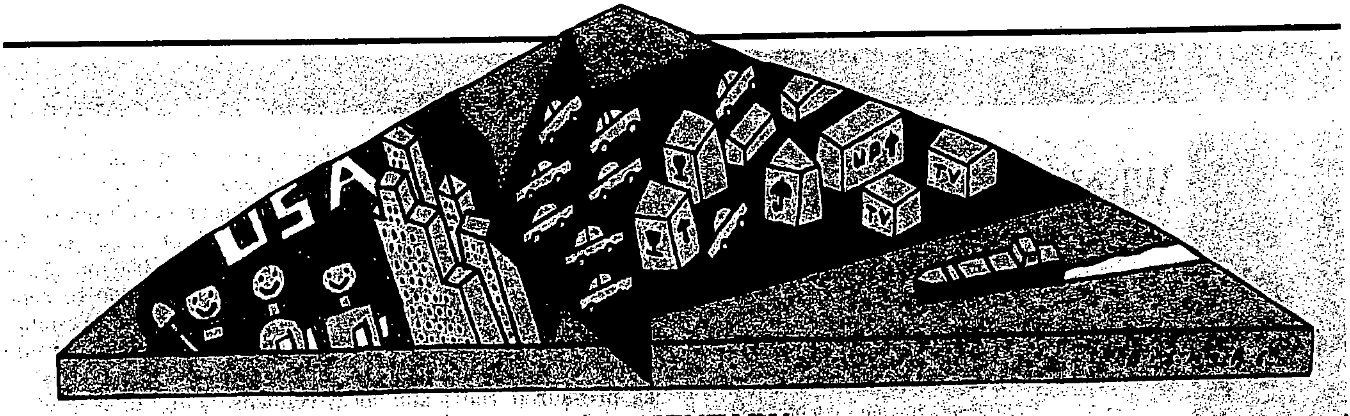
"The fact of the matter is that aggregate real wages move up with overall economic activity, that the share in the national income of compensation of employees has not gone down. . . . These are the data," he said.

Analysts have argued with one another for years about what has been happening to workers' inflation-adjusted incomes, and there are sets of numbers available to support lots of different views. But there is little dispute that, no matter how they are measured, real wages took a different track beginning in the early 1970s, when productivity, the amount of goods and services produced for each hour worked, began to rise much less rapidly than it had during the 1950s and 1960s.

By using price indexes that don't have some of the CPI's flaws—many of which have been fixed over the years—and considering wages and benefits together rather than just wages, workers' real pay, on average, appears to have been flat rather than declining between the early 1970s and early 1990s. Of course, in some shorter periods, such as when energy and food price shocks sent inflation skyrocketing, real pay fell sharply, as the chart shows.

The same thing happened during the period of slow growth and moderately high inflation that preceded the 1990-91 recession. But some economists believe that the relatively poor performance of workers' real wages in the latter half of the 1980s was also a function of a sudden spurt in the cost to employers of providing benefits such as health insurance to their employees. And that same group maintains that one reason that real wages are doing so well now is that the cost of those benefits has been going up much more slowly—only 2 percent in the past year, according to the Labor Department's employment cost index.

However much real wages are going up today, there is no way for workers to ever truly make up the ground they lost after the nation's productivity growth slowed so much in the 1970s. The issue is whether good economic policy, a strong private sector and good luck can keep them rising as much in the future as they are now.



COMMENTARY

By Michael J. Mandel

WHY THIS TRADE GAP ISN'T SO TERRIFYING

Strong growth, low inflation—and a substantial trade deficit? In a blue sky of upbeat economic statistics, the trade numbers have been a dark cloud. The latest figures, released by the Census Bureau on May 21, show that the U. S. trade deficit narrowed a bit in March from February, thanks to stronger exports. But so far this year, the trade deficit in goods is running at an annual rate of $203 billion, up from $133 billion in 1993.

The last time the trade deficit soared so high, in the 1980s, it was a national crisis and a sign of America's economic deterioration. As the trade deficit hovered around $150 billion in 1986 and 1987, politicians vied to see who could be more protectionist. And why not? America's industrial heartland appeared powerless against efficient German and Japanese competitors. The semiconductor industry appeared ready to surrender to the Japanese and the rising nations of East Asia.

But today's trade deficit, while larger than those of the 1980s, is far less menacing. Low unemployment rates indicate that few workers are being hurt by rising imports. Moreover, U. S. companies are maintaining their competitive edge in the high-skill, high-wage industries that have increased in importance as components of the national economy. As a result, the growing trade deficit has far fewer economic consequences than it did in the 1980s.

TECH STRENGTH. Consider the notion that imports cost Americans jobs. That certainly rang true in 1986, when the national unemployment rate was 7% and many states were still stuck with near-recession levels of joblessness. Michigan, Ohio, Washington, and Texas—and 15 other states—had unemployment rates of 8% and above. Small wonder that imports were seen as a key cause of the joblessness, and that unemployed auto workers could be seen on the nightly news smashing Toyotas with sledgehammers.

Today, with the national unemployment rate just below 5%, there's little evidence that imports are depriving anyone of jobs. Currently, only five states have unemployment rates exceeding 6%. Indeed, a more real concern than the trade deficit might be that the Federal Reserve, eyeing the low unemployment figures, could boost interest rates at some point to head off inflation.

Perhaps more important, the nature of the trade deficit has changed over the past decade. In the 1980s, the U. S. saw its competitive position in capital goods such as computers and machinery erode sharply. From 1983 to 1987, almost 70% of the growth of the merchandise trade deficit was in capital goods and automobiles (table). At the time, those were America's high-wage, high-skill industries.

But in the 1990s, the U. S. has held its own in capital goods. Moreover, despite the widening trade gap, the U. S. is now exporting advanced technology products such as aircraft and high-tech equipment at rates that could produce a $36 billion surplus this year. That's up from a surplus of $25 billion in such goods in 1996. And the category is no longer so dominated by big aircraft purchases, either. Exports of information-technology equipment such as semiconductors, computers, and accessories are up 3% over last year, while imports of info-tech equipment are down 3%.

NEW THINKING. The nature of the trade disputes has changed as well. In the 1980s, trade frictions revolved around Japan's bulging sales of autos and electronics to the U. S. Today, it's China that has become the focus of trade tensions. Indeed, the flood of Chinese goods has complicated the Clinton Administration's efforts to extend China's most-favored-nation status.

Despite the turmoil, however, a growing trade deficit with China is much less worrisome than a similar deficit with Japan. Japan was a surging industrial and technological rival, and its trade success did have implications for America's competitiveness. China, in contrast, is primarily taking advantage of low wages to produce inexpensive goods for export.

It's time to get away from thinking about the trade deficit as the scorecard on the economy. The prosperity of the U. S. is based on its rising productivity and high-tech investments—and that's true whether the trade deficit rises or falls.

Mandel is BUSINESS WEEK's economics editor.

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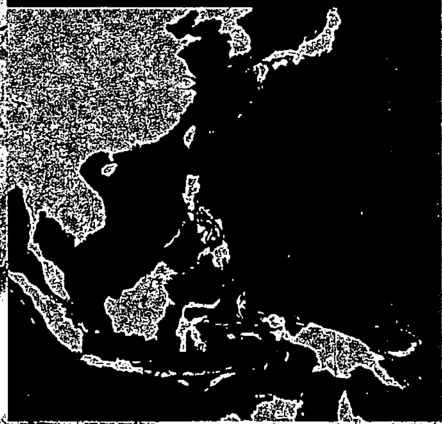


going global

East Asia–Pacific Rim

What started as a new wave of business for American entrepreneurs in the 1980s has become a sea change in the 90s. U.S. export activity has dramatically shifted away from traditional European markets toward the rapidly emerging Asian markets. In the past five years alone, American exports to Asia's top 10 markets have soared by more than 50%, reaching $179 billion last year—a healthy $74 billion more than Western Europe.

The global shift in trade has been driven by three factors:

- Asia's fast-growing economies have rapidly expanded the markets for U.S. products and services.
- Trade liberalization throughout the region has lowered barriers toward American imports.
- Accelerated foreign investment in the Asian economies—led by the United States—has triggered significant gains in the exchange of capital, intermediate goods, and professional services.

Driven by technology, rapid urbanization, and a rising middle class, Asia will account for half of all global trade growth in the 1990s. Long the world leader in population, the region's total will soon pass the 3 billion mark. It will also remain the world's fastest growing economic area well into the next century. The bottom line? Asia represents not only a significant market for U.S. goods and services, but also unparalleled opportunity for America's growing companies.

Turn Here for Contacts to Help You Do Business in the Pacific Rim

going global East Asia Pacific Rim

Making the Most of East Asia's "Miracle" Markets

In the early 1980s, opportunities for selling in Asia were generally associated with commodities such as aircraft, computers, industrial machinery, and medical equipment. Today, many growing companies recognize Asia as their number one market for exports, and the demand for American products ranges from prefabricated log cabins from North Carolina to Mrs. Fields chocolate-chip cookies, which set up shop in Hong Kong, Japan, and Thailand more than four years ago.

Why such opportunity and such a range of demand? With a preference for American innovation, technology, and style, Asian buyers hold U.S. products in high regard. "Everywhere, there's a fondness for 'Made in America,' " says Tom Vesce, president of Original Log Cabin Homes, Ltd., in Rocky Mount, N.C., whose company sells 70% of its products outside the United States. Vesce is convinced that the American can-do attitude is exactly what overseas customers want to buy. The sale of one housing unit in Japan in 1990, sparked Log Cabin Homes' international efforts. A small resort project in South Korea soon followed, and the company now sells prefabricated home packages in more than 50 countries. Most recently it signed a $6.4 million contract with a Thai distributor. "The deciding factors were the superior quality of our product and our emphasis on maximum value and service," reports Vesce.

Asia's big plus: people. While superior workmanship and service may be the secrets to success when tapping Asian markets, the key to Asian sales potential can be summed up in one word: *population.* This is a factor that goes beyond sheer numbers (and a regional total of almost three billion) to changing demographics. Changes in the composition, movement, and habits of the population in almost every Asian country are triggering unmatched opportunities for American exporters. While population growth rates are decreasing, life expectancy figures are rising. Within the next decade, there will be proportionately fewer children, but more young-adult, middle-aged, and elderly consumers.

Fundamental regional shifts from rural to urban lifestyles are also taking place. The populations of countries such as Indonesia, Malaysia, and Thailand, in particular, are relocating to the cities, seeking education and training, jobs, and better quality of life. The result is a growing middle class—and burgeoning market potential. As the population grows older and increasingly sophisticated, American exporters can expect sustained demand not only for more upscale consumer products, but also for health care, financial, entertainment, and travel services.

ASIA'S TOP 10 MARKETS

(Ranked by purchase of U.S. goods in 1996, in US$billion)

	Imports from U.S.	U.S. share of imports	Exports to U.S.	U.S. share of exports
1. Japan	$68.0b	23%	$113.5b	31%
2. South Korea	26.2	19	22.7	23
3. Taiwan	18.0	22	29.4	20
4. Singapore	16.9	17	20.4	17
5. Hong Kong	13.5	8	10.3	10
6. China	11.7	8	45.6	12
7. Malaysia	8.2	9	17.6	3
8. Thailand	6.9	11	11.1	20
9. Philippines	5.9	20	8.0	40
10. Indonesia	3.7	10	7.8	8

Source: U.S. Department of Commerce

Putting the "go-go" markets in perspective. The Asian market, however, is not all rising suns and maturing tigers. The "miracle economies" of East Asia have encountered blunt reality checks in the 90s. After two decades of economic boom, the go-go growth has been tempered by overcapacity, soaring costs, and vacant office towers. Japan is struggling to rebound from five years of stagnation, while South Korea scrambles to and high-yield and emerging-market debt. That has driven the "spreads"—the difference between the interest rates earned on Treasuries and rates on other debt—to such low levels that many bond analysts believe that investors are not earning enough yield to compensate for the additional credit risk they take on in non-government bonds.

Some investors might be delaying a decision to buy bonds until the Fed's July 2 meeting lest the central bank tighten monetary policy yet again by pushing up short-term rates a second time this year. However, Edward M. Kerschner, chief investment strategist at PaineWebber & Co., counsels against waiting. In each of the last seven rounds of tightening, he says, yields peaked and bond prices bottomed out before the last Fed tightening. For the bond bulls, the time to buy is now.

By Jeffrey M. Laderman, with Suzanne Woolley, in New York

COMMENTARY

By Michael J. Mandel

THE PRICES ARE FALLING! THE PRICES ARE FALLING!

Deflation is the unicorn of economics: something rarely if ever glimpsed. With few exceptions, price increases have been the norm ever since the Depression.

But the unicorn lives. So far in 1997, wholesale prices for finished goods, excluding food and energy, are falling at a 0.7% annual rate. And the declines are pervasive. In the past year, the wholesale price of cars has fallen by 1.9%, with similar drops in goods from washing machines to lipstick. Businesses are paying less for computers, trucks, and supplies such as industrial chemicals. In fact, wholesale prices for both consumer durables and business capital equipment are both heading down. The last time that happened was in 1960.

MICHAEL CLEVENGER/AP PHOTO

WHERE MONEY NOW BUYS MORE

PERCENTAGE CHANGE IN PRODUCER PRICES MAY '96-MAY '97

CONSUMER GOODS		BUSINESS GOODS	
MAJOR APPLIANCES	–2.2%	HEAVY TRUCKS	–4.5%
PASSENGER CARS	–1.9	GLASS CONTAINERS	–2.9
TIRES	–1.6	PHOTOGRAPHIC EQUIPMENT	–2.3
TOYS	–1.4	INDUSTRIAL CHEMICALS	–1.3
COSMETICS	–1.0	MOTORS AND GENERATORS	–1.0

DATA: LABOR DEPT.

NO DANGER. The U.S. may be at the beginning of a period where price decreases for many products become as common as price increases. That's troubling for some economists, who point out that deflation in the past has been associated with tough times.

But this time around, deflation signals positive trends. Profits and wages are up even as wholesale prices fall—a combination that can exist only because U.S. businesses are boosting productivity. And the trend has major benefits: Deflation will boost people's real incomes because consumers' purchasing power will grow, making wage gains go further. And over time, interest rates will fall as bond investors see that inflation is no danger.

How long can this deflationary period last? The latest figures show nonfinancial corporate productivity rising by a strong 2.9% over the past year. As long as these gains continue, companies can charge lower prices and still make money. Indeed, they may have no choice in a world of intense global competition.

Moreover, outside of high tech, there is simply not enough growth in the economy to ignite inflation. According to the latest data from the Federal Reserve Board, industrial production in 1997 is rising at a 4.1% annual rate, only slightly below 1996's strong 4.4% pace. But take out computers and semiconductors and the rate drops to 2.2%. That's down from a 3.1% rise in 1996 and well below a rate that will spark inflation.

The likelihood of deflation will grow as high tech takes a larger role in the economy. Consumers now spend $95 billion a year on televisions, stereos, and home computers—more than the $85 billion they shell out for new cars. Businesses spend more on high-tech gear than on industrial machinery. And with computer prices dropping 15% to 20% a year, the momentum for falling prices is enormous.

The shift to a deflationary economy will require a big adjustment by investors, businesses, and consumers. Deflation is good for lenders and bad for borrowers, who cannot count on inflation to ease their debt burden. This may help explain why personal bankruptcies have been on the rise despite low unemployment. Moreover, businesses have to learn how to function in an environment where waves of deflation sweep across the economy, hitting first one industry and then another.

It took time in the 1970s for people to accept the idea of persistent inflation. Now, we will find it equally hard to believe that prices can fall. But deflation may be here to stay.

Mandel is BUSINESS WEEK's *economics editor.*

Second thoughts about globalisation

Economists are often accused of playing down the costs of global integration, while protectionists deny its benefits. Is there a middle ground?

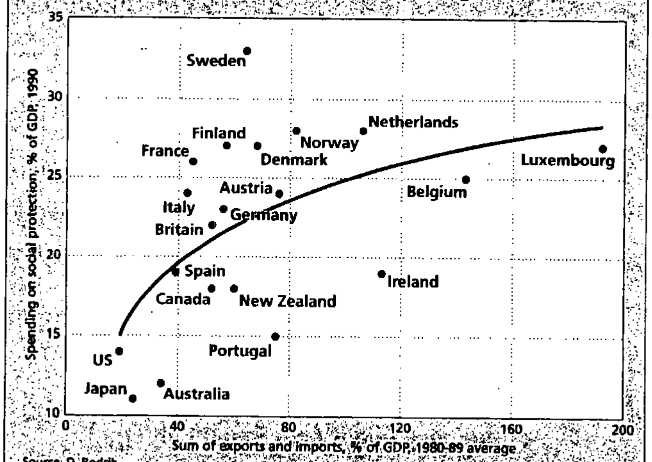
ECONOMICS FOCUS

THE debate about globalisation is largely a dialogue of the deaf. On one side, ivory-tower economists tout the benefits of increased trade and cross-border investment, while ignoring (or at least downplaying) the costs. On the other, the critics of freer trade and open capital markets refuse to acknowledge the gains from closer integration, often displaying at best an elementary grasp of economics.

Dani Rodrik, an economist at Harvard University with impeccable mainstream credentials, wants to rectify that. He has waded into the debate with a book* all the more controversial for being published by a think-tank known for its sympathy with the globalisers. Chastising his academic colleagues for their optimism, he aims to provide intellectual rigour for a more sceptical position.

Mr Rodrik's argument rests on three planks. First, he claims that his academic colleagues underestimate the effect of freer trade and capital flows on the established balance of power between employers and employees. Most economists contend that trade is only a minor cause of increased earnings inequality in America and other rich countries. Mr Rodrik says that this misses the point. Globalisation has made it easier for firms to shift production overseas, substituting foreign workers for local ones. The threat that jobs will go abroad, he suggests, could lie behind job insecurity, the erosion of non-wage benefits and the weakening of trade unions.

Sheltering from the trade winds?
Relationship between exposure to trade and spending on social protection



Source: D. Rodrik

His second point is that economists have been too ready to ignore rich-world concerns that globalisation will undermine social norms such as workers' rights. When, say, South Carolinian workers cry foul at losing their jobs to Honduran children, their complaints are more than mere protectionism. Their idea of "fairness", and with it popular support for freer trade, is being eroded.

Third, says Mr Rodrik, globalisation makes it increasingly difficult for governments to provide social insurance—which, he says, has mitigated the risks to some workers of freer trade and hence helped to make trade politically acceptable. Before the second world war the share of average government spending in industrial countries was roughly 20% of GDP. Now it is around 47%, and in rich countries spending on social protection is closely correlated with exposure to trade (see chart). But as capital and skilled labour become more mobile, it will become harder for governments to raise the taxes to finance social spending.

Coming from an economist of Mr Rodrik's standing, this is provocative stuff. But is it right? Granted, Mr Rodrik is correct to point out areas where economic research has been lacking: too much time has been spent poring over the statistical link between trade and wages, for example, and not enough on the broader effects of trade on labour markets. Other parts of his argument are much weaker.

Take the rise of the welfare state. His contention that trade lies behind the rise in social spending is dubious: in both America and Europe, it was in large part a political response to the depression of the 1930s—which was itself worsened by increased protection. Moreover, if social spending is intended as insurance against the supposed risks of freer trade, it is hard to see why in many countries such a big slice of it goes to pensioners, who gain from lower import prices but do not have jobs to lose.

Worse, obsessed with the idea that globalisation threatens the social contract in rich countries, Mr Rodrik almost forgets that both rich and poor countries stand to benefit enormously from trade. Thus the question in the rich world is not whether there are gains to be made (there are) or whether some people will lose (they will), but how the gains from trade are shared out. And how did Americans and Europeans come to see trade-union rights, bans on child labour and so forth as "fair", if not by getting rich enough to afford them? Without trade, perhaps the most important engine of growth in poorer countries, workers in developing countries stand little chance of ever doing the same. Paying too much attention to rich-world worries about differences in social norms runs the risk of perpetuating them.

And the alternative?

Insisting that prescription is not the main purpose of his book, Mr Rodrik offers few policies to limit the costs of globalisation. And those are likely to do more harm than good. He suggests, for instance, broadening the World Trade Organisation's rules on "safeguards" against sudden surges in imports. His proposal is to allow countries to impose protection if there is "broad domestic support" that imports are causing social disruption. Such support would be gauged by compelling a country to gather testimony from all relevant parties. But this could easily be abused. Would consumers' voices really be heard above producers' cries for help?

Or take his idea of a global tax on physical capital, intended to reduce the international mobility of employers. This would make investment less profitable, so harming economic growth. And why should poor countries, which crave foreign direct investment, sign up?

The point is not that a Panglossian view of globalisation is justified: there are certainly costs. Rather, it is that the protection of workers in rich countries, although it may be politically tempting, is an economic mistake—however it is dressed up.

* "Has Globalisation Gone Too Far?" Institute for International Economics, Washington, DC. March 1997.

FAX COVER SHEET

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Working for America's Workforce

August 21, 1997

MEMORANDUM TO JAY BERMAN

FROM: ANDREW SAMET

RE: FAST TRACK AND LABOR

As requested, here are some thoughts on the labor and fast track issue. These thoughts attempt to (1) place the labor standards issue into some historical context, (2) review the arguments for and against dealing with labor standards as part of trade liberalization, and (3) suggest what the Administration might do with regard to this matter in the near future. As I understood your request, this is written with no assumptions being made about what the fast track bill might or might not say with regard to the labor issue.

Labor and International Trade in Context

The first thing to note here is that the issue of labor standards and trade isn't new. Quite the opposite. Economic competition has driven the development of labor standards. In the nineteenth century labor standards didn't evolve solely out of the notion that a modern and fair society accords its workers certain rights -- although that was clearly important. But also out of a view that if some companies and firms were to provide these rights for workers, all firms should be under the same obligations so there would not be a competitive disadvantage. In other words, trade competition. (This has been true regardless of arguments by economists about how much or how little labor standards actually influence comparative advantage and trade.)

The nineteenth century trends and early efforts to create international labor standards led to the establishment of the International Labor Organization as part of the Treaty of Paris ending World War I. And the ILO henceforth became the responsible international authority for setting and evaluating compliance with labor standards. The ILO was also the only League of Nations institution that the United States joined (in 1934 under FDR), and the only one to survive World War II and become part of the United Nations system.

After World War II, it was also contemplated that there would be a relationship between the ILO and the new International Trade Organization. However, the ITO was stillborn. As was any constitutional relationship with the ILO.

The discussion on how to align interests in both trade and labor standards surfaced here and there into the Eisenhower Administration, disappeared for a time into the fog of the Cold War, and reemerged in the negotiating objectives of fast track bills in the 1970s and 1988. And it has become a central point of debate in the 1990s. It was given its first concrete form in the North American Agreement on Labor Cooperation (NAALC), which accompanied the NAFTA.

I give you a bit of the history only to make the point that (1) this is not a new, but an old issue, and (2) there is a very inspiriting historical tale that could be told should the Administration see the value in telling it.

The Argument About Labor Standards

Regardless of what a fast track bill might say, the Administration could make the case for the need to pursue the labor standards agenda.

Why?

At least three reasons.

First, it helps trade liberalization to address the labor standards issue. It arguably broadens support for (or at least mutes opposition to) trade agreements, and in no serious way diminishes it. Workers need reassurance that the agenda for the "global economy" also includes them -- viz, fair working conditions. The perception today is too much the opposite.

After all, it seems oft forgotten that the rationale for trade liberalization is to create wealth to improve the lives and living conditions of real people. And if the wealth only goes to a few, the political and economic rationale for trade liberalization is eroded. Moreover, the commitment to improving the living standards of real people is also the fundamental mandate of the ILO -- so in this there is a strong overlap between the ILO and WTO mandates that often gets lost in the details of actual negotiations and daily agendas.

Second, the labor standards issue raises concerns with consumers that they may be buying the products of exploited workers. As the world gets smaller, and our economy more global, especially in terms of consumer products, people aren't happy with the notion that they may be complicit in the exploitation of foreign workers. The phenomenon of child labor and sweatshop conditions is played out in the media constantly. Many Americans would prefer something be done to remove that burden from them.

Third, the implementation of basic labor standards is good economics. We spent much effort to get the OECD to produce a study in 1996 which vindicates that proposition. Implementing core labor standards isn't a question of what a country can afford. The OECD study tells us if a country want to be richer and grow faster, it can't afford not to implement these labor standards. In that regard, we have a collective interest in a bigger global economic pie, and a specific interest in pressing the labor standards agenda.

Even if one doesn't find the arguments for the labor standards agenda convincing, the arguments against it are even less so.

What are they?

First, countries can't afford the labor standards, and they will improve as they grow. As noted above, the evidence is if you want to be richer, implement core labor standards. The affordability argument is premised on a notion that we are suggesting all nations should have U.S. levels of wages and benefits -- many economists are not used to distinguishing "core" labor standards from "developmental" standards that will increase as an economy develops.

We have made a determined effort to say we are not in favor of negotiating wage rates or benefits. Indeed, we have opposed that notion. (Although the "living wage" issue continues to need a response -- see Kuttner's Washington Post op-ed on August 20.) Our idea is that if core labor standards are applied, workers will be able to bargain in the labor market for their value and their productivity -- which will be reflected in their wages and benefits. Put another way, if we believe in free trade, free capital markets, and other free markets -- shouldn't we insist on a free labor market. The core standards we are talking about are the minimum market regulators to allow a free labor market to function.

Second, the argument is made that this is all a protectionist effort. This is silly given that the Clinton Administration has one of the strongest pro-trade records in history. Why ask for new fast track authority to open markets if the intent is protectionism. We are on record opposing the use of labor standards for protectionist purposes. Further, we have the only concrete example of a labor agreement linked to a trade agreement with the NAALC. And not one peso of Mexican or dollar of Canadian exports to the United States have been blocked because of it.

Third is the argument that trade and labor just aren't "linked." This is a counter-factual argument. And there really isn't much point to such a debate. We want both more trade and better global implementation of core labor standards. We should use whatever mechanisms we can to get more of both. For example, the ILO should help the WTO agenda and the WTO should help the ILO agenda. You can't really say that as a member of the ILO we are concerned about labor standards only when we sit in the ILO, and that when we go down the hill in Geneva and enter the doors of the WTO we check at the desk our obligations to advance the mandate of the ILO. If the WTO can help us advance the objectives of the ILO -- we should consider how best to proceed. And vice versa.

Moreover, the OECD study made clear that there is a mutually reinforcing relationship between the implementation of labor standards and trade liberalization. In other words, a linkage. And this doesn't even require taking up the economists' argument about whether the implementation of core labor standards would raise or lower labor costs or effect trade flows. The OECD makes the point that more trade and more core labor standards are both good -- and mutually reinforcing.

Also, on a pragmatic level, if an export contract is canceled because of reports of child labor, or the repression of trade unionists, this is a linkage. One might wish it weren't so -- but it is. To argue it isn't is a bit silly. Indeed, the use of labels that indicate a product was not made with child labor, or firms adopting codes of conduct that limit who they will do business with based upon a set of labor conditions, all have trade impacts -- acknowledged or not.

In any event, these are the major arguments that I have dealt with in recent years for and against the labor standards issue.

Next Steps on Labor Standards

In some (not well-recognized) ways, we have been quite successful at placing the labor standards issue onto the international agenda. And we have done so largely as a result of developing a pragmatic and clear approach to defining the issue of "core" labor standards to undercut the arguments of opponents about imposing wages rates and protectionism (we're against both).

There are a number of on-going and pending opportunities that permit the Administration to move the labor standards agenda forward. These developments would logically form the basis for action items related to any policy pronouncement that might be made on the labor standards agenda.

First, is the ILO. In 1994 we succeeded in getting the ILO to establish a working party on trade and labor standards. Much ground work has been done in that working group, and it laid the basis for the agreement in June 1997 for the ILO to develop a new instrument to bind all member states to the "core labor standards," and to introduce a new mechanism to establish accountability for their implementation. This is a major development in the history of the ILO -- but a successful outcome isn't assured.

An Administration effort to push a positive outcome could be an important part of our next steps. The possibility for any success here, however, does require a continued credible effort by the Administration to insist on bringing the labor issue to the WTO and keeping it linked to trade initiatives -- because it is the threat of WTO action which provides the traction in the ILO to consider something serious. Success in the ILO will certainly not satisfy those who want a clearer connection to trade measures. Nevertheless, working the ILO angle is still worth the attempt.

Second, is the WTO. We spent some effort pressing the issue of core labor standards for the agenda of the Singapore WTO Ministerial. The labor standards issue ended up being the dominant political issue confronting the ministerial. The result was ministerial language that recognized the importance of core labor standards, but not agreement on the establishment of a working party in the WTO. The Singapore process showed our support for the labor standards issue was enough to (1) make it a major political issue; but (2) not enough to get a working party established over the opposition of many countries.

Although progress in the WTO seems unlikely anytime soon, our serious effort in the WTO remains critical to the possibility of moving the agenda forward in the ILO and elsewhere. And the previous fast track negotiating bill objectives have highlighted the importance of establishing a working party or some other process on labor standards within the GATT/WTO. The next WTO ministerial is in May 1998, and we need to develop a strategy of how we will handle the issue for that ministerial.

Third, is the FTAA process. We have had some success in laying the groundwork on the labor standards issue in the hemispheric process for the Free Trade Area of the Americas. The main problem today is that there is a recognized business forum providing input into the trade minister's process, but no parallel labor forum.

Through the OAS labor ministerial in 1995, a consensus was reached on the importance of improving labor standards in the process of economic integration. Argentine labor minister Caro Figueroa had been designated to present this position on behalf of the labor ministers to the trade ministers, first at Cartagena, Colombia last year and then in Belo Horizonte, Brazil last May. However, due to opposition from Mexico and a very few other countries, consensus on receipt of this report was blocked. Nevertheless, Brazil's trade minister distributed it.

The Leaders' meeting in April provides the next best opportunity to get a labor forum established so that we can channel the energy of the Hemisphere's labor unions in a positive direction in the FTAA process -- rather than allow them to make the argument they are being excluded. Indeed, it is most likely that once joined in the process the labor unions will become constructive -- albeit unsatisfied -- participants in building the FTAA. This should be a major Administration priority, and opposition is now isolated to only a few trade ministries.

During his trip in May, the President got the Central American leaders to agree that it was important to have the input of labor in the economic integration process. The President could make further progress in assuring success in April, by seeking support from Venezuela, Brazil, and Argentina for a positive role for labor during his October trip to South America.

Fourth, the Apparel Industry Partnership (AIP) is an important but fragile private sector initiative supported by the President that began last August. The initiative responds to public concern about exploitative labor conditions, including child labor. (See New York Times editorial of August 20.) The AIP announced agreement on a code of conduct and monitoring principles in April, and has agreed to set up an organization that will be responsible for implementation of the code and a consumer information program by November 1997.

Private sector initiatives can have an impact on rewarding firms and countries that implement core labor standards, compared to those that don't. Even as governments argue about whether international rules are needed, the interest of companies in avoiding negative publicity about sourcing from firms using exploitative working conditions is beginning to move the market. The Administration can continue to bring public attention to positive models and responses, and can encourage further movements in this direction.

The President raised the AIP issue with the Central American leaders, and Secretary Herman will be meeting with the labor ministers of Central America on November 4 and 5. A prominent part of the agenda is the codes of conduct issue. Most of the apparel associations in the Central

American nations have already adopted codes of conduct in response to these pressures. The discussion can be about how to better implement them and monitor for compliance.

The President also raised this issue with the EU leaders in the May Summit. And Secretary Herman discussed it with her EU counterpart, Commissioner Flynn. They agreed to some joint programs that would bring additional attention to these efforts in the European Union, and we are working with Flynn's staff to set up these meetings.

A well-coordinated and consistent effort by the Administration to bring attention to these issues can have a significant impact on company and market behavior. And no government trade sanctions or trade measures are involved. It is the use of market forces -- pure and simple.

Labor unions are part of the AIP, and are prepared to participate in these efforts. It might even be possible to introduce this subject into the APEC process through the human resources working group if the President raises it at the November leaders meeting in Canada.

Fifth, the OECD. We laid a helpful intellectual basis for our policy in the 1996 OECD study on the relationship of labor standards to trade, as discussed above. We have put in place a "consensus' on the list of core labor standards that don't depend upon the level of economic development. The labor standards issue in the OECD context has now moved into the MAI negotiations. This is potentially a very important development. It isn't clear, however, whether we are leading this in the MAI as we were in the debates on the OECD study, or we are taking a more passive approach. Leading the effort here should be part of our next steps.

Sixth, would be the international financial institutions. There has been some pressure on the IMF, World Bank, and regional development banks to take the labor standards issue more seriously. There is now a legal requirement for a report to Congress each year on the issue. President Wolfensohn gave an important speech on labor standards to the ILO annual conference in June. It isn't clear how significant a priority U.S. executive directors and Treasury have made the labor issue.

Seventh, there are other initiatives that could be taken to move the labor standards agenda under existing legislative authority. This might include a more aggressive use of the existing GSP, CBI, Andean, Section 301 and Customs law authorities. And introducing labor standards requirements into the CBI enhancement proposal and the Africa trade initiative should be considered. There are many ways the Administration could express its concern, and I have outlined some of these in other documents already sent to you. The only issue is agreement to move forward in that direction.

I hope these thoughts are of some use. If not, I can try again.

TAA → Ways + Means + Sec.
Treasury - NAD Bank

Section 108 Report
any other FTA

① Commerce quantification
② State - costs of inaction
③ Ag
④ Q+A

FAST TRACK ANECDOTES/DATA
PRODUCTS TO BE PRODUCED

Labor + Environment: what do we say on policy - would we ... if we could / if we can't, what?

I. Examples/Anecdotes

A. Opportunity Examples

- Examples of sectors (preferably related to upcoming negotiations requiring fast track) with quantification of opportunities, jobs likely to be created, barriers that exist to U.S. exports in these sectors and how failure to achieve fast track would undermine U.S. capacity to seize these opportunities (e.g., other countries reaching preferential trade agreements).
- Examples of companies that want to export but cannot because of specific barriers they face in a specific country
- Other opportunity examples

B. Costs of Inaction Examples

- Examples where U.S. companies lost sales because foreign companies had preferential access not shared by U.S.
- Examples of U.S. industries that are disadvantaged because another country has reduced barriers to its exporters (e.g., U.S. wheat farmers cannot sell into Brazil because they face a x% tariff while Argentine wheat producers face none).
- Examples where U.S. companies are producing in another country because that country has preferential access to a third market - and where company would indicate it will return production to the U.S. if the barrier were reduced for U.S. exports (e.g., IBM example) [Issue: Want to use relocation examples?]

II. Fact Sheets

A. Costs of Inaction Fact Sheet (General)
B. Opportunities Through Sectoral Negotiations (General)
C. "Fast Track and . . ."
- Agriculture
- Manufacturing
- Services
- Individual Sectors (10 sectors being examined)

D. The Facts on Trade with Developing Countries

Kevin -

III. Other Background Documents

- Anecdote/Example Source Book
    - Includes Cost of Inaction Anecdotes, Sectoral Examples, NAFTA Success Stories and Trade Success Stories Generally
    - Source Book also to be divided sectorally and geographically for use with Congress
- State and District Trade Data

need to identify targets

1) Status of gov't procurement neg. in '97?

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