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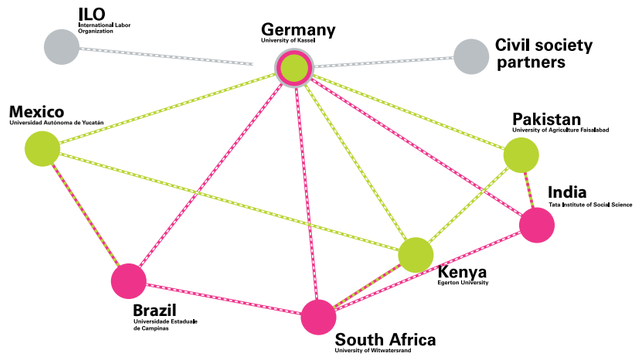

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Core Labor Rights

Competitive Pressures and Non-Compliance

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Core Labor Rights:

Competitive Pressures and Non-Compliance

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Abstract

The working paper's main objective is to explore the extent to which non-compliance to international labor rights is caused by global competition. From the perspective of institutional economics, compliance with core labor rights is beneficial for sustainable development. Nonetheless, violations of these rights occur on a massive scale. The violators usually blame competitive pressures. A number of studies have come to the conclusion that non-compliance does not provide for a competitive edge, thereby denying any economic rationale for non-compliance. While we sympathize with this conclusion, we find that these studies suffer from faulty assumptions in the design of their regression analyses. The assumption of perfect markets devoid of power relations is particularly unrealistic.

While workers' rights promise long-term benefits, they may incur short-term production cost increases. On the supply side, the production sites with the highest amount of labor rights violations are characterized by a near perfect competitive situation. The demand side, however, is dominated by an oligopoly of brand name companies and large retailers. Facing a large pool of suppliers, these companies enjoy more bargaining power. Developing countries, the hosts to most of these suppliers, are therefore limited in their ability to raise labor standards on their own. This competitive situation, however, is the very reason why labor rights have to be negotiated internationally.

Our exploration starts with an outline of the institutionalist argument of the benefits of core labor rights. Second, we briefly examine some cross-country empirical studies on the impact of trade liberalization (as a proxy for competitive pressures). Third, we develop our own argument which differentiates the impact of trade liberalization along the axes of labor- and capital-intensive production as well as low and medium skill production. Finally, we present evidence from a study on the impact of trade liberalization in Indonesia on the garment industry as an example of a low skill, labor-intensive industry on the one hand, and the automobile as an example for a medium skill, capital-intensive industry on the other hand. Because the garment industry's workforce consists mainly of women, we also discuss the gender dimension of trade liberalization.

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1. Overview

From the perspective of institutional economics, compliance with core labor rights is beneficial for sustainable development. According to the International Labor Organization (ILO), the following workers' rights are fundamental: freedom of association (Convention No. 87); the right to organize and bargain collectively (Convention No. 98); prohibitions of forced labor (Convention Nos. 29 and 105); discrimination in employment (Convention Nos. 100 and 111); and child labor (Convention Nos. 138 and 182). Nonetheless, violations of these rights occur on a massive scale (ITUC 2010). The violators usually blame competitive pressures. A number of studies have come to the conclusion that non-compliance does not provide for a competitive edge (ILO, 2009: and see below), thereby denying any economic rationale for non-compliance. While we sympathize with this conclusion, we find that these studies suffer from faulty assumptions in the design of their regression analyses. The assumption of perfect markets devoid of power relations is particularly unrealistic.

We start with the assumption of imperfect markets. On the supply side, the production sites with the highest amount of labor rights violations are characterized by a near perfect competitive situation. This is especially true at the lower end of the value chains due to the existence of many suppliers and the ease of market entry and exit. The demand side, however, is dominated by an oligopoly of brand name companies and large retailers. Facing a large pool of suppliers, these companies therefore have more relative bargaining power. As such, they switch sources in reaction to small changes in prices. While they master the rhetoric of corporate social responsibility (CSR), they are seldom willing to pay for it. They dictate prices which force the suppliers of simple products to super-exploit their workforce. Developing countries, the hosts to most of these suppliers, are therefore limited in their ability to raise labor standards on their own. This competitive situation, however, is the very reason why labor rights have to be negotiated internationally.

The paper's main objective is to explore the extent to which non-compliance to international labor rights is caused by global competition. The answer to this question is important for developing strategies against labor rights violations. If competition indeed plays a major role, then appeals for better corporate or

government behavior will not be sufficient; the structural causes would also have to be addressed. Our exploration starts with an outline of the institutionalist argument of the benefits of core labor rights. Second, we will briefly examine some cross-country empirical studies on the impact of trade liberalization (as a proxy for competitive pressures). Third, we will develop our own argument which differentiates the impact of trade liberalization along the axes of labor- and capital-intensive production as well as low and medium skill production. Finally, we will present evidence from a study on the impact of trade liberalization in Indonesia on the garment industry as an example of a low skill, labor-intensive industry on the one hand, and the automobile as an example for a medium skill, capital-intensive industry on the other hand. Because the garment industry's workforce consists mainly of women, we will also look at the gender dimension of trade liberalization.

2. Institutional Arguments: Workers' Rights for Sustainable Development

From an institutional perspective in economics, workers' rights contribute to long-term sustainable development. Both demand-side and supply-side arguments are put forward to demonstrate the stimulatory growth effects of workers' rights. From a demand-oriented perspective, highly unequal income distribution is regarded as an obstacle to sustainable development (Herr, 2011). First, it is argued that such inequality impedes the emergence of a mass market in durable consumer goods, so that developing countries cannot emulate the "Fordist" growth model of the United States and Western Europe. Second, the concentration of national income in the hands of a few people produces an excessively high savings ratio, so that growth-stimulating investment is too low. It also increases the likelihood of capital flight (Boyce & Ndikumana, 2002). Throughout the 1980s, profits from investments in Latin America were not fully reinvested, but largely transferred abroad (Altvater, 1992, pp. 219-236). Freedom of association and the right to collective bargaining are necessary preconditions for a more equal distribution of income (Rothstein, 1993, pp. 1-2).

The supply-side institutionalists cite two reasons why minimum social standards and resulting higher wages have a positive effect on a country's economic development prospects. First, higher wages promote the development of "human capital", without which no economic development is possible. Wages close to or below the minimum subsistence level make it impossible for workers to invest in their own education, or that of their children, and are often insufficient to pay for necessary health care. Higher wages, on the other hand, would not only enable workers to maintain and enhance their qualifications but would also increase the incentive to attend school and adopt performance-oriented behavior (Palley, 2004; Sengenberger, 2005). There is evidence that the early involvement of children in work can have serious consequences for their health and development (Forastieri, 1997; UNICEF, 2009).

Second, they argue that social standards are necessary for making the transition from an extensive to an intensive use of labor. Under the prevailing system of sweatshops, employers have no particular interest in using labor intensively because workers are paid based on how many items are produced; hence, no

fixed labor costs arise. Capital stock is usually small and consists of outdated machinery that cannot be used more efficiently. The resulting low labor productivity in turn precludes raising wages. In such a situation, minimum social standards could increase interest in measures to raise productivity by changing the structure of incentives for firms and workers. For firms, they would make the extensive use of labor less attractive; for workers, they would make it more rewarding to strive for the success of the firm. If, for instance, a strategy of "flexible specialization" is to succeed, certain preconditions must be met to ensure that workers can earn better wages, show themselves to be cooperative, and acquire professional qualifications. Social standards could help create those preconditions (Piore, 1994). As the minimum wage in Puerto Rico increased, for example, turnover and absenteeism declined, job applicants were more thoroughly screened, and "managerial effort" improved (Robertson et al. 2009, pp. 9-14; Card & Krueger, 1995, p. 247).

Neo-classical economists doubt whether a minimum wage could eradicate the sweatshop system; they consider it more likely that a minimum wage above the market-clearing price would lead to unemployment and a growing informal sector. If the efficiency wage argument were applied, firms would voluntarily make it the basis of their system of remuneration. The strategy of "flexible specialization" therefore requires no special regulation. In their view, the resolution of the classical tension between a system of incentives and productivity on the one hand and the impermissible withdrawal of labor and free-loading on the other, depends mainly on the production technique and on preferences, such as between work and leisure, and risk and the employment regime, including the prevailing ideology (i.e., worker morale; Srinivasan, 1996, pp. 68-69). It has to be asked, however, whether these latter factors are not precisely those conditions that the institutionalists consider necessary for the strategy of "flexible specialization" which have to be set politically.

Studies conducted by the ILO (2009), which look specifically at certain international labor standards, seem to be in line with the institutionalist argument. They show that compliance to labor standards positively contributes to a country's competitiveness and good economic performance. Other studies have argued in a similar direction (cp. Dehejia & Samy, 2009). However, given the persistence of violations of core labor rights, the question remains whether

violations are the result of competitive pressures. Unintentionally, the study co-authored by David Kucera raises some doubts about the validity of these studies. Kucera has won great merits for the operationalization of labor standards by developing a set of indicators for these standards (Kucera, 2007). The study he conducted together with Ritasch Sarna shows, in line with the institutionalist argument, that weak labor rights do not correlate positively with strong export performance. However, the study identifies one exception: East Asia. The authors do not consider these countries to be representative: "[…] the East Asian experience is anomalous in the broader global context" (Kucera & Sarna, 2004, p. 25). This move to fortify the general argument is not convincing. Global competitive pressure originates exactly from this region (Berik & van der Meulen, 2010). A second look at the above mentioned studies reveals that they treat all countries the same in their regression analysis, and neither account for global market shares nor for changes in these shares.

3. Head-to-Head: South-South Competition

While almost all countries have ratified some ILO conventions, the new export nations in particular have been slow to ratify even core conventions. Some of the motives for not signing on to the ILO conventions are political in character. Dictatorships have good reasons to believe that trade unions might become places of government opposition (e.g. Solidarnosc in Poland). There are also economic reasons. While the "high road" promises long-term benefits, it may incur short-term costs. The amount of these costs, their impact on competitiveness, and their long-term rewards are difficult to appraise (Dehejia & Samy, 2004). ILO studies conducted in India suggest that as a portion of the final price of carpets to the consumer, labor-cost savings realized through the employment of children are between 5 and 10 per cent for carpets (Anker et al., 1998).

However, the likelihood of higher wages does not automatically translate into higher production costs. According to the institutional argument mentioned above, the observance of labor rights will lead to greater efficiency, which compensates for higher wages. In the short-term, higher costs are nevertheless likely before the efficiency gains are realized. Given that most export goods from developing countries are sold to wholesalers or transnational corporations, which command a strong market position vis-à-vis the producers, even small differences in production costs can be expected to be decisive for market success.

The competition among the countries in the South has not received nearly as much attention as the North-South trading relationship. However, theoretical arguments as well as empirical evidence suggest that competition is fiercer along the South-South than the North-South axis (Ghose, 2000). The greater the similarity between the competing regions with regards to factor endowment and market position, the more acute this danger (Mosley & Uno, 2007). The extent of competition among Southern countries is influenced by the following factors: (a) simple production techniques which allow for easy market entrance, (b) fast growing labor forces because of a crisis in subsistence agriculture, (c) foreign indebtedness which forces countries to maximize export earnings, and (d) the ability of transnational corporations to switch supply sources and to relocate production facilities. The latter is more likely in labor intensive, low skill industries such as the toy or garment industries.

In a number of product lines, fierce competition has led to an environment conducive to violating core workers' rights. The search for cheap labor is well documented for the garment industry. Pressure originates from brand-name manufacturers as well as large retail chains (Wick, 2009; Kolben, 2004). Because of fair trade campaigns, brand-name buyers are trying to enforce certain labor and environmental standards on their suppliers. However, they seem not to be willing to pay for the extra compliance costs of their suppliers (Zhang, 2011).

4. Trade Impact on Women

An UNCTAD study on the impact of trade liberalization on women has argued that it provides women with more job opportunities which, in turn, earn women a higher status and more decision-making powers within the household (Tran-Nguyen & Zampetti, 2004, p. 18). While this may be true for some women (see the differentiation between "mistress" and "maid" by Young, 2001), feminist scholars have contended that trade liberalization, far from bringing about wage equality between men and women (Berik et al., 2003; Berik, 2007; Kongar, 2007), has an adverse impact on women workers. Women are mostly concentrated in jobs with poor working conditions and little to no union rights (Barrientos, 2007; Seguino & Grown, 2007). Export industries employing women are typically located in Export Processing Zones (EPZs; ICFTU, 2004: 11), where labor rights are restricted. Women in these industries, therefore, suffer from long working hours (Kusago & Tzannatos, 1998, p. 15; Kabeer & Mahmud, 2004, p. 146), unhealthy and unsafe working conditions, wage discrimination (ICFTU, 2004: 12), and violations of reproductive rights (Reysoo, 2005). Seguino (1997) and Chu (2002, p. 62) have argued that this exploitation of women has been the backbone of the expansion of export-oriented labor-intensive manufacturing industries. Therefore, in the attempt to address gender equality through labor standards, one has to consider constraints resulting from the globalization process (Seguino, 2006, p. 97).

In the form of investment liberalization, globalization constrains efforts to improve the situation of women in export industries. It allows firms to move their production plants from country to country in search of the most favorable conditions in terms of regulations and labor costs. The ability to relocate production is, of course, dependent on the amount of fixed costs, i.e. of investments specific to the location. Companies in the auto industry are also trying to circumvent labor by investing in other places (looking for a "spatial fix" to their competitive problems), but because of the capital intensity of their investments (and the resulting lower levels of mobility), it is quite likely that sooner or later workers in the new plants will also start organizing themselves (Silver, 2003, p. 41). Since women workers are concentrated in "mobile industries" whereas men are more concentrated in "immobile industries", women are more vulnerable to globalization (Seguino, 2006, p. 98). So-called "vertical" Foreign Direct Investments (FDI), which are driven by the search for cheaper production

costs, are typical for mobile industries. The "mobile" plants usually feed into global production chains. Immobile industries are recipients of mostly horizontal FDI, except resource extraction industries. In these types of industries, companies locate production in a country close to their customers (and behind tariff and non-tariff barriers), so that labor costs are of minor consideration.

Summarizing the above arguments, it cannot be ruled out that competitive pressures via trade liberalization increase the likelihood of core labor rights violations. The degree of competition depends on a number of factors, most importantly on the ease of entry into the industry. Low skill and capital requirements allow for easy entrance and high mobility. Workers in mobile industries will therefore face lower bargaining power and more violations of core labor rights than workers in immobile industries.

5. Case Study: Garment and Auto Industry in Indonesia

We selected Indonesia for empirically exploring our hypothesis concerning the differential impact of trade liberalization on mobile and immobile industries. Indonesia is currently experiencing regional trade liberalization. In 2002, the member countries of the Association of Southeast Asian Nations (ASEAN) agreed on further economic integration and lowered a number of trade barriers among themselves. Garment and automotive industries are important for Indonesia. They are very suitable for a comparison between low-skill mobile and medium-skill immobile industries. The gender distribution of the workforces mirrors this difference between the two industries. We investigated the period between 1999 and 2005: three years before and after 2002, the completion deadline for the six ASEAN original member countries. We are aware that the effects of freer trade might materialize in time; however, taking a longer post-liberalization period may also lead to distortions caused by other trends. For this reason and for significant data restrictions, our study is of an exploratory nature.

For the measurement of changes in labor standards in the garment and automotive industries we developed a scoring scheme borrowed from Viederman & Klett (2007) with some relevant adjustments (see Constructing Qualitative Indicators in Annex). The paucity of data rules out regression analysis. We therefore limited the analysis to a descriptive comparison of statistical trends of factors that might influence labor standards and the scores for labor standards in the respective industries. In addition, we conducted interviews with representatives of workers, employers and the government. The interviews were conducted for a better comprehension of the data. Before presenting the results, it is salient to understand the organization of production in the garment and automotive industries, particularly in Indonesia, as well as the competition that takes place in these industries.

5.1 Garment and Automotive Value Chains

The apparel value chain consists of five main parts, namely: (1) raw material supply; (2) provision of components, such as yarn and fabrics manufactured by textile companies; (3) production networks of garment factories, including their domestic and overseas contractors; (4) export channels provided by trade intermediaries; and (5) marketing networks at the retail level (Gereffi & Memedovic, 2003, pp. 3-4). Apparel is considered a buyer-driven value chain, in which "…large retailers, brand-named merchandisers, and trading companies play the pivotal role in setting up decentralized production networks in a variety of exporting countries…" (Gereffi, 1994, p. 97). Brand name companies such as Nike and large retailers such as Walmart exercise control over garment suppliers through product and design specifications.

Indonesian garment producers are mainly so-called Original Equipment Manufacturers (OEM). They focus on the manufacturing process. They source and trim fabric, and provide all production services from packaging and delivery to the retail outlet. OEMs usually manufacture based on the design and specifications required by the customer and in many cases use raw materials specified by the customer (Gereffi & Frederick, 2010, p. 13). Full package suppliers in Indonesia may outsource some parts of production, such as cutting, sewing and trimming, to local subcontractors or offshore to overseas subcontractors. Some East Asian countries with low labor costs, such as Cambodia and Vietnam, host these subcontracted assembling activities (Gereffi & Frederick, 2010, p. 13). The garment production process is highly fragmented and employs a multitude of subcontractors (USAID, 2008, p. 11). Subcontractors face stiff competition. They survive by responding swiftly to buyer demand for low cost and high quality. One way of meeting the demands of buyers is to subcontract to home-based workers. Producers who are forced out of the market as a result of shifting comparative advantage sometimes survive by becoming intermediaries between the new low-cost production sites and the retailers (Kaplinsky, 2000, p. 27). Taiwanese footwear and clothing producers are a good example of this so-called triangle manufacturing (Gereffi, 1999a). Regional free trade agreements facilitate triangle manufacturing.

In the automotive industry, the value chain was traditionally organized in tiers (Veloso & Kumar, 2002, p. 12). Original equipment manufacturers (OEM) carry out

the functions of designing and assembling the cars. First tier suppliers deliver their products directly to the automakers. Second tier suppliers produce simpler parts that are assembled by the first tier suppliers. The third and fourth tiers supply raw materials. Today, some of the first tier suppliers have become system integrators that design and integrate components, subassemblies, and systems into modules that are placed directly by suppliers in automaker assembly plants (Veloso & Kumar, 2002: 12). The automotive value chain serves as an example of a producer-driven value chain, in which the production system is controlled by transnational companies (TNCs) or other large industrial enterprises (Gereffi, 1994, p. 97).

During its initial development in the 1960s, the automobile sector in Indonesia was mainly assembling cars coming from abroad on a Semi-Knocked Down (SKD) basis (Puraka et al., 2008, p. 14). In the 1970s, the Indonesian government imposed several policies, such as an import ban on Completely Built Up (CBU) cars as well as high import duties for not using domestic components (Aswicahyono et al., 1999, p. 6; Nag et al., 2007, p. 25). In the1990s, a similar policy was enacted according to which the government provided incentives for using domestic components. All these government interventions resulted in the growth of the component sector. Currently, the Indonesian automobile sector is supplying, assembling and distributing foreign automotive brands, mostly Japanese. Some Indonesian component manufacturers have reached first tier auto component producer status for several Japanese automobile companies. However, most of the locally supplied components require few skills and technological knowhow, while the Japanese car companies produce more sophisticated components in-house. The Indonesian automobile commodity chain features vertical inter-firm linkages and subcontracting networks as a result of government intervention and import substitution policy in the past (Aswicahyono, 2000, p. 231).

The Indonesian automobile assembling and component (particularly first and second tiers) companies are in the hands of major groups. Some of these firms produce for more than one foreign brand name, but mostly Japanese brands. In Japan, Japanese car companies adopt a keiretsu network with their suppliers, which are characterized by a tight and stable relationship. Irawati (2008, 2010) argued that the keiretsu network is found in the relationship between Japanese

foreign auto companies and Japanese-affiliated suppliers in Indonesia, excluding the pure domestic suppliers from the keiretsu network. The relationship between Japanese car companies with pure domestic suppliers is mostly shallow, short-term, and non-exclusive (Sato, 1998a, as cited in Aswicahyono, 2000, pp. 219-233). For pure domestic suppliers, not only does this situation lead to unstable relationships with customers, but it also hinders the technological transfer from customers to these suppliers. Japanese car companies may have eschewed including pure domestic suppliers in their keiretsu networks because of the latters' large number, small scale of operation, and low product quality (Aswichayono, 2000, pp. 233-4). As a result, pure domestic supplier firms are relatively vulnerable to shutdown and face difficulties related to appropriating returns from investments in their skill base (see also Doner et al., 2006, p. 57).

5.2 Competitive Pressures from ASEAN Free Trade Agreement

The step to establishing a free trade area in the ASEAN region was decided in 1992 during the Fourth ASEAN Summit of Heads of Government (Cuyvers & Pupphavesa, 1996, p. 3). The main instrument of AFTA is the so-called Common Effective Preferential Tariff (CEPT), which stipulated that tariff barriers should be reduced to 0-5% by 1 January 2002 for the six original member countries[1] (Soesastro, 2005, p. 1). It is argued that AFTA paved the way for the more efficient and competitive ASEAN countries' manufacturing sectors in the global market (Kaihatu, 2003, p. 113). From new trade theory's point of view, AFTA is expected to allow industries within ASEAN to reach economies of scale by providing them with a larger market and at the same time protecting them from competition outside ASEAN.

Indonesian garment producers have supported AFTA in the expectation of an expanding market (Interview with Indonesian Garment Producers Association, May 15, 2009). This expectation was partly met. While exports to ASEAN increased between 2001 and 2005, ASEAN competitors were also able to penetrate the Indonesian domestic market (Figure 1).

[1] There are actually five original ASEAN member countries, namely Indonesia, Malaysia, the Philippines, Singapore and Thailand. Brunei Darussalam joined ASEAN on 8 January 1984 (ASEAN Secretariat). However, compared to other newer member countries, Brunei Darussalam is often considered one of the original member countries.

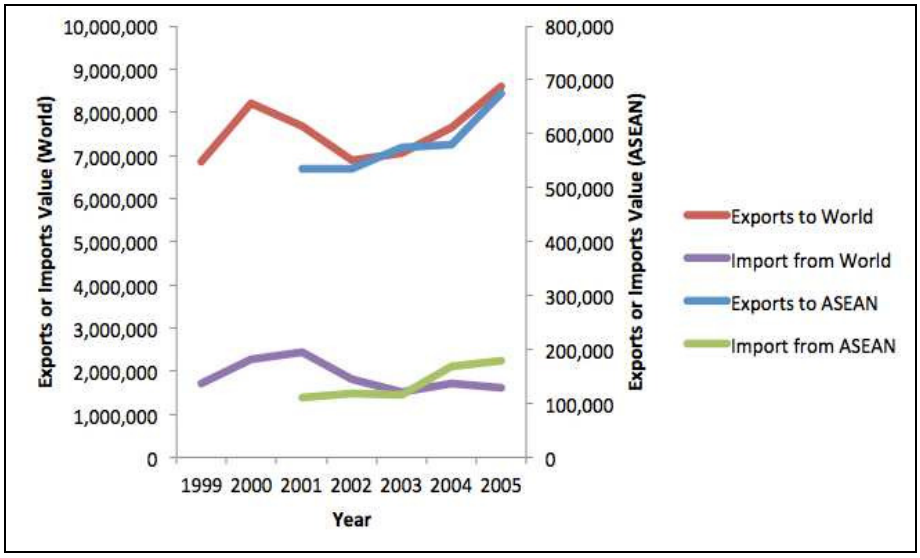

Figure 1: Indonesian Garment Exports and Imports with ASEAN and World, 1999-2005. Note: In US Thousands Dollar;

Sources: International Trade Centre (HS code 50-63) for data on exports to and imports from ASEAN; Ministry of Trade for data on exports to and imports from the world

AFTA is considered an instrument for reconfiguration of regional garment value chains. According to an interview with the Indonesian Garment Producers Association (May 15, 2009), AFTA is used by garment suppliers in the region to strengthen garment products' competitiveness for the global market instead of targeting the ASEAN market. Such regional reconfiguration allows garment suppliers to specialize in certain niches. Recalling the concept of triangle manufacturing proposed by Gereffi (1999), AFTA might be used by Indonesian garment producers to concentrate more on their role as full package suppliers, while other production activities, such as cutting, sewing and trimming, would be increasingly subcontracted to other ASEAN countries like Vietnam and Cambodia. This indicates that while AFTA seems to be in favor of Indonesian full package suppliers, it disproportionately affects garment producers who previously carried out cutting, trimming and sewing activities, for example. In other words, competitive pressures resulting from AFTA might squeeze out Indonesian lower-end garment suppliers.

Indonesian automotive producers also increased exports to the ASEAN market between 2001 and 2005 (Figure 2). As economies of scale are substantial for the automotive industry, AFTA has become an important opportunity for Indonesian

automotive producers to increase their output. As Gaikindo, the Indonesian automotive producers association, pointed out, increasing exports to ASEAN are accounted for not only by component and Completely Knocked-Down (CKD) vehicles, but also CBU (Interview May 13, 2009). The improvement of CBU vehicle exports to ASEAN, as well as the intensified engagement of the Indonesian automotive industry, reflects the increasing exposure of the industry to regional competition.

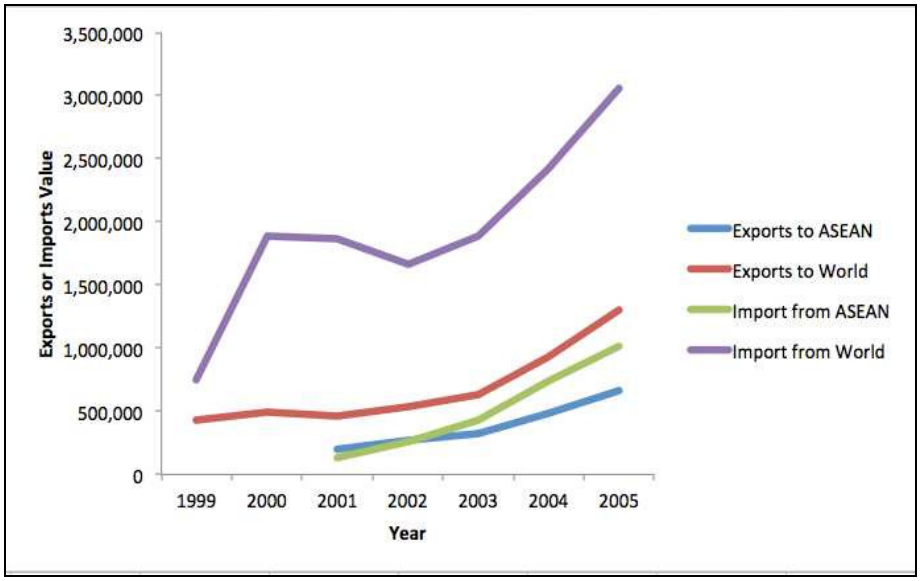

Figure 2: Indonesian Automotive Exports and Imports with ASEAN and World, 1999-2005, Note: in US Thousand dollars

Sources: International Trade Centre for Data on exports to and imports from ASEAN; Ministry of Trade for Data on total exports and total imports; GDP data from NationMaster

From the perspective of the global value chain approach, AFTA might contribute to the restructuring of regional auto value chains. As Takii (2004, p. 9) argued, Japanese companies have considered regional strategies in ASEAN under a liberalized trade regime. Some Japanese companies and part-makers have considered making use of the liberalized trade regime for inward benchmarking (Puraka et al., 2008, p. 63). In this case, competition occurs between assemblers and suppliers of the same brand in the region. The regional strategies of Japanese companies are also pointed out by Gaikindo although with a different perspective (Interview May 13, 2009). According to Gaikindo, there are companies that spread production of different types of vehicles to different countries based on the type of vehicle that the country can produce competitively. For example, Indonesia is a

competitive producer of the Multi-Purpose Vehicle (MPV), while Thailand can produce the sedan competitively. Based on these strategies, Indonesia exports more MPVs to ASEAN as CBU vehicles and at the same time continues exporting CKD vehicles and components. In these types of strategies, competition takes place between different auto brands. To conclude, competition between automotive producers is evident in both possible regional strategies.

The above descriptions demonstrate how AFTA amplifies competition between producers within garment and automotive industries in ASEAN countries. However, the degree of competition between the two industries might be different depending on several factors, particularly ease of entry into the industry. As mentioned, easy entrance into an industry may bring about high mobility. This is the case for the garment industry, which has low skill and capital requirements for entry. High mobility might contribute to intensified competition. On the other hand, a relatively difficult entrance might reduce the level of mobility. The automotive industry is case in point, which requires high skill and capital as prerequisites to enter the industry. A relatively lower level of mobility might discourage stiff competition. This difference in the level of mobility might lead to different levels of bargaining power among workers in the two industries, presumably resulting in different labor situations. This issue will be presented in the next section.

5.3 Trends of Labor Standards

Statistics on wage and employment trends in both industries are not readily available. One of the few sources is Hidayat & Widarti (2005, p. 41, p. 49), who studied the large and medium garment and automotive companies in the years 1996, 1998, 2000, and 2002. Their data shows that both industries experienced increasing employment and higher monthly wages for production workers. Monthly wages were generally higher for production workers in the automotive industry. The profile of production workers reflects gender distribution between the industries. However, their data does not capture the situation for workers in small companies, which constitute a particularly large share in the garment industry. In addition, it does not cover the informal sector within these industries, especially the home-based garment industry which serves an important function in the Indonesian garment value chain. We, therefore, have constructed

qualitative indicators for measuring labor standards in both industries (see Annex).

Figure 3 shows our scores of labor standards in the garment and the automotive industries for the period between 1999 and 2005. They are well below the perfect score (40 points), with scores of labor standards in the automotive industry surpassing those in the garment industry. Increasing scores after 1999 reflect the enactment of the Trade Union Act of 2000. It was the first labor act ever stipulating freedom of association. In 2003, the Law on Manpower further strengthened labor rights. However, because of enforcement problems, both industries continued to score below 30. The government failed in monitoring and implementing the labor laws effectively.

As mentioned, the scores for labor standards in the automotive industry outperform those in garment industry in the period between 1999 and 2005. The gap reflects differences in the implementation of labor standards. The garment industry experienced sustained violations in the following areas: freedom of association and collective bargaining, child labor, unequal remuneration and other forms of gender discrimination, occupational health and safety, and wages and working hours. Lack of enforcement of these labor standards also took place in EPZs, which resulted in a downgrade of the implementation score in the garment industry. This is because garment factories are also located in EPZs. Apart from this, the difference in scores of institutional capacity also contributed to the gap. While the capacity of NGOs is perceived to be strong in both industries, government capacity is viewed to be stronger in the automotive industry than that in the garment industry. This is because the government capacity to enforce labor laws was still weak in small companies and informal sectors during that time, and it is important to note that garment companies are mostly middle and small level companies (Interview with Indonesian Garment Producers Association, May 15, 2009) which also involve home-based workers (see below).

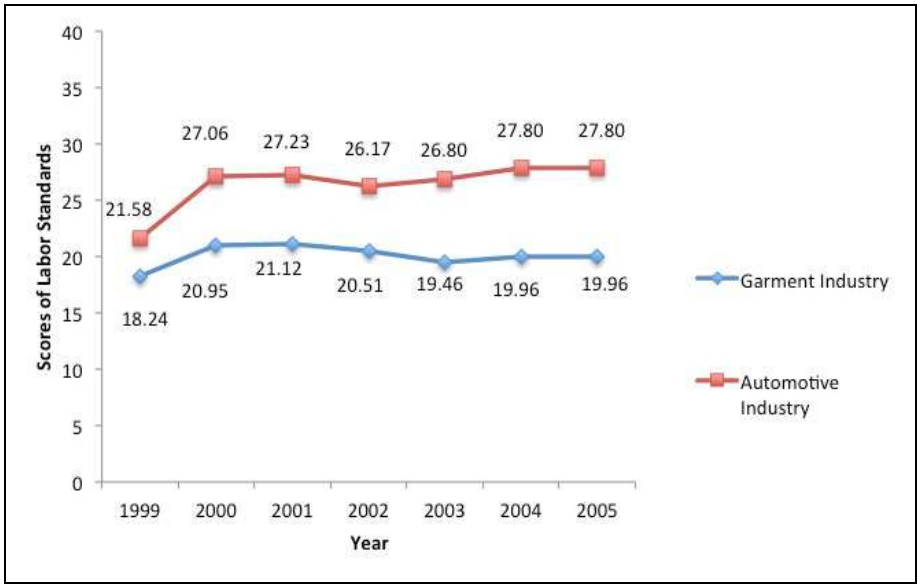

Figure 3: Trends of Labor Standards in the Garment and Automotive Industries in Indonesia, 1999-2005

Sources: Own data

The garment industry employs home-based workers. These are mainly married women. The process of garment companies outsourcing to home-based workers involves a long chain, from the factory to the outsourcing agent, to the "juragan" or "pengepul" (labor broker), a person who connects the agent or the factory to the home-based workers (Interview with MWPRI, June 18, 2009). Consequently, the home-based workers most likely do not know the company that initiates the orders. This is a real challenge for defending these workers' rights in the bargaining process with companies. Furthermore, this chain of the subcontracting process is mainly invisible in the sense that it is closed, forming a black economy that encompasses the domestic sphere (Stephanus, 2007, p. 5). Companies benefit from home-based work because it provides them with additional labor resources without incurring fixed costs and without responsibilities for working hours and conditions (Interview with MWPRI, June 18, 2009). These violations of labor standards, however, are not fully understood or reported by home-based workers, who remain unorganized. This can be explained on the one hand by the separation in location between these workers and workers in the companies. On the other hand, home-based workers will most likely not have much time for organizing activities due to long working hours. They are also not yet recognized as workers and are accordingly not included in

workforce statistics (Stephanus, 2007, pp. 3-6). The government regards them as those who only want to spend their time to earn additional money for their households. Indonesia has not yet ratified ILO Convention No. 177 on Home Work. Therefore, the government does not monitor compliance with labor standards in home-based work (Interview with MWPRI, June 18, 2009). This negligence also extends to labor organizations (Stephanus, 2007, p. 6). It is a clear sign of the deeply engraved gender bias in Indonesian society.

5.4 Trade Openness and Labor Standards

The data shows the differential impact of freer trade on labor standards. In the labor-intensive garment industry, increased exports were accompanied by a lowering of labor standards (cp. Figures 1 and 3). The most plausible explanation for this trend is that the Indonesian industry lost out to competition from Vietnam and Cambodia for markets outside ASEAN (see Figure 1). The generally decreasing trend of labor standards in the garment industry during the same period indicates that these increasing exports were only possible at the expense of garment workers.

In the capital-intensive automotive industry, strong export performance went along with improved labor standards (cp. Figures 2 and 3). This means that the privilege of liberalized market access provided by AFTA was taken advantage of by automotive producers. This also implies that the ASEAN market became more important in relation to the markets in the rest of the world for the Indonesian economy during that time. Although labor standards improved, the increase was not really significant and labor stayed well below perfect scores. Nevertheless, labor standards in the automotive industry remained better than those in the garment industry during the same period.

There seemed to be relatively intense competition between car producers in Indonesia and those in other ASEAN countries occurring between 2003 and 2004 (data from International Trade Centre, available at www.trademap.org). During this period of time, as Figure 3 shows, labor standards in the automotive industry increased despite intense competition and free trade. It suggests that free trade does not necessarily lead to a race to the bottom in the automotive industry; improvements are possible.

6. Summary

In this paper we have shifted the discourse on trade and core labor standards from a focus on nations in a North-South relationship to industries engaged in South-South competition. There is strong competition among peers and an oligopoly of brand name companies or large retailers on the buyers' side, especially for industries with easy market entry and exit, which are typically low-skill and labor intensive. The oligopolistic buyers switch sources in reaction to small changes in prices. The buyers impose prices on the suppliers of simple products which leave them little choice but to super exploit their workforce and, in many cases, to violate core labor standards. Our case study suggests that the ASEAN free trade agreement AFTA intensified competition among garment manufacturers in the region. Indonesian garment companies responded by increasing outsourcing, utilizing home-based workers, and disregarding international labor rights to a greater extent than before. In a gendered division of labor, non-compliance disproportionately affects women. In the automotive industry, the free trade agreement allowed for more specialization among the different locations. The increased competition was thus mitigated by the benefits of larger economies-of-scale. Furthermore, the capital intensity of the automobile industry reduced the threat of plant closures. Both factors help to explain why labor relations slightly improved after the free trade agreement had been ratified. The beneficiaries of this improvement were mainly male workers.

In sum, the case studies support the theoretical claim that with the combination of increased competition among producer and buyer oligopolies, non-compliance with core labor rights becomes more likely. Developing countries, the hosts to most of these suppliers, are therefore limited in their ability to raise labor standards on their own. This competitive situation, however, is the very reason why labor rights have to be enforced internationally.

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Annex: Constructing Qualitative Indicators

In the pursuit of measuring labor standards, we relied on the ILO Core Conventions. They enjoy international recognition (Block, 2007, p. 47). In addition, we borrowed Viederman & Klett's (2007) model of indicators for conditions of work, including their scores and weights, with some relevant adjustments. These indicators, we believe, not only capture labor standards, but also the implementation of such standards.

Viederman & Klett (2007) developed qualitative indicators based on four categories, namely: (1) ILO Conventions; (2) laws and legal systems; (3) institutional capacity; and (4) implementation effectiveness. They are weighted at 10%, 25%, 15% and 50% of total scores, respectively. Since this was an industry-level analysis, we omitted the first category, which captures the countries' status of the ratification of ILO Conventions.

The second category of Viederman & Klett's model is comprised of two subcategories: (1) convention-related issues and (2) conditions of work. They are weighted at 75% and 25% of the category scores, respectively. The first subcategory consists of four sections: freedom of association, forced labor, child labor and equality/discrimination. Each of them is weighted at 25% of the subcategory. We retained this as the first category in our model of indicators. Since we were also attempting to capture alternatives to labor regulation tools as defined by Kühl (2003), we oriented alternatives of labor regulation tools as the second category in our model of indicators since these tools cannot be perceived as laws and legal systems (i.e. are not enacted by the government). This category should, therefore, be weighted less than the laws and legal systems category (10% in our model of indicators).

The third category of Viederman & Klett's model of indicators is comprised of two subcategories, namely: (1) governmental capacity; and (2) non-governmental capacity. We also retained both of these subcategories.

The fourth category of Viederman & Klett's model of indicators consists of two subcategories: (1) Convention-related issues; and (2) conditions of work. They are weighted at 80% and 20% of the category, respectively. Similar to those in the laws and legal systems category, the Convention-related issues subcategory is comprised of four sections representing the four core labor standards, with each

of them weighted at 20%. The conditions of work subcategory consist of: (1) health and safety conditions; and (2) wage conditions. Each of them is weighted at 50% of the subcategory. We maintained this categorization in our model of indicators.

Viederman & Klett calculated and incorporated a deduction resulting from freedom of association laws suspended in EPZs, which reduces the total scores of indicators in the laws and legal systems category. They did not specifically mention the percentage of this reduction. Instead of adding all the scores of indicators in this category and then deducting the total score by points resulting from the absence or the lack of such legislations in EPZs, we decided to address this deduction in each of the labor rights observed. We believe that doing so allows a more accurate point reduction. We propose a 50% reduction from the score of labor rights observed in this category. Considering that liberalization creates intense competition, especially between firms or manufacturers located in EPZs, this amount of reduction is plausible. Furthermore, the deduction used by Viederman & Klett only captures the absence or lack of legislation concerning freedom of association rights. Consequently, deductions resulting from the absence or the lack of legislation concerning other rights in EPZs are undermined. In the same vein, we addressed deduction in each of the labor rights observed in the implementation effectiveness category. This is dissimilar to Viederman & Klett's model, which addresses the deduction only for freedom of association rights. Additionally, while Viederman & Klett propose a reduction of 25% for the freedom of association score, we propose a 50% reduction. This is also in order to capture the intense competition of lowering labor rights that takes place in EPZs.

In sum, after the adjustments, our model of indicators consists of four categories, namely: (1) laws and legal systems; (2) alternatives of labor regulation tools; (3) institutional capacity; (4) and implementation effectiveness. They are weighted at 25%, 10%, 15%, and 50%, respectively. The model of indicators is comprised of 44 indicators that were developed based on the four categories.