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Globalization and the Middle Class*

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Abstract

The most important question for social policy today is: can the United States participate in global trade while maintaining a robust middle class? Or does expanded global trade necessarily mean doom for the U.S. middle class and others in advanced industrial nations? This question might have sounded provocative, incendiary, or just plain silly a decade ago, but it can no longer be ignored. Several different approaches have been advocated to preserve the living standards of the middle class in advanced countries in the face of expanded global trade. This essay examines three clusters of policies that are the most promising, policies to (1) encourage a race to the top that can counterbalance a race to the bottom; (2) promote the creation of local and regional agglomeration economies that will act as counterweights to a race to the bottom, and (3) foster firm-level innovation and develop the skills and human capital of the local population. It concludes that we adopt policies that braid these three together in order to preserve the U.S. middle class.

Introduction

In 1992, Ross Perot famously warned that we would hear a “giant sucking sound” as millions of U.S. jobs in the United States move to Mexico. His claim, greeted with widespread mockery at the time, may not have been quite as outlandish as it seemed. While there has been no thundering ‘shluurrrp’ or any similar sucking sound, there has been a gradual but steady movement of jobs overseas, first in manufacturing and then in certain services. And for those jobs still here, wages have stagnated because middle class workers are being forced to compete directly or indirectly with low wage workers from around the world.

* A condensed version of this piece will appear in Kirpatrick, Scott & de Burca, GLOBAL GOVERNANCE (Hart Publishers 2013)

The most important question for social policy today is: can the United States participate in global trade while maintaining a robust middle class? Or does expanded global trade necessarily mean doom for the U.S. middle class and others in advanced industrial nations? This question might have sounded provocative, incendiary, or just plain silly a decade ago, but it can no longer be ignored. In the stream of global commerce, labor standards tend to flow to the lowest point. The price of labor in China now affects what workers in Detroit can bargain for. Safety conditions in Viet Nam now affect the availability of jobs in North Carolina. Yet efforts by developed countries to impose their labor standards on developing countries have met with staunch resistance and accusations of protectionism from developing countries.¹ Moreover, under the current rules of global trade, countries cannot unilaterally use trade sanctions to impose their labor standards on countries with lesser standards.

Some have argued that trade does not lower labor standards globally because multinational corporations (MNCs) raise labor standards in the countries where they locate production. However, evidence that they actually do so is sparse at best. For every Banana Republic, there is at least one Nike. And there are only Banana Republics because non-governmental organizations (NGOs) and consumer advocates have shamed a high profile name-brand producer into adopting a code of conduct and an external monitoring system, and other corporations do not want similar scrutiny. Moreover, not all corporations are vulnerable to consumer pressure, and consumers, as a whole, are fickle and unreliable advocates in any event. It is true that MNCs offer jobs in places where jobs have been intermittent or nonexistent, and the jobs they provide usually pay more than the local alternatives. But MNCs also relocate repeatedly as soon as workers demand too much. It is quixotic to expect MNCs to provide Western standards of decent work environments.

Moreover, any salutary intentions Western multinational firms might have to offer minimally decent labor standards when they move to poor countries frequently dissipate once they arrive. In China, Viet Nam, and other Asian countries, U.S. multinationals are powerful actors in the domestic political arena and have used their influence to resist improvements in, and even to reduce, labor standards in their host countries.²

¹ See, Kevin Kolbin, *The WTO Distraction*, 21 Stan. L. & Pol'y Rev. 461, 468-471 (2010). See also, Kevin Banks, *Trade, Labor And International Governance: An Inquiry Into The Potential Effectiveness Of The New International Labor Law*, 45 Berkeley J of Empl and Labor Law 45, 60-61 (2011);

² David Barboza, *China Drafts Law to Boost Unions and End Abuse*, New York Times Business Section, October 13, 2006. See also, Labor Strategies, *Behind the Great Wall of China; U.S. Corporations Opposing New Rights for Chinese Workers*, available at

Given the trends in global labor standards, what, if anything, can be done to protect labor standards for the middle class in the developed world? Will protection for labor standards in the developed world contribute to the impoverishment of the developing world? Will declining labor standards in the global north lead to a decline everywhere, so that the tide of trade not only does not raise all the boats, but actually sinks them all instead? Or, can labor standards be improved universally through some felicitous dynamic that raises all boats?

Five different approaches have been proposed to try to save the middle class in the industrialized world without impoverishing the developing world.

First, some have called for more powerful transnational institutions that have the power and authority to impose hard law solutions – something like the International Labor Organization (ILO) but with teeth. The argument is that the ILO, or the World Trade Organization (WTO), or some kind of global labor tribunal with sufficient power and legitimacy should set minimal standards, define fundamental labor rights, and set up an enforcement mechanism akin to the International Criminal Court to adjudicate and remedy allegations of breaches.³

Second, there are some who call not for equalizing or even harmonizing labor standards, but simply to bolster the safety net so that everyone can have a decent standard of living regardless of trends in labor markets. One scheme of this type is the proposal for a basic income (sometimes called a “citizenship grant” – a socially adequate level of support made available to every citizen without any work requirement or other type of strings attached.⁴

http://laborstrategies.blogs.com/global_labor_strategies/files/behind_the_great_wall_of_china.pdf (last visited 9/14/12).

³ See, e.g. Barry, Christian & Reddy, Sanjay G., *Global Justice and International Economic Arrangements: International Trade and Labor Standards: A Proposal for Linkage*, 39 *Cornell Int'l Law J* 545 (2006); Hyde, Alan, "The International Labor Organization in the Stag Hunt for Global Labor Rights", 3 *Law & Ethics of Human Rights* 154 (2009); Macklem, Patrick, "Labour Law Beyond Borders", 5 *J. Int'l Economic Law* 605 (2002).

⁴ See, e.g., Guy Standing, *THE PRECARIAT: THE NEW DANGEROUS Class* 171 – 173; (London: Bloomsbury Academic, 2010); Guy Standing, *GLOBAL LABOUR FLEXIBILITY: SEEKING DISTRIBUTIVE JUSTICE* (Basingstoke: Macmillan, 1999); Jirgen de Wespalaere and Lindsay Stirton, *The Many Faces of Universal Basic Income*, 75 *Political Quarterly* 266-274 (2004) ; For a general overview of issues and a collection of Working Papers on Basic Income, see, The Basic Income Guarantee Network, at <http://www.usbig.net/whatisbig.php>.

A third approach is to advocate policies that encourage a race to the top that can counterbalance a race to the bottom. As discussed below, there have been several different proposals for mechanisms to facilitate a race to the top.⁵

Fourth, some advocate the creation of local and regional agglomeration economies that will act as counterweights to a race to the bottom. Proponents of this approach – including this author -- advocate measures to empower local groups so that workers can obtain a share in the surplus that agglomeration provides.⁶

A fifth approach provides that the only way developed countries can protect their labor standards in the era of global trade is to foster firm-level innovation and develop the skills and human capital of the local population.⁷

Of these five approaches, the first two might be attractive, but are highly unlikely to materialize in the foreseeable future. Given today's political landscape, it is nearly inconceivable that either a transnational labor authority with genuine rule-making and adjudicatory authority will be established any time soon, or that national states will choose to provide their citizens with a significant level of basic income. Hence it is more fruitful to consider the other three approaches – encouraging a race to the top, facilitating agglomeration economies, and fostering flexible labor practices. Each of these approaches has not only been theorized and debated in the scholarly literature – each has actually been implemented in some places.

However, each of the latter three approaches has a dark side along with the bright side. That is, each one holds potential for a fairer form of globalization and a more promising future for the middle class in the developed world, but each also contains serious dangers. Moreover, to get to the bright side of any of these, there are certain regulatory or institutional mechanisms that will have to be put in place. None will automatically provide the middle class with a lifeline – they each require political mobilization and enlightened policy design.

In this article, I describe each of the latter three approaches, illustrate some places where each has been implemented, and elucidate each one's dark and bright side. I then consider whether these approaches can be braided together and used as a lifeline to save the middle class.

⁵ See Section ____, *infra.*,

⁶ See Section ____, *infra.*

⁷ See Section ____, *infra.*

First, though, it is necessary to review the conventional debates about labor and trade.

I. Labor Standards and Free Trade -- Unholy Alliance or Harmonious Marriage?

A. Free Trade in Theory: The Ricardian Argument for Free Trade, and Its Critics

Almost two hundred years ago, David Ricardo showed that free trade between two nations was beneficial for both, regardless of their relative wealth, factor endowments, or level of productivity. According to his analysis, each nation would export those goods in which it had a “comparative advantage” and import those goods in which it did not. In Ricardo’s two-country model, if Portugal can produce both textiles and wine more cheaply than England, and if the cost differential between Portugal and England were greater in wine than in textiles, then it would be beneficial for Portugal to export wine to England and import textiles from England. At the same time, it would be to England’s advantage to export textiles to Portugal and import wine, again so long as its cost differential is less for textile production than for wine production. This is because while Portugal has an absolute advantage in both commodities, English has a comparative advantage in textiles.

For example, following Ricardo’s example, imagine that Portugal and England both produce wine and textiles, but they have different costs of production (monetary units) as follows:

Product	Cost of Production (in monetary units)	
	Portugal	England
Wine 10 liters	3 monetary units (MU)* (3.3 liters per MU)	5 monetary units (MU) (2 liters per MU)
Textiles 10 bolts of cloth	5 monetary units (MU) (2 bolts per MU)	10 monetary units (MU) (1 bolt per MU)
Cost of 10 liters wine and 10 bolts cloth	8 MU	15 MU

*Ricardo used “labor hours “as his standard unit, but in today’s vernacular, it makes more sense to stipulate a uniform monetary unit of currency such as the dollar or the euro or some imagined “Monetary Unit (“MU”).

In this case, if the two countries do not trade at all, it will cost England 15 MUs to get 10 liters of wine and 10 bolts of cloth. If England instead uses its resources to make only wine, it can make 30 liters for the same 15 MUs. In that case, it can keep 10 and sell 20 to Portugal. In exchange for the 20 liters of wine, England would receive 6 MUs (in Portuguese wine prices). With that, it could purchase 12 bolts of cloth at Portugal’s cloth prices, giving it 10 units of wine and 12 units of cloth, or 2 more than it would if there has not been trade.

Conversely, if Portugal does not trade, it will have 10 liters of wine and 10 bolts of cloth by spending a total of 8 MUs. If instead, Portugal only produces textiles, it can use the same 8 MUs to produce 16 bolts of textiles. In that case, it can get keep 10 bolts and sell the other 6 to England for 6 MUs in English prices. With that 6 MUs Portugal receives for selling the cloth to England, it can purchase 12 liters of wine from England , giving it 10 bolts of cloth and 12 liters of wine for 8 MUs, or 2 more than if there were no trade.

In sum, in this example, with and without trade, total production would be:

	<u>Result Without Trade</u>			<u>Result With Trade</u>	
England	10 wine liters	10 bolts of cloth		10 wine liters	12 bolts of cloth
Portugal	10 wine liters	10 bolts of cloth		12 wine liters	10 bolts of cloth
Total Production	20 wine liters	20 bolts of cloth		22 wine liters	22 bolts of cloth

Another more intuitive example often used to explain the theory of comparative advantage is as follows: Suppose the best lawyer in a town is also the best typist. The lawyer would still be better off hiring a secretary to do his or her own typing.

On a moment’s reflection, one would agree that this is correct. After all, lawyering is more lucrative than typing, so utilizing one’s time as a lawyer and paying someone else to type makes sense. However, this metaphor is not directly applicable to nations that are made up of distinct groups who do not necessarily have

the same interests or the same ability to protect those interests in the face of global trade.⁸

An overwhelming percent of economists interpret this simple model as presenting a powerful case for the benefits of free trade, even between countries of vastly different wealth, resources, and levels of technological development.⁹ In the classic Ricardian model, overall output is increased by trade. Moreover, free trade permits each country to exploit its own comparative advantage, and with unfettered trade, the gains can be shared. However, the model does not prove that both trading partners are automatically or always made better off by trade. Whether both nations gain or just one gains depends upon many factors, including the institutional arrangements inside each country, the rules governing international trade, the structure of domestic industry, and the specific numbers in the boxes in the specific context.¹⁰

Some economists have raised theoretical and empirical questions about the Ricardian model. Over time, the model predicts that countries will specialize in production areas where they have comparative advantage. But some question whether specialization will always occur or will always be beneficial to the specializing country. For example, some posit that to benefit from free trade over time, developing countries first need to develop manufacturing industries, and thus they should shield those industries from global competition to give them a chance to develop.¹¹ Some also question whether the existence of market imperfections or path dependency have impaired a country's ability to develop the full potential of its productive capacity.¹² Nonetheless, since Ricardo, it is an article of faith for most economists that free trade benefits all countries that participate in an open trading regime.

Stripped to its essence, Ricardo's theory shows that overall production is greater with free trade. It also shows that in some circumstances, there are mutual benefits of trade for *nations*. However, it does not address the advantages vel non of specific groups or individuals within those nations. Thus, despite the power of the

⁸ See, Alan S. Binder, *Free Trade*, in THE CONCISE HISTORY OF ECONOMICS, 2d Ed. (David R. Henderson, ed., 2007)

⁹⁹ Sonali Deraniyagala and Ben Fine, *New Trade Theory Versus Old Trade Policy: A Continuing Enigma*, 25 Cambridge J. of Econ. 809, 809 (2001) (reporting finding that in 1996, 97% of U.S. economists support unrestricted free trade).

¹⁰ See Alan V. Deardoff, *How Robust is Comparative Advantage?*, 13 Review of Int'l Economics 1004, 1005-1006 (2005); David Kennedy unpublished memo (on file with author).

¹¹ For a historical review of the "infant industry" argument for an exception to free trade, see Douglas A. Irwin, *Retrospectives -- Challenges to Free Trade*, 5 J. of Econ. Perspectives 201- 208 (1991).

¹² See Sonali Deraniyagala and Ben Fine, *supra*. N. ___ at 812 – 816 (summarizing arguments).

theory of comparative advantage, it does not necessarily follow that everyone within a given nation gains as a result of free trade. Rather, Ricardo's theory treats each nation as a black box, but within the box, specific groups can win, lose, or draw in a free trade game.¹³ As Paul Samuelson writes, the theory of comparative advantage makes its most important omission by "treating all people in each region as different *homogeneous* Ricardian laborers." According to Samuelson, that assumption obscures "the realistic cases where some Americans (capitalists and skilled computer experts) may be helped by [the decimation of] the real free-trade wage rates of the semi-skilled or the blue-collar factory workers."¹⁴

The important point is that the Ricardo theory of comparative advantage does not prove that *all* groups within a nation benefit from free trade. It simply does not talk about distribution within, or between, countries. However, this omission is not a fatal flaw in the eyes of economists. Most economists evaluate free trade, as well as other economic policies, under a Hicks-Caldor model of efficiency.¹⁵ A policy is "efficient" under a Hicks-Caldor definition of efficiency not if everyone benefits, but if everyone could theoretically benefit.¹⁶ That is, a policy is efficient if the winners' incomes were sufficiently enhanced that they could compensate the losers and still come out ahead.¹⁷ Thus Ricardo's theory of free trade might or might not benefit all groups within a country. The impact on the middle class in an advanced country would be determined by whether there were distributional measures in place to ensure that firms, workers, and other social groups all shared in whatever advantages the trading regime wrought.

¹³ Sonali Deraniyagala and Ben Fine note that the theory has "a particularly underdeveloped notion of what constitutes a nation." *Supra*. n. ___ at 816.

¹⁴ Paul A. Samuelson, *Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization*, 18 *J. of Econ. Perspectives*, 135, 143-44 (2004).

¹⁵ See, e.g. Jules Coleman, *The Normative Basis Of Economic Analysis: A Critical Review Of Richard Posner's The Economics Of Justice*, 34 *Stan. L. J.* 1105 (1982) (discussing and criticizing Posner's adoption of Hicks-Caldor efficiency criteria).

¹⁶ Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 *Econ. J.* 549-50 (1939). In a Hicks-Caldor efficiency model, it would not be relevant whether some groups lose, so long as the winners can compensate the losers. Yet in the real world, the issue of compensation, or redistribution, is very important. See, Richard S. Markovits, *A Constructive Critique of the Traditional Definition and Use of the Concept of "The Effect of a Choice on Allocative (Economic Efficiency)": Why the Kaldor-Hicks Test, The Coase Theorem, and Virtually All Law-and-Economics Welfare Arguments Are Wrong*, 1993 *U. Ill. L. Rev.* 485, 489 (1993)

¹⁷ See Joseph E. Stiglitz, *THE PRICE OF EQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE* at 63 (W.W. Norton & Co., 2012).

Furthermore, Ricardo's theory is addressed to the effect of trade on "nations." It shows that "nations" can benefit from trade when they specialize and produce goods in which they have comparative advantages. However, it is not clear from the theory what it means for a "nation" to benefit. In today's world, most economists measure the wealth of nations in several different ways, with the most prominent being gross domestic product (GDP). But GDP is not the same as the wealth of individuals or entities who reside in the nation.

GDP refers to the total value of goods and services produced within a particular country's territorial borders in a particular time frame. Thus it is theoretically possible for GDP to be large even if all the assets within the country are foreign-owned and all the wages and salaries of the workforce go to foreign workers. That is, a country could have a high GDP even if all the income went to non-nationals and its own citizens were impoverished.¹⁸

In Ricardo's era, there were no publically traded corporations and no international stock exchanges. Large trading companies had charters that permitted them to monopolize trade with particular regions. Those trading companies often had diffuse stock ownership, and entrepreneurial financiers purchased shares and options across borders, but on the bulk of ownership was nationally based.¹⁹ In contrast, today firm ownership is dispersed globally, just as are firm assets, workers, customers, and suppliers. Because the owners of multinational corporations – i.e. the shareholders – are dispersed around the globe, trade can benefit owners of productive resources without necessarily creating prosperity for their nations of origin.

The more corporations pull away from their national moorings and instead operate in a global market under disparate legal regimes with shareholders and decision-makers from many nations, the less the effect of comparative advantage will redound to the benefit of any particular nation. Trade, under Ricardo's theory, will create more goods overall, but the distribution of those goods and the benefits that accrue from them could be located anywhere. That is, when giant multinational firms have interests that are distinct from individuals or other firms in their nation-states, the conclusion that free trade benefits all *nations* does not necessarily hold.²⁰ Hence

¹⁸ See, e.g., Richard A. Brecher and Jagdish N. Bhagwati, *Foreign Ownership and the Theory of Trade and Welfare*, 89 *J. Political Economy*, 497-511 (1981) (Concluding that "welfare aspects of international trade theory need to be reconsidered, when national and aggregate income differ in the presence of foreign ownership.")

¹⁹ Franklin A. Gevurtz, *The Globalization Of Corporate Law: The End of History or a Never-Ending Story?* 86 *Wash. L. Rev.* 475, 481-483 (2011).

²⁰ Stephen Hymer, *Efficiency (Contradictions) of Multinational Corporations*, 60 *American Econ. Rev.* 44, 446-448 (1970).

trade policies that maximize advantage for firms no longer translate neatly into beneficial effects for particular nations much less domestic social groups within nations.

B. The Distributional Impact of Free Trade

Two lines of analysis propose a mechanism by which trade may help some groups in rich and poor countries, but not necessarily everyone. These analysts argue that unfettered trade between rich and poor countries can lower labor standards for working people in wealthier countries, either by triggering a *race to the bottom* or by fostering *regulatory competition*, whereby countries loosen regulatory standards to attract producers.

The prediction that firms will move to locations offering the lowest level of labor standards was used to explain firm relocation decisions within the United States when firms in the textile industry moved from New England to the South to take advantage of low wage and nonunion environments.²¹ In the latter part of the 20th century, as capital became more mobile internationally and barriers to international trade declined, the concept of a “race to the bottom” has been transposed to the international arena. The theory holds that if capital is unrestrained, firms will move production away from high wage or high labor cost locations and locate their production facilities where labor costs are lower. This dynamic will depress wages in the original high cost locations because more and more jobs will be lost. For the corporations which do not move their jobs overseas, they will be forced to lower their wage levels to that of the lowest cost producer. Hence critics of unrestricted trade warn that without some enforceable international labor standards or other external constraint on capital mobility, firms will leave high labor standard countries and relocate wherever they can find the cheapest labor.

A somewhat different critique of free trade is the theory of regulatory competition. Regulatory competition occurs when nations compete for business by

²¹ Beth English, A COMMON THREAD: LABOR, POLITICS, AND CAPITAL MOBILITY IN THE TEXTILE INDUSTRY 116-17 (2006). The phrase “race to the bottom” is usually attributed to Justice Brandeis, who used it to decry the trend of states to weaken their incorporation laws in order to attract corporate charters. *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 559-60 (1933) (Brandeis, J., dissenting). He wrote, “[t]he race was one not of diligence but of laxity. Incorporation under [competing state] laws was possible; and the great industrial States yielded in order not to lose wholly the prospect of the revenue and the control incident to domestic incorporation.” *Id.*

keeping labor standards low to attract businesses.²² The theory of regulatory competition maintains that globalization induces domestic nations to revise their regulatory regimes so as to downgrade their level of labor protective regulations in order to retain or attract private capital.²³ Many labor advocates predict that regulatory competition will trigger a downward spiral, in which nations compete with each other for lower labor standards.²⁴ They also fear regulatory competition will mean that labor unions will lose their political allies at the domestic level and thus be rendered powerless to resist the subsequent changes.²⁵

The dynamic of regulatory competition and race-to-the-bottom theories are not mutually exclusive. Each posits different effects of trade on labor, effects caused by the actions of different actors. A race-to-the-bottom theory addresses choices of firms, and presupposes that firms, at least in some instances, will make locational decisions based on the cost of labor. Regulatory competition presupposes that governments make decisions about levels of labor protective regulation based on the threat of jurisdictional competition for jobs. It is reasonable to believe that both

²² See e.g., Jim Yardley, *Export Powerhouse Feels Pangs of Labor Strife*, N.Y. TIMES, Aug. 23, 2012 at __, available at http://www.nytimes.com/2012/08/24/world/asia/as-bangladesh-becomes-export-powerhouse-labor-strife-erupts.html?pagewanted=all&_moc.semityn.www (discussing the lengths that Bangladesh officials will go to keep its status as “an export powerhouse, second only to China in global apparel exports such as , as factories churn out clothing for brands like Tommy Hilfiger, Gap, Calvin Klein and H&M.”).

²³ For a schematic analysis of the dynamics of regulatory competition over labor standard regulations, see David Charny, *Regulatory Competition and the Global Coordination of Labour Standards*, in Daniel C. Esty & Damien Geradin, *REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES* (Oxford Univ. Press 2001) 311, 315 - 323.

²⁴ There are other types of regulatory competition as well. Wolf-Georg Ringe, a professor of comparative law at Oxford University, describes regulatory competition in the field of corporate law in Europe after the European Court of Justice ruled that it was permissible for parties to choose where to incorporate. Numerous countries altered their laws once it became permissible for firms to choose to incorporate in the EU country with the least restrictive capital requirements. Wolf-Georg Ringe, *Sparking Regulatory competition in European Company Law*, in R. de la Feria & S. Vogenauer (eds), *PROHIBITION OF ABUSE OF LAW – A NEW PRINCIPLE OF EU LAW* (Oxford, 2009), available at <http://ssrn.com/abstract=1326964>.

²⁵ See Katherine V.W. Stone, *To the Yukon and Beyond: Local Laborers Afoot in the Global Labor Market*, 3 J. of Small & Emerging Bus. 93 (1999). Katherine V.W. Stone, *Labor and the Global Economy: Four Approaches to Transnational Labor Regulation*, 16 Mich. J. Int'l Law 987 (1995).

dynamics are operative and feed off each other, such that firms' search for cheaper labor induces countries to lower labor standards.

C. *The Impact of Liberal Trade on the Middle Class*

There is considerable evidence showing that firms relocate when they can achieve significant labor cost savings in low-wage countries.²⁶ In the mid-1980s, diversified multi-national firms began to develop global strategies to move production between locations in order to exploit cost differentials, exchange rate fluctuations, and disparate labor law regimes.²⁷ And firms often move repeatedly as these cost differentials change. For example, many firms moved from Brazil to Haiti, and then from Haiti to Bangladesh when they were faced with the prospects of rising labor costs.²⁸ In 2005, when the WTO lifted textile quotas, industry analysts widely predicted that retailers would abandon their suppliers in low cost states such as Cambodia, Mexico and Bangladesh, and relocate to the even lower cost state of China. Indeed many multinational firms moved production to China in the 2000s, but when Chinese wages began to rise, some moved again to Viet Nam. The U.S. Association of Importers of Textile and Apparel anticipated that its members, some of the largest retailers in the world, will "react to the WTO's lifting of quotas . . . by slashing the number of countries they source production in from 50 today to just five or six countries by 2007."²⁹

Despite the anecdotal examples, firms do not *inevitably* relocate to the lowest labor cost countries. Rather, evidence suggests that some firms relocate to take advantage of lower labor costs, but the pattern is often more complex than a simple race-to-the-bottom theory would predict.³⁰ Industries in which labor costs are not a large proportion of total costs are less likely to move than those that are labor

²⁶ Jeff Cowie, *CAPITAL MOVES* (Cornell Univ. Press, 1999); etc.

²⁷ See, e.g., C.K. Prahalad & Yves L. Doz, *THE MULTINATIONAL MISSION: BALANCING LOCAL DEMAND AND GLOBAL VISION* 102 (Free Press, New York, 1987).

²⁸ Katherine V.W. Stone, *To the Yukon Trail*, supra. n. 24, 3 J. of Emerg. Bus. Law 97-98.

²⁹ Ellen Israel Rosen, *The Wal-Mart Effect: The World Trade Organization and the Race to the Bottom*, 8 Chap. L. Rev. 261, 264 (2005).

³⁰ See, e.g., Eric Tucker, *"Great Expectations" Defeated?: The Trajectory of Collective Bargaining Regimes in Canada and the United States Post-Nafta*, 26 Comp. Labor L.& Pol. J. 97 (2004) (finding that NAFTA did not erode collective bargaining laws in the United States, but did have a negative effect on the implementation of collective bargaining laws and the outcomes of bargaining in Canada).

intensive. Some industries, such as the hospitality industry, health services, or building services, need to be near their customers. Others benefit by being near their distribution markets, such as evidenced by the decision by Japanese carmakers to produce cars for the U.S. market in the United States. Some producers benefit from being close to natural resources or research facilities that are important to their production processes. Others do not move to lower labor cost countries because they benefit from agglomeration economies that result from proximity to other firms in their field.³¹ In addition, some firms require their workforce to possess a high level of skills or education and need to locate where workers with those skills are available. And some producers are willing to shoulder higher labor costs because they place a great value on political stability.

Skeptics of the race-to-the-bottom theory further point out that if it is true, then Haiti and Rwanda would be a great location for multinational firms. But law professor Stephen Diamond explains the fallacy of this argument:

[T]his “misstates the problem. The ‘race to the bottom’ defines a different and new issue: the ability of sophisticated multinational corporate capital to combine high-productivity technology with labor that is paid substantially less than that found in the developed world. Developing this dynamic is not as simple as finding the worst-paid and most-repressed workers in the world. What one finds, in fact, in countries like Haiti or Rwanda are not workers in the classic sense--ready and available to be part of the disciplined structure of a modern capitalist firm. In large part the populations of those countries are at a near-feudal level of development, with the ‘workforce’ resembling peasants, not modern workers. The difference in China or Mexico or Indonesia is that decades of rule there by modernizing authoritarian states has produced a new kind of workforce that is akin to that found in Europe or the United States, but at a wage level far below that of the advanced economies and without the independent political power that characterizes countries with strong labor movements.”³²

³¹ Matthew Drennan, *THE INFORMATION ECONOMY AND AMERICAN CITIES*; Annalee Saxonian, *REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128*, (1994); other examples

³² Stephen F. Diamond, *The Race to the Bottom Returns: China's Challenge to the International Labor Movement*, 10 U.C. Davis J. Int'l L. & Pol'y 39, 41-44 (2003).

Thus it might be more accurate to speak not of a race to the bottom, but a race to middle-level countries that have both cheap labor and stable institutions because that mixture often provides the most attractive locations for mobile firms. Thus a revised race-to-the-bottom hypothesis maintains that firms will move jobs not to the most backward regions with the cheapest labor, but to those regions that also have the institutional structure to provide financial and political stability.

The race-to-the-bottom theory needs another restatement as well. When firms have a choice about where to produce, they tend to choose locations with lower labor costs and reasonable political stability for the *labor intensive aspects of their production*. Or, stated differently, when all else is equal, firms tend to prefer locations with low wages, poor safety provisions, weak protections for unions, and other low labor standards. To be sure, the precondition that all else be equal contains many unstated geographic, political, sociological and economic factors, but even with these caveats, the conditions that foster a race to the bottom are still present. Indeed, firms sometimes rearrange their production processes so as to locate those operations that do not require high skills in lower-wage countries, and locate those operations that require highly educated labor in developed areas.

In addition, even when firms stay in place, just the threat of moving can have a detrimental impact on labor standards in the home countries. In a recent empirical study, economics professor Minsik Choi found that threats of capital mobility have a significant effect on wages and bargaining. As Choi concludes,

the increased outward investment by U.S. manufacturing industries has been negatively associated with the wage premium that union members shared during the period from 1983 to 1996. . . . This study finds that firms' enhanced locational mobility as a result of the globalization process (e.g., the recent launches of NAFTA and WTO) is effective in pressuring workers who fear losing their jobs to concede at the bargaining table and accept a lower share of the rent.³³

II. Is There a Silver Bullet? Three Current Approaches

There have been several proposals for stemming or alleviating races to the bottom and regulatory competition without abandoning a commitment to expansive

³³ Minsik Choi, *Threat Effects of Capital Mobility on Wage Bargaining*, in Pranab Bardham, Samuel Bowles & Michael Wallerstein, eds. GLOBALIZATION AND EGALITARIAN DISTRIBUTION” 64, 78 (Princeton Univ. Press, 2006).

global trade. Each one has some risks and potential benefits. They are discussed below.

A. *Transforming Races to the Bottom into Races to the Top*

One approach to the problem of labor and trade maintains that labor standards will not deteriorate as a result of trade, but rather that labor standards can, and under certain conditions will, rise. This approach posits the possibility of a “race to the top,” at least if the necessary institutional framework is in place.

One must cited race-to-the-top view is the “ratcheting labor standards” (RLS) approach advocated by Charles Sabel, Archon Fong, and Dara O’Rourke. They argue that firms can be induced to emulate the best practices of other firms if there is sufficient information, transparency, and accountability. RLS is a proposal for raising international standards based on the assumption that with a properly structured meta-framework, a race to the top will occur. As the authors describe:

[L]ike the metaphorical ratchet wrench we invoke, the [RLS] framework attempts to set into motion a process that begins with the dismal labor outcomes often found in the facilities worldwide, and then gradually, but systematically move them upwards. The standards are based initially upon the best that current performance offers, the regulatory frame compels facility-level improvements, and then re-sets standards at that new, elevated level of realized performance. The ratcheting-rule framework recognizes (like voluntary codes) that we have limited knowledge of the diverse needs of workers in developing countries and of feasible social performance, but aims nonetheless (like the ILO proposal) to provide enforceable standards backed by sanctions.

The ratcheting labor standards concept is a mirror image of the race to the bottom in that it focuses on behavior of firms that act in the global labor and product market. Rather than race to the bottom, the RLS advocates assert that sufficient transparency and credible monitoring will pressure firms to race to the top. Sabel, Fong & O’Rourke describe three prerequisites for RLS to be successful – “[p]ublic transparency, comparison and evaluation, and continuous improvement.”³⁴ Of these, the first two require specific institutional mechanisms to be in place. As the authors explain, *transparency* involves requiring firms to disclose their treatment of workers and factory conditions. *Comparison* involves having a public agency that verifies to

³⁴ Charles Sabel, Archon Fong & Dara O’Rourke, *Ratcheting Labor Standards: Regulation for Continuous Improvement in the Global Workplace*, available at <http://www2.law.columbia.edu/sabel/papers/ratchPO.html>

that firms have used appropriate procedures in their disclosures, identifies best and worst practices, and publishes the disclosures so that comparisons can be made. *Continuous improvement* is up to the firms. The theory assumes that firms will have an incentive to improve their labor standards once their practices are subject to public scrutiny in a systemic and credible way.

According to its proponents, RLS will result in a race to the top only under a particular complex regulatory framework. Hence it is not a theory of “natural” trends, but rather a method of countering an underlying race to the bottom. For RLS to operate successfully, there must be mandatory transparency and monitoring mechanisms, combined with some sort of transnational body to promulgate the mandates and impose sanctions for noncompliance. But if there were such a transnational body to so regulate international labor standards, then that body could also regulate labor standards directly. From there would follow a fair question as to whether the most effective way to regulate is through mandatory standards or a more flexible, RLS-type approach.

Another race-to-the-top theory posits that developing nations will seek to emulate the high labor standards of developed nations once they have repeated and sustained contact with them. This approach, termed “constructive engagement,” was used to argue that China should be admitted to the WTO because the experience of trading with developed countries will induce it to raise its labor standards as well as its human rights practices.³⁵

The constructive engagement theory disputes the existence of a “natural” race to the bottom, and maintains instead that there is a natural tendency of countries to emulate more developed ones. However, it is not yet proven that this tendency exists.³⁶ Rather, the evidence demonstrates that countries only raise labor standards when NGOs, consumer boycotts, or labor groups are successful in forcing them to do so.

One currently prominent school of thought argues that races to the bottom can be reconstructed into races to the top by means of a new style of regulation called “new governance.” The new governance approach abjures the use of top-down, one-size-fits-all “command and control” regulation. In its place, proponents of new governance advocate regulatory projects that are locally-based and tied to local

³⁵ Stephen F. Diamond, *The Race to the Bottom Returns, The 'Race to the Bottom' Returns: China's Challenge to the International Labor Movement*, 10 U. C. Davis J. Int'l L. & Pol'y 39 (2003-2004).

³⁶ Stephen Diamond shows that the constructive engagement approach has not improved human rights or labor standards in China. *Supra.* at ____.

conditions. Furthermore, new governance advocates support regulatory regimes that are dialogic and that permit adjustment in goals and techniques based upon experience.³⁷ Proponents claim that new governance regulatory techniques deliver flexibility and innovation, ultimately making them more effective.

The European Union has adopted a new governance framework for social regulation through a method it calls the “Open Method of Coordination. (OSM)”. According to the President of the Lisbon European Council, who coined the term, the OMC “is comprised of four elements: (1) fixed guidelines set for the Union, with short-, medium-, and long-term goals; (2) quantitative and qualitative indicators and benchmarks; (3) European guidelines translated into national and regional policies and targets; and (4) periodic monitoring, evaluation and peer review, organized as a mutual learning process.”³⁸

The OMC is an elaborate system for articulating goals, guidelines, and policy aspirations for individual EU countries to adopt, coupled with an on-going system for measuring progress and comparing best practices. Law professors Louise and Dave Trubek have given a detailed account of the potential for a race to the top for labor standards in their writing about the EU's European Employment Strategy (EES) and the Open Method of Coordination (OMC). They have shown that the OMC framework operates as a governance mechanism that encourages dialogue, spreads best practices, and deters races to the bottom within the EU. Writing in 2005, they described the EU's OMC and explained how it departs from the previous hard law -- the so-called Community Method -- for making social policy.³⁹ As they say, the OMC was devised to transform European labor relations and social policies in order to enable Europe to be internationally competitive while retaining its commitment to a solidaristic welfare state.

³⁷ Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 Colum. L. Rev. 267, 267 (1998); Charles Sabel, & William Simon, *Minimalism and Experimentalism in the Administrative State*, 100 Geo. L. J. 53, 78 – 82 (2011) ; *See also* Ian Ayres & John Braithwaite, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 4–7 (1992).

³⁸ Berkard Eberlain and Dieter Kerwer, *New Governance in the European Union: A Theoretical Perspective*, 42 J. of Common Market Studies 121, 123 (2004) (citing James Mosher, “Open Method of Coordination: Functional and Political Origins, 13 ESCA Review 6-7 (2000).

³⁹ David M Trubek & Louise G. Trubek, *Hard and Soft Law in the Conception of Social Europe: The Role of the Open Method of Coordination*, 11 European L. J. 343 (2005).

In the Trubeks' account, the OMC is a poster child for new governance. The OMC, like other new governance proposals, involves articulating aspirations at an abstract level, and at the same time establishing a process by which those aspirations are concretized, implemented, evaluated, and modified over time. They give some evidence the early 2000s where the EES raised labor standards in some fields of social policy.⁴⁰ Dave Trubek has also explored the application of the OMC and similar new governance mechanisms in the context of a controversial labor decision involving regulatory competition and the Posted Worker Directive in Europe.

In the *Laval* case,⁴¹ a Latvian construction company, Laval, won a contract to work on a school building in Sweden. Laval brought in some of its Latvian workers to do the work, but it refused to apply or negotiate their terms under the prevailing Swedish Building Trades collective agreement. Instead, it determined to pay its Latvian workers a considerably lower wage than comparable Swedish collective bargaining would have required.⁴² In response, the Swedish Building Trades union called a strike of suppliers and others dealing with the Latvian company, ultimately shutting down the building project and putting the company out of business.

The case went to the European Court of Justice on the question of the legality of the Swedish unions' use of the strike weapon. The case required the court to interpret Article 49 of the EC Charter, a provision that prohibits "restrictions on the freedom to provide services" across national boundaries, in light of the more recently adopted Posted Worker Directive (PWD), which authorizes host states to apply their own labor standards to non-nationals posted there for temporary assignments.

In *Laval*, the ECJ held it was unlawful for Swedish unions to utilize economic weapons activities against the Latvian construction company, ruling that the Posted Worker Directive did not apply to the Swedish collective agreement because it was not national legislation, and therefore it was unlawful for the Swedish unions to strike to impose them. According to Cambridge University professors Catherine Barnard and Simon Deakin, the court decided in favor of "regime portability," i.e., "the right of the foreign service provider to apply the law and/or agreements of its country of

⁴⁰ Id at 351 & n. 20.

⁴¹ *Laval un Partneri Ltd v. Svensk Byggnadsarbetareförbundet*, judgment of 18 December, 2007.

⁴² For a concise statement of the facts of the case, see Alan Riley, *The Vaxholm Case of Swedish 'Social Dumping' The ECJ Does its Job*, Center for European Policy Studies Commentary (2008).

origin . . . in preference to that of the host state, where the latter imposes a higher regulatory burden, unless those laws can pass a justification test.”⁴³

Most pro-labor activists and scholars have been very critical of the decision, accusing it of authorizing social dumping.⁴⁴ In contrast, Trubek applauded the decision as a reasonable interpretation of the Posted Worker Directive, and praised it for giving the directive a new governance framework cross-border labor contracting.

He argues that the ECJ treated the PWD as requiring that labor standards be negotiated, not mandated. He contends that the Posted Workers Directive creates a structure that induces negotiation between the relevant national and sub-national parties, and can be used to resolve dilemmas in the area of international labor standards.

According to Trubek, the OMC is a soft form of regulation, but it is not as soft as it sounds. For the OMC to operate successfully, there needs to be mandatory transparency and monitoring mechanisms, combined with some transnational body to promulgate the mandates and some type of sanctions for noncompliance, even if they are informal. Hence, hard laws need to underlie the soft law processes of consultations, negotiations, persuasion, and informal concertation. This necessary underpinning exists in the EU, but it is not clear if it exists anywhere else. For example, efforts by the International Labor Organization to institute new governance and soft law mechanisms have not been promising.⁴⁵

Over and above the disagreements about new governance and the *Laval* case, there is a lot of dispute about the overall effectiveness of the OMC. Despite some successes, many countries in Europe have been dismantling their labor safeguards without providing an alternative system for labor protection. This process began well before the Great Recession and has continued apace since, so that now, in many countries, the economic crisis and the austerity it spawned threatens the European model of labor protection. Much of the dismantlement has not occurred in the context of OMC negotiation, but rather in spite of it. For example, in the early 2000s,

⁴³ Catherine Barnard & Simon Deakin, *Regulatory Competition After Laval*, in BEFORE AND AFTER THE ECONOMIC CRISIS: WHAT IMPLICATIONS FOR THE 'EUROPEAN SOCIAL MODEL'? Marie-Ange Moreau and Iryna Ulasiuk (eds.), London: Elgar Publishing, 2011 at ____.

⁴⁴ Barnard & Deakin, supra.; Ulrich Munkenburger, *Towards a Viking/Laval Manifesto for Social Europe*, in BEFORE AND AFTER THE ECONOMIC CRISIS: WHAT IMPLICATIONS FOR THE 'EUROPEAN SOCIAL MODEL'? (Marie-Ange Moreau and Iryna Ulasiuk, eds.), (London: Elgar Publishing, 2011) 239;

⁴⁵ For a detailed account of the failure of ILO efforts to move to new governance approaches, see Luccio Baccaro & Valentina Mele, *Pathology of Path Dependency? The ILO and the Challenge of New Governance*, 65 *Indus. & Labor Rel. Rev.* 195 (2012).

Germany reformed its unemployment system in a way that reduced benefits and pressured unemployed workers to accept low wage work despite adamant opposition of the unions.⁴⁶ In that same period, Italy amended its labor laws to relax job security protection, despite opposition in the form of demonstrations and strikes by three million workers.⁴⁷ These changes were not negotiated in a harmonious and consensual way. Was this a failure of the OMC, or a sign of not enough new governance? Could more new governance have led to better outcomes?

It is not yet clear how the OMC, or other EU new governance mechanisms, have fared in the Great Recession. Did the OMC mitigate the consequences of the recession? Or, would more hard-law, centralized regulation of labor market policies have been a better barricade against the ravages of the financial crisis? There is no definitive study that tells us whether international collaboration, cooperation and coordination helped save jobs, incomes, or benefits. We do not know whether the OMC spread best practices, or if it simply gave countries a fig leaf to cover their actions of dismantling labor market protections without creating viable alternatives. These are important questions that must be addressed if we want to consider new governance as an antidote to the race to the bottom in global labor standards.

B. Agglomeration and Sticky Industry Strategies for Labor Organizing

A second approach to the problem of labor standards and free trade focuses on firms' own locational decisions. While corporations have a tendency to hopscotch across the globe, jumping over any country that imposes burdensome labor regulations, there is also evidence that some corporations have a gravitational pull toward a particular place. Some firms want to be near their customers, raw materials or suppliers and hence are loathe to locate overseas. Auto repair shops, dry cleaners, restaurants, hospitals, and numerous other fields that provide immediate services to customers cannot realistically hope to relocate overseas. And of course, local

⁴⁶ In the early 2000s, Germany enacted a series of reforms to its unemployment system that reduced the period of unemployment benefits and changed the definition of “suitable work, such that after one year, an unemployed person was required to accept any job regardless of previous qualifications or wage levels. There were mass protests in opposition to these measures. See, Amchin Kemmerling and Oscar Bruttel, *New Politics in German Labour Market Policy: The Implications of the Recent Hartz Reforms on the German Welfare State*, 29 *West. German Politics* 90, 96-98 (2006).

⁴⁷ Melinda Henneberger, *Millions of Italians Take to the Streets in a General Strike*, N.Y. Times, Apr. 17, 2002, at A3.

government jobs, construction and building services are also necessarily place-based activities.

Also, some types of manufacturing and high end service industries are tied to a particular place and hence unlikely to move, at least in the short run. Economists have noted that corporations often want to locate near other firms that produce in their field so as to take advantage of agglomeration economies that exist in specific regional locales.⁴⁸ They have found that in certain sectors, firms can get extra value from the sheer fact of agglomeration. One well-known example is of the Silicon Valley computer software industry.⁴⁹ Other examples of successful localized agglomeration economies are the clusters of biotechnology firms around Princeton, New Jersey, of banking and financial firms in New York City, and of computer hardware manufacturing firms around Austin, Texas. Regional economists attribute much of the positive effects of agglomeration economies to the skills and knowledge that is concentrated in, and shared among, the locality's work force.⁵⁰ That is, globalization is not a one-way juggernaut, but rather it is a process that exists in tension with local embeddedness.

The potential of agglomeration for union organizing has only recent been exploited. In the face of union decline, many labor leaders and progressive activists have turned away from the traditional paradigm of federally supervised union organizing and toward an alternative model focusing on "sticky industries" and emphasizing coalition building with other local progressive groups. These campaigns target firms that are unlikely to move overseas, or across the country, to escape rising labor costs – i.e. firms in industries that offer inherently immobile services, have fiscal ties to local governments, or operate as part of an agglomeration economy.⁵¹

In the United States, Los Angeles has been at the center of the development of this local approach.⁵² Labor resurgence in L.A. began in the early 1980s when a

⁴⁸ For example, Paul Krugman found that 85% of carpets sold in the United States were produced within a 65 mile radius of Dalton, Georgia. Paul Krugman, *GEOGRAPHY AND TRADE*. Cambridge, MA: MIT Press, 1993.

⁴⁹ See ANNA LEE SAXENIAN, *REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128* (1994).

⁵⁰ See generally JOHN McDONALD, *FUNDAMENTALS OF URBAN ECONOMICS* (1998).

⁵¹ See STONE, *Widgets to Digits*, *supra* note ___ at ___.

⁵² See, Katherine V.W. Stone & Scott Cummings, *Labor Activism in Local Politics: From CBAs to 'CBAs'*, in *THE IDEA OF LABOUR LAW* (Guy Davidov & Brian Langille, eds. 273-292 (Oxford Univ. Press 2011).

coalition of activists, trade unionists, and progressive UCLA academics tried to stop General Motors from closing its auto plant in Van Nuys. The coalition was successful for a few years, but the plant cut back production throughout the decade and eventually closed altogether in 1991.⁵³ The fate of the Van Nuys anti-plant-closing campaign convinced some activists that to succeed, they needed to target industries that were not likely to leave the city.⁵⁴ In 1993, unions and community groups formed the Los Angeles Alliance for the New Economy (LAANE) to develop and implement a sticky industry strategy, with an initial focus on tourism.⁵⁵

Over the past two decades, LAANE has worked with other local organizations on a range of local issues. In concert, these groups have achieved many victories, including several broad living-wage ordinances that include health benefits for many groups of public and private sector workers;⁵⁶ a “worker retention ordinance” that prevents firms that contract with the airport from discharging their workers each time a sub-contract changes hands;⁵⁷ a “sweat-free procurement ordinance” that requires the city’s contractors to maintain provide decent working conditions and pay a living wage,⁵⁸ and a “Clean Trucks ordinance” requiring trucking firms at the ports to hire drivers rather than utilize independent contractors.⁵⁹

In addition, LAANE has created an innovative instrument, the “community benefit agreement,” in which local unions and community groups bargain with

⁵³ Id at ____.

⁵⁴ *Id.* at ____.

⁵⁵ Id at ____.

⁵⁶ Los Angeles Administrative Code, Section 10.37 et seq

⁵⁷ Los Angeles Administrative Code, Section 10.36 et seq., known as the Los Angeles Service Contractor Worker Retention Ordinance.

⁵⁸ Los Angeles Administrative Code, Section 10.43, *et seq.* As explained by the City’s Department of General Services, “The Ordinance requires vendors who provide equipment, goods, materials, and supplies to the City, to comply with the City’s [Contractor Code of Conduct](#). . . . In addition, all garment, uniform, foot apparel, and related accessories vendors are also required to provide a [Procurement Living Wage](#) and benefits to employees who work directly on fulfilling City contracts.” http://gsd.lacity.org/sms/sweat-free_procurement.htm. (visited September 18, 2012).

⁵⁹ City of Los Angeles, Tariff No. 4. The LA Clean Trucks Ordinance has been the subject of extensive litigation, which is summarized in *American Trucking Ass’n v. City of Los Angeles*, 660 F.3d 384 (9th Cir., 2011) (cert. pet’n pending).

developers of large real estate projects to ensure that the developers utilize local workers, pay living wages, and provide on-the-job training. In exchange, the unions and community groups pledge public support for the development project and refrain from activities that would interfere with the developers' ability to obtain necessary permits and approvals from the public authorities. These types of agreements were pioneered in Los Angeles and are now found in 40 cities.⁶⁰

Local activism has been a dynamic factor in labor politics in other countries as well. For example, over the past two decades, in some areas of Italy, Spain, the United Kingdom and other countries, local labor groups, local employers, and local government officials have negotiated social territorial pacts that set local labor market policy on issues such as unemployment insurance arrangements, worker training programs, and other labor market measures. In some cases, the territorial pacts are negotiated not only by the traditional social partners – employers' associations and trade unions – but also with civic groups and other organized local constituencies.⁶¹ This kind of territorial bargaining has helped foster agglomeration economies. According to Bruno Caruso,

territorial employment pacts in Italy have fostered territorial bargaining in the so-called economy of 'districts' which often correspond to sectors traditionally featuring small firms or craftsmen (textiles, furniture, building, tourism) [Territorial bargaining has supported] the competitiveness of micro firms by injecting a heavy dose of flexibility (as regards working hours, wages, and geographic location) into both the internal and external labour

⁶⁰ On the origin and operation of community benefit agreements, see Virginia Parks; Stone & Cummings, *supra*. On the theory of CBAs, see generally Julian Gross et al., *Community Benefits Agreements: Making Development Projects Accountable* (2005), available at <http://www.goodjobsfirst.org/pdf/cba2005final.pdf>. On the operation of community benefit agreements, see Richard C. Schragger, *Mobile Capital, Local Economic Regulation, and the Democratic City*, 123 Harv. L. Rev. 482 (2009).

⁶¹ See, Ida Regalia, *New Forms of Employment and New Problems of Regulation*, in Ida Regalia, Ed., *REGULATING NEW FORMS OF EMPLOYMENT: LOCAL EXPERIMENTS AND SOCIAL INNOVATION IN EUROPE* (Routledge, 2006) 4, 13. See also, Ida Regalia, *Regional and Local Level Experiments in Labor Market Policy in Europe*, in Katherine Stone & Harry Arthurs, *AFTER THE STANDARD CONTRACT OF EMPLOYMENT: INNOVATIONS IN REGULATORY DESIGN* (New York: Russell Sage Foundation Press, 2013).

market. These measures are almost always accompanied by others supporting income levels if not permanent employment security.⁶²

Local organizing efforts that target sticky industries can be an effective means to raise labor standards despite a decline in the effectiveness of unions at the national level. Local campaigns can achieve improvements for workers not only via hard law, such as local ordinances or statutes, but also via soft law such as through quasi-enforceable multi-party agreements between unions, community groups, and employers. And unlike protectionist measures, local pressures to share in profits from sticky industries do not compromise job opportunities in developing countries because these industries were not likely to move abroad in the first place.

To succeed, locally focused organizing efforts require a national legal system that permits localities to legislate autonomously regarding labor conditions. In the United States, the doctrine of preemption has operated as a barrier to many local initiatives in the past.⁶³ Preemption is a function of the Supremacy Clause of the U.S. Constitution, which provides that when state law conflicts with federal law, the federal law takes precedence.⁶⁴ Preemption is implicated whenever localities engage in private sector labor regulation, such as by providing organizing rights to private sector workers whose rights to unionize are specified in the National Labor Relations Act.⁶⁵ State law is also preempted when it conflicts with other explicit federal statutes. Preemption is a moving target, and local groups have become adept at

⁶² Bruno Caruso, *Decentralised Social Pacts, Trade Unions and Collective Bargaining – How Labour Law is Changing*, in Mario Biagi, *TOWARDS A EUROPEAN MODEL OF INDUSTRIAL RELATIONS* 193, 210 (2001)).

⁶³ For example, the issue of preemption was central in the Los Angeles Clean Trucks Ordinance litigation, *American Trucking Ass’n v. City of Los Angeles*, 660 F.3d 384 (9th Cir., 2011) (cert. pet’n pending).

⁶⁴ There are several different types of preemption in the labor area, of which the most relevant here are *Garmon* and *Machinists* preemption. In *San Diego Building Trades Council v. Garmon*, the Supreme Court held that any activity that is actually or arguably protected by Section 7 or actually or arguably prohibited by Section 8 of the National Labor Relations Act is preempted. 359 U.S. 236 (1959). In the *Machinists v. Wisconsin Employment Relations Commission*, the Court held that states cannot regulate in labor relations matters which Congress intended to leave unregulated and subject to the free play of economic forces. 427 U.S. 132 (1975).

⁶⁵ See, e.g., *Chamber of Commerce v. Brown*, 128 S.Ct. 2408 (2008) (using *Machinists* preemption to nullify a California Law that required certain employers who received certain types of state funds from using those funds to deter union organizing).

framing their demands and ordinances in a way so as to avoid federal or state preemption. But the rules keep changing.⁶⁶

Other countries have their own versions of preemption – sometimes termed competency – whereby localities are allowed exemptions from national legislation in order to make negotiated concessions at the local level. Hence, the architecture of federal, state and local relations is a design feature that determines the success of local initiatives.

In addition, local organizing strategies require a healthy local economy with viable sticky jobs. Many of the jobs that are targeted by these local initiatives are relatively low paid service jobs. However, when local labor groups are active in an advanced agglomeration economy, they can mobilize higher paid workers.⁶⁷ For example, highly trained technical workers in Seattle organized the Washington Alliance of Technology Workers (WashTech), initially to improve workplace issues at Microsoft. Subsequently WashTech joined forces with the Communications Workers Union and other local groups, and it has become a major force in the efforts to limit the off-shoring of jobs and to preserve overtime pay for contract workers in the state of Washington.⁶⁸

Local and regional organizing can also transform casual low-paid jobs into regular, better-paid jobs. For example, in Los Angeles in 1999, the Service Employees International Union (SEIU) transformed jobs in the home health care industry by organizing 74,000 low-wage health care workers and creating a state agency to serve as the “employer of record.”⁶⁹

⁶⁶ There have been numerous preemption challenges to local labor ordinances in the past decade, and the courts have been divided. For example, the D.C. Circuit upheld a District of Columbia ordinance requiring that contractors retain employees of their predecessors for a period of time. *Washington Service Contractors v. District of Columbia*, 54 F.3d 811 (1995). On the other hand, the Seventh Circuit recently invalidated a state law that required hotels in Chicago to give their room attendant employees one day of rest in every seven day period.

⁶⁷ See, Amy Dean and David Reynolds, *A NEW NEW DEAL: HOW REGIONAL ACTIVISM WILL RESHAPE THE AMERICAN LABOR MOVEMENT* (Cornell Univ. Press, 2011) (describing the author’s regional bargaining strategies in Silicon Valley.)

⁶⁸ See www.washtech.org (last visited, July 27, 2012).

⁶⁹ See, Eileen Boris & Jennifer Klein, *Organizing Home Care: Low-Waged Workers in the Welfare State*, 34 *Politics & Society* 81, 91-95 (2006); Linda Delp and Katie Quan, *Homecare Worker Organizing in California: An Analysis of a Successful Strategy*, 27 *Labor Studies Journal* 1 (2002).

The strategy of local organizing targeting sticky jobs stands to gain from public policies that help foster agglomeration economies. That is, to fully realize the potential of agglomeration source of labor gains, there needs to be industrial policy that supports regional specialization.⁷⁰ Several countries in Europe have pursued such a policy, which has enabled unions and local organizations to share in the benefits of regional specialization.⁷¹

The agglomeration-plus-local-mobilization approach is one way labor groups can defend labor standards in the developed world without triggering claims of protectionism or inflicting harm on the developing world. If national economic policy is oriented toward fostering agglomeration economies – such as through industrial policies to promote regional development – then labor groups could capture some of the gains. But until we have a serious, sustained industrial policy in the United States, local labor initiatives can raise wages and labor standards at the bottom of the labor market, but they will not have much impact on the upper portions.

C. *The Alchemy of Innovation*

A third approach to preserving labor standards in advanced countries is to encourage innovation in the workplace. Since the 1980s, several economists and political scientists have argued that the only way that rich or middle-level countries can maintain their standards of living in the face of practically infinite low cost and educated labor in India and China is to stay on the cutting edge of innovation.⁷² For example, UCLA economist Ed Leamer writes:

[t]he policy response to the globalization force is pretty straightforward: we need to make the educational and infrastructure investments that are needed to keep the high-paying nonconstestable creative jobs here at home and let the

⁷⁰ According to social geographer, Jennifer Clark, “[l]ocal policy-makers can promote local and regional institutions that facilitate the development of good jobs and sustainable economic growth in the face of these pressures.” Jennifer Clark, . . .

⁷¹ See e.g., Ann Markusen, *Sticky Places in Slippery Space: A Typology of Industrial Districts*, 72 *Economic Geography* 293, 297 - 302 (1996) (describing Italian industrial districts); See also, Michael Piore and Charles Sabel, *THE NEW INDUSTRIAL DIVIDE* (1984).

⁷² Geoffrey Garrett, *Globalization’s Missing Middle*, 83 *Foreign Affairs* 84-96 (2004); Edward E. Leamer, *A Flat World, a Level Playing Field, a Small World After All, or None of the Above?* 45 *J. of Econ. Lit* 83 (2007).

rest of the world knock themselves silly competing for the footloose mundane contestable jobs.⁷³

Today most firms recognize that they have to adapt quickly to changes in technology, product market conditions, resource constraints, supplier availability, customer preferences, trading rules, exchange rates, design ideas, and other constantly-moving factors. But adaptation is not enough -- they must innovate. Management theorists maintain that innovation in product design, production processes, quality control, cost control, and information flows are seen as the key to maintaining a competitive edge. In the words of the Harvard Business School's Dorothy Leonard, "[i]nnovate or fall behind: the competitive imperative for virtually all business today is that simple."⁷⁴ Like the blood-thirsty Venus-flytrap in the Little Shop of Horrors play, firms require not only innovation, but continuous innovation simply to survive.

The quest for innovation puts a spotlight on human resource policies, and particularly those policies designed to elicit knowledge. According to management theorist, Debra Amidon, the advent of the innovation imperative is linked to the discovery of the economic value of knowledge. Amidon writes, "[k]nowledge -- often defined in terms of Intellectual Capital -- is clearly the source of new economic wealth. Innovation is the process by which that wealth is converted into action, products, services or initiatives."⁷⁵

Harvard Business School Professors Thomas Davenport and Laurence Prusak explain the innovation imperative in terms of the velocity and intensity of global competition. They warn that any product, no matter how novel, can be reverse-engineered; any new idea can walk out the door when an employee departs; and any new method of production or marketing can be replicated, transmitted, and implemented more cheaply someplace else. From this discouraging insight, they conclude that "[k]nowledge, by contrast, can provide a sustainable advantage." Further, they opine that in today's marketplace, "pricing pressures leave no room for inefficient production . . . Companies now require quality, value, service, innovation and speed to market for business success."⁷⁶

⁷³ Id at 119.

⁷⁴ Dorothy Leonard & Susan Strauss, *Putting Your Company's Whole Brain to Work*, in KNOWLEDGE MANAGEMENT, 109, 110 (Harv. Business School Press, 1998).

⁷⁵ Debra M. Amidon, *THE INNOVATION SUPER HIGHWAY: HARNESSING INTELLECTUAL CAPITAL FOR COLLABORATIVE ADVANTAGE* (Butterworth-Heinemann 2002).

⁷⁶ Thomas Davenport & Laurence Prusak, *WORKING KNOWLEDGE: HOW ORGANIZATIONS MANAGEMENT WHAT THEY KNOW* at 17 (Harv. Bus. School Press, 1998),

Firms in older industrialized countries are particularly vulnerable in this high velocity global marketplace because they often have higher fixed costs and legacy costs than newer firms in the emerging economies. The task for firms in the industrialized world is thus two-fold: they have to lower their fixed costs while at the same time reorganizing work to promote innovation.

Firms also need to cut costs in the face of intense global competition. However, the effort to marry cost-cutting with innovation is an uneasy one. Workers are reluctant to propose innovations that will cut costs if doing so will lead to layoffs. Firms can avoid this effect – what some management researchers have called the “iron law of layoffs”⁷⁷ -- if they ensure that there will not be any layoffs. However, in today’s economic environment, firms are reluctant to make such a commitment, and even if they do, the promises are not credible. Instead, firms are moving in the opposite direction by making everyone dispensable.

Firms are achieving flexibility by adopting measures that turn fixed costs into variable costs. For non-labor fixed costs, firms can turn fixed costs into variable costs by renting rather than owning plant and equipment and minimizing inventories through just-in-time contracts with suppliers and customers. Similarly, firms seek to shift fixed labor costs to variable costs by adopting work practices that give them numerical, functional, and operational flexibility. Some examples of such cost-shifting practices are:

1. Expanding the use of temporary work and independent contractors rather than employing full-time workers where possible.
2. Utilizing outsourcing to locate routine work overseas and/or using a supply chain of suppliers and assemblers to perform routine tasks in low wage areas.
3. Turning regular workers into optional workers by relaxing legal restrictions on dismissing workers.
4. Lowering the cost and increasing the returns on labor inputs by more efficient deployment of human resources through measures such as cross-utilization, and broad-banding.⁷⁸

⁷⁷ See Keating, et.al., *Overcoming the Improvement Paradox*, 17 European Management Journal 120 (1999).

⁷⁸ “Broadbanding” is a human resource practice in which firms cluster a number of jobs within a single “band,” and then move employees between those jobs as needed. It is a departure from the strict job definitions of the earlier era. For more detail, see generally, Stone, *FROM WIDGETS TO DIGITS*, supra. at ____.

5. Using bench-marking to align labor prices with going rates for comparable tasks in other firms.
6. Instituting pay-for-performance compensation systems to provide individual incentives for efficient production.

Each of these measures purports to reduce costs in the short run as well as restructure labor relations to yield flexibility-engendered cost-savings in the long run. Furthermore, several of the measures enumerated above are touted for their impact on innovation. They are advocated as steps that will help convert workplaces into laboratories of innovation. The first three of the listed practices not only trim excess labor costs, they also help transform the culture of long-term attachment. Having temporary and optional workers working alongside “regular” workers undermines the previous culture of permanence. Even more importantly, the use of temporary and short-term contract workers enables firms to bring in workers with specific or rare skills that are tailored to new technologies or products. It also enables them to hire workers on a trial basis and assess their potential contribution over time before making a long-term employment commitment.

These new practices, however, are in tension with the labor law regimes that have persisted for the past century in most of the industrialized world. Until the 1980s, most Western countries had labor law systems that provided iron-clad protection against dismissals, and many even prevented employers from transferring employees between jobs or departments. Most countries placed severe restrictions on the ability of employers to utilize temporary workers or bring in workers with specific skills on a short-term basis. In addition, many had powerful unions that imposed centralized wage setting, so that compensation could not be used to award or incentive performance.

Today new labor law regimes are being constructed that attempt to facilitate flexibility and promote innovation. In fact, labor laws have been revised and rewritten throughout the industrialized world over the past twenty years. Almost universally, the new labor laws are designed to provide firms with increased flexibility in order to reduce costs, foster innovation, and enable firms to respond with alacrity to fast-changing product market trends. For example, Australia abandoned its century-old award system of labor regulation in 2005, and is still in the process of revising its entire regulatory framework. Japan has enacted so many new labor laws that it is an open question whether its long-standing tradition of firm-based employment practices will survive. Throughout Europe, new labor laws have been enacted that permit temporary employment contracts, relax dismissal protection, enable firms to utilize workers on a project basis, modify unemployment systems so

as to put downward pressure on wages, and in other ways, make employment flexible.⁷⁹

Those changes enable firms to deploy workers more flexibly and change the size of their workforce with ease. Proponents justify these changes in the name of promoting innovation and enabling firms to remain competitive.

There is, however, a dark side to these changes to labor law. They shift risks that were previously borne by the firm onto workers. The changes have also undermined unions, fostered pay disparities within firms thus contributing to rising income inequality, and created a generation of young people who despair of ever finding stable employment arrangements. If left unremedied, the emerging regulatory regimes will lead to a deterioration of the standard of living for workers, heightened insecurity, and an increase in inequality.⁸⁰

So the question is, can these flexibility reforms, which are designed to foster innovation, be coupled with protection for workers' labor standards and thus provide an antidote to a race to the bottom? Flexible work practices will work to the benefit of the middle class only if they are accompanied by a new kind of safety net that can protect workers when their jobs are "flexibilized." In light of the reality of today's labor market, in which firms are constantly changing their product and resource mix, jobs are continually in a state of flux. In this world, we need to devise social policies that provide not job security, but what I have called "livelihood security."⁸¹ We need policies aimed at the problem of transitions.

Today's workers move frequently between jobs, and into and out of the labor market, throughout their working lives. Workers need to be able to learn new skills, weather periods of unemployment, retool, engage in entrepreneurial activity, and transition from school to work and from work to retirement. Fluidity and transitions into and out of the labor market are a fact of life for workers today, and therefore social policy needs to address the burdens these transitions create. We need to restructure social programs that currently rely on long-term job attachment, and instead, design those that enable workers to flourish in an open-ended, boundaryless labor market. This means we need policies for workers in transition, such as income maintenance programs, lifetime learning opportunities, relocation assistance, child care assistance, portable benefits, and even housing policies that suspend mortgage payments periodically throughout a person's working life. We need a social safety net that doesn't draw a sharp line between employment and unemployment, but one

⁷⁹ See Katherine V.W. Stone, GLOBALIZATION AND FLEXIBILIZATION, .. .

⁸⁰ See, Stone, FROM WIDGETS TO DIGITS, supra. : Guy Standing, THE PRECARIAT; Beatrice Appay, . .

⁸¹ Stone, FROM WIDGETS TO DIGITS, at ____.

that recognizes that individuals should have freedom to choose to move between labor market statuses without risking financial ruin.

III. Braiding the Approaches to Build a Lifeline

Each of the three approaches I have described offers a plausible path to preserving high labor standards in industrialized countries in the face of global trade, but none of them is a magic bullet. And each has been implemented with some success, but only in limited settings.⁸²

It is important to note that the three approaches are not mutually exclusive and that there are potential synergies between them. Indeed, some synergies are already in place already. For example, the EU is using the OMC's race-to-the-top technique to promote a policy goal called "flexicurity." "Flexicurity" refers to programs that attempt to reconcile firms' demands for flexibility with workers' needs for security.⁸³ The EU adopted "flexicurity" as one of its primary social policy goals in the early 2000s.⁸⁴

"Flexicurity" describes a nexus of measures that attempt to bridge the gap between flexible production for firms and livelihood security for citizens. According to the European Commission's 2007 and 2008 "Employment in Europe" reports, "Flexicurity" aims at ensuring that EU citizens can enjoy a high level of employment security, that is the possibility to easily find a job at every stage of active life and have a good prospect for career development in a quickly changing economic environment." Implicitly adopting a New Governance approach, the Commission acknowledged that there was not one path to flexicurity, but rather that each nation

⁸² For in-depth discussions about how several countries are approaching this challenge, see essays in K. Stone & H. Arthurs, eds., *AFTER THE STANDARD CONTRACT OF EMPLOYMENT: INNOVATIONS IN REGULATORY DESIGN* (Russell Sage Foundation Press, 2013).

⁸³ Wilthagen, Ton, Tros, F.H. and Van Lieshout, Harm, *Towards 'Flexicurity'? Balancing Flexibility and Security in EU Member States* (September 2003). Available at SSRN: <http://ssrn.com/abstract=1133940>

⁸⁴ See Wilthagen, T., and Tros, F., *The concept of 'Flexicurity': a new approach to regulating employment and labour markets*", 10*Transfer* 166-186 (2004). See also, Tangian, Andranik S, *Monitoring flexicurity policies in the EU with dedicated composite indicators*, WSI-Diskussionspapiere, No. 137, <http://hdl.handle.net/10419/21581> (2005) at 9-10 (discussing spread of flexicurity policies and discussions throughout Europe in early 2000s.).

should devise its own balance of flexibility and security consistent with its own history and labor market institutions.⁸⁵

There are also overlaps and synergies between the local organizing and flexible work practices approaches to protecting jobs from outsourcing. For example, some local organizing campaigns that target sticky industries address the problem for workers of flexible labor markets. They advocate measures such as regional benefit funds and job training programs to offer lifetime learning so that displaced workers can continually learn new skills. It is anticipated that measures of this sort would be to permit firms greater flexibility in their labor practices while also establishing institutions to provide workers with greater overall security.

While the three approaches are potentially mutually supportive, they are not wholly congruent. For one thing, they involve different actors. The new governance approach relies on actions of experts to design and evaluate the policies that are implemented by policy-makers. Indeed, this aspect of new governance has opened it up to criticism that, as a method of regulation, it fails to involve local actors or mobilize grass roots support. Moreover, some contend that the OMC's expert orientation has made it vulnerable to political cutbacks because it has not created an informed public who can defend its mission or its measures in the face of conservative turns in politics or austerity measures imposed from afar.⁸⁶

One additional concern about new governance regulatory approaches is that it can be used not only for progressive social policies, but also for conservative ones. After all, new governance is a process, not a prescription for substantive policy. Thus, there is nothing inherent in new governance approaches to ensure that they will be used to foster security or other measures to benefit the middle class. As a technique, new governance needs to be combined with other substantive approaches if it is to solidify a progressive regulatory agenda by protecting against the atrophying pressures of races to the bottom.

⁸⁵ Ruud Muffels, *Flexibility and Employment Security in Europe: Setting the Scene*, in R. Muffels, ed., *FLEXIBILITY AND EMPLOYMENT SECURITY IN EUROPE: LABOUR MARKETS IN TRANSITION* (Edward Elgar, 2008) at 3, 15. But see Van Der Berg, *Flexicurity: Theory, Practice or Rhetoric?*, Conference of the Centre for Labour Market Research (CARMA) at Aalborg University, Aalborg, Denmark (2008) (characterizing the EU's pathway approach as a retreat from true flexicurity.) available at http://www.epa.aau.dk/fileadmin/user_upload/conniek/konferencer/Papers/W-2-Axel-v-d-Berg.pdf

⁸⁶ See, e.g., Kerstin Jacobsson and Asa Vifell, *Integration by Deliberation: On the Role of Committees in the Open Method of Coordination*, Workshop on The Forging of Deliberative Supranationalism in the EU, Florence, 2003, available at http://www.sv.uio.no/arena/english/research/projects/cidel/old/Workshop_Firenze/contJacobsson.pdf, at p. 21-22.

Unlike the top-down bias of new governance, efforts to promote and target sticky industries involve local labor and community activists. Their success depends upon there being strong community groups and unions that can pressure firms and local governments to provide benefits to the middle class. The kind of dynamic activism found in Los Angeles in the past twenty years may be unique, but many other cities have their own nexus of unions and organizations dedicated to aiding the middle class. Also, in an era of internet communication, success breeds success. Living wage campaigns originated in Baltimore quickly spread to nearly 140 other cities. Community benefit agreements were first concluded in Los Angeles, but are now found in more than 30 cities.⁸⁷

The third strategy discussed above is to permit firms to pursue innovation through the implementation of flexible work practices. In the first instance, it involves actions by corporate managers. However, For this approach to offer promise to the middle class, it requires more than simple flexible work practices – it also requires a different kind of social safety net than the one that now exists. If firms are to deploy workers on an as-needed basis and churn their workforces without making long-term commitments, then they will need workers who are instantly available and able to perform the tasks they need. But this kind of on-demand work-schedule is burdensome, particularly for anyone with young children or other care-giving responsibilities.⁸⁸ It also breeds tremendous insecurity, as no one knows how long their present job will last or when there will be another one. If we are to move to making a work style prevalent, we also need to provide a new form of security that helps bridge transitions and enables people to exist in a role that falls between employee and entrepreneur. We need to give people skills and the inducement to acquire new skills, as well as livelihood support when they are between projects. Thus a new regulatory approach is required. And before this will happen, there needs to be a grass roots movement directed toward the national political level, animated by a political vision about how the middle class can be saved in the era of flexible production.

Ultimately, each of these approaches requires a political coalition that is willing and able to take these braids, weave them into a rope, and use it to send a lifeline to the middle class that appears, at the moment, to be drowning in globalization. It is a heavy, but important, agenda.

⁸⁷ Virginia Parks and Dorian Warren, *The Politics And Practice Of Economic Justice: Community Benefits Agreements As Tactic Of The New Accountable Development Movement*, 17 J. Community Practice 88, ___ (2009).

⁸⁸ See, Susan Lambert, *When Flexibility Hurts*, New York Times Op-Ed page, September 20, 2012.