Improving Adherence to Labor Regulations along the Global Value Chain: Incentivizing Exporting Firms

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Abstract

As value chains have become increasingly globalized, modern trade agreements are being designed to promote labor regulation adherence amongst parties, particularly when involving North American or European members. Indeed, for the U.S., all trade agreement negotiations since the North American Free Trade Agreement (NAFTA) have incorporated provisions on labor standards. However, the extent of cross-border implementation and enforcement of labor regulations in the context of trade agreements remains difficult to assess.

To assess regulatory efficacy in the context of international trade, observations of occupational incapacity can be analyzed in correspondence with patterns of trade. With macro data from the ILO and UN Comtrade, there is evidence of trends of decreasing occupational incapacity from 1993 through 2012 in conjunction with increasing exports for some countries. Other countries display increasing occupational incapacities over this time period. While this could be indicative of varying degrees of regulatory efficacy, data limitations prevent direct links to be drawn between incapacities and trade. Proper assessment of regulatory efficacy requires firm-level analysis.

In this paper, I present a macroeconomic model of heterogeneous firms facing labor regulations. In this framework, I build from the vantage point of the individual firm, considering how regulatory measures affect firm decision-making. The model predicts that higher firm productivity increases the likelihood of the firm's adherence decision and affects the firm's survival in the market. This is an important theoretical contribution, as little economic research has been done to connect labor regulations with macroeconomic or trade theories of the firm.

Predictions from my model are in line with existing empirical work from researchers assessing the Better Work initiative. Better Work is a partnership between the ILO

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and the International Finance Corporation (IFC). The Better Work initiative performs regulatory compliance assessments of apparel factories and works with these factories to improve working conditions over time. Through these assessments, firm level data has been collected on regulatory compliance. Additional statistics on firm characteristics and performance measures have been collected through an impact assessment evaluation. Using these datasets, Brown et al. (2015) found factory productivity to be increasing in compliance, and Jetha and Linsen (2015) documented positive links between compliance and survival. I will use these datasets to estimate and calibrate my theoretical model.