

TEACHING FREE ENTERPRISE IN ARKANSAS

GUIDE FOR TEACHERS



SMU | COX

O'NEIL CENTER FOR
GLOBAL MARKETS & FREEDOM



ARKANSAS CENTER FOR
RESEARCH IN ECONOMICS

UNIVERSITY OF CENTRAL ARKANSAS

INTRODUCTION TO THE PROGRAM

The O'Neil Center for Global Markets and Freedom developed this Teaching Free Enterprise program to help Arkansas educators gain valuable content knowledge and expertise in order to meet the Arkansas Social Studies Curriculum Framework for Economics regarding Economics in classroom instruction. Top economics scholars from various higher education and research institutions are providing lessons, activities and exercises that can be readily implemented in the classroom.

This document presents one of the units that address some of the most important, yet often misunderstood, aspects of free-enterprise economies.

Q&A

01 *How should this curriculum be used?*

The modules can be taught individually or in sequence in whatever order the educator prefers. The educator can always use this guide and the materials that are available on:

 teachingfreeenterprise.com

02 *What time of year is best?*

In Texas, Economics is a One-Half Credit Course per semester class. Most schools offer it twice a year. You can use these materials anytime during the semester.

03 *What grade level?*

The modules are designed for 8-12 grade implementation.

04 *Do I need written permission to use the lessons?*

The use of these lessons and materials in a classroom setting for any educational purpose is allowed. In order to make copies to share with colleagues please contact us for written authorization, although we probably have extra copies of this manual for shipping. There are unique users that we need to set up for the online portal in order to let the system function properly and teachers to have ease of use, thus free individual registration is the best possible choice.

05*How do I get started?*

We strongly recommend giving a complete read through this manual first, then watch some of the online videos of the presentation you attended in case you missed something or didn't attend. Once these steps are taken, decide if you are making copies or using the slides provided in the website, then you are ready to go!

06*Technology Requirements*

The www.TeachingFreeEnterprise.com website is designed to function in all commercially available operating systems and browsers.

If you are planning to project the videos to students, we recommend a large screen set up with a projector or a large monitor for students to be able to see from any portion of the room.

07*How are the lessons organized?*

_____	Title
_____	Introduction
_____	Guiding Questions
_____	Objectives
_____	Suggested Lesson Length
_____	State Standards
_____	Background Reading for direct teaching or adaptations for student reading.
_____	Suggested Classroom Procedures
_____	Classroom Ready Materials
_____	Additional Resources and References from highly regarded institutions.

08

How much time per lesson?

Each unit is designed for 90 minutes of classroom interaction with students. It can be taught over 90 minutes with a small break (block schedule) or over two consecutive days with 45 minutes of instruction each (traditional schedule).

09

Alignment to Standards

These lesson plans, materials and activities align with:

Arkansas Social Studies Curriculum Framework for Economics (2014)

The modules can be taught individually or in groups in whatever order the Teacher prefers.

10

How do I assess student learning?

In the online portal, available for printing:



There is one quiz per unit with 10 multiple choice questions each.

There is one test per unit with 15 multiple choice questions each.

Student Activity Worksheets are also included with each unit.

CONTACT THE DEVELOPING TEAM



You can click on Contact Us on the <http://TeachingFreeEnterprise.com> website to show our most updated contact information, contact us directly at the O'Neil Center for Global Markets and Freedom at: www.oneilcenter.org or contact the Arkansas Center for Research in Economics at acre@uca.edu or by emailing the Program Coordinator Terra Aquia at tvotaw@uca.edu.

SWEAT- SHOPS

TEACHING FREE ENTERPRISE



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**ARKANSAS CENTER FOR
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SWEAT- SHOPS

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INTRODUCTION

“Sweatshops” operating in poor countries have very low wages, by United States standards, and they have long work hours in often unsafe environments. They are almost universally condemned by First World citizens who have not thought through the economics of how and why they operate and what the consequences of many proposed regulations might be. [...] continued.

INTRODUCTION

“Sweatshops” operating in poor countries have very low wages, by United States standards, and they have long work hours in often unsafe environments. They are almost universally condemned by First World citizens who have not thought through the economics of how and why they operate and what the consequences of many proposed regulations might be.

Sweatshop workers choose to work in these unsafe factories because they believe that these jobs are their least bad option. Employers only choose to hire these workers because they profit by doing so. Policies that decrease the profitability of hiring these work-

ers will lead to fewer jobs which means taking away the very jobs that citizens in poorer countries thought was their least bad option.

Sweatshops are part of the process of economic development that transforms a poor country into a rich country. As sweatshops are created they bring in physical capital, technology, and opportunities to acquire human capital that all lead to increased worker productivity. Competition between employers results in that increased productivity translating into higher wages and better working conditions over time. This is precisely the development process the United States went through.

GUIDING QUESTIONS

01

How do the wages and working conditions compare to the other alternatives available to workers in countries where sweatshops operate?

02

How are wages in sweatshops determined?

03

What would be the impact of mandating higher minimum wages or increased safety standards?

04

What is the main way that sweatshop conditions improved historically?

OBJECTIVES

01

Students will discover how wages are determined in a competitive market.

02

Students will be able to predict intended and unintended consequences of government regulations.

03

Students will be able to explain the process of economic development.

SUGGESTED LENGTH



It can be divided into two 45 minute segments.

ARKANSAS CURRICULUM FRAMEWORKS / SOCIAL STUDIES

	Economics	EDM.1.E	1
		EM.2.E	2
		EM.3.E	2, 3
		NE.5.E	2
		NE.6.E	3
		GE.7.E	1, 2, 3
	United States Government	SFG.6.USG	1
	United States History Since 1890	Era10.7.USH	3, 5
		Era10.8.USH	1
	World History	Era9.4.WH	2, 5
Reading Standards for Literacy in History/Social Studies		RH.9-10	1, 2, 3, 4, 5, 10
Writing Standards for Literacy in History/Social Studies		WHST.9-10.1	a, b, c
		WHST.9-10.2	a, b, c, d, e, f
		WHST.9-10.3	a
		WHST.9-10.4	
		WHST.9-10.5	
		WHST.9-10.8	
		WHST.9-10.9	
		WHST.9-10.10	
Reading Standards for Literacy in History/Social Studies		WHST.11-12.1	c, d, e
		RH.11-12.2	
		RH.11-12.3	
		RH.11-12.4	
		RH.11-12.7	
		RH.11-12.10	
		WHST.11-12.2	a, b, c, d, e
		WHST.11-12.4	a
		WHST.11-12.5	
		WHST.11-12.8	
		WHST.11-12.9	
		WHST.11-12.10	

ARKANSAS CURRICULUM FRAMEWORKS

- EDM.1.E*** Students will make decisions after considering the marginal costs and marginal benefits of alternatives.
- EDM.1.E.1*** Evaluate the roles of scarcity, incentives, trade-offs, and opportunity cost in decision making (e.g., PACED decision making model, cost/benefit analysis).
- EM.2.E*** Students will evaluate different allocation methods.
- EM.2.E.2*** Demonstrate changes in supply and demand (e.g., shifts, shortages, surpluses, availability) that influence equilibrium price and quantity using a supply and demand model.
- EM.3.E*** Students will investigate the role of producers, consumers, and government in a market economy.
- EM.3.E.2*** Compare and contrast major forms of business organizations (e.g., sole proprietorships, partnerships, corporations, non-profits, franchises).
- EM.3.E.3*** Evaluate intended and unintended consequences of government policies created to improve market outcomes (e.g., regulatory, participatory, supervisory).
- NE.5.E*** Students will analyze the current and future state of the economy using economic indicators.
- NE.5.E.2*** Evaluate the impact of advancements in technology, investments in capital goods, and investments in human capital on economic growth and standards of living.
- NE.6.E*** Students will analyze monetary and fiscal policies for a variety of economic conditions.
- NE.6.E.3*** Examine fiscal policy tools used by the executive and legislative branches of the government (e.g., taxation, spending).
- GE.7.E*** Students will analyze ways in which trade leads to increased economic interdependence.
- GE.7.E.1*** Analyze the role of comparative advantage in trade and global markets using available data and a variety of sources.

GE.7.E.2

Explain ways in which current trends in globalization affect economic growth, labor markets, rights of individuals, the environment, technological advancement, and resource and income distribution in different nations.

GE.7.E.3

Research the impact of international and national economic and political policies on global trade using a variety of sources from multiple perspectives.

SFG.6.USG

Students will assess the relationship between the federal government and the economy.

SFG.6.USG.1

Analyze the impact of the federal government's fiscal policy on the economy (e.g., taxing, spending).

Era10.7.USH

Students will analyze domestic and foreign policies of the United States since 1968.

Era10.7.USH.3

Examine continuity and change in foreign policies over multiple administrations since 1968 using a variety of primary and secondary sources (e.g., policies that resulted from Strategic Arms Limitation Talks/Treaty I [SALT I], Camp David Accords, Oil Producing Exporting Countries [OPEC], Strategic Defense Initiative, Iran-Contra Affair, North American Free Trade Agreement [NAFTA], Japanese markets, Dayton Accords).

Era10.7.USH.5

Construct explanations of change and continuity in foreign policy since the emergence of modern America.

Era10.8.USH

Students will analyze social and economic trends of the United States since 1968.

Era10.8.USH.1

Examine the effects of globalization on the United States (e.g., regional trade blocks, European Union [EU], NAFTA, international organizations, multinational corporations).

Era9.4.WH

Students will analyze the challenges and accomplishments of the contemporary world.

Era9.4.WH.2

Evaluate social, economical, political, and technological causes and effects of accelerating global interdependence.

Era9.4.WH.5

Assess the social, economic, political, and technological efforts to address economic imbalances and social inequalities among the world's peoples.

RH.9-10

Reading Standards for Literacy in History/Social Studies

RH.9-10.1

Cite specific textual evidence to support analysis of primary and secondary sources, attending to such features as the date and origin of the information.

RH.9-10.2

Determine the central ideas or information of a primary or secondary source; provide an accurate summary of how key events or ideas develop over the course of the text.

RH.9-10.3

Analyze in detail a series of events described in a text; determine whether earlier events caused later ones or simply preceded them.

RH.9-10.4

Determine the meaning of words and phrases as they are used in a text, including vocabulary describing political, social, or economic aspects of history/social science.

RH.9-10.5

Analyze how a text uses structure to emphasize key points or advance an explanation or analysis

RH.9-10.10

By the end of grade 10, read and comprehend history/social studies texts in the grades 9-10 text complexity band independently and proficiently.

WHST.9-10.1

Write arguments focused on discipline-specific content.

WHST.9-10.1.c

Use words, phrases, and clauses to link the major sections of the text, create cohesion, and clarify the relationships between claim(s) and reasons, between reasons and evidence, and between claim(s) and counterclaims.

WHST.9-10.1.d

Establish and maintain a formal style and objective tone while attending to the norms and conventions of the discipline in which they are writing.

WHST.9-10.1.e

Provide a concluding statement or section that follows from or supports the argument presented.

WHST.9-10.2

Write informative/explanatory texts, including the narration of historical events, scientific procedures/ experiments, or technical processes.

WHST.9-10.2.a

Introduce a topic and organize ideas, concepts, and information to make important connections and distinctions; include formatting (e.g., headings), graphics (e.g., figures, tables), and multimedia when useful to aiding comprehension.

WHST.9-10.2.b

Develop the topic with well-chosen, relevant, and sufficient facts, extended definitions, concrete details, quotations, or other information and examples appropriate to the audience's knowledge of the topic.

WHST.9-10.2.c

Use varied transitions and sentence structures to link the major sections of the text, create cohesion, and clarify the relationships among ideas and concepts.

WHST.9-10.2.d

Use precise language and domain-specific vocabulary to manage the complexity of the topic and convey a style appropriate to the discipline and context as well as to the expertise of likely readers.

WHST.9-10.2.e

Establish and maintain a formal style and objective tone while attending to the norms and conventions of the discipline in which they are writing.

WHST.9-10.2.f

Provide a concluding statement or section that follows from and supports the information or explanation presented (e.g., articulating implications or the significance of the topic).

WHST.9-10.3

Write arguments focused on discipline-specific content.

WHST.9-10.3.a

Note: Students' narrative skills continue to grow in these grades. The Standards require that students be able to incorporate narrative elements effectively into arguments and informative/explanatory texts. In history/social studies, students must be able to incorporate narrative accounts into their analyses of individuals or events of historical import.

WHST.9-10.4

Produce clear and coherent writing in which the development, organization, and style are appropriate to task, purpose, and audience.

WHST.9-10.5

Develop and strengthen writing as needed by planning, revising, editing, rewriting, or trying a new approach, focusing on addressing what is most significant for a specific purpose and audience.

WHST.9-10.8 Gather relevant information from multiple authoritative print and digital sources, using advanced searches effectively; assess the usefulness of each source in answering the research question; integrate information into the text selectively to maintain the flow of ideas, avoiding plagiarism and following a standard format for citation.

WHST.9-10.9 Draw evidence from informational texts to support analysis, reflection, and research.

WHST.9-10.10 Write routinely over extended time frames (time for reflection and revision) and shorter time frames (a single sitting or a day or two) for a range of discipline-specific tasks, purposes, and audiences.

WHST.11-12.1 Write arguments focused on discipline-specific content.

WHST.11-12.1.c Use words, phrases, and clauses as well as varied syntax to link the major sections of the text, create cohesion, and clarify the relationships between claim(s) and reasons, between reasons and evidence, and between claim(s) and counterclaims.

WHST.11-12.1.d Establish and maintain a formal style and objective tone while attending to the norms and conventions of the discipline in which they are writing.

WHST.11-12.1.e Provide a concluding statement or section that follows from or supports the argument presented.

RH.11-12.2 Determine the central ideas or information of a primary or secondary source; provide an accurate summary that makes clear the relationships among the key details and ideas.

RH.11-12.3 Evaluate various explanations for actions or events and determine which explanation best accords with textual evidence, acknowledging where the text leaves matters uncertain.

RH.11-12.4 Determine the meaning of words and phrases as they are used in a text, including analyzing how an author uses and refines the meaning of a key term over the course of a text (e.g., how Madison defines faction in Federalist No. 10).

RH.11-12.7 Integrate and evaluate multiple sources of information presented in diverse formats and media (e.g., visually, quantitatively, as well as in words) in order to address a question or solve a problem.

RH.11-12.10 By the end of grade 12, read and comprehend history/social studies texts in the grades 11-12 text complexity band independently and proficiently.

WHST.11-12.2

Write informative/explanatory texts, including the narration of historical events, scientific procedures/ experiments, or technical processes.

WHST.11-12.2.a

Introduce a topic and organize complex ideas, concepts, and information so that each new element builds on that which precedes it to create a unified whole; include formatting (e.g., headings), graphics (e.g., figures, tables), and multimedia when useful to aiding comprehension.

WHST.11-12.2.b

Develop the topic thoroughly by selecting the most significant and relevant facts, extended definitions, concrete details, quotations, or other information and examples appropriate to the audience's knowledge of the topic.

WHST.11-12.2.c

Use varied transitions and sentence structures to link the major sections of the text, create cohesion, and clarify the relationships among complex ideas and concepts.

WHST.11-12.2.d

Use precise language, domain-specific vocabulary and techniques such as metaphor, simile, and analogy to manage the complexity of the topic; convey a knowledgeable stance in a style that responds to the discipline and context as well as to the expertise of likely readers.

WHST.11-12.2.e

Provide a concluding statement or section that follows from and supports the information or explanation provided (e.g., articulating implications or the significance of the topic).

WHST.11-12.3

Write informative/explanatory texts, including the narration of historical events, scientific procedures/ experiments, or technical processes.

WHST.11-12.3.a

Note: Students' narrative skills continue to grow in these grades. The Standards require that students be able to incorporate narrative elements effectively into arguments and informative/explanatory texts. In history/social studies, students must be able to incorporate narrative accounts into their analyses of individuals or events of historical import.

WHST.11-12.4

Produce clear and coherent writing in which the development, organization, and style are appropriate to task, purpose, and audience.

WHST.11-12.5

Develop and strengthen writing as needed by planning, revising, editing, rewriting, or trying a new approach, focusing on addressing what is most significant for a specific purpose and audience.

WHST.11-12.8

Gather relevant information from multiple authoritative print and digital sources, using advanced searches effectively; assess the strengths and limitations of each source in terms of the specific task, purpose, and audience; integrate information into the text selectively to maintain the flow of ideas, avoiding plagiarism and overreliance on any one source and following a standard format for citation.

WHST.11-12.9

Draw evidence from informational texts to support analysis, reflection, and research.

WHST.11-12.10

Write routinely over extended time frames (time for reflection and revision) and shorter time frames (a single sitting or a day or two) for a range of discipline-specific tasks, purposes, and audiences.

BACKGROUND ON SWEATSHOPS

Abigail Martinez earned only 55 cents per hour stitching clothing in an El Salvadoran garment factory. She worked as long as 18 hours a day in an unventilated room while the company provided undrinkable water. If she upset her bosses, they would deny her bathroom breaks or demand that she do cleaning work outside under the hot sun. Abigail's job sounds horrible. Yet, many economists defend the existence of sweatshop jobs like hers.

Wages and working conditions in Third World sweatshops are appalling compared to the wages and conditions that most students are likely used to. The largest company in the world, Walmart, is headquartered here in Arkansas and is often criticized for supplying its stores with toys and clothing made from sweatshops. Any decent human being who has witnessed poor workers toiling in a sweatshop should hope for something better for those workers. Economists have defended sweatshops not because they are heartless but because sweatshops are the best achievable alternative available to the workers who choose to work in them, and the spread of sweatshop employment is part of the process of development that can eventually lead to higher wages and improved working conditions.

How bad are the alternatives to sweatshops? In Cambodia hundreds of people scavenge for plastic bags, metal cans, and bits of food in trash dumps. Nicholas Kristof reported in the New York Times that "Nhep Chanda averages 75 cents a day for her efforts. For her, the idea of being exploited in a garment factory - working only six days a week, inside, instead of seven days in the broiling sun, for up to \$2 a day - is a dream." Other common alternatives are subsistence agriculture, other informal sector work, begging, or even prostitution.

Despite all of their drawbacks to Western eyes, most sweatshops with low wages and poor working conditions are places where workers voluntarily choose to work. Rarely do employers actually use the threat of violence to obtain employees. Admittedly, workers' other options are often much worse. A starving person with no alternative employment is likely to take a very bad job if offered one. But that doesn't change the fact that the bad job was his best option. To help sweatshop workers, more options are needed. Unfortunately, much of the anti-sweatshop movement is aimed at taking away the sweatshop option but will not replace it with something better that's actually attainable.

ALTERNATIVES TO SWEATSHOPS

From 1995 through 2010, 85 unique sweatshops in 18 countries were reported in major news sources in the First World. With the exceptions of Mauritius and South Africa, all were located in Latin America or Asia. Bangladesh, China, India, and Indonesia accounted for just over 60 percent of the cases. Table 1 (see Appendix) contains each individual sweatshop job. Often the sweatshops are subcontractors selling to major multinational brands, so in many cases the articles did not identify with which multinational they were contracted, but this information is reported when available.

Poverty is widespread in the countries where sweatshops operate. Significant fractions of the populations in these countries live on less than \$2 or \$1.25 per day. When the sweatshops earnings are adjusted for purchasing power the average sweatshop wage in each of these countries exceeds the \$2 per day threshold.

The protested sweatshop wages even compare favorably to average incomes in most countries. Workers in firms accused of being sweatshops in Brazil, Mauritius, South Africa, and Thailand all, on average, earn less than 50 percent of the average income in their countries, sometimes significantly less. In each case there is a good explanation why these sweatshops don't compare as favorably as those in other countries. In Brazil, Mauritius, and Thailand, the sweatshops employed immigrants, often illegal, from even poorer countries, not native citizens. Their sweatshop earnings were greater than average in their countries of origin. South Africa was unique in that it was an urban minimum wage being applied to a rural factories and the very workers who were supposed to be helped rebelled against the authorities. Chinese sweatshop earnings also do not compare as favorably because China has large income inequalities between regions. Many articles report rural Chinese in poor inland provinces migrating to richer coastal provinces to work in sweatshops. Thus using national income data overstates the alternatives available to many of the sweatshop workers.

In short, there is a reason people choose to work in sweatshops. They choose to work there because sweatshops are often their best available form of employment.

WAGE FORMATION

Sweatshop wages, like wages in more developed countries, are determined by bidding between employers and potential employees. Employers often make the offer, but potential employees are free to accept the offer or reject it. If employers can't attract enough workers at the wage they are offering, they will need to raise the wage to convince more workers to choose to work for them. But they will not continue raising their wage offers indefinitely.

A worker's productivity limits the maximum amount an employer is willing to pay them. Economists call this the worker's marginal revenue product. Simply put, an employee who generates \$2 per hour of revenue for the employer that would not have been generated if that employee was not working there

has a marginal revenue product of \$2 per hour. The maximum wage an employer would be willing to pay that worker is \$2 per hour. At a wage of \$2.01 per hour, the employer is losing one cent for every hour that employee works. A profit-maximizing business doesn't hire workers who increase their losses.

Just because a worker can create \$2 per hour of revenue doesn't mean that an employer would like to pay him or her that much. Ideally, the employer would like to pay him or her zero and pocket the entire \$2 per hour as profit. But few people, even in very poor countries, are willing to work for nothing. To convince a worker to accept a job, the employer must offer him or her more than whatever that worker can make at what the worker perceives as their next best alternative. Workers compare the available wages, working conditions, hours, etc., and choose the offer that he or she may think is in their best interest.

These two factors determine the bounds at which wage bargaining can occur. The upper bound is limited by the worker's productivity. The lower bound is limited by the worker's next best alternative. The actual wage must fall somewhere between these two bounds.

Often activists mistakenly advocate imposing higher legal minimum wages to help poor sweatshop workers. Passing a law that mandates higher pay does nothing to make workers more productive, nor does it create new alternatives to bid workers away from their current jobs. Legal minimum wages simply outlaw potential gains from trade between employers and workers.

A minimum wage increases the relative cost of low-skilled labor compared to high-skilled labor and capital. Rather than passively accepting lower profits, a profit-maximizing company responds to a minimum wage law by decreasing the amount of low-skilled labor it uses and replacing it with higher-skilled workers and capital. In the context of sweatshops, this could take the form of firing some workers and replacing them with machines while keeping other workers. Alternatively, a firm could move from a less-productive country to a more productive one. Both of these actions may help some workers but will harm the least productive and poorest ones. Firms may also balance the increased pay with cuts

to other forms of compensation such as health and safety conditions, for which activists often advocate regulations to improve.

Sweatshop wages and working conditions improve when these two bounds move upward. That entails the process of development.

DEVELOPMENT

Sweatshops are not new. They first appeared in Great Britain in the late 18th century and persisted there until the early 20th century. In the United States the first textile sweatshops appeared in the early 19th century in Rhode Island and Massachusetts. Virtually every wealthy country in the world had sweatshops at one point in their past. Sweatshops are an important stage in the process of economic development.

To achieve and maintain a high standard of living, a country's workers need to have a high level of productivity. Or, in other words, they need to get a lot of valuable output for every hour they work. The proximate causes of high productivity are physical capital, human capital, and technology. Sweatshops play a role in increasing all three of these.

Understanding human capital's role in development is the most straight-forward. When workers have greater skills, they are able to get more output out of a given level of inputs. These greater skills could come from formal education, but they also can come from experience and on-the-job training. On-the-job learning can be important for developing greater human capital, particularly in low-skilled occupations.

Physical capital is vitally important to having a high standard of living. The most brilliant man in the world would quickly starve if he didn't have any tools to work with. But capital goods, tools, machinery, factories, and buildings all must be created. Capital is created when people forgo some current consumption to use scarce resources to create the capital that will later produce even more consumption goods for them. Capital comes from savings. This is one reason the industrial revolution took so long to produce higher standards of living

in Great Britain. Current consumption had to be forgone and capital slowly accumulated. As productivity and profits rose, there was a greater ability to save and create even more capital.

More recent development success stories had a distinct advantage over Great Britain when they developed. Their capital formation could happen much faster because they could draw on savings from wealthy countries in addition to their own savings. When foreign firms made investments in those countries, they created many of the buildings and machines that the citizens of Hong Kong, Singapore, Taiwan, and South Korea would work with. The same is true in poor countries today. When multinational companies open up sweatshops in Third World countries, they are using the savings in First World countries to create capital in Third World countries. Overtime, the accumulation of capital in these countries leads to increased productivity and higher standards of living.

Better technology is also important for development. Technology allows people to obtain more output from both their labor and capital inputs. In Great Britain much of this technology needed to be invented for capital goods to embody it. But when the United States began to industrialize, it copied much of the technology that was already created in Great Britain. Furthermore, the United States benefited from foreign investment that brought new technologies with it. The same process of benefiting from other countries' technology is happening in Third World countries today.

Sweatshops are often the best available alternative to poor workers in the Third World. Sweatshops themselves are also part of the very process of development that will lead to their own elimination. When foreigners make investments in Third World sweatshops, they bring in capital and new technologies as well as give workers an opportunity to build human capital. All three of these things contribute to making workers more productive, which ultimately raises their wages and leads to improved jobs.

The cure best for sweatshops is economic development. But in order to develop countries need more than just sweatshops. They need good institutions the support the rule of law, economic freedom, and strong private property rights. In that environment, a free enterprise system is capable of raising living standards and eliminating sweatshops.

SUGGESTED CLASSROOM PROCEDURES

WORKER ALTERNATIVES AND WAGE FORMATION (45 MINUTES)

01

WARM UP VIDEO (3 MINUTES)



<https://youtu.be/O2sW2wt3nLU>



02

ALTERNATIVES TO SWEATSHOPS EXERCISE (20 MINUTES)

LIST

During the first five minutes of this exercise, have each student make a list of the five most likely alternative jobs that current sweatshop employees might work in if sweatshops disappeared. Have them imagine a country in Latin America or Asia and construct their list based on the country they choose. For each job they list have them note whether they think the wages in would be higher or lower compared to sweatshops and whether the working conditions would be better.

UNIT DISCUSSION ACTIVITY

Go through the DISCUSSION ACTIVITY (see Appendix 2) during the next 15 minutes and examine how jobs that have been protested as harmful sweatshops compare to actual living standards in the countries where they operate. Ask students how they might revise their lists in light of this evidence.



DISCUSSION ACTIVITY

03

WAGE DETERMINATION EXERCISE (22 MINUTES)

Ask one student to volunteer to be a hypothetical sweatshop worker (probably best to pick a good student). Bring them up front in the class and explain that the rest of the students are going to be sweatshop factory owners trying to hire them.

State that the worker student creates \$2 dollars of value a day stitching in any of the factories the rest of the students own. And that each factory owner needs to write on a piece of paper how much they are willing to pay per day to hire the worker student. But before they write their price explain that: 1) only the student with a winning bid (as chosen by the worker student) will get a reward, 2) that the size of the reward that you give them will be based on how much profit they make, and 3) any student who loses money in their business will be penalized (extra credit points and deductions on an assignment can easily be used as a reward to simulate the profits and losses experienced by businesses). Creating some form of reward is crucial to incentivize the students to act as real business people. Also explain that prior to these factories coming to town the worker student had been salvaging scraps from a trash dump and earning 20 cents a day.

Once they have each written a bid pick one student's bid at random and ask the worker student if they were given only this option, or their alternative in the trash dump which would they take. Continue to pick a few people's bids at random and each time increasing the student worker's alternatives to include the trash dump and all prior bids.

You should be able to find cases where the pay offer is higher than all the prior offers and cases where it is lower than the best offer. The student worker should accept accepting offers that would raise their wage and declining offers that would lower their wage.

After doing this at random enough to make the point, ask if anyone has a higher bid than the current best option. Continue to do so until you have discovered the highest bid in the class. It should be at \$2 or less. Any amount over that you need to explain that the worker only brings in \$2 in revenue and if you are paying more than that you lose money by hiring the worker (and then penalize those students) and say they are now out of business and revert to the highest bid that was \$2 or less.

Use this exercise to explain:

_____ **1**

The lower bound of acceptable compensation to a worker is whatever their next best existing alternative is.

_____ **2**

The upper bound of their compensation is limited by how much revenue that they can create for the firm (their productivity).

_____ **3**

That competition between firms tends to push actual wages up towards their upper bound.

Next, ask the student factory owner with the winning bid how they would respond if the government mandated that all workers must be paid at least \$3 per day. They should explain that they would fire the worker or never hire them because now they would have made losses like their out-of-business classmates.

_____ **4**

Explain that mandating higher minimum wages does not increase productivity it simply outlaws the hiring of anyone who has productivity below the minimum wage.

_____ **5**

Explain that competition can help push wages to the upper bound but that that upper bound can be quite low in poor countries so the real way to end sweatshop conditions is to think about how the upper bound (worker productivity) is increased.

SWEATSHOPS AND THE PROCESS OF DEVELOPMENT (45 MINUTES)

01

WARM UP ACTIVITY (10 MINUTES)



a

Ask the students if they ever had a part-time job. Ask a few of them to tell you about their jobs. Ask them if they would have cared if their employer paid them 30% more but did something to change the characteristic of the job that made it much less pleasant or more dangerous. You will have to just think on your feet and use what they give you (example: waitress, they paid 30% more but required serving on roller skates while carrying boiling pots of coffee over your head).

The point is only to establish that they care about tradeoffs between working conditions and wages. It doesn't matter whether they take or reject any change you propose.

b

Next, go back to one of your students who was the successful sweatshop factory owner. Ask them if they care about whether they had to pay their employee \$2 a day in wages or whether they paid \$1.50 in wages and 50 cents in other health and safety benefits.

You should establish that it is simply a cost to them and the employers are indifferent between the mix of wages and other forms of compensation. They only care about the total amount.

02

READING AND DISCUSSION (20 MINUTES)

a

During the first 6 minutes, read:
"Bangladesh's Factory Collapse: A One-Year Retrospective"

H <https://goo.gl/u1y3r2>

b

Then, follow with 14 minutes of Discussion Questions

i

Why are working conditions so unsafe in Bangladesh?

ii

Put yourself in the position of a desperately poor Bangladeshi worker trying to feed, clothe, and shelter his or her family. How would you likely want most of your meager compensation? Wages, health, safety?

iii

What impacts would mandating higher legal minimum safety standards have in Bangladesh?

03

THE CURE FOR SWEATSHOPS (15 MINUTES)

Go back to your student sweatshop worker who had a productivity of \$2 a day in your previous exercise. Now state that their productivity has increased so that employing them would now generate \$50 a day in revenue. Repeat the previous exercise on worker pay with the new productivity number. You should be able to establish rather quickly that the sweatshop worker will now earn close to \$50 a day. Ask the student if they would take the pay increase 100% in wages or if they would sacrifice some of the pay increase for improved safety and other working conditions. (If they won't "buy" any safety it is easy enough to redouble their wages again until they do).

a

Make the point that wages and working conditions improved so that the student was no longer a "sweatshop" worker but a normal worker. The cause of the improvement was the increase in productivity.

b

Ask the students to volunteer what factors might have improved a worker's productivity and make a list on the board. You can provoke them by asking things like, why are you likely to earn more money than a great great grandparent living in 1880 in the United States.

i

You should get factors, such as the amount of physical capital workers use, the technology available to them, and their educational level (human capital).

ii

Now ask when a sweatshop is established in a poor country what does it bring with it? It increases physical capital with its investment, often brings new production technologies, and creates opportunities for human capital improvements (at least relative to working on the farm).

iii

Thus, sweatshops bring with them some of the proximate causes of higher productivity. Thus, sweatshops, are part of the very process of development that leads to their own disappearance.






iv

Explain that in Great Britain and the United States the process of moving from pre-industrial to "post-sweatshop" took more than 100 years because all of the capital and technology had to be created and discovered anew. Countries like Hong Kong and South Korea made the jump in only about 30 years because the world had so much more capital and technology that could pour in.



v

The key for getting rid of sweatshops is to set the right environment for economic development and then the whole process can happen much more quickly today.

ADDITIONAL RESOURCES / ACTIVITIES

-  Powell, Benjamin (2016) . "Sweatshop Regulation: Tradeoffs and Welfare Judgments" Journal of Business Ethics. Volume 135, No.4.
-   Child Labor Assignment
<https://youtu.be/EUDJNwHngVI>
Assignment: Write up how the general economics of sweatshops applies to children.
-   Debating Sweatshops
<https://youtu.be/2ML84KVbqhU>
Assignment:
- What are the best arguments for regulating sweatshops?
 - What the best arguments against regulating sweatshops?
 - Which argument do you find more compelling? Why?

REFERENCES

-  Powell, Benjamin. Out of Poverty: Sweatshops in the Global Economy. Cambridge, MA: Cambridge University Press, 2014.
-  <http://econlib.org/library/Columns/y2008/Powellsweatshops.html>



SWEATSHOPS

APPENDIX 1/ SWEATSHOP WAGES REPORTED IN THE PRESS

TABLE 1

SWEATSHOP WAGES REPORTED IN THE PRESS

COUNTRY	YEAR	COMPANY	REPORTED WAGE	PER
Bangladesh	2010		\$23.52	month
Bangladesh	2010		\$30.89	month
Bangladesh	2010		\$31.24	month
Bangladesh	2009		\$3.50	week
Bangladesh	2009		\$0.06	hour
Bangladesh	2008		\$0.10	hour
Bangladesh	2008		\$23.78	month
Bangladesh	2006		\$13.30	month
Bangladesh	2005		\$0.21	hour
Bangladesh	2004	MaryKate & Ashley	\$0.18	hour
Bangladesh	2004	H&M	\$0.07	hour
Bangladesh	2004	MaryKate & Ashley	\$0.08	hour
Bangladesh	1997		\$0.25	hour
Brazil	2007		\$170.00	month
Brazil	2004		\$65.00	month
Burma	2004	NBA	\$0.14	hour
Burma	2004	NBA	\$0.07	hour
Cambodia	2004		\$2.00	day
China	2007	Apple, Compaq, Nokia, Sony	\$50.00	month
China	2006	Apple	\$50.00	month
China	2005	Disney	\$0.32	hour
China	2005		\$120.70	month
China	2005	Make Poverty History Campaign	\$0.17	hour
China	2005		\$0.69	hour
China	2004	NFL, NBA, MLB	\$0.17	hour
China	2004	NBA	\$0.16	hour
China	2004		\$1.00	day
China	2002		\$0.12	hour
China	2001		\$0.20	hour
China	2001		\$0.15	hour
China	1998		\$0.13	hour
China	1998		\$0.30	hour
China	1997	Nike	\$1.75	day
China	1997		\$16.00	month
China	1996		\$25.00	month
Costa Rica	1998	Rawlings Baseball	\$1.12	hour

COUNTRY	YEAR	COMPANY	REPORTED WAGE	PER
Dominican Republic	2008		\$7.29	day
Dominican Republic	2000		\$0.69	hour
El Salvador	2001	Gap	\$0.55	hour
El Salvador	2001	Gap	\$0.60	hour
El Salvador	2001	Gap	\$30.00	week
Haiti	2010		\$14.39	week
Haiti	2004		\$0.55	hour
Haiti	1996	Disney	\$0.28	hour
Honduras	1996	Levi's and Nike	\$5.40	day
Honduras	1995		\$0.30	hour
Honduras	2003	PDiddy	\$0.75	hour
Honduras	1996	Wal-Mart/Kathie Lee	\$0.31	hour
India	2010		\$0.41	hour
India	2010		\$130.54	month
India	2010		\$107.00	month
India	2010		\$98.44	month
India	2008		\$0.32	hour
India	2008		\$0.40	hour
India	2008	Banana Republic	\$0.30	hour
India	2007		\$34.16	month
India	2007		\$2.47	day
India	2007		\$2.41	day
India	2007		\$76.57	month
Indonesia	2004	H&M	\$1.00	day
Indonesia	2004	Adidas, Jansport	\$110.19	month
Indonesia	2004	Nike	\$2.00	day
Indonesia	2002	Nike	\$0.27	hour
Indonesia	1997	Nike	\$2.46	day
Indonesia	1996	Nike	\$2.28	day
Indonesia	1996		\$117.00	month
Indonesia	1996	Nike	\$115.00	month
Indonesia	1996	Nike	\$0.14	hour
Indonesia	1996	Nike	\$0.22	hour
Indonesia	1996	Nike	\$0.45	hour
Laos	2010		\$1.60	day
Mauritius	2007	Topshop (Designer Kate Moss)	\$8.02	day

COUNTRY	YEAR	COMPANY	REPORTED WAGE	PER
Mauritius	2007		\$0.62	hour
Nicaragua	2004	Talbots, JC Penney, Eddie Bauer, Kmart	\$0.50	hour
Nicaragua	2001		\$135.50	week
Nicaragua	2000	Kohl's dept. stores	\$3.00	day
Nicaragua	2000		\$0.17	hour
Nicaragua	2000		\$0.19	hour
Nicaragua	2000		\$0.20	hour
South Africa	2010		\$11.10	week
South Africa	2010		\$14.39	week
Thailand	2006		\$2.00	day
Vietnam	2004	NBA	\$0.15	hour
Vietnam	2000	Nike	\$564.00	year
Vietnam	1997	Nike	\$1.60	day



SWEATSHOPS

APPENDIX 2/ UNIT DISCUSSION ACTIVITY/
SWEATSHOP WORKING CONDITIONS



SWEATSHOP WORKING CONDITIONS

- _____ Low Pay (by Western Standards)
- _____ Long Hours
- _____ Health and Safety Risk
- _____ Poor Conditions

FIGURE 2/ PERCENT OF POPULATION LIVING ON LESS THAN \$1.25 AND \$2 PER DAY (PPP)

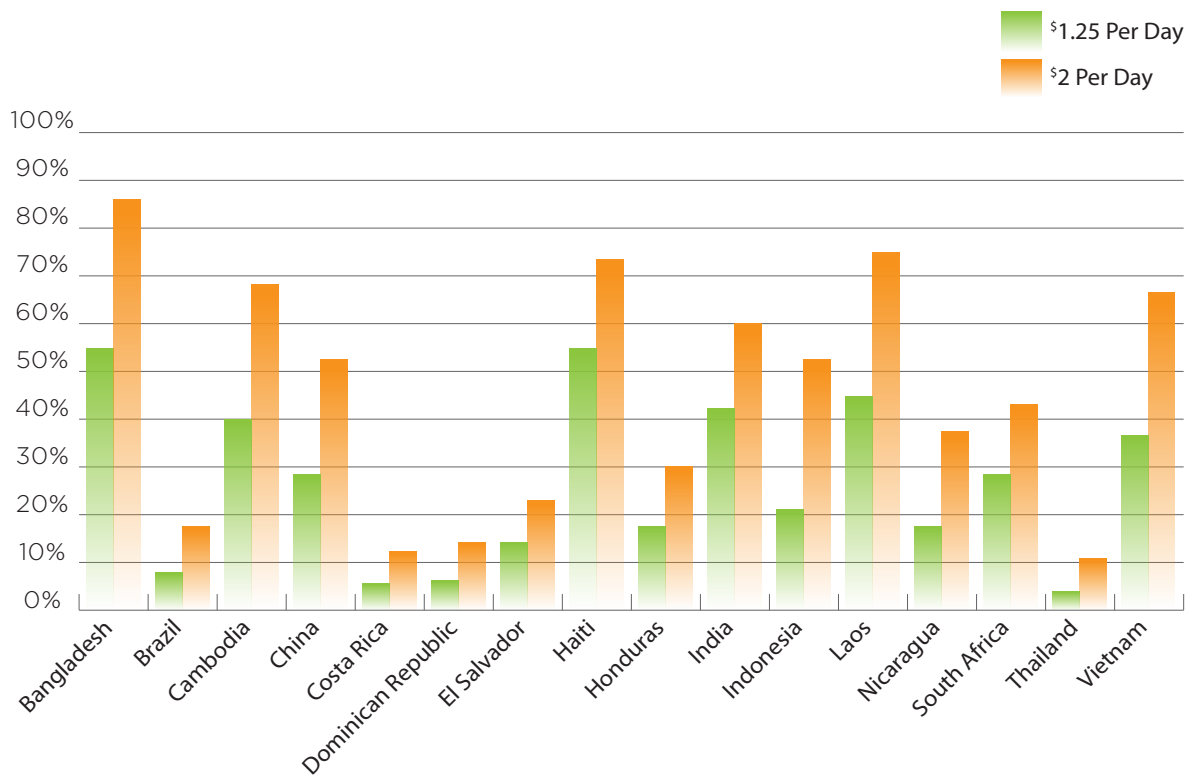


FIGURE 3/ AVERAGE SWEATSHOP EARNINGS PER DAY

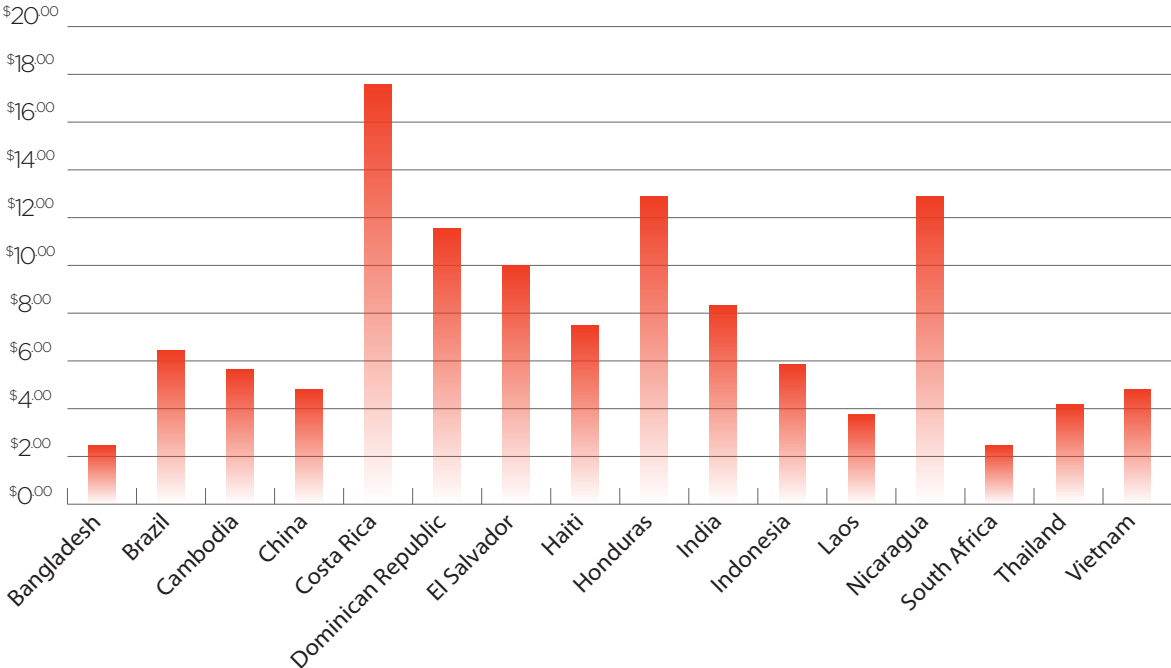
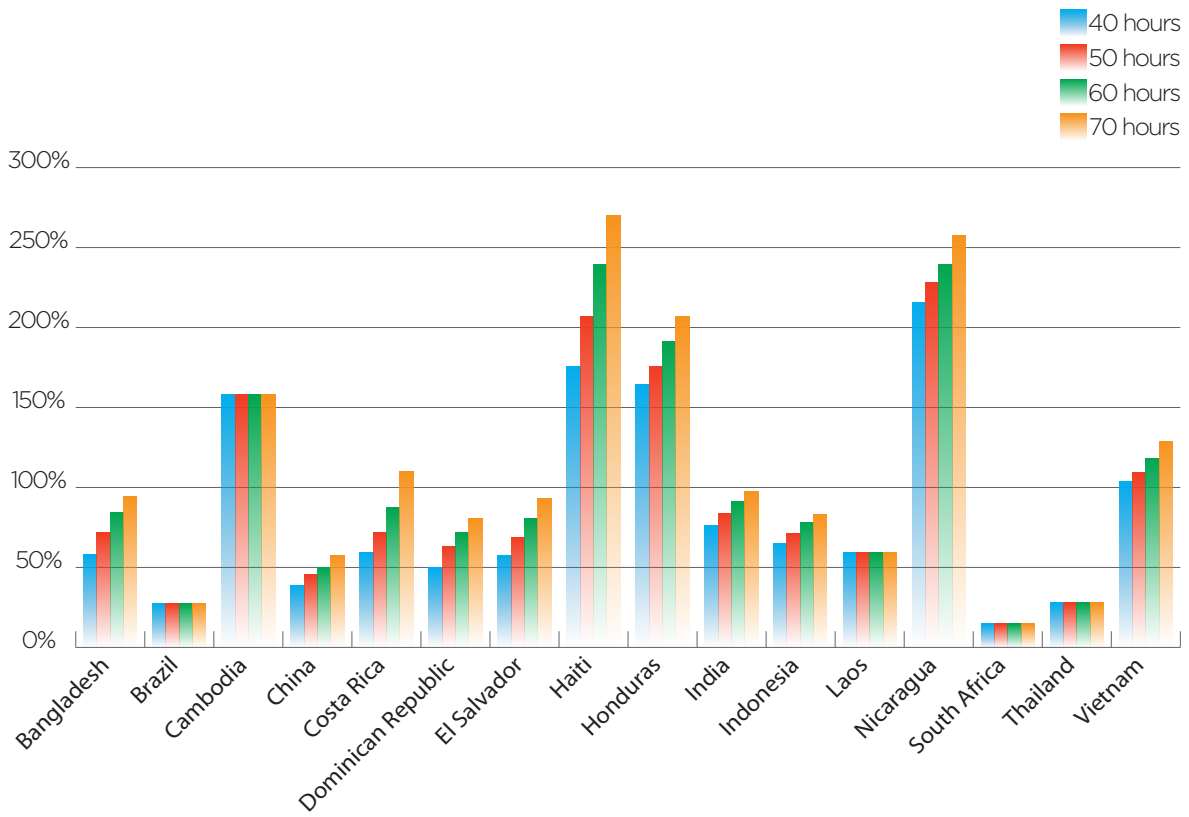


FIGURE 4/ AVERAGE SWEATSHOP EARNINGS AS A PERCENT OF AVERAGE INCOMES





SWEATSHOPS

JOURNAL ARTICLE/ SWEATSHOP REGULATION: TRADEOFFS AND WEL-
FARE JUDGEMENTS

SWEATSHOP REGULATION: TRADEOFFS AND WELFARE JUDGEMENTS

"Sweatshop Regulation: Tradeoffs and Welfare Judgments" *Journal of Business Ethics*. Volume 135, No.4

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ABSTRACT

The standard economic and ethical case in defense of sweatshops employs the standard of the "welfare of their workers and potential workers" to argue that sweatshop regulations harm the very people they intend to help. Scholars have recently contended that once the benefits and costs are balanced, regulations do, in fact, raise worker welfare. This paper describes the short and long-run tradeoffs associated with sweatshop regulation and then examines how reasonable constructions of measures of "worker welfare" would evaluate these tradeoffs finding that the standard economic and ethical case against sweatshop regulations is well supported.

SWEATSHOP REGULATION: TRADEOFFS AND WELFARE JUDGEMENTS

KEYWORDS:

**SWEATSHOP
MINIMUM WAGE
LABOR LAW**

INTRODUCTION

Over the last 20 years, economists from across the political spectrum have generally acknowledged that third-world sweatshop employment is superior to the available alternatives for these workers and have viewed many proposed regulations as likely to lead to a decrease in sweatshop employment that makes workers worse off. Economist John Miller, himself a critic of sweatshops, summarized the consensus view succinctly, "Their proposition is as simple as this: 'Either you believe labor demand curves are downward sloping, or you don't... Of course, not to believe that demand curves are negatively sloped would be tantamount to declaring yourself an economic illiterate'" (2003, p. 107).

Numerous scholars (Arnold 2003, 2010; Arnold and Bowie 2003, 2007; Arnold and Hartman 2003, 2005, 2006; Miller 2003; Pollin et al. 2004) attempted to identify mechanisms that would undermine the standard negative employment consequences predicted by economists over the decade following Miller's assessment. Powell and Zwolinski (2012) and Powell (2006, 2014) argue that these scholars made numerous errors and that their arguments do nothing to undermine the standard negative consequences predicted by economists. In evaluating the consequences of sweatshop employment and proposed sweatshop regulations both Powell (2014, p. 3) and Powell and Zwolinski (2012, pp. 450-451) explicitly use the welfare of actual and poten-

tial sweatshop workers as their standard of evaluation. However, in both cases, the precise way that they measure welfare is only vaguely or implicitly defined.

The most important objection raised to the standard economic case against sweatshop employment, and that case as reclaimed by Powell and Zwolinski, comes from Coakley and Kates (2013). The crux of their argument is that Powell and Zwolinski focus mostly on the employment costs of sweatshop regulation but that a welfarist evaluation of sweatshop regulations would weigh both costs and benefits. They argue that the costs in terms of employment losses need not be great and that other potential benefits of regulation might outweigh those costs. They conclude that, "The regulation of sweatshop labor has the potential to greatly increase overall human welfare in general, and the welfare of the globally worst off in particular. Powell and Zwolinski provide no reason to think otherwise" (2013, p. 558).

Unfortunately, Coakley and Kates misconstrue the tradeoffs associated with sweatshop regulation. They focus exclusively on short-run tradeoffs, ignoring the potential long-run consequences that regulation could have on the welfare of the worst off. Their analysis of short-run tradeoffs is based on faulty economic assumptions that lead them to drastically underestimate the negative consequences of sweatshop regulation on the welfare of the worst off and to overestimate the benefits.

Any evaluation of the merits of sweatshop regulation requires both sound economics and sound ethical evaluations. The next two sections rely on economics to explain the tradeoffs associated with sweatshop regulation. The next section examines the short-run tradeoffs. Section 3 examines the long-run tradeoffs. Section 4, welfare judgements,

evaluates under which normative frameworks sweatshop regulation would be desirable, and under which frameworks it would not be, given the tradeoffs outlined in the prior to sections. The final section concludes.

SHORT-RUN TRADEOFFS

Virtually all economic policies create benefits as well as costs. This section will establish the short-run benefits and costs associated with regulating sweatshops and attempt to use economic theory to give a general idea of some of their empirical magnitudes.

Sweatshop regulations can take many forms and it is beyond the scope of this article to sort out all of the different impacts that each might have.¹ The remainder of this essay will focus on the costs and benefits associated with mandating minimum (or living) wages in countries with sweatshops. A commonality among virtually all forms of sweatshop regulations is that they raise the relative cost of firms hiring the labor that is being regulated, a minimum wage is no exception. Minimum wages have the potential to generate an external benefit from the increased income the workers who remain employed receive and spend thus boosting local labor demand. Similarly, money spent on health and safety improvements to comply with regulatory requirements could also boost local labor demand. Thus, while the minimum wages as is used as the example of a sweatshop regulation, the argument made in this paper generalizes to many sweatshop regulations.

What are the tradeoffs associated with implementing a higher minimum wage in a country where sweatshops operate? Coakley and Kates (2013) give a partial, and somewhat misleading, account of these costs and benefits. They note that,

1. "Sweatshop workers will have more income" (p. 554).
2. "If the price of the produced goods increase, and if consumers reduce consumption accordingly, then employment in developing world sweatshops might decrease as well" (p. 555).
3. The price of the goods that these workers produce might increase (p. 554).
4. Profits for sweatshop owners might decrease (p. 554).
5. "Given that sweatshop workers spend their additional income on local goods and services, the employment of developing world non-sweatshop workers might increase as a result" (p. 554).

Although points three and four would be relevant for many ethical theories, they will be ignored as irrelevant here, since we are employing some version (types of which are discussed in Sect. 4) of a welfare standard that counts only the welfare of poor third-world workers and potential workers. The factory owners and consumers do not fall into these categories. Point five has an obvious, and unrecognized by Coakley and Kates, counterpart:

- 5a. Unemployed sweatshop workers earn less income and spend less in the local economy and thus decrease the employment of non-sweatshop workers in the Third World.

Coakley and Kates also fail to note:

6. Laid off sweatshop workers increase the supply of labor in non-sweatshop sectors driving down wages and decreasing employment opportunities for nonsweatshop workers (who in turn also spend less in the local economy, just as in 5a).

¹ Interested readers can see Powell (2014) for an extensive treatment of the effects of the various types of regulation. These include, among others, minimum wages (Chapter 3), health, safety, and working conditions regulation (Chapter 5), and child labor (Chapter 6). See Clark and Powell

The important tradeoff is between modified versions of points one and two, both of which are misstated by Coakley and Kates.² Put correctly, point one would read, “increased wages of those workers who remain employed.” Whether the incomes of these workers are higher or not depends on how the employers adjust employee hours. In the face of higher wage rates employers can reduce the quantity of labor they hire both by laying off workers or decreasing employee hours.

Point two, as stated by Coakley and Kates is overly specific and subsequently leads them to underestimate the unemployment effects of increased minimum wages. A decrease in the quantity of goods consumers demand due to higher prices of the goods is only one channel through which unemployment is created. Stated correctly, the important tradeoff is between how much incomes of sweatshop workers who remain employed increase (modified 1), compared to how badly do those workers, who become unemployed as a result of the higher wage mandate, suffer (modified 2), and how do both of these factors impact non-sweatshop workers (5, 5a, and 6).

Coakley and Kates' argument relies entirely on their misstated point two. The crux of their argument (pp. 555–556) is that significant mandated increases in sweatshop worker wages will do little to increase the price of consumer goods, so unemployment effects would be minimal unless consumers had extremely elastic demand. They summarize their position by writing:

Thus, aside from the general product price elasticity, there are two fundamental factors to consider in determining whether an increase in the minimum wage paid to workers is likely to lead to an expected welfare gain overall. First, how poor are the workers compared to owners and consumers? Second, how much of the product price is attributable to worker wages? This in turn yields two predictions: That the poorer the workers compared to owners and consumers, the larger the welfare gain from the income transfer effects; and that the smaller the proportion of the cost

attributable to worker wages, the smaller the welfare loss from direct employment effects. The upshot is that welfare gains from an increase in the minimum wage paid to workers are expected to be the highest in the following set of circumstances: where consumers and owners are much more wealthy than workers and where worker compensation is a small part of the product price overall. These are precisely the dominant characteristics of developing world export-oriented sweatshops (2013, p. 556).

But share of labor's cost of the final product and consumers' elasticities are not the only, or most important, factor determining the unemployment effect of mandating higher minimum wages. There are many ways to make products that come out of sweatshops. Yet nowhere do Coakley and Kates consider substitutability of inputs in production. Virtually everyone in the scholarly debate surrounding sweatshops agrees that firms are greedy and attempt to maximize their profits. If laws increase the cost of sweatshop labor in any country, firms can remix their inputs of how they make products, in order to minimize costs in light of the new relative price structure. The remixing will take place regardless of labor's share of the total cost.

There are three obvious substitutes for using third-world labor from any given country: more productive (and expensive) first-world labor; less labor and more capital; and labor in other third-world countries. In any given situation, one or more of these channels will be used. The first two of these channels is clearly “bad” when using any welfare standard that exclusively counts the welfare of the workers and potential workers from poor countries. Section 4 will explore the welfare implications of a shift of production between third-world countries.

How much of the burden of a higher wage mandate is borne by which parties effected by it will depend on relative elasticities (just like a tax). In this case, the burden of higher wages for some employees will be borne by some combination of owners of

² Additionally, if the minimum wage applies to all sectors of the economy and not just the industry with sweatshops, non-sweatshop workers also face the tradeoffs between points one and two and the unemployed sweatshop workers have decreased opportunities to get reemployed in other areas of the economy.

firms, consumers, and other thirdworld workers. In a world where multinationals order from domestic subcontractors and can shift their orders around the globe, and where capital is internationally mobile, both the multinationals and the owners of capital that can go into factories are highly elastic. Labor is not highly mobile though. Labor is not highly mobile partly because it is bundled with the consumption of being near ones family, friends, and enjoying the culture one was raised in. But more importantly for laborers in poorer countries, significant policy barriers prevent the international mobility of labor.³

Coakley and Kates considered only the least important channel of how wage mandates could decrease employment in third-world sweatshops. When the entire market is examined, it is obvious that the third-world workers' labor supply is the least elastic factor of production and thus the one likely to bear most of the burden of any mandated wage increase.

The fact that poor laborers are likely to bear the largest share of the burden of an increased wage mandate does not, by itself, settle the debate. It just means that Coakley and Kates were making illinformed general empirical guesses. The desirability of a wage mandate remains an empirical question of how big the income gains are to those who remain employed and how big the losses are to those who lose their jobs (and the losses to others caused by increased labor market competition from the unemployed workers) coupled with a specific measure of "welfare."

It is beyond the capability of economic science, to lay out any permanent estimate of the empirical tradeoff between wage mandates and unemployment. The laws of economics dictate that the tradeoff exists, but its size will vary by time and place, as relative elasticities vary. All measures of elasticity are historical data, not permanent relationships. With that in mind, rather than making calcu-

lations of labor's share of the cost of a good and hypothesizing about consumer elasticities, as Coakley and Kates did, the more appropriate way to get a better idea of the size of the tradeoffs involved is to look at actual minimum wage mandates in poorer countries and the associated unemployment effect.

The real value of the minimum wage in Indonesia more than doubled from 1989 to 1996. Harrison and Scorse (2010) study the Indonesian labor market over this time period, including the employment and wage impact of the minimum wage increase. They find that employment dropped by 35 % in the industries, footwear and apparel, that are most associated with sweatshop labor (2010, p. 265). Coakley and Kates are correct that this information, in and of itself, is not enough to make a welfare judgement. These employment losses need to be weighed against the wage increases of remaining workers. However, one cannot assume that the wages of the remaining workers doubled, as Kates (2015, p. 202) later mistakenly does. Some workers earned more than the minimum wage before it was increased. A 35 % drop in employment could be associated with not a single worker receiving a wage increase, if firms fire all low wage workers and retain only those who were previously earning more than the new statutory minimum. Harrison and Scorse control for the fact that the initial minimum wage was often non-binding and find that a 1 % increase in the real value of the minimum wage was associated with only a 0.675 % increase in the real unskilled wage (2010, p. 259). As a rough first approximation, doubling the minimum wage led to a 67.5 % increase in the wages of 65 % of the workers at the expense of unemployed the other 35 %.⁴ Even this is a lowend estimate of the employment costs because Harrison and Scorse's difference in difference methodology of studying the employment impact of the minimum wage necessarily does not account for jobs lost when entire firms exit or fail to enter the Indonesian market because of the minimum wage increases.

³ See Powell 2015, particularly Chapter 2, for a summary of the negative economic consequences for world welfare, and particularly the welfare of those trapped in poorer countries, caused by government restrictions of international labor mobility.

⁴ This unemployment estimate is derived from statutory minimum wages as they were actually enforced. It is widely appreciated that enforcement of minimum wage laws in poor countries is extremely lax (Strobl and Walsh 2000; Bell 1997; Rama 1996). Thus a vigorously enforced minimum wage, as most anti-sweatshop activists desire, would have even greater unemployment effects.

To make a welfarist judgement, one must weigh the gains to the winners against the losses to the losers. No reliable estimates are available about how big the losses were for those who were unemployed by the minimum wage increases. But it bears keeping in mind that 57.1 % of the Indonesian population was living on less than \$1.90 per day between 1991 and 1995 (World Bank 2015).⁵ Extreme poverty earnings were likely the norm for those who were forced out of the apparel sector by minimum wage increases.

What does this say about point 5 and 5a above? Workers who lose their jobs likely see substantial falls in their incomes. This, at best, leaves a very small net increase in total income to all current and former apparel industry workers when the gains are taken against the losses.⁶ But this is not the end of a short-run welfare calculation. Now point six needs to be considered. Increased labor market competition for non-sweatshop workers results from the 35 % of sweatshop workers who were unemployed. Also, the negative employment impact of firm exit (and failure to enter) would need to be added to these costs. Under many likely scenarios this turns what at first might be a small net gain into a net drain, even in the short-run.

The Indonesian case illustrates how one would correctly begin to assess the short-run tradeoffs that Coakley and Kates suggest should be considered. The estimated empirical results of the wage increases and unemployment effects from Indonesia in the 1990s are merely that. There are no universal empirical laws of magnitude (direction is another story) but as we outlined above we have good theoretical reasons, based on characteristics that lead factors to be more or less elastic, to believe that there are substantial tradeoffs between mandated wage increases and job losses in the affected industry. Furthermore, as Powell and Skarbek (2006) and Powell (2014) demonstrate, the alternatives to sweatshop

industry employment in most countries where they operate are usually quite dire. But there are long-run tradeoffs that also need to be considered in any welfarist perspective.

LONG-RUN TRADEOFFS

Sweatshop regulations, such as a minimum wage or mandated safety improvements, are aimed to make a one-time permanent improvement in sweatshop conditions. For example, mandating a minimum wage of \$2 per day aims to lift all workers immediately above that standard. If there were not the problematic short-run tradeoffs documented in the previous section, this policy would once and for all lift workers above that wage and never let them fall below it again. However, I know of no reasonable argument that a minimum wage or other safety regulation mandate would change the future expansion path of wage growth over the long-run. Without the short-run adverse effects, at best, poverty would just permanently be less bad than it otherwise would have been. The regulations do nothing to speed the process of economic development that eventually eliminates extreme poverty.

However, there are good reasons to believe that sweatshop regulations harm the long-run process of wage growth that occurs through the process of economic development. The proximate causes of high living standards are the quantity of physical capital, level of technology, and quality of human capital. When sweatshops operate in third-world countries, they bring physical capital with them in the form of investment, they often bring new production technologies, at least relative to those technologies previously being used in the country where they locate, and, relative to agricultural labor or other service sector employment where their

⁵ In 2011 PPP international dollars.

⁶ Curiously, though Coakley and Kates cite Powell and Zwolinski's use of the Harrison and Scorse study and say that we must weigh these costs and benefits, they never actually perform these calculations themselves. Instead they rely on their faulty method of considering only labor's share of a goods cost and assume consumers have fairly inelastic demand and then assert that net income could go up substantially and create a multiplier that stimulates the local economy leaving even those who lose their jobs not much worse off. Kates (2015) later attempts to make the calculation but does so incorrectly.

employees might otherwise work, they often provide more opportunities for human capital improvements.

Even if a short-run tradeoff led to larger income gains to those who keep their jobs compared to the income losses of those laid off, and the losses to those in the other sectors who face lower wages because of competition from the laid off workers, that does not necessarily lead a farsighted welfareist to conclude that welfare has been improved. Laid off workers will likely build less human capital while working in non-manufacturing sectors which will limit their income growth relative to what it could have been had they been able to stay in factory employment. The higher costs associated with sweatshop regulation will lead fewer firms to open new factories than otherwise would have. That limits capital creation through investment and decreases the amount of technology transfer that occurs compared to what it otherwise would have been.⁷ These two factors lower the future productivity, and thus wage growth, of everyone, including the sweatshop workers who remained employed.

There is also a large literature that shows that higher levels of economic freedom (and improvements in economic freedom) are associated with higher income levels, higher growth rates, and better performance on most measures of standards of living (See Hall and Lawson 2013 for a recent survey of this literature and Gwartney et al. 2015 for the most recent version of the index). Although capital, technology, and human capital are proximate causes of high standards of living, good institutions are the fundamental cause. They lead to better economic coordination of whatever resources are available. Better institutions, as measured by economic freedom, also lead to higher levels of investment and a greater productivity out of any given level of investment (Gwartney et al. 2006). When both the direct and indirect channels through investment are taken account of, a one unit decrease in economic freedom has been shown to be associated with a decrease in long-run growth rates by 1.5 percentage points (Gwartney et al. 2006).

Sweatshop regulations constitute decreases in the economic freedom of both employers and employees to agree on any mutually agreeable employment terms. In terms of the economic freedom of the world index cited above, these restrictions decrease freedom in the areas of labor market regulation and business regulation. But corruption of enforcement officials is also likely whenever mutually beneficial exchanges in any market are prohibited. Increases in corruption might undermine measures of property rights and the rule of law in the economic freedom index.

Any, even modest, improvement in worker incomes can make a meaningful difference in people's lives when living standards are so low. But the best case improvements that could hope to be achieved by any sweatshop regulations pale in comparisons to the life altering changes brought about by the process of economic development. Capital and technology flow into countries that embrace policies of economic freedom and secure property rights causing rapid increases in living standards. The sweatshop countries of the 1950s, like Hong Kong, Taiwan, Singapore, and South Korea, that adopted policies supportive of economic freedom jumped from a pre-industrial standard of living to first-world living standards in a generation (Powell 2014). It is hard to imagine a reasonable welfarist position that would weight any small improvement in living standards that might have been achieved for workers in 1960 through sweatshop regulation more heavily than the massive welfare gains over the subsequent 20-30 years that would have been delayed by such regulations.

More empirical work on the size of the negative longrun consequences of sweatshop regulation and growth is warranted. The amount of reduced growth would obviously be related to the size of a minimum wage mandate or the cost of compliance with other sweatshop regulations. The above paragraph does not claim that the Asian economies would not have eventually developed if they had passed a small increase in their minimum wage in 1960. The long-run economic

⁷ Rama (1996) examines the minimum wage increases in Indonesia discussed above and finds that they were associated with a 5 % decrease in investment.

tradeoffs identified only indicate that any growth would have come more slowly and thus the lost welfare in the intervening years needs to be accounted for.

With both short-run and long-run tradeoffs in mind, it is now time to turn to the task of evaluating the tradeoffs associated with sweatshop regulation in light of different welfare standards.

WELFARE JUDGEMENTS

Economic science is capable of establishing the tradeoffs associated with policy changes. But economic science, by itself, is incapable of establishing the desirability of any policy. To establish the desirability of an economic policy, an ethical judgement must be rendered in light of the tradeoffs established by economics.

Sweatshop regulations decrease economic efficiency. Any regulation that changes relative prices in a way that does not reflect the real scarcity of resources necessarily creates deadweight losses that shrink the economic pie.⁸ But efficiency is, itself, a normative standard that needs ethical justification. It counts the income of everyone, rich and poor, the same. Implicitly, it assumes a dollar of income generates the same amount of human welfare regardless of who receives it. Although there are good arguments in favor of using economic efficiency as a welfare standard, in the context of the debate surrounding the regulation of sweatshops, I have chosen to argue exclusively in terms of the welfare of sweatshop workers and other poor people who are potential factory workers, in the Third World. This standard, in the spirit of value-free economics, embraces the ends of the anti-sweatshop activists—the welfare of the world's poor—and asks if the proposed means, sweatshop regulations, promote that end.

But “welfare of sweatshop workers and

other poor people in those countries” is not something that can be scientifically measured. Utility is not interpersonally comparable and all values gained and lost are subjective to those experiencing them (Stringham 2010). Any time that we are measuring gains to the winners compared to losses to the losers we are necessarily moving beyond the scope of what science is capable of establishing. We can measure dollar gains to winners compared to dollar losses for losers, just like we measure efficiency, but that does not directly translate into utility if those dollars are worth more to some people than to others. Despite these limitations, let's proceed to explore some aspects of “worker welfare” with these important caveats in mind.

DOES EVERYONE COUNT EQUALLY?

Should the income gains to the sweatshop workers who remain employed simply be netted against the income losses to those who lose their jobs and the other poor workers who face lower incomes because of competition from the newly unemployed sweatshop workers? If standard economic efficiency was our baseline, the answer for most economists is clear—yes. But the whole point of using “third-world worker (and potential worker) welfare” as a welfare standard explicitly rejects counting the welfare of all equally. It ignores the welfare of capital owners and first-world consumers.

Is there a break point where the welfare of some people counts for nothing and the welfare of all of the rest count equally? Once one uses a welfare standard that explicitly excludes any welfare gains or losses to the relatively rich, one is implicitly adopting a standard where the welfare of the least well off people matters more. If one embraces a strong Rawlsian position, that only values the welfare of the least well off, then clearly sweatshop regulations would be undesirable. Sweatshop regulation cause income losses to the poorest of the poor through layoffs while

⁸ If relative prices were failing to reflect the real scarcity of resources, it is possible, in theory, for a regulation to change relative prices to better reflect relative scarcities and thus eliminate deadweight losses and increase the economic pie. Advocates of sweatshop regulations have not made any convincing case that their preferred regulations could fall into this category.

the remaining sweatshop workers, who are relatively better off, experience gains. But one need not embrace a fully Rawlsian position in order for such considerations to impact how one judges welfare gains and losses from sweatshop regulation.

Once one rejects counting everyone's welfare equally, one does not have to take the polar opposite position that only the welfare of the least well off count. Perhaps, a more consistent line of reasoning would conclude that any gains or losses matter more, the poorer the person experiencing them is? That standard could justify excluding the welfare of the rich people residing in the First World. But, since sweatshop workers usually have much higher living standards than many of the people living in the countries where they operate (Powell 2014; Powell and Skarbek 2006), such a standard would also have to weight the income losses to those who are unemployed (and those who they then compete with) more heavily than the gains to those workers who remain employed after the regulation is implemented.

A complimentary line of reasoning might posit that a given dollar of income would generate more utility the lower the income of the person receiving it is. If this is assumed, then the income losses to the poor who are harmed by sweatshop regulations would again count more heavily than the income gains to those who remain employed. Welfare, as measured this way, could decrease even if total income in the poorer country increased as a result of sweatshop regulation.

It only seems logical to count the income losses to the poorest more heavily than any income gains to the relatively better off workers once one has already abandoned counting the income (or welfare) of everyone equally by excluding gains or losses the relatively rich in the First World.

WHEN DO PEOPLE COUNT?

Coakley and Kates considered only short-run costs and benefits. But, as Sect. 3 demonstrated, sweatshop regulations create additional long-run costs in terms of worker welfare with no corresponding long-run additional potential benefits. What is the appro-

prate time horizon for evaluating costs and benefits?

It seems odd to employ any welfare standard that cares about the world's poor today but not their welfare a year from today. Similarly, why should not their welfare, and their children's welfare, be counted 20 or 30 years or more down the line. It is obviously appropriate to use a discount rate to discount future costs or benefits compared to those achievable today. But, given the small or non-existent short-run welfare gains that might be achieved through any regulation, compared to the dramatic overall changes in living standards achieved through economic development, it would seem that at most plausible discount rates any, even small, decreases in economic growth because of sweatshop regulations would create welfare losses that dwarf any gain that could possibly be achieved in the short run.

WHERE DO PEOPLE COUNT?

If a minimum wage increase is mandated in Indonesia, which poor workers' welfare counts? Just Indonesians? Coakley and Kates point out that when factories relocate, in response to an increase in the Indonesian minimum wage, some might relocate to other poorer countries. Thus measuring only Indonesian worker welfare misses the welfare gains to other poor workers who should also count (2013, p. 555). Fair enough. But embracing this line of reasoning has other important implications.

First, given the tradeoffs and welfare considerations outlined above, honesty requires advocates of, say, an Indonesian minimum wage increase, to explicitly admit that they favor a minimum wage increase because they weigh the benefits it will create for poorer Bangladeshi workers more highly than the losses suffered by Indonesia. I know of no anti-sweatshop scholar who has admitted this tradeoff and embraced it.

Second, if promoting the welfare of Bangladeshi workers is the goal, what welfare standard dictates that it should come at the expense of other poor, but slightly better off,

Indonesian workers? Would not one instead favor imposing harsher anti-competitive restrictions on even wealthier workers in the First World? Perhaps an international ban on producing apparel in the First World? Then, both poor Bangladeshi workers and poor Indonesian workers would be helped rather than harming one for the benefit of the other.

Some advocates of sweatshop labor might mistakenly take this argument as a case for international sweatshop regulations that proportionately impact all third-world countries rather than regulating sweatshops on a country-by-country basis. An international regulation that eliminated the ability of firms to secure greater profits by moving between third-world countries in order to avoid the cost of sweatshop regulations would only lead to greater substitution of first-world workers and capital for thirdworld workers. Thus, an international regulatory regime may lead to less switching of production between thirdworld countries, but it would also cause greater welfare losses than when a single third-world country regulates sweatshops, when employing any welfare standard that takes into account all workers in the Third World and weights their welfare more heavily than first-world workers and capitalists.

If we are not evaluating the welfare of only a country adopting a sweatshop regulation, but third-world welfare more generally, then perhaps the policies that could create the greatest gains for poorer countries are not sweatshop regulations at all. They would be policies that raise the welfare of all third-world countries rather than harming some for the benefit of others.

CONCLUSION

The standard economic case against sweatshop regulation (Powell 2006, 2014; Powell and Zwolinski 2012), based on considerations of the welfare of sweatshop workers and their impoverished countrymen, remains on solid ground despite claims to the contrary (Coakley and Kates 2013).⁹

Coakley and Kates are only able to claim that sweatshop regulation “has the potential to greatly increase overall human welfare in general, and the welfare of the globally worst off in particular” (p. 558) because they: (1) misconstrue short-run tradeoffs and, in particular, ignore the most important channels through which the short-run tradeoffs create unemployment for sweatshop workers; (2) ignore the long-run decreased income growth that results from regulation; (3) adopt an odd welfare standard, that entirely excludes the worlds rich, but then fails to weight the extremely poor any more heavily than the moderately poor.








There is no objective scientific way to measure “welfare.” Such measurements are more art than science. A measure of welfare can always be constructed in such a way that the person constructing it can reach whatever conclusion they desire. But not all art is equal. Good art incorporates the science that establishes the tradeoffs that policies confront. Good art should have compelling reasons anytime it weights the gains to people differently. In the case of sweatshop regulation, it is certainly plausible to weight the income changes to the poor more heavily than the income changes to the wealthy. But once that is done, it would seem that good art should also weight the income changes to the extremely poor more heavily than the changes to the moderately poor. Good art recognizes both current costs and benefits and future costs and benefits and discounts accordingly.

Once the tradeoffs associated with sweatshop regulation are correctly understood, most (all?) renderings of a reasonable standard of “worker welfare” should lead one to conclude that such regulations harm the welfare of the very people they are intended to help.

⁹ The arguments in this paper equally undermine the claims made by Kates (2015) with regard to his “preference and choice” argument.

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