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## Social dumping and relocation: is there a case for imposing a social clause?

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### Abstract

Public opinion in Europe seems worried about the relocation of production plants toward low wage countries often accused of practicing ‘social dumping’. To reduce the incentives for relocation trade unions proposed the adoption of ‘social clauses’ protecting domestic markets from commodities produced in countries where minimal labor condition are not met. We analyze the effects of the adoption of a social clause in a vertically differentiated Bertrand duopoly. We assess how such a policy affects firms’ relocation decisions in order to be able to assess its welfare implications. We also characterize the optimal social clause policy, both under domestic welfare maximization, and from an efficiency point of view. While we show that a social clause policy cannot be dismissed on domestic (or world) welfare grounds, its case is weaker the higher is the domestic wage and the lower is the foreign wage. © 2001 Elsevier Science B.V. All rights reserved.

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### 1. Introduction

It is well known that free trade and financial liberalization induce structural changes which have important redistributive effects. It is thus natural that the

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groups which suffer from such policies lobby for measures aiming at mitigating their losses. A striking example of this is the protest of the labor (and environmental) organizations against ‘globalization’ during the November 1999 WTO meeting in Seattle. On that occasion, tens of thousand of trade unionists participated in protest rallies and marches organized by the AFL-CIO.<sup>1</sup> According to the labor organization, ‘fundamentally flawed trade policies have resulted in the loss of hundreds of thousands of high-paying manufacturing jobs and [have] undermined domestic measures designed to protect human rights and the environment. Trade agreements have [...] empowered multinational corporate giants while leaving workers and communities to fend for themselves in an increasingly bitter global competition for scarce jobs and investment.’<sup>2</sup> Moreover, according to the AFL-CIO, the reduction of tariff and non-tariff barriers, together with the fall of transportation costs, has magnified the appeal of relocating production plants toward low-labor cost countries practicing ‘social dumping’. Under these circumstances, ‘the only winners are multinational corporations that [...] move factories, jobs and investment capital at a moment’s notice to escape national laws, collective bargaining agreements and simple standards of human decency’.<sup>3</sup>

The term ‘social dumping’, though very widely used nowadays, has not yet found a precise economic definition.<sup>4</sup> This is not surprising since the very concept of ‘dumping’ is still quite controversial among economists.<sup>5</sup> If it is true that the distinction between dumping and price discrimination hinges on the razor’s edge, this is even more so for the distinction between social dumping and comparative advantage.<sup>6</sup>

Barros and Cabral (2000) present a model in which peripheral countries may have an interest in subsidizing foreign firms to induce them to serve domestic demand by local production, and this in order to reduce unemployment. ‘Social dumping’ is there treated in the same spirit as fiscal competition among jurisdictions. In such a framework, the welfare effects of ‘social dumping’ – defined as the lowering of domestic wages to attract foreign investments – concern exclusively the countries that engage in the ‘social dumping’ game, and the workers are those who bear the burden of the race to the bottom.

Another way of addressing the ‘social dumping’ issue, i.e. the ‘flight of capital

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<sup>1</sup>The most vivid images of the meeting remain indeed the clashes between activists and police that led to the city’s curfew and to the patrolling of the streets by the National Guard.

<sup>2</sup>AFL-CIO Home Convention 1999. Available on the Internet at: [http://www.aflcio.org/convention99/res1\\_6.htm](http://www.aflcio.org/convention99/res1_6.htm)

<sup>3</sup>Remarks by R. Trumka, Secretary-Treasurer of the AFL-CIO, Labor and the Global Economy Conference, Berkeley, California November 21, 1996. The same arguments are nowadays raised against the granting of permanent normal trading relations to China by the American Congress.

<sup>4</sup>We refer to Cuyers and Kerremans (1998), for different perspectives on social dumping and social competition.

<sup>5</sup>For a discussion of this concept see, for instance, Ethier (1987).

<sup>6</sup>See Bocard et al. (2000) for a political economy model studying the interaction between comparative advantage and social protection.

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