



# Trade Openness, Foreign Direct Investment and Child Labor

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**Summary.** — The skeptics of globalization argue that increased trade openness and foreign direct investment induce developing countries to keep labor costs low, for example, by letting children work. This article argues that there are good theoretical reasons why globalization might actually have the opposite effect. We test this with various measures of child labor and provide the first analysis of foreign investment in addition to trade. We present evidence that countries that are more open to trade and/or have a higher stock of foreign direct investment also have a lower incidence of child labor. This holds for the labor force participation rate of 10–14-year old children, the secondary school nonattendance rate and a count measure of economic sectors with child labor incidence as the dependent variables. Globalization is associated with less, not more, child labor.

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## 1. INTRODUCTION

Child labor is problematic on a number of counts, ranging from the welfare, health and physical integrity of the affected children to downward pressure on adult wages (Arat, 2002). ILO (2002a, p. 16) estimates that in 2000 about 211 million children aged 5–14 years old have been engaged in some form of economic activity globally. Of these, only 25 million are deemed as acceptable by the standards set by various ILO conventions and recommendations (mainly light work by children aged 12–14 years old).

In recent years the impact of globalization on the incidence of child labor has started to spark both public and academic debate, and has become an issue that invokes passion because it brings together people concerned about the exploitation of children on moral and ethical grounds and organized labor interested primarily in protecting jobs (Basu, 1999; Grote, Basu, & Weinhold, 1998; Srinivasan, 1998). We will

argue that theoretically globalization, defined as increased trade openness and penetration by foreign direct investment, can have both positive and negative effects on the incidence of child labor in developing countries. Like most researchers we will focus on these countries since child labor takes place mainly within them (ILO, 2002b). We will also present strong and robust evidence that more “globalized” developing countries have a lower incidence of child labor than those that are less open to

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trade and less penetrated by foreign direct investment.

We improve upon the three main existing empirical cross-national studies on the subject, namely Shelburne (2001), Cigno, Rosati, and Guarcello (2002) and Edmonds and Pavcnik (2004), in two important ways: First, unlike these studies that mainly address trade openness, we look also at penetration by foreign direct investment (FDI) defined as the stock of FDI over gross domestic product (GDP). Rather than trade openness alone, FDI is often directly accused of engaging in exploitative activities as such notorious cases involving Nike exemplify (Grote *et al.*, 1998). Second, like most studies we use the labor force participation rate of 10–14-year old children as the dependent variable in our main estimations, but we also test the robustness of our results on three other dependent variables that capture different aspects of the child labor problem. One of these has never been examined in this context and measures the number of economic sectors in developing countries, in which evidence for child labor can be found. The other two measure the primary school and the secondary school nonattendance rates.

The article is structured as follows: Section 2 discusses the fundamental determinants of child labor. Section 3 addresses in some detail the impact of globalization. Section 4 reviews existing empirical evidence. Section 5 describes the research design for our own study, results of which are discussed in Section 6. Section 7 concludes.

## 2. THE FUNDAMENTAL DETERMINANTS OF CHILD LABOR

To many people in developed countries it is shocking and morally repulsive that parents would willingly send their children to work. Case studies show, however, that it is often impoverished parents that send their children to work in order to survive as a family (Grootaert & Kanbur, 1995). Even altruistic parents who care about the welfare of their children can thus be forced to see their children as a source of income (Basu & Van, 1998). As Ahmed (1999) has put it: “There is by now a virtually unanimous view that poverty is the main, although not the only cause, of child labor.”

Despite extreme poverty, parents might not want to send their children to work full-time.

If they are hit by a temporary economic crisis, however, then the additional income from child labor could be essential for survival. In principle, short-run economic setbacks can be sustained through borrowing money. But poor parents will often face binding credit constraints, and whilst they are unable to borrow money they are able to send their children to work (Baland & Robinson, 2000). Child labor thus functions as a mechanism for consumption smoothing. But what might have started as temporary work can translate into more permanent employment if the children lose their right to attend school, lose interest in school, or lose even their capability to pursue education.

If we assume selfish instead of altruistic parents, then children will be sent to work if the payoff to parents from such work is higher than the potentially larger, but uncertain and future return of sending the children into education in order to acquire better skills. Credit market constraints play again an important role here as investment in education is expensive, the cost of which is only recovered in the future. Selfish parents will also consider that whereas they will have more or less full control over any income from the child labor, they might not be able to control the future income of their better educated children once they enter the labor force as adults. More altruistic parents might derive utility from knowing that their better educated children will lead a better life as adults in the future even if they do not participate in the higher income of their grown-up children.

Schooling costs and conditions and the availability and quality of education options have an impact upon the demand for child labor in changing the opportunity costs of sending children to work rather than to school. In particular, a household’s decision whether to withdraw a child from primary school is influenced by the availability and quality of secondary school options. This is because one of the benefits of primary school education is that it provides entrance to higher levels of schooling. Higher public expenditures on education lower the costs for the poor, in particular for sending their children to school and should therefore lower the incidence of child labor. Higher school quality raises the return from education. Many studies show that parents who have achieved a higher level of education are also more likely to ensure that their children similarly receive a good education (Basu & Tzanna-

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