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The Shanghai Effect: Do Exports to China Affect Labor Practices in Africa?

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Summary. — To investigate whether Africa's exports to China influence labor practices in Africa, we reconsider the debate over trade's influence on regulatory standards in exporting countries. The first generation of trade–regulation scholars asked whether high levels of exports influenced regulatory standards of exporting countries, with inconclusive results. The second generation of scholarship focused not on how much a country exported but to whom it exported, identifying a "California Effect" by which firms and consumers in (mostly developed) importing countries projected their high regulatory standards on less developed export partners. Structural change—especially the rise of China as a major importer—poses a challenge to these optimistic findings. Drawing on insights from the analysis of compositional data, this paper introduces a third generation of trade–regulation research, which suggests examining not only with whom a country trades, but also how the composition of markets in a country's export basket reshuffles over time. Specifically, we explore the possibility of a "Shanghai Effect" whereby African countries begin to reflect the lower labor standards of China, which has emerged as a major destination for their exports. We show that when a country increases exports to China, the net effect on domestic labor standards depends critically on the labor practices of other export destinations compositionally displaced by China exports. Our analysis of a panel of 49 African countries for the period 1985–2010 produces a small continent-wide estimate of China's negative influence on African labor practices. In-sample simulation at the country level uncovers a moderate Shanghai Effect for a handful of countries only.

Key words — labor rights, globalization, compositional data, Africa, China

1. INTRODUCTION

Do exports to China influence labor practices in African countries? International trade is widely recognized as an important mechanism for the cross-country diffusion of regulatory standards, norms, and industrial practices. Scholars suggest that importing countries can exploit market leverage to project their regulatory preferences onto their exporters abroad. Most major export destinations located in the Global North have higher regulatory standards than exporting countries in the developing world, but China, an emerging destination for a large share of African goods, has standards that are markedly lower than other major importers and even many African exporters. [1]

We examine the possibility of a "Shanghai Effect"—the effect of exports to China on the domestic regulatory standards and industrial practices of exporting countries—that undermines labor practices in African countries catering to China's growing demand for resources and products. Scholars note the rise in the importance of China as the destination for Africa's exports (Mayer & Fajarnes, 2008). Yet there is no mention of how China's rising trade salience might influence regulatory standards in Africa. Instead, this discussion tends to focus on the role of Chinese foreign direct investment (FDI) in Africa, causing some to confuse trade with FDI. To the best of our knowledge, ours is the first quantitative study to systematically examine the consequences of African exports to China on African labor practices. In some ways, this is a tougher test of the influence of international economic context on labor rights in exporting countries. FDI has a direct impact on production and labor practices because the foreign investor manages the production facility. In contrast, trade has an indirect impact via supply chain linkages only. Hence, we believe this study offers powerful insights to assess how the increasing salience of China as an importing economy (as opposed to a foreign investor) shapes labor practices across African countries.

As a broader contribution to the trade–regulation debate, we introduce a compositional data approach to the analysis of export-context effects on exporting countries. Using new, compositionally appropriate interpretations of export-context models, we show that when a country increases exports to a specific major importer, the net effects of that trade on domestic labor standards depend not only on the major importer's labor standards, but also on the labor practices of other export destinations displaced by the new trade.

Our paper speaks to the literature on how trade (more specifically, exports) influences regulatory standards and industrial practices such as labor, environmental, and human rights in exporting countries. First generation trade–regulation studies focused on the role of export salience, assuming that exposure to global markets influences regulatory standards across exporting countries. This literature developed conflicting arguments and reported inconclusive results. Some found that high export salience leads to lower standards in exporting countries because firms in developed countries began outsourcing their products from developing countries to lower their production and labor costs. Seeking to retain and attract

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export opportunities, developing countries competitively lowered their regulatory standards, leading to races to the bottom. At the same time, developing country firms seeking a foothold in global markets sought to leverage their relative cost advantages by adopting abysmal labor practices.

Against this negative view of trade, others suggested that exposure to global markets created incentives for exporting firms to adopt superior production practices across countries (Perkins & Neumayer, 2007). These authors pointed to East Asian countries whose export-led growth led to improvements in domestic regulatory standards. They also noted that prior to the 1990s, regulatory standards tended to be much higher in the open economies of Western Europe compared to the closed economies of Eastern and Central Europe and the former USSR. From this perspective, exposure to the global economy creates incentives for exporting firms to upgrade their technology and seek superior quality. This engagement also creates avenues for the exchange of ideas and norms about appropriate public policies and corporate conduct, all of which leads to improvement in industrial practices and regulatory standards.

Second generation studies suggested that a focus on overall exports misspecified the variable of interest. What mattered for regulatory diffusion was not how much a country exported, but to whom. These studies disaggregated overall exports, recognizing that export-led regulatory diffusion reflected the standards of the destinations to which countries' goods were exported. The key mechanism was the influence exercised by firms and consumers in importing countries on the exporting countries, often called the California Effect (Vogel, 1995). Key actors in importing countries (such as environmental groups, human rights groups, and trade unions) pressured importing firms to improve on these counts, who in turn influenced their suppliers abroad. Scholars report on the positive influence of bilateral export pressures on environmental issues (Perkins & Neumayer, 2007), labor issues (Greenhill, Mosley, & Prakash, 2009), and human rights (Cao, Greenhill, & Prakash, 2013) in developing countries.

Because the largest export destinations are located in developed countries with high regulatory standards, the second-generation literature tended to report optimistic results for export-led diffusion. Unpacking the composition of export context that lies at the heart of second-generation models reveals important unexamined questions. First, suppose that a country's largest export destinations maintain low or even declining standards. Might we not observe a "Shanghai Effect" that reverses the optimistic California logic by diffusing low labor standards? Second, suppose that over time, a country shifts its exports toward markets with lower standards. To what extent will labor practices adjust to the new market context that exporters face? Third, assume that a country historically had "artificially" high labor standards because it exported to jurisdictions with higher labor standards. Now suppose this foreign pressure is removed because export markets have shifted to a new destination that neither has high labor standards nor demands its exporting countries establish such standards. Even without the active diffusion of low standards from the new importing destination to the exporting country, might the mere replacement of high-standards export jurisdictions (such as the EU and the US) with low-standards importers (such as China) lower domestic standards in exporting countries by reducing the salience of pressure from so-called "Californias"?

To systematically answer these questions and further work out the logic of the California Effect, we introduce a third generation approach to trade–regulation studies that takes seriously the country-specific compositional nature of export context. We examine not only to whom a country exports, but also how the changes over time in the saliences of export markets with different standards influence the regulatory standards of the exporting country. Like any set of variables that sums to a fixed constraint, the percentage of exports sent to each jurisdiction in a country's export portfolio are a form of compositional data (Aitchison, 2003): when a country sends a greater percentage of its exports to a given market, it must logically reduce the share of exports to some of its other partners. [2] And because aggregate measures of export context use the percentage composition of exports to weight exposure to other countries' labor standards, they are subject to a similar compositional logic. Therefore, to interpret the export-context effects of an increase in exports to one country, we must "unpack" the aggregate estimates of export context effects in second generation models. In doing so, we make two contributions. First, we show that the aggregate results reported by second generation studies hide considerable variation in the trade–regulation relationship across exporting countries that should be disaggregated. Second, we show that this diversity is a direct result of variation in the compositional structure of exports in each country-period, and can only be fully understood by working through the tradeoffs that occur when the salience of one export market rises at the expense of another.

Empirically, we assess how rising exports to China—now Africa's biggest trading partner overall (Johnston, Morgan, & Wang, 2015)—have influenced labor practices in African countries, even after controlling for inward foreign investment that may have independently influenced these practices. Although we find small to moderate aggregate estimates of China's negative influence on African labor practices, continent-level estimates of the Shanghai Effect mask considerable variation at the country level. Both China export salience and tradeoffs between the different export contexts induced by each country's composition of exports matter greatly in specific cases. Only in countries where exports to China have increased dramatically *and* have displaced exports to the high labor standards countries of the West do we observe noteworthy Shanghai Effects.

The next section of this paper reviews the trade–regulation literature and introduces the circumstantial evidence for a large, Africa-wide Shanghai Effect. The third and fourth sections explain the logic of compositional data and show how the export context variables popular in second generation studies can have strikingly different substantive implications depending on the compositional assumptions made in their construction. The fifth section explains our estimation strategy, the sixth and seventh sections present our results, and the final section concludes.

2. REGULATORY RACES TO THE TOP AND BOTTOM

Whether a focus on exports hurts or helps labor rights has been extensively debated in the globalization literature (Caraway, 2009; Elliot & Freeman, 2003; Greenhill *et al.*, 2009; Mosley & Uno, 2007). Globalization pessimists suggest that because developing countries can create comparative advantage by keeping labor costs low, both governments and exporting firms have incentives to suppress labor rights. Exports contribute to economic growth and generate resources for the state in a variety of ways. Hence, the interests of exporters and ruling elites coincide, which leads to suppression of labor rights.