

# **The Boomerang Tariff: *Financing Development Through Fair Trade***

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## **ABSTRACT**

This paper explores the concept of applying a ‘boomerang tariff’ to imported goods which are produced in sub-standard conditions leading to social or environmental impacts. The amount of boomerang tariff on a good is based on the value of these impacts, which are externality costs unpaid for by the manufacturer, and thus accounts for the full cost of production, equivalent to a Pigouvian tax. The boomerang tariff’s primary objective is to generate revenue to fund development programs which address the social and environmental impacts associated with sub-standard conditions of production, that is, to compensate for the ‘embodied pollution’ or ‘embodied misery’. The boomerang tariff model is also useful as an educational tool to increase the general public’s awareness of the issues surrounding production in different countries.

A comprehensive case study of the Indonesian footwear industry, which focuses specifically on the Nike brand, is used to illustrate the application of the boomerang tariff. The major steps involved in applying the boomerang tariff are outlined. The case study summarises the conditions of production and the negative impacts they have on individual workers and communities. The case study contains illustrative estimates of the boomerang tariff level that could be applied and the amount of revenue this would generate. The development opportunities provided by redistributing this revenue to Indonesian communities are also discussed.

This paper acknowledges the potential challenges and criticisms the boomerang tariff model raises and discusses these issues in the concluding section. The boomerang tariff model is presented as a workable solution to increase sustainable development in developing countries and promote fairer global trading practices. However it is only one of many campaigns that address problems associated with the rules of international trade and the consequences of unequal conditions of production. The boomerang tariff model is a solution that strongly complements existing campaigns, and does not seek to replace them.

This paper represents a starting point for further researching the proposition and articulating its application in a real world policy context.

## INTRODUCTION

This paper argues that some key imbalances in the global trading system can be addressed through applying an import tariff on goods produced in sub-standard conditions. Currently, the terms of world trade greatly favour developed nations and place pressure on under-developed countries to reduce labour and environmental standards of production in order to remain competitive. Coined the ‘boomerang tariff’ because of its redistributive function, this model is a variant of a ‘social tariff’. It aims to account for the full human and environmental costs of production and removes the incentive for transnational corporations to seek out countries with the worst conditions of production.

Primarily the boomerang tariff is a development financing mechanism that increases redistributive and social justice. The tariff revenue is hypothecated, or allocated, to fund overseas development projects to address the human and environmental problems associated with sub-standard production conditions. Importantly, the boomerang tariff is not intended as a protectionist or revenue raising activity for the importing country, unlike traditional tariff instruments which have historically been motivated by national self-interest.<sup>1</sup> In contrast, the boomerang tariff model adopts an international human rights and social justice approach to trade by providing direct development assistance to address the adverse impacts that arise when the full costs of production are not met. This requires moving away from a self-interested perspective on the part of both individual nations and individual consumers. This approach strengthens calls for shifting towards a truly globalised vision of financial, social and environmental responsibility. The concept of globalisation ultimately requires the transcendence of national borders, not only to enable free capital flows and the closer integration of national economies, but also to provide necessary public services and address critical environmental problems.

This paper presents the argument for applying the boomerang tariff model within the current system of international trade, discussing the importance of this step and what outcomes and benefits it will yield. The paper firstly outlines the conceptual framework of the boomerang tariff proposal and provides theoretical support for this argument. This involves highlighting the main features of the boomerang tariff, comprehensively evaluating the proposition through comparison to similar proposals and providing an understanding of the context in which this proposal would be applied. The paper goes on to present a case study, applying the boomerang tariff model to the production of Nike footwear in Indonesia. This case study demonstrates the process of implementing the boomerang tariff, outlines some of the benefits that could be expected and discusses the challenges involved in applying the model. This paper concludes by indicating future directions for the research.

## THE BOOMERANG TARIFF MODEL

The production costs for many goods in developing countries are often artificially depressed because the full social and environmental costs of production are not accounted for. That is, production conditions are not adequately regulated, generating social and environmental impacts. This paper refers primarily to the boomerang tariff with regards to developing countries, however the tariff could also apply to some developed countries in which many of the problems identified are also apparent.

Some argue that low labour costs and poor social conditions, limited environmental restrictions and widespread tax concessions for exporters allow exporting countries to maintain their comparative advantage in the global marketplace. However, when the production of goods incurs welfare costs above and beyond the monetary cost of production,

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<sup>1</sup> W. Corden, ‘The Theory of Protection’, Oxford University Press: London, 1971, pp. 1.

the theory of comparative advantage simply does not hold.<sup>2</sup> Rather than regarding such factors as a form of comparative advantage, the boomerang tariff accounts for the costs of associated social and environmental impacts.

These “hidden” costs, commonly known as externalities, refer to the additional non-monetary costs that are borne by third parties as a result of a given economic activity.<sup>3</sup> Two common externalities that arise during the production process are the cost of environmental damage through resource depletion or pollution, and the cost of employees’ unmet basic needs as a result of low wages, poor working conditions and inadequate public infrastructure. The English economist A. C. Pigou first suggested this notion of ‘internalising’ external costs by applying a tax on every additional unit of production. This concept was originally applied to environmental damages, however, we argue that externalities can also include reduced individual welfare and community wellbeing.

The presence of social and environmental externalities corresponds to an implicit production subsidy, because production is effectively cheaper than it would otherwise be. As in the case of financially subsidised goods, this can result in ‘dumping’ of products on foreign markets. The term ‘social dumping’ was coined in the 1920s to describe the export of products at prices below what the costs of production would be if international labour standards were enforced.<sup>4</sup> It could be said that such goods contain ‘embodied misery’. Thus, the boomerang tariff is in some ways analogous to the ‘countervailing duties’ which are already permitted under WTO rules. Countervailing duties on dumped imports aim to raise their market price to match the cost of production.

In addition to internalising “hidden” social and environmental costs, the boomerang tariff has the primary objective of generating funds to address the identified social and environmental impacts. The revenue from the tariff would be hypothecated, involving a pre-commitment by the government of the importing country to allocate it to a specific purpose, placing the cost of this development assistance on those who benefit from the consumption of the goods in question.<sup>5</sup>

Economists and treasury officials often argue against the hypothecation of taxation revenue on the grounds that it does not allow policy to react to changing circumstances or changing priorities.<sup>6</sup> Providing a clear rationale for redistribution of the revenue raised is a major advantage of this approach, which effectively minimises the political influence on the allocation of hypothecated funds.<sup>7</sup> However there is no reason, in the case of the boomerang tariff, to predetermine the required levels of revenue or expenditure, since there are no domestic political commitments associated with the tariff. On the contrary, when the conditions of workers in the exporting country improve as the expected result of the tariff, the tariff levels would be reduced accordingly.<sup>8</sup>

The suggested recipients of the revenue raised by the tariff would be local non-government organisations (NGOs), funded to provide specific improvements in services, living and working conditions and environmental quality for the local community. An administrative body would be responsible for distributing the revenue in order to ensure transparency and accountability. Such an administrative body would be under multilateral control and be

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<sup>2</sup> C Hamilton, ‘The Case for Fair Trade’, *Journal of Australian Political Economy*, vol. 48, Dec 2001, pp. 61

<sup>3</sup> *Ibid.*

<sup>4</sup> S. Charnovitz, ‘Promoting Higher Labour Standards’, *Washington Quarterly*, vol. 18, Summer 1995, p. 167.

<sup>5</sup> M Spackman, ‘Hypothecation: A View from the Treasury’ in O’Riordan, T. (ed), *Ecotaxation*, Earthscan Publications: London, 1997, p. 46.

<sup>6</sup> S Smith, ‘Environmental Tax Design’ in O’Riordan, T. (ed.) *Ecotaxation*. Earthscan Publications: London, 1997, p. 30.

<sup>7</sup> *Ibid.*, p32.

<sup>8</sup> In this respect the hypothecated funds are similar to the cohesion funding that applies to economically disadvantaged countries and regions in the European Union.

subject to independent scrutiny. The Global Environment Fund<sup>9</sup> (GEF) is an example of an existing multilateral body that administers funding for a specific purpose. The funds generated by the boomerang tariff would be administered through an open tendering process to grant contracts to NGOs which meet specific funding criteria. The integrated needs assessment process described below would be used to identify and cost the specific development objectives for each project. This contracting model for the provision of overseas aid funding is consistent with the trends in the sphere of international development.

It will be necessary to identify the particular exports from each country that the tariff will apply to and determine the appropriate levels of boomerang tariff for different goods. An integrated needs assessment could provide an estimate of the scale and impact of social and environmental costs associated with the production of certain export goods. A single integrated set of indicators would be used to measure both social and environmental impacts simultaneously. Measures on these indicators would be compared to defined standards and benchmarks, to estimate the extent of need in each situation. Both the indicators and the benchmarks would be drawn from current and future reports by multilateral organisations, such as the United Nations, the International Labour Organisation and the World Bank. Using indicators and benchmarks accepted by the international community is necessary to ensure that the tariff operates in an impartial and equitable manner. Similarly, the needs assessment would be applied to all countries, not just developing countries. Estimates of the economic value of social and environmental impacts could be based on the cost of past NGO programs to address such impacts in other similar contexts. Alternatively, an acceptable level for the tariff could simply be negotiated without having completed an integrated needs assessment.

The application of the integrated needs assessment process is most straightforward in the case of Export Protection Zones (EPZs). They are geographically defined zones in which exporting manufacturers receive special concessions from the government as incentives to attract foreign investors. Many of the EPZs are on the scale of full-sized urban and industrial developments, complete with the provision of modern infrastructure. However, immediately outside these zones, the local communities suffer the negative impacts of industrialisation without many of the benefits. Since the EPZs largely operate as enclosed microcosms, it would be highly appropriate to apply the boomerang tariff to goods produced in these areas.

A major advantage of the boomerang tariff model is that it can be applied bilaterally as an effective development financing mechanism. For example, Australia could impose this tariff on imports and raise a considerable amount of money towards development in the country of production, without waiting for support or agreement from other developed countries. Ultimately, full multilateral application of this tariff would generate the greatest outcomes. If the boomerang tariff were applied multilaterally, the incentive to gain a competitive edge by not paying the full costs of production would be reduced in the long term. A related longer-term benefit of the tariff is improved allocation of investment resources as a result of more accurate market signals, which reflect the full costs of production. However, the legitimacy of the boomerang tariff model primarily rests upon its demonstrable effectiveness as a development financing mechanism to address the social and environmental impacts experienced by those who work to produce the goods we import.

### ***Relationship to other approaches***

The boomerang tariff is only one of many proposals, and campaign elements, that address problems associated with the rules of international trade and the consequences of unequal conditions of production. Many Australian organisations work on such campaigns, including

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<sup>9</sup> The GEF is an international investment management firm which invests in companies that make positive contributions to environmental quality, human health and the sustainable management of natural resources (Global Environment Fund (2003), 'Investing in a Cleaner and Healthier World', p.1).

Oxfam Community Aid Abroad, Aid/Watch, AFTINET, ATTAC, the Fairwear campaign, and Global Trade Watch. The boomerang tariff model is a concept that would strongly complement these existing campaigns. It provides another lens for viewing the same problems, in the hope of inspiring the development of workable solutions. The development and implementation of such solutions should ideally involve the full and equal participation of the affected countries.

The boomerang tariff holds similarities with fair trade campaigns that encourage consumers to purchase goods that are produced under better conditions. Such goods are usually more expensive, corresponding to the full cost of production. Consumers are encouraged to voluntarily pay slightly more for their coffee, tea or clothes in the knowledge that producing these goods did not harm workers and the environment. The criteria for deciding what is a 'fairly-traded good' include the labour conditions maintained by the producer and the adoption of mechanisms to minimise environmental damage.<sup>10</sup> Specific criteria are developed for each category of goods by international organisations such as the Fair Trade Labelling Organisation (FLO), which also monitors and controls participating producers and traders.<sup>11</sup> In the local region, the Fair Trade Association of Australia and New Zealand assists with these and other functions, including identifying fair trade producers particularly in the Asia-Pacific region.<sup>12</sup> The international market in fairly-traded goods has grown to \$500 million per annum, with 500,000 small scale farmers obtaining an estimated extra \$40 million as a result.<sup>13</sup> The imposition of a boomerang tariff would ensure that all imported goods are "fairly traded".

The boomerang tariff also holds similarities with the "social clause" and "social tariff" campaigns. In recent years, a broad international consensus has emerged that a set of core labour standards must be defined and recognised, and that these standards should not be used for protectionist trade purposes.<sup>14</sup> The "social clause" campaign sought to incorporate core labour standards in trade agreements at the World Trade Organisation (WTO). The "social tariff" model proposed an import tariff on goods produced in countries which fail to comply with ILO core labour standards, and in this respect was similar to the boomerang tariff. An alternative formulation of the social clause by the European Union proposes a 'carrot' for countries which can demonstrate they meet core labour standards, in the form of additional trade preferences.<sup>15</sup>

Whilst encouraging developing countries to enforce social and environmental standards, these approaches are sometimes viewed as attempts to protect the jobs of workers in industrialised countries, at the expense of those in poorer countries.<sup>16</sup> Representatives from some developing country NGOs and worker organisations have argued that attempts to reform the existing system are liable to carry hidden agendas or be easily co-opted.<sup>17</sup> Nevertheless, surveys conducted by the National Key Centre in Industrial Relations at Monash University found that most union officials and activists from developing countries support the linkage of trade and labour standards.<sup>18</sup> They also refer to past empirical research that suggested most

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<sup>10</sup> European Commission 'The Common Agricultural Policy: Attitudes of EU consumers to fair trade bananas', Directorate-General for Agriculture, 1997, Brussels.

<sup>11</sup> European Commission 'The Common Agricultural Policy: Attitudes of EU consumers to fair trade bananas', Directorate-General for Agriculture, 1997, Brussels.

<sup>12</sup> Fair Trade Association of Australia and New Zealand, 'About Us: The Role of the Fair Trade Association of Australia and New Zealand'.

<sup>13</sup> J Vidal, 'The West's Taste for Guilt-Free Foods is Helping to Increase Sales by 25% a Year', *Guardian Weekly*, September 11-17 2003, pp. 8.

<sup>14</sup> OECD, 'Policy Brief: International Trade and Core Labour Standards', *OECD Observer*, October 2000.

<sup>15</sup> OECD, 'Policy Brief: International Trade and Core Labour Standards', *OECD Observer*, October 2000.

<sup>16</sup> T Bramble, 'Solidarity versus Sectionalism: The Social Tariff Debate', *Journal of Australian Political Economy* – Special Issue on Globalisation and Australia, 48, Dec 2001, pp. 73-114.

<sup>17</sup> N Bullard, 'It's Time for 'Uncivil' Society to Act', *FOCUS*, 2 April 2000, pp. 3.

<sup>18</sup> G Griffin, C Nyland and A O'Rourke, *op. cit.*, pp. 20.

NGOs, research centres and trade unions from developing countries supported introduction of a social clause.<sup>19</sup>

Conditional support for a social clause among Southern NGOs and unions was also expressed at the 1996 meeting of the Democratic Labour Caucus in Manila.<sup>20</sup> In an official statement participants supported a 'conditional yes' on the inclusion of a social clause in multilateral trade agreements within the WTO.<sup>21</sup> Their response explicitly rejected a framework of trade without social responsibility. Participants argued that the implementation of the social clause must incorporate a number of conditions. These conditions reflect the various practical concerns that developing country NGOs have expressed in response to the social clause proposition. They show that core labour standards can be linked to trade agreements in such a way as to benefit developing countries. The nominated conditions include:

- Assistance and incentives to improve labour conditions and sufficient compliance time should be provided for violators, rather than being punished by sanctions.<sup>22</sup>
- The ILO should be primarily responsible for monitoring, adjudicating and enforcing labour rights.<sup>23</sup>
- The WTO system of representation should be changed to give developing countries a strong say in social clause adjudication.<sup>24</sup>
- Additional trade incentives and trade preferences would be encouraged and sufficient compliance time given to violators.<sup>25</sup>

These criticisms make it apparent that any attempt to incorporate core labour standards into trade agreements must provide developing countries with adequate funding and reasonable timeframes for compliance. The boomerang tariff proposal is consistent with this, as its main thrust is to serve as a mechanism for applying principles of fairness and social justice. It has been suggested that a formal structure be established at the international level, involving both the WTO and the ILO, to "enable a full examination of the relationship between trade, employment and core labour standards".<sup>26</sup> Such a body would be in a position to develop appropriate mechanisms such as the boomerang tariff, with the equal participation of developing countries.

Protection of domestic workers and local industries in the importing country is not one of the aims of the boomerang tariff model. It is primarily a development financing mechanism<sup>27</sup> which generates funds to actively reduce impacts on workers and the environment in developing countries. In this respect the boomerang tariff is more akin to the Tobin Tax, which raises money for development goals by applying a low fixed tax rate to certain highly speculative financial transactions. This tax is designed to curb speculation in foreign currency exchange and it is argued that the revenue collected should be used for genuine social development, thus incorporating a redistributive element.<sup>28</sup>

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<sup>19</sup> Egger, M. & Schumperli, C. (1996). *Clause sociale, Sondage au pres de ONG et syndicats europeens et du Sud*, Lausanne, Pain pour le prochain et Declaration de Berne (mimeo).

<sup>20</sup> Ibid, pp. 6.

<sup>21</sup> Participants included 26 signatories from trade unions and NGOs from Hong Kong, South Africa, the Philippines and Germany.

<sup>22</sup> SALIGAN, 'A Conditional "Yes" on the Issue of Social Clause in Trade Agreements', The National Conference on the Social Clause, 16-18 October 1996, Manila.

<sup>23</sup> Ibid.

<sup>24</sup> Ibid.

<sup>25</sup> G Griffin, C Nyland and A O'Rourke, op. cit., pp. 6.

<sup>26</sup> ICFTU, 'Trade Union Statement on the Agenda for the 5<sup>th</sup> Ministerial Conference of the World Trade Organisation', 2003.

<sup>27</sup> For a review of other development financing mechanisms see Clunies Ross (2002).

<sup>28</sup> War On Want, 'The Tobin Tax: Win-win for the World's Poor'.

## CASE STUDY: FOOTWEAR PRODUCTION IN INDONESIA

### *Introduction*

This case study illustrates the implications of applying the boomerang tariff model to the Indonesian footwear industry. It describes the various stages of applying the model, and discusses the associated benefits and challenges. The case study provides a general overview of the various costs involved in production and thus helps to identify the aspects of work that would need to be considered when assessing the social impacts associated with this type of production. The boomerang tariff is designed to address these problems by redistributing the funds raised from footwear consumers to the communities involved in footwear production. This would fund specific programs that focus on improving working conditions, safety measures and other workplace practices and providing necessary infrastructure and services.

The focus has been directed to the textiles, clothing and footwear (TCF) industry because it is a good example of a globalised production process, where materials are sourced from one country, assembled in another and then purchased as finished products abroad. The growth of this industry has been strongly characterised by shifts in cheap labour sources around the globe (see Appendix A). The industry is characterised by contractual agreements between corporations and sub-contractors. This in effect distances the corporation from the production conditions, providing them with a stronger bargaining position and encouraging intense cost competition amongst sub-contractors.

Nike footwear has been chosen as an example due to the availability of information for this manufacturer, which in part derives from the high profile of the campaigns relating to this brand. It is recognised that other, less well known, footwear brands have similar practices in developing countries.

Within developing countries, the cost of employing labour is held artificially low because of reduced wage levels and violation of international labour standards. Workers in these countries are at the bottom of the global 'production pile', they are the most expendable of resources and not compensated sufficiently for their labour power. The cost of production should incorporate the cost of providing resources to meet the needs of these employees, reflecting the full labour costs of the productive process. Sharon Beder encapsulates this notion of recognising workers rights through increasing corporate social responsibility in developing countries:

"It's not about better conditions than a decade ago, it's not about conditions better relative to if they were working in rural areas of their nation. What it is about is companies with the capacity to fulfil the basic needs of their workers- to treat them with the basic dignity they'd be required to if producing in western nations- but who choose not to, merely because they can, due to their extremely strong bargaining position [because of ineffective government regulation and intervention, desperate workers and threats of capital flight]."<sup>29</sup>

### *Why Nike?*

The decision to use Nike footwear production as a case study is based on practical and theoretical convenience, which is held to outweigh any disadvantages associated with using such a widely publicised case study. This paper is not in any form an adjunct or extension of existing anti-sweatshop campaigns. The concept of the boomerang tariff is being investigated on its own merits.

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<sup>29</sup> S Beder, 'Nike continues to Greenwash Sweatshop Labour', *The Ecologist*, April 2002

Nike is a highly appropriate example as its development as a transnational producer strongly parallels the general global movements within the manufacturing industry.<sup>30</sup> Nike can be held to typify industry practice and is thus an appropriate focus to use in applying the boomerang tariff concept. Nike is both an industry leader and the largest producer in the international sports shoe market, with a 37% share of the footwear market, and thus has great capacity to ensure that factory workers rights are protected.<sup>31</sup> Furthermore, due to heightened international interest in the Nike campaign by various stakeholders, abundant primary evidence exists about factory conditions, the company's cost structure and other production related issues. Importantly, other footwear companies and major industry players including Reebok, Slazenger and Adidas have been identified as engaging in similar exploitative practices. Indeed, it is often the case that the same Indonesian factories obtain contracts from multiple transnational corporations.

The major problem in using Nike as a case study is the automatic associations that have in recent times become inextricably linked to the Nike brand. Phil Knight, the CEO of the company, acknowledged in 1998 that "the Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse."<sup>32</sup> This association has been facilitated by the media's embrace of the issue<sup>33</sup>. In response to this attack, Nike has poured its marketing expertise into developing its own corporate reputation as a company that is concerned about working conditions in its contractors' factories.<sup>34</sup>

### *Indonesia's Clothing and Footwear Industry*

Nike wields enormous influence and is a dominant competitor in the global marketplace employing 550 000 people around the world, in 700 factories in 50 countries.<sup>35</sup> In 1998, Indonesia produced 84 million Nike shoes a year – more than any other country.<sup>36</sup> Younger women dominate Nike's workforce, with generally at least 75% of a factory's workforce comprising of female employees (See Appendix B for greater detail). Only a shrinking fraction of what the consumer pays for a product accounts for the cost of producing it. Out of that reduced cost of production, the proportion that pays workers' wages is itself shrinking in most developing countries (See Figure 1).<sup>37</sup> There are varying estimates of labour costs as a proportion of total costs and these differ from country to country (see appendix A). For example, Nike estimates that the cost of labour that goes into producing a shoe represents about 4% of the good's retail price.<sup>38</sup>

The textile, clothing and footwear (TCF) industry is highly labour intensive. Clothing production inputs are predominantly raw materials, which are transformed into finished goods by labour. Labour can represent anything up to 80% of the finished products value (ILO, 1995). Therefore, it is of concern that workers and the communities that they live in are not being fully compensated for their value adding contributions to this productive process. The global fluidity of TCF production reflects the incessant pursuit for cheap labour and

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<sup>30</sup> In the 1960's Nike's production was concentrated in Taiwan and South Korea whose low levels of education, low employment age, lack of alternative employment, lack of long term employment prospects and anti-union climate combined to produce a low-wage labour environment. However, in the 1980's a second generation of even lower wage countries emerged namely Indonesia, Thailand, Vietnam, Bangladesh and China. More recently, reports have uncovered Nike investigations into the viability of production in Cambodia, North Korea and India (Brookes and Madden, 1995: 6).<sup>30</sup>

<sup>31</sup> Maquila Solidarity Network, 'Nike Campaigns: Is Nike Being Unfairly Singled Out'

<sup>32</sup> B Herbert, 'Nike Blinks', New York Times, 21 May 1998.

<sup>33</sup> Between 1995 and 2000, more than 1500 news reports and opinion columns were written about the scandalous working conditions within the third world factories producing Nike products (Klein, 2001: 366).

<sup>34</sup> S Beder, Op. cit.

<sup>35</sup> H Jensen, 'Low Pay, High Desire: A Tale of 2 Swooshes in Indonesia', Denver Rocky Mountains News, 2 July 2000, pp. 41A.

<sup>36</sup> Clean Clothes Campaign (1998) *Nike – A Code of Conduct which has Improved... on paper*. Newsletter 10 August 1998.

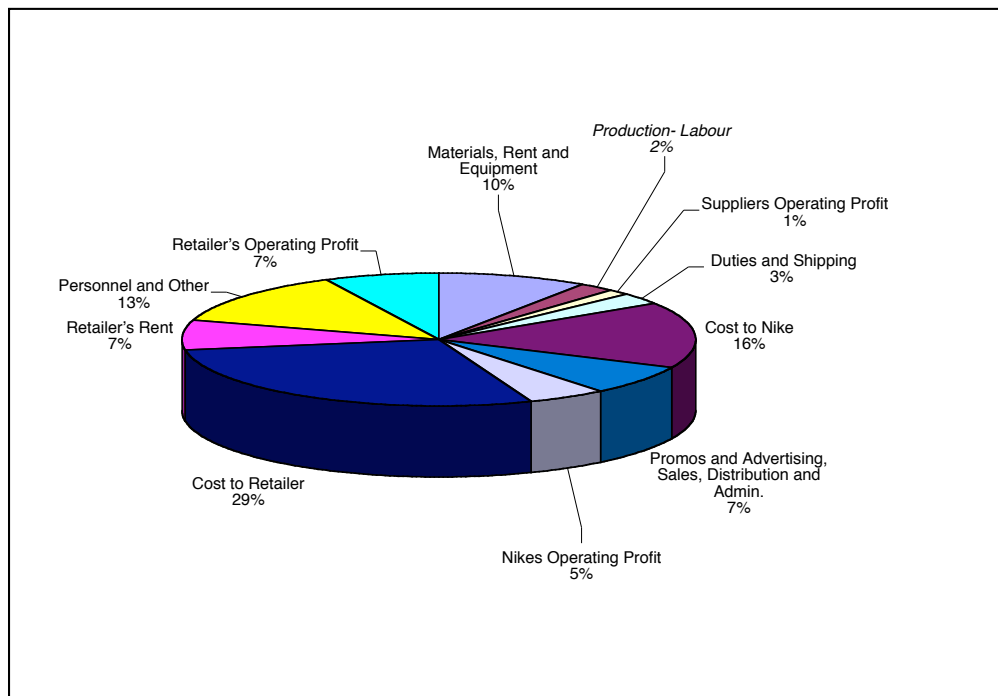
<sup>37</sup> Washington Post cited in T Connor and J Atkinson, 'Sweating for Nike: A Report on Labour Conditions in the Sport Shoe', Industry Community Aid Abroad Briefing Paper, vol. 16, November 1996.

<sup>38</sup> L Skenazy, 'Cashing in on Sweat of Workers Abroad', Philadelphia Inquirer, 23 August 2001.



conditions which place minimal onus on corporations to operate in an efficient and ethical manner.

**Figure 1: “Why it Costs US\$70 for a pair of Athletic Shoes**



## THE BOOMERANG TARIFF: A STEP-BY-STEP PROCESS

### *Step 1: Identifying the Problems with Nike Production in Indonesia*

This section will illustrate the nature of working conditions in Indonesian factories producing Nike goods, predominantly footwear, and identify the extent of the problems associated with this type of production. This will highlight the specific areas of need, the negative impacts that current conditions have on individuals within the community and the importance of implementing the boomerang tariff to generate positive and lasting change. The information used for this analysis has been sourced primarily from a series of Oxfam reports. Oxfam have produced three reports (in 1996, 2000 and 2002), which combine government data, Nike documents and interviews with workers. An account of working conditions in Indonesia which is posted on the official Nike website has also been incorporated, to highlight the disparity between official documentation and NGO reports.

The initial Oxfam report revealed that the primary concern of most workers was forced overtime. Workers were both physically and verbally harassed if they refused to work overtime and methods of public humiliation and torment were also used to instil shame in the offenders.<sup>39</sup> Since this initial investigation most workers are reported to be working less overtime than in peak periods in the past and many factories have also announced voluntary overtime above a certain number of hours.<sup>40</sup> Paradoxically, due to extremely low wage levels overtime is virtually “forced by nature” as workers need to supplement what is a meagre typical weekly wage if they are to sustain themselves let alone support a family.<sup>41</sup> Linda Lim, a student working in conjunction with Nike to ensure that Nike codes of conduct are adhered to and having a practical effect, visited two Nike factories in Indonesia and Vietnam and reported “many workers are actually attracted to the worst firms because of this opportunity for large amounts of overtime.”<sup>42</sup> This issue is linked to the problem of regulation, as Nike sub-contractors are predominately local entrepreneurs and therefore not subject to the same enforcement of national overtime limits as overseas firms.

Both wage levels and living standards of Nike factory workers remain unequivocally low. Nike’s investigation into wage levels in 2001 revealed that most Nike contracted workers were paid above the legal minimum wage. However the legal minimum wage level legislated by the government is admittedly below their own estimate of the living cost of a single male, thus forcing workers to rely on overtime to maintain a basic level of subsistence. Whilst the minimum wage was marginally increased in 2002, the potential gain to a worker was offset by increases in prices and a reduction in overtime worked for that same period.<sup>43</sup> In addition, many factories incorporate the provision of food or accommodation as part of the worker’s wage rather than as an additional benefit, further devaluing the productive capacity of labour. The provision of mainly dormitory style accommodation in the cities, combines incredibly cramped conditions with very few accessible facilities to create a lifestyle for workers that challenges basic living standards.<sup>44</sup> In many cases, factories provide their own dormitory facilities that appear to have been constructed to hold only half the number of people who actually reside there.<sup>45</sup>

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<sup>39</sup> T Connor and J Atkinson, ‘Sweating for Nike: A Report on Labour Conditions in the Sport Shoe’, Industry Community Aid Abroad Briefing Paper, vol. 16, November 1996.

<sup>40</sup> From peaks of 77 hours per week to an average of 45 to 60 hours.

<sup>41</sup> T Connor, *We Are Not Machines: Indonesian Nike and Adidas Workers*, Oxfam: 2002, pp. 19-20.

<sup>42</sup> L Lim (2000), ‘My Factory Visits in Southeast Asia and UM Code and Monitoring’, 9 June 2000.

<sup>43</sup> T Connor, *op. cit.* pp. 22.

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.*

Footwear production poses many serious risks to workers' quality of life. Acute injury hazards caused by exposure to dangerous chemicals, excessive heat or noise and skeletal disorders caused by repetitive actions and heavy lifting are just some of these threats.<sup>46</sup> The inadequate provision of training and protective equipment, physical exhaustion and unacceptable working conditions are identified as the main reasons for the high incidence of workplace accidents within Nike factories.<sup>47</sup> The provision of limited onsite health services has been argued to be more a means of control rather than welfare provision. These services are alleged to be an obstacle to workers choosing to take the legally mandated paid menstrual leave. Whilst technically factories have changed their policies and more women are taking menstrual leave, these women are still subjected to the humiliating ritual of 'proving they're menstruating' by removing their underwear in the presence of a doctor, in order to be able to claim their legal entitlement.<sup>48</sup>

Until July 1998, Indonesian workers were only permitted to join the official government union SPSI. However since the fall of President Soeharto, the formation of independent unions has been legalised. Evidence reveals that improvements in factory practices can be directly related to greater unionisation. Offices are now provided for independent unions enabling union representatives to actively communicate with factory workers and union organisers are no longer isolated from fellow workers. These advances are significant but still offset by more informal mechanisms that continue to undermine workers' ability to collectively organise, due to their well-founded fears of the consequences of being involved in union movements.

### ***Step 2: Costing Dimensions and Integrated Needs Assessment***

For the purpose of this case study, the areas of social impact associated with Nike production are based on the problems identified in the above section. Thus, the main areas of need that would be addressed by this tariff include the inadequate provision of public infrastructure, services and accommodation for Nike factory workers, insufficiently low wage levels leading to increased working hours, sub standard workplace conditions and workplace safety measures and the lack of collective representation for factory workers. The 'living wage' concept is one example of an effective needs assessment tool which is currently used to determine adequate wage levels. The 'living wage' can be broadly defined as able to cover a worker's basic needs, include an element of discretionary income and has the capacity to cater for dependants.<sup>49</sup> As such, it can be used to obtain a simple estimate of the externality costs borne by individuals when their wages fall below this level.

To provide an indication of the possible costing dimensions involved in applying the boomerang tariff to this case study, we have outlined the process of attaching a 10% tariff to Nike shoes produced in Indonesia (See Figure 2). This is comparable to the level of tariff protection that is already awarded to the TCF industry in Australia.<sup>50</sup> The example assumes the boomerang tariff is operates multilaterally and thus applies to every Nike shoe produced in Indonesia, regardless of which country it is sold in. The pricing and revenue figures provided are intended to be for illustrative purposes only.

It should be noted that administration costs are not accounted for here, since the main purpose of the figures is to capture the scope of change which such small measures could enable. This

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<sup>46</sup> Nike has recently introduced what is termed "water based solvents" in response to the harm caused by exposure to toluene, which was previously used as an adhesive during footwear production. These new formulations are more accurately described as 'reduced-solvent' chemicals that still lead to cases of respiratory illness amongst factory workers.

<sup>47</sup> T Connor, op. cit.

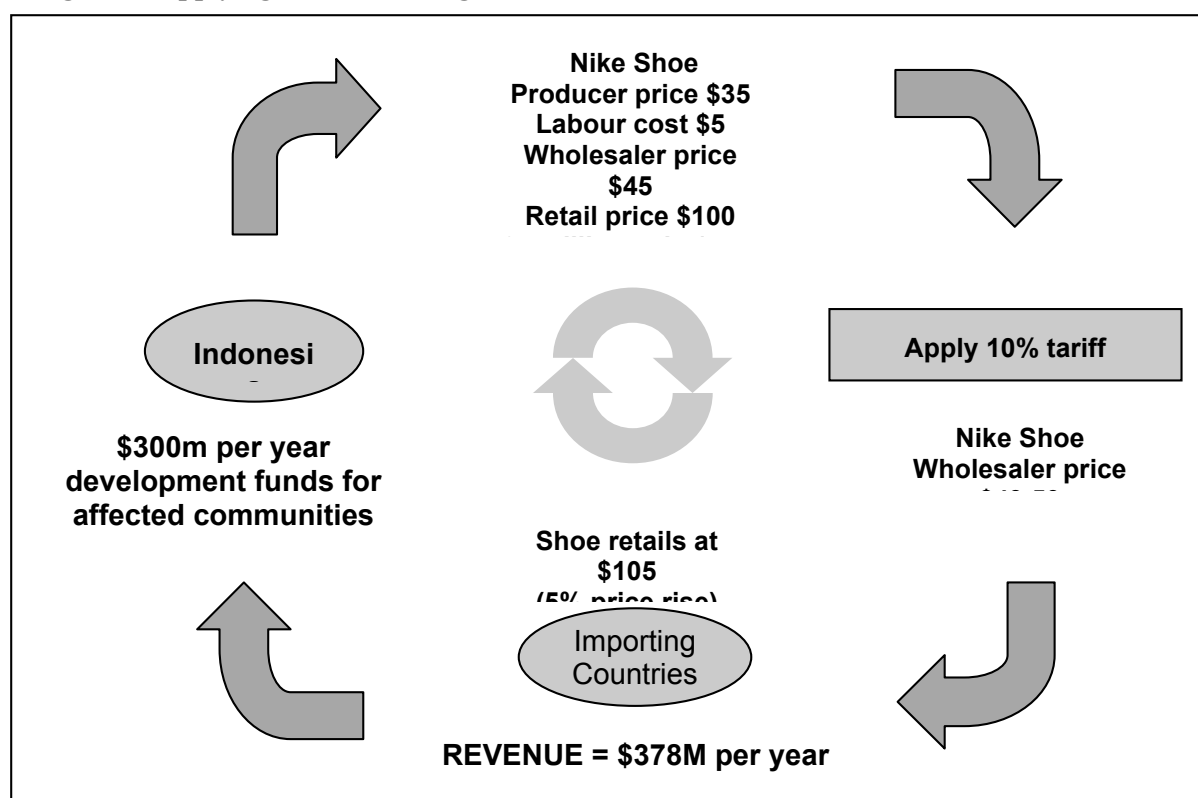
<sup>48</sup> *Ibid.* T Connor, op. cit., p. 26.

<sup>49</sup> Labour Behind the Label (2000/1), 'Wearing Thin: The State of Pay in the Fashion Industry', Norwich, pp. 24.

<sup>50</sup> Despite a recent reduction in tariff levels, they remain relatively high at 25% for clothing and 15% for most textiles and footwear. Industry Commission (1997), 'The Textiles Clothing and Footwear Industries', vol. 1, Report No. 59, pp. 201.

diagram illustrates the significant amount of revenue that could be raised by the boomerang tariff and then used to address the problems identified in the needs assessment process. The estimated cost of contracting Indonesian NGOs to independently monitor Nike subcontractors and ensure compliance with the company's code of conduct amounts to US\$150 000.<sup>51</sup> This amount indicates reflects the actual cost of conducting an integrated needs assessment process within a given community and establishing NGO programs to address the identified needs.

**Figure 2: Applying the Boomerang Tariff**



### ***Step 3: Redistribution of Tariff Revenue***

The boomerang tariff is designed to fund development programs which address impacts identified by the integrated needs assessment. The conditions of production cannot be directly addressed in the boomerang tariff model, because these conditions are largely determined by the employer. Nor can the revenue from the tariff be used to directly increase workers' wages because this could have negative impacts on other local manufacturers and lead to greater unemployment. However, the development programs funded by the tariff benefit workers by providing them with the necessary services and infrastructure needed to improve their standard of living and increase their capacity to associate with one another.

For example, the estimated annual cost of providing clean drinking water for 8 000 workers in an Indonesian factory producing Nike shoes is US\$240,000.<sup>52</sup> This figure indicates one way

<sup>51</sup> Victoria International Development Education Association, 'Behind the Swoosh', Global Citizens for a Global Era, vol. 1, Issue 3, Nov 2000, pp. 3.

<sup>52</sup> *Ibid.*

in which the revenue raised by the boomerang tariff could be used to improve essential services for factory workers. The strategies and programs for addressing the identified needs should be implemented by local NGOs with 'bottom-up' involvement from the community. It is argued that solutions owned by the community are likely to create lasting change and will also generate opportunities for local employment and skill development.<sup>53</sup>

In the longer term, it is also anticipated that employers will improve workplace conditions because of the financial disincentive created by the tariff. A condition for removal of the tariff could be the uniform application in an exporting country of the appropriate labour, social welfare and environmental standards.

## POTENTIAL CRITICISMS AND RESPONSES

Nike spokesman Vada Manager contends that if Nike doubled its workers' wages this would lead to disaster for the workers. "If you exponentially increase labour costs, that impacts the cost of production, which then means the retail cost may increase, which then reduces the amount of items sold", leading to worker layoffs.<sup>54</sup> However, if a 10% boomerang tariff was applied to Nike footwear and the extra cost passed onto the consumer, it would add about five dollars to the retail price.<sup>55</sup> Thus, although the boomerang tariff would slightly elevate the sale price of goods produced, the difference to the consumer would be minimal, with limited impact on demand, and yet the benefits associated with the return of the hypothecated funds could be significant.

The case study highlighted the notion that inequity may arise if the boomerang tariff revenue is used to increase workers' wages. It is argued that if the tariff were used to increase the wages of those workers, then in effect that company would be rewarded for its deleterious practices, because the cost of its labour would be partly paid for by the tariff. Provision of services to address social externalities avoids such an employer subsidy. Likewise in the case of environmental externalities, the tariff revenue should not be spent on subsidising the shift towards more efficient and less polluting production. Rather it should fund the development of programs and infrastructure to directly address the problems that are caused by pollution and inefficiency and to strengthen the monitoring and regulatory capacity of local authorities and communities.

The administration of the boomerang tariff may be criticised for being too expensive. However, the cost involved in carrying out the extensive needs assessment process would be minimised if multinational corporations were required to provide the relevant information regarding factory conditions, wages and other productive activities and to assist in the process of identifying the range and depth of needs within the broader community, thereby shifting the responsibility from the community to the corporation. This level of needs assessment reflects activities that should be undertaken in any case.

The boomerang tariff proposition is in some ways incompatible with current WTO rules, which may be regarded as a weakness. However, we maintain that the incompatibility between the boomerang tariff proposal and some aspects of current WTO rules, is primarily due to the inconsistency and hypocrisy of those rules. The WTO regime has come under increasing scrutiny and criticism, leading to the collapse of the latest round of negotiations in Cancun in September 2003. The capacity of the WTO as a democratic organ of global governance is impugned by allegations that the interests of wealth countries and multinational corporations have captured it.<sup>56</sup>

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<sup>53</sup> Waddell, R. (1993). *Replanting the Banana Tree – A study in ecologically sustainable development*. APACE, UTS: Sydney.

<sup>54</sup> L Skenazy, "Cashing in on Sweat of Workers Abroad", *Philadelphia Inquirer* 23/8/2001, p1.

<sup>55</sup> T Connor, *We Are Not Machines*, Oxfam.

<sup>56</sup> G Monbiot, (2003), *The Age of Consent: A Manifesto for a New World Order*.

There are three main areas in which the boomerang tariff proposition differs from current WTO rules. Firstly, member countries are not permitted to introduce new bilateral tariffs, and all new tariff measures must be endorsed and enforced by the WTO. Yet this may become less relevant in an era of increasing bilateral trade negotiations.

Secondly, the WTO rules do not permit different standards of production to be used as grounds for import restrictive measures. That is, like products must receive like treatment, regardless of how they are produced – known as the ‘product/process distinction’. The ‘product/process distinction’ has been heavily criticised because it inevitably places “economic considerations ahead of concerns for other issues... that arise from how the product is made”.<sup>57</sup> The WTO argues that the alternative would involve individual countries banning imports on the basis of their own (more or less arbitrary) environmental, health and social standards (WTO in Hamilton 2001 p.63). Yet the WTO rules sometimes make exceptions to this distinction; for example, goods produced using prison labour can already be subject to trade restrictions.<sup>58</sup> This serves to emphasise the point that a certain level of international consensus on minimal production standards is required. Regional trade agreements such as the North American Free Trade Agreement (NAFTA) incorporate much wider labour guidelines, drawing upon the ILO’s core labour standards.<sup>59</sup> Similarly, the criteria for applying the boomerang tariff would be based upon international standards for the protection of human and environmental wellbeing.

The third area of divergence between the boomerang tariff and current WTO rules, lies in the definition of a ‘subsidy’. The WTO rules allow countries to impose anti-dumping measures in the case of financially subsidised goods. On the other hand, they ignore the implicit production subsidies which arise because the costs of meeting workers’ needs and protecting the environment are not accounted for.<sup>60</sup> Yet some countries do not provide explicit financial subsidies, but provide an implicit subsidy to producers by not enforcing environmental and labour standards which would make them pay the full costs of production (Hamilton 2001 p.66). As in the case of financially subsidised goods, what follows is that the products are effectively *dumped* on foreign markets because their price does not include all the costs of production. Thus the social tariff is in some ways analogous to the ‘countervailing duties’ which are already permitted on dumped imports to raise their price to the market price.

## CONCLUSIONS

The boomerang tariff has the potential to address the most vexing dilemma associated with the free trade – fair trade debate. That is, how to deal with the embodied pollution and embodied misery that is contained in goods produced in countries where there is a significant burden of environmental and social externalities. The boomerang tariff is one of many measures that can address this issue, others such as standards, labelling, incentives will all be required. The key strength of the boomerang tariff is in the ability to generate sufficient funds that are actually linked to the origin of the problem, and that it can provide a direct incentive for right action.

In proposing the boomerang tariff, our motives are to invite debate, including opening the debate on the question of how it is possible for the world to reap the benefits of internationalisation and global inter-connectness, while minimising environmental harm and

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<sup>57</sup> P Singer, (2002), *One World: The Ethics of Globalization*.

<sup>58</sup> See Article XX (e) of the General Agreement on Tariffs and Trade (1947).

<sup>59</sup> P Grady & K Macmillan, (1999), “Integrating Labour Standards”.

<sup>60</sup> For the first time, the Uruguay Round GATT negotiations restricted the definition of a subsidy to financial contributions by government bodies.

social misery. We believe that the boomerang tariff is worthy of consideration as a means of furthering this goal

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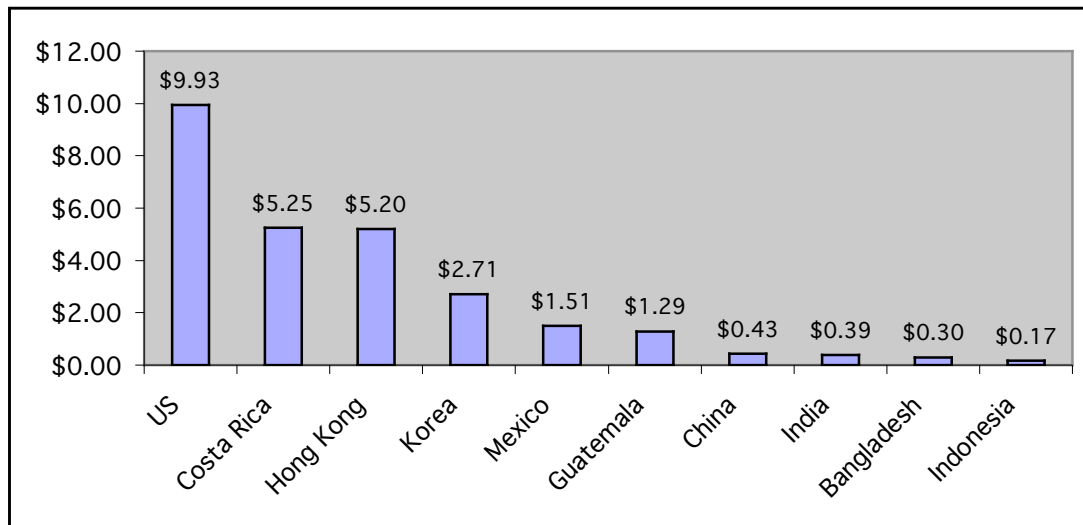
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## APPENDIX A: LABOUR COSTS



Labour Costs: Average hourly labour costs in the clothing industry in selected countries, 1998. (Source: UNCTAD 2002).

## APPENDIX B: TCF FACTS & FIGURES

Indonesia has a population of 210 million people and recorded a gross national income of \$119.9 billion in 2002, ranking the country 32<sup>nd</sup> in the world<sup>61</sup>. However, gross national income per capita for this same period was estimated to be \$570, ranking the country 153<sup>rd</sup> in the world<sup>62</sup>.

Between 1968-70 and 1998-2000, Indonesia's product structure of merchandise exports shifted from 98% primary product production and 1% manufactures to 42% primary products and 52% manufactures.<sup>63</sup> In 2000 Indonesia was the 11<sup>th</sup> largest exporter of clothing in the world with exports valued at \$4.73 billion which represents 2.4% of total world exports or 7.6% of its total merchandise exports.<sup>64</sup> In 1996 Indonesia's shoe production peaked with the export of 250 million pairs of shoes valued at approximately \$2.2 billion. This level fell considerably to \$1.5 billion in 2001 and is continuing to fall.<sup>65</sup>

Nike indirectly employs 550 000 people across the world, in 700 factories in 50 countries.<sup>66</sup> Nike only employs 8000 people directly, predominantly in marketing and financial capacities in their US headquarters. In Indonesia Nike employs 120 000 people half of which are involved in footwear production.<sup>67</sup> Since 1996 Nike's share of footwear production has declined from 38% to 30% and with the pending closure of another factory by the end of 2002, this share is expected to fall to 26%.<sup>68</sup>

Independent contractors fulfil all Nike's production; their production locations have followed changing sources of cheap labour and institutional advantages. The bulk of this production is consumed in the western world with 53% of sales in the US, 27% in Europe and 12% in Asia.<sup>69</sup>

The estimated cost of doubling the average 10c an hour wage of Nike's 80 000 Indonesian factory workers amounts to US\$22 m a year, which is a little more than the US\$20 m that Nike paid Michael Jordan for promoting Nike products.<sup>70</sup> This would represent only 2.8% of Nike's annual advertising budget.<sup>71</sup> Furthermore, if the wages of labour were doubled and the extra cost passed onto the consumer, it would add no more than the cost of a pair of shoelaces, or in different terms would represent 4% of the cost of a \$100 pair of shoes.<sup>72</sup>

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<sup>61</sup> World Bank Group, World View, *World Development Indicators*, 2002.

<sup>62</sup> *Ibid.*

<sup>63</sup> World Trade Organisation (WTO), Annual Report 2002, p. 26.

<sup>64</sup> WTO, Annual Report 2002, p. 155.

<sup>65</sup> S Dume and M Tkacik (2002), 'Footwear is Fleeing Indonesia Raising Competition Questions: Nation's Economic Development May Not Be A One-Way Street', Wall Street Journal, September 9 2002.

<sup>66</sup> H Jensen, "'Low Pay, High Desire: A Tale of 2 Swooshes in Indonesia'" *Denver Rocky Mountains News*, July 2<sup>nd</sup> 2000, p. 41A.

<sup>67</sup> S Dume and M Tkacik, op. cit.

<sup>68</sup> *Ibid.*

<sup>69</sup> Nike, Annual Report 2002,

<sup>70</sup> VIDEA, op. cit., p. 3.

<sup>71</sup> *Ibid.*

<sup>72</sup> T Connor, *We Are Not Machines*, Oxfam, 2002.