

Public Ethics Radio

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Episode 18, Prakash Sethi on Apple's Labor Standards

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MATT PETERSON: Hello and welcome to Public Ethics Radio. I'm Matt Peterson.

Over the past few months, Apple has been receiving unflattering media scrutiny for the labor practices of its Chinese manufacturers. Programs like *This American Life* and the *Daily Show* have joined the *New York Times* and other traditional outlets in detailing long hours and harsh working conditions at Apple-contracted factories. Most recently, the Fair Labor Association, or FLA, a monitoring group that Apple belongs to, seemed to ratify these reports.

Like a presidential candidate, Apple seems to be inviting media attention because it's on top. But does being on top mean Apple has special responsibilities to address the labor conditions in its the factories it contracts in China? And to what extent is one company, even one as dominant as Apple, capable of affecting labor standards in China's vast economy, not to mention the rest of Asia?

Today on Public Ethics Radio, we speak to someone who has worked on these issues for years on the ground in China and elsewhere: Professor Prakash Sethi. Prof. Sethi spoke to Christian Barry from New York.

CHRISTIAN BARRY: Today we're joined by Professor Prakash Sethi, who is the president of the International Center for Corporate Accountability. He is also a distinguished professor at Baruch College in the City University of New York and has many other appointments.

Prakash Sethi, welcome to Public Ethics Radio.

PRAKASH SETHI: Thank you.

CHRISTIAN BARRY: Prakash, recently there's been a lot of discussion in the news—in fact it's not all that new, but there's been a bit of a flurry of activity—about Apple. And in particular, about the labor practices that are involved in the production of Apple products.

One thing that's sort of been striking is the difference between the, sort of, the public face of Apple and the way in which it appears to its customers, and many of the stories that focus on the conditions that are actually going on in the production of these products.

Could you talk a little bit about these different sides of the same firm, and then perhaps relate it to more general issues facing firms that are producing particularly in China and other developing countries?

PRAKASH SETHI: Well, the major issue is not even China. The major issue is how globalization has created a supply chain where companies have tremendous bargaining power, and they tend to exploit it to their own advantage. Apple is not the first and not the last example of this activity, it's just the latest one.

Think of Apple as a company which has two sides to its problem or challenge. One is the customer, and the other is the worker or the cost. The idea from Apple's viewpoint is to maximize its income from the product and the services it produces and sells. From the viewpoint of the customer, we would call this a culture of value.

In other words, Apple produces extremely good products which are unique, discrete innovations, compared to the consumer electronics industry, which essentially is repeated, low-cost, short-life products, type of thing. So Apple can ask the most price for its products. Nothing illegal about it. The customer is willing to pay a price at which it feels, the customer, feels that it is getting value for its money. And so, Apple has no incentive to make that product available to the customer at less than the price the customer is willing to pay. Why should she, why should Apple expect or accept a lower price or profit? The same thing applies at the other end.

Now remember, Apple can charge high prices because it has a unique product and therefore it has market power. The same market power applies to the supply side. It can buy lots of products. It can also have multiple suppliers that would compete with each other to provide services to Apple. Since Apple does not have any investment in that capital, they don't really care how those factories are managed as long as they provide an excellent product for Apple.

And the—so, in other words, Apple in terms of customer gets the most price it can, and in terms of workers it pays the least amount it can. The goal in both these aspects is exactly the same: to maximize Apple's profits.

CHRISTIAN BARRY: So the idea on the production lane is that any attempt of any particular firm who is involved in helping produce these products for Apple, to improve the working conditions, reduce working hours, and so on and so forth, would expose it to being undercut by competitors, because these competitors are also facing this demand from Apple, and, insofar as they are willing to do so, they can do so.

So I know that the phrase is often used is the "race to bottom," but perhaps the more accurate phrase is then that there's a "chill" in the sense that, even if wages increase, even if working conditions improve, they improve a great deal less than they might otherwise, because of these competitive pressures.

PRAKASH SETHI: Exactly. And you see the competitive pressures are deliberate. Why would Hewlett Packard want to pay more than it has to? The only company that can pay more than it has to is the company that is the most profitable. And that is Apple. And therefore, if Apple as an industry leader could flaunt the industry in terms of making new products and selling them, it could bring about the same kind of pressure on the industry to change the conditions.

But it has no interest in doing so, because Apple is not concerned about the workers. And therefore, well, when all this public hoopla is gone, nobody will care what Apple is doing. And this is—

CHRISTIAN BARRY: So you say it doesn't care about the—about the workers. And even if that's true, one question is that Apple is very much about its brand and about itself and about selling itself and a certain image and a certain relation with its customers.

PRAKASH SETHI: Yeah.

CHRISTIAN BARRY: And one wonders why that same type of consideration, with its brand, would not lead it, especially if it can do so without taking on tremendous cost, to these improvements. But why isn't that a more potent factor in determining its business model?

PRAKASH SETHI: Chris, we have been there before. When there was a tremendous public hew and cry about toys, the world's leading toy company, called Mattel, went through the same situation: made all kinds of promises, made some improvements—and when the media attention dies, which it always does because it is not a continuous news item—and the industry did not follow suit, Mattel did not feel that it should be spending more money when it doesn't have to. Nike did the same thing.

CHRISTIAN BARRY: You were involved in Mattel. You were involved in Mattel for a while, were you not?

PRAKASH SETHI: Exactly. Yeah. Because just like Apple, Mattel created a totally independent monitoring system, far different than FLA, because they wanted to make sure that whatever they do or claim would have public credibility. And they did achieve that.

But what happened was that after five or six years, everything was going fine. But Mattel's competitors did not choose to follow suit. And since Mattel's toys were competing against its competitors and were selling at places like Walmart, Mattel simply felt it did not have to do it to justify itself.

In other words, Mattel could afford to pay extra because it was a leading company. But the question from the stock market comes in: if Hasbro can produce a toy at 5.95, why should I pay Mattel 5.97? And Mattel would not sell at 5.95 because profit margins go down. And therefore, in the short run, the effect on the share price becomes evident. Every three quarters—every quarter when you come out and say “Oh, our operating margins are 16.3 compared to Hasbro's 16.45,” the market penalizes the shares.

CHRISTIAN BARRY: Right.

PRAKASH SETHI: Maybe it is short-term. The actual, incremental cost to give the workers what the companies promise in their own codes of conduct, and what the China laws provide, is really insignificant in terms of the total price at which they sell the product to the market.

And so, essentially, Apple, like Nike before that, like Levi Strauss before that, like Mattel before that, will do only because right now it's in public attention—there will be some

superficial changes, but after a while, unless until there's a corporate culture that says, "We will do the right thing," nothing will change.

CHRISTIAN BARRY: So any incentives that are provided by concern with brand and with protecting brand are relatively limited. It's easy to wait it out, effectively, or to even make some meaningful changes knowing that those changes are probably not going to increase costs very significantly. The brand can be repaired, things move on—

PRAKASH SETHI: Well, the whole—

CHRISTIAN BARRY: and then it's basically back to business as usual.

In what ways was that the case—I know that you worked specifically with Mattel on its code, on designing its code, and then also in terms of assessing it—what happened? Did they simply do away with the code? Or did you find that you were encountering more and more obstacles in trying to carry out your audits?

PRAKASH SETHI: No, there were no obstacles at all. The whole question was: no other company in the industry was making any disclosures that were meaningful. The industry had a captive group of auditors, which is a sort of industry-controlled and supported audit group. It would go to a factory, where they look around, come back. And that was it. There was no pressure from the customers.

Apple could change tomorrow if it felt that its product is being degraded or customers are avoiding its product. That's not the case. So there is zero pressure from the customer, which is Apple's biggest concern. There's zero pressure from the industry, its competitors. They don't want to do that, because they would have more to lose to challenge Apple than Apple has to lose by challenging them, so Apple has no pressure from them. Apple has no pressure from the NGOs either, because NGOs cannot leverage public discontent to encourage or induce Apple to behave differently.

The recent meeting, the stockholders' meeting, the only question that the institutional investors asked was about changes in the voting procedures of Apple's board. Not a single question was raised about working conditions. The government doesn't care, neither ours nor Chinese. Chinese would take umbrage to think that somebody said that they are not enforcing their laws.

So where's the pressure? The news media would come in for four weeks, and after that there's no news. And so Apple really has no pressure whatsoever, except as something that it wants to do because it feels it's the right thing to do. And that is still out in the field. We don't know if Apple would do what it says it would do.

CHRISTIAN BARRY: So that, in your view though, there's nothing that's preventing it, in terms of competitive pressures from its peers, from actually taking on a different type of role. That is, it doesn't have a financial incentive, a direct financial incentive, to be a, a sort of a leader in this area. But there's nothing—there aren't incentives against its doing so. That is, the cost of its doing so would not be so much that it would threaten its market position.

PRAKASH SETHI: Absolutely. Because it has no disincentive to do it except competitive pricing. In other words, if somebody else is coming up with an iPhone, which can be made

for \$2 less, multiply it by 20 million units, and it's a lot of money. And so at the buyer level, at the operational level, at the manager level, everybody looks at the price. It's how am I doing compared to my competitors? But at an overall corporate level, it is insignificant.

So it's not a question of ability to pay. It is a question of "Why do I need to pay when no one else is doing, and I'm not being forced to do it?"

CHRISTIAN BARRY: We're talking to Prakash Sethi about issues relating to corporate accountability and labor standards. We'll be back in a moment.

MATT PETERSON: This is Public Ethics Radio.

CHRISTIAN BARRY: We're talking about labor standards, production, and manufacture in developing countries and related issues with Professor Prakash Sethi.

Prakash, in general there's no reason to believe that people sort of involved in these companies and corporations are any more sort of morally obtuse than anyone else. If the costs are so minimal, it's just hard to see why it is that there isn't more prospect for change.

So at a shareholder meeting, you know, there are shareholder activists, they try sometimes to introduce a resolution into the bylaws of the company, that has something to do with respect for workers' rights. They're almost always routinely defeated. Why is that? Is it—I mean are these investors simply being morally obtuse? Or is there some rationale that they have that makes it seem as if—that it's somehow permissible to block these types of initiatives?

PRAKASH SETHI: I can't answer that question because I don't know.

CHRISTIAN BARRY: Yeah.

PRAKASH SETHI: I have tried to figure it out. You know, it seems to me Steve Jobs could make, or Bill Gates could make \$40 billion and leave \$20 billion for charity. But why couldn't he spend \$1 million dollars while he is running Microsoft to treat the workers right and leave the \$19 billion for charity? I can't answer your question.

All I know is companies do, by and large, what needs to be done at the minimum. There was a time when Levi-Strauss said "We will move out of China, because we cannot monitor or control the factory conditions." They did move out. But they had to go back, because every other place was exactly like that, and China by that time had a core of manufacturing facilities that simply could not be matched in other countries.

Think of it another way: Apple has been doing this monitoring the last six, eight years. Every year they send their monitors from the company. They come back with the same routine story: "Yes, there are some violations of overwork, yes there are some violations." So, the answer is, "We will train the management."

This is the same factory that produces the most precise, the most precision-oriented electronic gadgets, where even a micro or mini-micro change would be called a defective product. How does Apple manage to employ these quality conditions to such extreme extent, and yet unable to impose its workers' standards for the last six, 10 years? Simply because they are low in their priority.

Essentially the point is, in a free market, the—or in an ideal competitive market that we call capitalism and free economy, the output of a product or the value is created is distributed roughly in proportion to the contribution that land, labor, and capital makes toward its production. Labor is then, means, you know, all of the physical facilities type of thing.

But what if capital has greater bargaining power than labor? So the total value is the same, but the capital says “Folks, I want 15 percent more. If not, I’m going to go someplace else.” Capital can move, workers cannot move. True, if you had more capital than you could find use for it, you would give capital at a lower rate.

The same thing applies to workers. They have more workers and therefore they are willing to work for lower and lower price until such time that you are at the subsistence level. If you pay them less than that, workers will starve and there will not be enough workers. So the subsistence-level wage then becomes a de facto wage. If you change the de facto wage to slightly more and if everybody does that, there will be no problem.

The reason foreign multinationals make it that way is because the workers, or the representatives of the workers, the countries, do not have bargaining power in the marketplace compared to the bargaining power of the capital. And so they get the short end of the stick.

CHRISTIAN BARRY: So there are, obviously there are a lot of different ways in which you can imagine these sorts of issues could be addressed. One of the problems, though, is that the political feasibility of all the proposals that are on the board, whether from trying to strengthen the position of labor relative to capital, whether liberalizing immigration flows, whether guaranteeing a global minimum wage or minimal working conditions, all of them seem to be such that they will encounter pretty significant opposition by people who have a great deal of political leverage.

PRAKASH SETHI: You are—

CHRISTIAN BARRY: And one stage I know that you argued that one of the possibilities was to sort of brand yourself as a market leader, as Mattel tried to do, and as Apple seems to do, but now you seem a bit skeptical about that prospect as well. So I just wanted to ask: prospectively, is it simply an issue at the moment of hoping that someone decides—who is in the unique position of being in a company that is a market leader—to take a different approach to this, or what sorts of initiatives do you think hold the most promise for . . . yeah.

PRAKASH SETHI: Well, why blame the companies? If you and I do not care about what Mattel does except, you know, making some noises about it and then go end up buying iPad and iPod too and everything else, why blame Apple alone?

CHRISTIAN BARRY: No, I wasn’t speaking of blaming. Yeah.

PRAKASH SETHI: The customer is the ultimate arbiter. Where are my values? Where is my culture? Where is my ethics?

CHRISTIAN BARRY: Good.

PRAKASH SETHI: And, you know, one the beauties of the free market is that the customer has the control. And in this case, the customer has alternative choices. Think of how quickly the contaminated food gets out of the market.

CHRISTIAN BARRY: Well, let me ask you about that, actually, with respect to alternatives. So, I mean, from what I gather, if you, for example, need to use personal computing, there actually are no alternatives. Basically anything that you will use will be produced in a way that's problematic, will probably contain trace minerals that were extracted from countries with terrible problems—

PRAKASH SETHI: Yep.

CHRISTIAN BARRY: —so it's not obvious what it would mean as a customer to sort of opt out. At least insofar as it's very difficult to see how you would actually function without these sorts of products.

So, you know, consumer boycotts or those sorts of things, obviously those too are things that would bring a great deal of pressure on companies. But are you hopeful about the prospects of that?

PRAKASH SETHI: Just consumer boycotts are not likely to work, unless until there was a tremendous intensity of moral offense. Remember when the original boycotts started—the apparel. Young people were very concerned about “made in China” type of thing. But after a while, the only thing they could buy was made in China. And so they couldn't do it.

I worked with a couple of colleges, where College A was making about \$40 million a year in licensing fee, making sports apparel. That money was going for scholarships. The first argument was, well, if we didn't have that money, we can't give scholarships. The college actually offered the apparel manufacturer or licensee that we would give you, or we would accept, a lower licensing fee, if you could guarantee us that the workers in these factories where you are manufacturing would meet the minimum conditions that our code calls for or the Chinese law calls for.

The licensee said they couldn't do it, because if we do it with one, we would have to do it with everybody else, and nobody else is going to do it. And the factory was simply allowed to change its practices, because it had to deal with 15 other companies. So the whole system is such that the weakest link gets the most punishment.

CHRISTIAN BARRY: And what's interesting is that the—the argument that you're making is, in a way, it's true that you're saying it could be, it should be, a leader. But there's another sense you're not actually acting it to—asking a firm that is a market leader to be a leader, in the sense that you're not asking them to take on a great deal of cost and sacrifice.

You're asking them—given that they, unlike other firms, are not so open to competitive undercutting by their competitors—that they do what we all should do, which is be able to take on a certain amount of cost in order to make significant improvements in the, in the, conditions.

PRAKASH SETHI: But there is no—no, the use of the adjective “great” is totally misplaced. They are not going to greatly increase their cost. Their costs would be marginally

greater or higher compared to their competitors, but if they were willing to take that cost and are transparent that it is obvious that they are doing exactly what they say that they are doing and it is not just a PR exercise, they can force the companies.

You know, the first mover's advantage—if it becomes that Apple is the one that says “This is how we will treat our workers,” and from every indication this is how they treat their workers, HP and Nokia and other companies would not be able to avoid that. Everybody in the world is now saying, “How could I make an iPad that could sell like Apple iPad?” Why can't they say then, “How could I possibly have a factory that we could also proclaim ‘we care about our workers?’” Not being benevolent, but being fair. Apple would do it if they wanted to.

CHRISTIAN BARRY: Suppose there is a—suppose you're not the market leader, right. Suppose you're a firm that's not the market leader.

PRAKASH SETHI: Okay.

CHRISTIAN BARRY: Then, is it, are you effectively just locked into the system, whereby you'll be—

PRAKASH SETHI: Nope, you're not. No, you're not. Think of it this way: let's say you are a very small fry in a big market. You come up just like Apple, you say, “I will be small company, but I will make only organic food.” Or, “I will have only sustainable farming.” You would create a product. If the customer can believe what you are saying is true and not just PR, you would create a niche. And that's what Apple did.

And so, if you could create a niche which becomes a highly desirable characteristic that our—just like, you know, “Our chickens can roam, it's free range chicken,” we could say “Our workers are treated like human beings.” But you would have to make a claim, you would have to accept public cynicism, and you would have to ride above the noise level, but once you've done it, you've set the ground. You know.

CHRISTIAN BARRY: Yeah. Well one of the interesting things—

PRAKASH SETHI: Good guys are not necessarily in short supply. They just have to do it.

CHRISTIAN BARRY: Yeah, well I, think that one of the things that has been very effective in, you mentioned the sort of organic food production and free range chickens, is that, the way in which those working on some of those issues with respect to food production have connected the consumer to the process of production in a way that is much more intimate than anything that has really been able to, that has really occurred with respect to textiles or electronics. Right? In that, you know, you look at a chicken nugget, and you see a vivisected bird, a tortured vivisected bird—

PRAKASH SETHI: Absolutely.

CHRISTIAN BARRY: —whereas that's not yet the case with electronics.

And I wonder the extent to which it's simply, it's simply something that hasn't been done yet or whether there are—

PRAKASH SETHI: No, no. It's precise—look. There are a couple of companies in France that would clearly say on their labels, apparel labels, “This fabric, or this apparel, was made in a factory that met all our conditions.” And you could call up, get the factory's name if you want to. In other words, if it was a false label, the company would be liable for penalties because it is fraudulent advertising.

We don't do it here. Because we know we cannot make that claim. So if one company is willing to make that claim, it would create a small niche. But right now the customer doesn't have a choice. I would be perfectly willing to pay two more dollars or five more dollars if I knew that those \$5 really are going to go where they're supposed to go.

And so, you know, the market leader or the first mover's advantage is there, if you wanted to take. Starbucks changed the world in terms of creating a coffee image. Maybe they are not perfect. But they are still doing things differently than every other coffee shop was doing.

They could do that. Nike could certainly do it, if they choose to. You know, you pay \$300 million to Air Jordan or Mike Jordan or in his good days Tiger Woods. So you pay \$250 million. What's he going to do? Where is he going to go to get that kind of money? So essentially, you are paying Mike Jordan or Tiger Woods because you can afford to, and because they know they can get it. You know. It's like the salary cap. The players get used to it. It gets adjusted.

Right now, the provider of the labor has no bargaining power. So he or she gets squeezed. If you have a \$100 or a \$600 iPad, where is the law that says that only \$15 of it or \$100 of it would go to the production and not \$130?

If the labor costs were set, and they were enforced, so the price would go up by \$20. Or, put it differently, operating margins for Apple would go down by \$20. But so what? Everybody else is going down. Where does it say the operating margins should be that high? They are high simply because they can be high. And if I can get more money, why should I get less money?

So the question is, forcing these companies either by law or by public pressure to do what they claim they are already doing, but they are not.

CHRISTIAN BARRY: Prakash Sethi, thank you very much for joining us Public Ethics Radio.

PRAKASH SETHI: Thank you very much.

MATT PETERSON: Thanks for listening to Public Ethics Radio. The show is produced by me, Matt Peterson, and Barbara Clare. Christian Barry is our host. The show is supported by the Centre for Moral, Social, and Political Theory at the Australian National University and the Carnegie Council for Ethics in International Affairs.

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