Made in America: US Child Labor Risk

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Key Takeaways

1. As stakeholders have raised scrutiny for child labor in regions with lenient employment regulations, 'Made in America' claims have come to represent a near-guarantee of higher labor standards; however, violations of child labor laws and scrutiny of working conditions for minors remains a significant risk for US employers.
2. Increased hiring pressure for low wage positions, industry-specific (e.g., agriculture) labor shortages, and changes to state-level regulations have created new incentives for businesses to expand hiring among minors, creating risks of potential abuses and high-profile incidents, even in situations where minors are legally employed.
3. Private equity firms should evaluate high-risk businesses to ensure that portfolio companies more prone to child labor violations because of their industry or location maintain strong programs to combat child labor in their workforces.

In recent months, regulatory and media scrutiny has exposed high-profile instances of child labor in the US, linking well-known brands and private equity firms to the exploitation of underage workers, often migrant children from Central America completing dangerous jobs. As the political landscape remains gridlocked on the high-profile topic of immigration policy, companies and their private equity owners are increasingly held responsible for a failure to properly vet employees for valid identification, leading to scrutiny and financial loss. Most notably, in February 2023 the Department of Labor (DOL) publicly released information proving that a Blackstone Group-owned company, Packers Sanitation Services, Inc. (PSSI), illegally utilized over 100 children aged 13 to 17 for work in hazardous conditions across 13 meatpacking facilities. As a result, PSSI paid $1.5M in civil penalties and lost a large number of its top customers, leading to mass layoffs and reduced revenue. In nearly all public-facing media about this development, including a "60 Minutes" exposé, Blackstone and its claims of "model management" are mentioned, demonstrating the level of responsibility generally attributed to private equity owners.

Child Labor in the US

Child labor in the US has been labeled an 'invisible problem.' Often, discussions of company-funded child labor focus on international supply chains, and rightfully so; according to the International Labour Association, in 2022 nearly 160 million children worldwide, 10% of all children, were engaged in child labor (whether legal or illegal). Notably, Europe and Northern America reported the least prevalence of child labor by a wide margin, with 2.3% of those aged 5-17 in labor as compared to Sub-Saharan Africa (23.9%), Northern Africa and Western Asia (7.8%), Eastern and Southeastern Asia (6.2%), Latin America (6.0%), and Central and Southern Asia (5.5%).

Despite the relatively low prevalence of child labor in the US, enforcement controls within the country continue to identify and prosecute child labor violations, and related cases have been on the rise throughout the last decade. According to the DOL, between 2013 and 2022 the number of minors involved in cases regarding violations of child labor laws increased by 278%. Notably, while the number of DOL cases has remained consistent, the number of minors per case has risen from an average of two in 2013 to five in 2022; though concrete reasoning has not been provided for this trend, it could suggest that more minors are being found per company and that these companies maintain presumably larger workforces. Generally, these trends can likely be attributed to both an increase in child labor, largely completed by minor immigrants from Central America looking for work, as well as an increase in regulatory scrutiny. For example, in July 2023 a Labor Department official explained that the 44% increase in the discovery of children illegally employed from October 2021 to July 2022 was due to a greater emphasis on labor law enforcement. Ultimately, companies with US workforces are not automatically free from risks of child labor violations stemming from illegal employment or the insufficient protection of legally employed minors, which could lead to negative consequences, including public and regulatory scrutiny and financial loss.

High-Risk Industries

Agriculture is the industry most often linked to child labor in the US and worldwide. Agricultural labor laws are also generally more lenient, and the Fair Labor Standards Act (FLSA) establishes specific provisions for agricultural employees, allowing children above the age of 12 to work unlimited hours in agriculture outside of school time. Though the law places restrictions on hazardous work, hazards remain; for example, minors are allowed to work in tobacco fields, exposing them to health risks (e.g., nicotine poisoning from 'green tobacco sickness'). Additionally, violations are more likely to occur if children already work in the industry, as the Government Accountability Office (GAO) found that the majority of work-related fatalities in the US stem from agriculture.

Generally, industries with a higher use of temporary workers hired through agencies and industries that rely on physical work (e.g., manual labor, factories) are more likely to experience child labor violations. A study conducted by the Institutional Shareholder Services (ISS), which found that the US is the only OECD country aside from Turkey with active child labor cases, also noted that the automobile, food products, and retail sectors appear to be at a higher risk for child labor violations, likely due to their use of temporary workers, limited educational requirements, and need for manual labor. As an example, McDonald's shareholders are demanding child labor audits after the corporation experienced regulatory violations from using children to complete hazardous work. Private equity firms investing in these industries should take these trends into account throughout the diligence and monitoring process.

High-Risk Regions

Certain locations within the US may be at a heightened risk for child labor violations based on the concentrations of unaccompanied children within the state. To highlight this point, Verité pulled HHS data on states with the most unaccompanied children released to sponsors per capita; states at a higher risk included Maryland, Louisiana, New Jersey, Virginia, Tennessee, Texas, DC, Florida, Delaware, and Rhode Island. Based on the organization's findings, Verité recommended companies compare their locations to factors that increase the likelihood of child labor, including the density of unaccompanied children released to sponsors and the prevalence of manual labor-intensive work.

Local legislation may also be a risk factor for child labor, as the increased legal employment of minors could lead to dangerous work scenarios and cause high-profile safety incidents, in addition to facilitating the employment of children outside of the acceptable age range. In recent years as a response to labor shortages and a backlash against government intervention, certain Republican-led state governments have sought to loosen labor restrictions for minors. Per the Economic Policy Institute, the last two years have seen at least ten states introduce and/or pass laws weakening restrictions, most notably in the Midwest; example proposed or passed bills include components eliminating age verification requirements, lifting parent/guardian permission mandates, removing hazardous work restrictions, and extending work hours. While states modifying regulations may result in less direct violations, companies can still face significant consequences from a reputational standpoint, particularly if children are injured in the course of work. Legal modifications may also lead to violations; for example, a law passed in Arkansas that removes state verification to confirm the ages of workers under 16 may make it easier for children under 14 (the legal limit) to join the workforce. A recently signed law in Iowa lets children as young as 14 work in meatpacking facilities and includes provisions protecting companies if children are injured on the job.

Implications for Private Equity

To properly mitigate risk of child labor in their portfolios, private equity firms must take concrete steps to diligence and monitor at-risk companies. During diligence, investors should investigate whether companies maintain strict hiring processes, particularly for workers hired through third-party agencies and for contractors. As a best practice, companies should conduct thorough pre-engagement diligence through public databases (e.g., Violation Tracker, NLRB Cases) and news searches on a temporary hiring agency to review for any labor incidents associated with the Company. Use of identity verification systems such as E-Verify to complete initial and annual re-verification checks is a strong practice to introduce internally and within third-party agencies. Companies in higher-risk industries or locations should pair these systems with robust policies, including guidance on reporting mechanisms (e.g., anonymous hotlines, escalation procedures, non-retaliation policies) and additional managerial training on labor verification processes and their role in maintaining compliance with child labor regulations.

Ultimately, firms and diligence providers should evaluate their current understanding of what constitutes robust capacity to manage child labor violation risks based on current trends. For example, 'Made in America' claims cannot be an automatic verification of strong, compliant labor practices. Finally, after a transaction is completed, firms should continue to monitor portfolio companies for any changes to their risk exposure (e.g., workforce expansion into states with different labor regulations, a new reliance on seasonal/temporary workers) and help portfolio companies adjust their controls accordingly.

How Malk Can Help

To limit ESG risk related to poor labor practices within a potential or current investment, investors should complete in-depth due diligence. Additionally, ESG should be integrated throughout the entire investment period through monitoring and programmatic investment as companies scale to manage ongoing and upcoming risks. Malk can help investors throughout this process and guide portfolio companies to implement the aforementioned best practices. By providing comprehensive due diligence that goes beyond an ESG score and developing detailed recommendations tailored to each company, Malk enables investors to proactively manage ESG risks and identify value creation opportunities across their portfolio.

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