

# Towards Better Work

## Understanding Labour in Apparel Global Value Chains

Edited by  
Arianna Rossi  
Amy Luinstra  
and  
John Pickles

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## Towards Better Work in Central America: Nicaragua and the CAFTA Context

*Jennifer Bair and Gary Gereffi*

### Introduction

Like many other low-income industrializing economies, Nicaragua's export sector relies heavily on apparel manufacturing for revenues and employment. However, at least among the major garment-producing countries in the Western hemisphere, Nicaragua is unique: unlike the majority of its neighbours in Latin America, its apparel industry has expanded since 2005. In this sense, Nicaragua's experience counters a general trend in the global garment industry towards greater concentration in Asia, and particularly China, the world's largest clothing exporter.

Nicaragua is also the only country in Central America, and the second in the Americas (following Haiti), to participate in the Better Work programme. Here, too, the Nicaraguan case is exceptional because Nicaraguan garment factories are not associated with systematic abuses of workers' rights. The government's record of labour law enforcement, and the industry's compliance with those laws, at least in recent years, has been relatively positive. Consequently, the Nicaraguan government viewed participation in the Better Work programme mainly as an opportunity to publicize what it perceived as the country's existing strengths as a 'high road' exporter.

Nicaragua's participation in Better Work comes at a critical time in the evolution of its garment sector. Growth in apparel exports has been fuelled by the country's participation in the Dominican Republic-Central American Free Trade Agreement (CAFTA-DR) with the United States, which was signed by the governments of Nicaragua and five other countries in the region in 2004. While duty-free access to the US market has provided the CAFTA signatories an advantage vis-à-vis

other apparel exporters, for most of the CAFTA countries this advantage has not been sufficient to offset the greater competitiveness of Asian suppliers.

A decisive factor permitting the expansion of Nicaragua's apparel exports to the United States is the fact that Nicaragua was granted preferential treatment under CAFTA in recognition of its status as the least developed among the participating countries. Specifically, Nicaragua was granted a limited volume of tariff preference levels (TPLs), which enable garments assembled in Nicaragua from materials that do not meet the yarn-forward rules of origin established under the CAFTA (e.g. fabrics originating in Asia instead of the Americas) to access the US market duty-free. Although it is unclear precisely how much of Nicaragua's export dynamism is attributable to TPLs, they have undoubtedly helped to fuel the sector's growth. However, the TPL preference granted to Nicaragua under CAFTA is a temporary one, and it is set to expire in 2014.

The current climate of uncertainty in Nicaragua created by the scheduled expiration of the TPLs casts into stark relief the trade-dependent nature of its development strategy. The competitiveness of its chief manufactured export – clothing – is contingent on trade preferences that are outside the control of either the Nicaraguan government or the private sector. This situation raises important questions about the relationship between economic upgrading (the process of increasing competitiveness in foreign markets) and social upgrading (the process of generating more and better jobs) in global value chains (see Bernhardt, Chapter 2 in this volume). At present, Nicaragua's ability to leverage participation in the apparel value chain into economic and social upgrading appears contingent on the regulatory environment created by the CAFTA regime. If the TPLs are not extended and the industry is unable to adjust to the loss of these preferences, economic upgrading may be stalled or even reversed. This, in turn, is likely to affect negatively the broader agenda of social upgrading since it is difficult to improve wages, working conditions and employment security in an export sector dominated by a shrinking industry.

How might Nicaragua benefit from its engagement with the Better Work programme, and conversely can Better Work use its experience in Nicaragua to find new ways to improve productivity and labour outcomes in the apparel global value chain? Can Better Work strengthen the tenuous connection between economic and social upgrading by creating more stable export growth prospects with foreign buyers? Given that Better Work is a partnership between the International Labour Organization (ILO) and the World Bank's private sector financing arm,

the International Finance Corporation (IFC), how can this unique structure advance Better Work's objectives in developing countries?

This chapter argues that Nicaragua presents a challenge as well as an opportunity for Better Work to move beyond a model of monitoring factory level compliance in favour of an approach that identifies the root causes of non-compliance at the firm level. In order to meet this challenge and seize the opportunity that Nicaragua provides, Better Work needs to develop an innovative and dedicated approach to stakeholder engagement with the goal of enlisting participating brands as genuine partners in the search for decent work. If Better Work Nicaragua instead opts for a narrower agenda (e.g. monitoring factories for compliance with international standards and domestic labour law, but leaving other issues, like buyer-supplier relations, unaddressed), then the value of Better Work to the prevailing (and generally inadequate) system of social compliance audits is limited.

### Mapping Central America in the global value chain

The MFA phase-out and the removal of quotas on textile products on 1 January 2005 marked the end of over 30 years of restricted access for developing country exporters to the markets of the European Union (EU) and North America. Retailers and other buyers became free to source apparel in any amount from any country, subject only to a system of tariffs and a narrow set of transitional safeguards that were set to expire at the end of 2008. This caused a tremendous shift in the global geography of apparel production and trade and a restructuring of firm strategies, as companies sought to realign their production and sourcing networks to accommodate new economic and political realities (Tewari 2006).

In tandem with the liberalization of global garment trade, regional trade agreements have also played a major role in strengthening ties between the United States, the largest apparel market in the world, and its main trading partners. The North American Free Trade Agreement (NAFTA), which was signed in 1994, and CAFTA, which was signed a decade later, aimed to improve the competitiveness of the US textile industry and apparel exporters from Mexico and the Caribbean Basin in the face of rapid growth of low-cost apparel exports coming primarily from Asia (see Frederick and Gereffi 2011; Gereffi, Spener and Bair 2002).<sup>1</sup>

Table 11.1, which shows the growth of US apparel imports from 1990 until 2011, tracks the rise and fall of various apparel suppliers. Total

US apparel imports more than tripled between 1990 and 2005 from US\$21.9 to US\$68.7 billion. Although imports fell between 2005 and 2009, reflecting the impact of the deep global economic recession in 2008–2009, by 2011 they had rebounded to US\$77.7 billion. China was the leading exporter at the beginning of this period (US\$2.74 billion), but the CAFTA countries collectively were in second place, with 52 per cent of China's apparel export total in 1990. However, China's US apparel exports accelerated much faster than its rivals did after 2005, with its total share of the US market in 2011 nearly quadrupling the import market share claimed by the CAFTA countries. China exceeded Mexico's US market share in the same year by a factor of eight.

From a regional perspective, therefore, Mexico and Central America both experienced sharp declines in their share of US apparel imports between 2000 and 2011: Mexico's share fell from 15 to 5 per cent, while the share of the CAFTA-DR countries, taken as a group, decreased from 16 to 10 per cent. During this same period, China enjoyed dramatic growth in its share of US apparel imports, which rose from 8 per cent in 2000 to 22 per cent in 2005 and 38 per cent in 2011. Viet Nam also burst onto the scene during the past decade, going from virtually no apparel exports to the United States in 2000 to a US import share of 4 per cent in 2005 and 9 per cent in 2011. While CAFTA-DR and Mexico have been losing US import market share since 2000, China, Viet Nam, Bangladesh and Cambodia were all gaining ground.

One of the key questions for Mexico and Central American countries is the degree to which NAFTA and CAFTA would maintain or even strengthen the position of regional exporters in a liberalized global garment trade. While Mexico's US import market share has fallen dramatically in the past decade, the decline has been both more gradual and uneven within the CAFTA region. CAFTA has helped maintain the position of Central American and Caribbean exporters among leading suppliers of apparel to the United States, although the value of the region's exports to the United States fell from US\$9.1 billion in 2005 to US\$7.9 billion in 2011. Within CAFTA, the Dominican Republic and Costa Rica witnessed significant declines in their exports to the United States, but these declines have been offset by growth in shipments from Honduras, El Salvador and, most recently, Nicaragua.

As Table 11.1 shows, in both 2005 and 2011 Honduras ranked first among CAFTA exporters to the United States. El Salvador and Nicaragua now rank second and third, with Nicaragua edging slightly ahead of Guatemala in the most recent year. Nicaragua's exports to the United States nearly doubled in value between 2005 and 2011; all other

Table 11.1 US apparel imports: regional and Asian suppliers, 1990–2011

Partner	1990	1995	2000	2005	2009	2010	2011	'90	'00	'10	'11
World	21,937	34,649	57,232	68,713	63,105	71,398	77,659	12	8	39	38
China	2,739	3,518	4,499	15,143	23,503	27,975	29,392	7	16	10	10
CAFTA-DR	1,434	4,745	8,973	9,104	6,145	7,016	7,853	7	16	10	10
Viet Nam	0	17	47	2,725	5,068	5,877	6,644	0	0	8	9
Bangladesh	429	1,067	2,116	2,372	3,410	3,930	4,510	0	0	6	6
Mexico	508	2,566	8,413	6,078	3,391	3,541	3,804	2	15	5	5
Cambodia	0.1	0.5	808	1,713	1,871	2,222	2,592	0	2	3	3
Total	23	43	71	71	71	71	71	23	43	71	71

Note: % represents a country or region's market share of the total value of US imports of apparel in a given year. Source: US Department of Commerce, Office of Textiles and Apparel (OTEXA); imports by country by MFA category; category 1: all apparel.

Table 11.2 US apparel imports from CAFTA countries, 1995–2011

Country	Value (in US\$ millions)						% of CAFTA-DR Value					
	1995	2000	2005	2010	2011	7,853	'95	'00	'05	'10	'11	
CAFTA-DR	4,745	8,973	9,104	7,016	7,853							
Honduras	919	2,323	2,622	2,414	2,615		19	26	29	34	33	
El Salvador	582	1,583	1,619	1,638	1,738		12	18	18	23	22	
Nicaragua	74	336	716	1,017	1,357		2	4	8	14	17	
Guatemala	682	1,487	1,816	1,152	1,321		14	17	20	16	17	
Dominican Republic	1,731	2,425	1,849	626	654		36	27	20	9	8	
Costa Rica	757	819	482	168	167		16	9	5	2	2	

Source: U.S. Department of Commerce, Office of Textiles and Apparel (OTEXA); MFA category 1: all apparel imports.

countries in the CAFTA region except El Salvador declined during this period. While in 2005 Nicaragua accounted for only 8 per cent of the region's apparel exports to the United States, by 2011 that percentage had increased to 17 per cent.

Despite this strong performance, CAFTA regulations have created an environment of uncertainty in Nicaragua due to the pending expiration of TPLs. In recognition of the lower cost, greater availability and sometimes better quality of Asian fabrics, CAFTA allows Nicaragua to receive preferential access to the US market for a certain quantity of apparel (up to 100 million square metre equivalents) sewn in Nicaragua from materials that do not meet CAFTA's rules of origin. The CAFTA granted Nicaragua TPLs for a ten-year period, and they are due to expire in 2014. Nicaragua was the only CAFTA country to receive TPLs, which have been crucial, given the absence of domestic textile production in the country and the limited availability of cost-competitive fabrics produced in the Americas.

In 2009, 82 per cent of Nicaragua's exports to the United States entered the country duty-free under a variety of different special trade regimes. Over one-third of exports (35 per cent) entered under the regional rules of origin established by CAFTA, while 47 per cent of exports were imported under the TPLs granted to non-originating exports. As these figures suggest, Nicaraguan manufacturers are heavily reliant on TPLs. The CAFTA's yarn-forward rule of origin, combined with the looming expiration of the TPLs, is generating alarm on the part of local stakeholders that US buyers will shift orders to other suppliers, especially in Asia, when the TPL benefit expires. As explained in this

chapter, these fears are exacerbated by the fact that a sizable percentage of the companies that are active in Nicaragua are subsidiaries of foreign companies with a global presence, including factories in Asia to which they could redirect orders should they decide to cease production in Central America.

## Results

This chapter is based on data gathered during field research that was conducted by the authors during fall 2010 and summer 2011.<sup>2</sup> A total of 52 interviews were carried out for this project, of which 29 were with companies; 13 with government agencies, including the National Free Zone Commission (CNZF), the Ministry of Labour and PRONicaragua, the government's foreign investment promotion arm; and the remaining ten with other stakeholders, including Better Work staff, the apparel industry association and other employer organizations, trade union officials and labour rights experts.<sup>3</sup>

The CNZF directory was used to identify a representative sample of companies in terms of national origin, product mix and size, although larger firms were oversampled. With the exception of two (a converter of woven fabrics and a new agro-enterprise for cotton), these companies were engaged in the manufacture of either woven or knit apparel. In numerical terms, they represented approximately 40 per cent of the total number of garment firms operating in Nicaragua under the CNZF regime, but 79 per cent of total apparel manufacturing jobs. In this section, the findings from the fieldwork are summarized, addressing first the general themes of economic and social upgrading that are central to this volume before describing a distinction within the apparel value chain that was identified between 'Americas-based' and 'Asia-based' segments.

## Economic upgrading

Many studies of the global value chain for apparel differentiate between 'full-package' production, in which suppliers coordinate all aspects of production and purchase the fabric used in the client's orders, and assembly subcontracting, in which the client finances the raw materials and pays the supplier simply for cutting the fabric and assembling the garment. Furthermore, several scholars describe the transition from assembly subcontracting (also known as CMT for 'cut, make and trim') to full-package manufacturing as a form of economic upgrading (Bair and Gereffi 2001; Gereffi 1999). Based on empirical evidence from

cross-regional comparisons of exporters in East Asia and Latin America, as well as case studies of particular exporting clusters in several countries, they claimed that full-package manufacturing provides suppliers with increased competitiveness and larger margins than traditional assembly subcontracting. Because this production model may give local suppliers more control over links in the value chain beyond assembly – for example, the sourcing of inputs and post-assembly processes such as laundering and finishing – they further reasoned that it is more likely to encourage the development of backward and forward linkages to other kinds of activities; thus, stimulating investment and employment across different segments of the chain.

The Nicaraguan industry hosts a mix of full-package and assembly production. The salient distinction in this regard is between knit and woven apparel.<sup>4</sup> All of the companies in the knit sample are either full-package producers, meaning that they finance the purchase of fabric used in clients' orders, or they manufacture their own brands of apparel in addition to doing some subcontracting of private label (store brands) for retailers. Among manufacturers of woven garments, a greater mix of assembly subcontracting and full-package production was found. The greater prevalence of the full-package model among knitwear companies reflects the fact that these manufacturers are much more likely to be vertically integrated producers that convert the fabric they produce into garments. For example, five of the knitwear companies we interviewed are using a regional production model that involves Nicaraguan sewing factories and Honduran knitting mills.<sup>5</sup> Several others have knitting mills in Asia that produce the fabrics assembled in Nicaragua.

Contrary to the stylized upgrading trajectory that assumes a move from assembly subcontracting to full-package production (Gereffi 1999), two of the companies interviewed that manufacture woven garments have moved in the opposite direction. Full-package production became too expensive for these companies to sustain, given the rising costs of fabric and the lack of accessible, affordable credit to finance these textile purchases. Several of the firms in the sample reported that they were unable to access credit from local banks, and because their assets (namely, their factories) were located in Nicaragua they were unable to secure financing from foreign banks. The credit crunch these manufacturers face is exacerbated by client purchasing practices, since apparel suppliers may have to wait a month or more for payment from the foreign brands whose orders they fill. Consequently, significant working capital (in excess of US\$1 million) is required to finance the textile purchase for even a relatively modest full-package order.

Beyond the particular issue of financing, several companies expressed scepticism about the merits of full-package production versus assembly subcontracting. They pointed out that full-package manufacturers incur much greater risks, since they have no alternative but to absorb the cost of goods returned or rejected by the client – for example, for poor quality. Although full-package production may be more profitable than traditional assembly subcontracting, not all manufacturers are convinced that the margins are sufficiently high to offset this greater risk. Furthermore, the firms interviewed reported that they do not necessarily have greater control over the production process when filling a full-package order due to the detailed specifications client firms provide.

For example, when placing an order buyers may specify not just the particular fabric they want the manufacturer to use, but even the particular vendor from which the textiles should be purchased. This level of buyer oversight limits the degree to which firms can purchase from local producers, even when such inputs are available. Client decisions about fabric sourcing are particularly critical in the Nicaraguan context, given the limited availability of TPL for non-originating fabrics. In short, these findings support the view that while full-package production may be a necessary condition of economic upgrading in the post-MFA apparel industry, it is not a sufficient condition of sustained competitiveness nor of social upgrading (Bair and Werner 2011; Plankey-Videla 2012; Schrank 2004).

Given some of the disadvantages of full-package production, why is it still the dominant production model in Nicaragua? Simply put, apparel manufacturers report that the ability to finance and coordinate full-package orders is a prerequisite for doing business with many clients. Much of the production carried out in Nicaragua is for the private label lines of mass retailers, such as Walmart, Target and Kohl's. These companies want to place orders with suppliers that can deliver a 'full-package'. Accordingly, buyers expect their suppliers to do more than just assembly or CMT, and the firms interviewed in Nicaragua are no exception. The majority offer additional services, most typically the laundering that is a standard part of the production process for jeans and twill pants, or, in the case of knitwear manufacturers, screen-printing and embroidery. Several companies also provide more sophisticated pre-production activities, including pattern marking and grading, and some product development. These findings indicate economic upgrading, as Nicaragua's value chain lengthens to include links beyond sewing.

Nevertheless, for a number of firms the additional value generated by expanded capabilities was offset by increased cost pressure due to the stagnant, or in some cases even declining, prices paid by clients. Two companies put the decline in prices over the last several years at 10–20 per cent. Many were unable to pass on rising production costs to foreign buyers. At the time of the authors' fieldwork, firms reported having been negatively affected by a dramatic spike in the price of cotton (and, thus, cotton textiles), which began during the second half of 2010 and continued into 2011 before declining. Local factors also contributed to increased cost pressures. Several firms noted the rise in labour costs caused by a series of government-mandated minimum wage increases that occurred under the current presidential administration, prior to the negotiation of the first Tripartite Agreement in 2009 (discussed below).

Yet, in spite of these challenges, Nicaragua's share of the global apparel market has been growing. The trajectories of several of the firms interviewed reflect the export performance described here. Numerous firms indicated that their plants were operating at 100 per cent production capacity at the time of the fieldwork. One company had actually grown substantially over the preceding year from 300 employees to 1,400 employees, and another three were planning expansions that would increase production volumes by between 20 and 50 per cent. While Nicaragua fulfils one of the two criteria for economic upgrading described by Bernhardt in Chapter 2 of this volume (increased market share), it fails to meet the other: the unit value of its exports declined between 1990 and 2009. For this reason, Nicaragua is classified by Bernhardt as an intermediate case of upgrading, having achieved an increase in export volumes without a corresponding increase in the value of its exports.

### Social upgrading

Assessing the degree to which social upgrading is occurring in Nicaragua's apparel industry is a challenging task, particularly in the absence of macro-comparative data on wages and working conditions that could be used to benchmark Nicaragua against other countries over time. In purely quantitative terms, the picture is clear: the number of jobs has increased substantially. When moving from quantitative to qualitative metrics, however, the situation becomes more complex.

The authors found that labour issues were a far less acute concern for firms than trade-related developments, principally the scheduled expiration of the TPLs in 2014. Although the social compliance of garment exporters has been a matter of public debate, the companies interviewed

expressed relatively little concern about the costs and pressures of complying with either the client's standards or Nicaraguan labour law. Virtually all reported being subject to client codes of conduct, but less than half of the companies in the sample were WRAP-certified (Worldwide Responsible Accredited Production is an industry-organized certification system). One was an FLA (Fair Labor Association) participating supplier, and another was going through FLA certification at the time of the interview in summer 2011.

Manufacturers expressed frustration with the redundancies inherent in the current social compliance system: because factories generally produce for multiple buyers, each with its own code of conduct and procedures for monitoring performance, many factories undergo audits multiple times throughout the year. Several firms noted that the principal reason they would consider participating in Better Work was the decision of some brands and retailers to accept the results of Better Work audits in place of their own.

A striking finding from the firm-level interviews with regard to labour was the relatively high rate of turnover. For knit firms, turnover among production workers was especially volatile. On the low side, one US-owned company in the sample that uses a modular production system to produce a variety of complex intimate garments in relatively small volumes reported turnover of less than 12 per cent per year. In contrast, other manufacturers had turnover rates of between 120 and 180 per cent annually, and one acknowledged an annual turnover rate of 300 per cent. No clear pattern emerged with regard to a correlation between turnover rates and reported wages, the presence or absence of a union or the location of the factory (urban versus rural area). Although the small sample size makes it difficult to generalize about the factors that might explain either very low or very high turnover rates, it appeared that companies offering more generous fringe benefits, such as transportation to and from the factory and subsidized lunch in an on-site cafeteria, enjoyed lower turnover.

Unsurprisingly, there was a correlation between turnover rates and productivity: companies having turnover rates above 60 per cent a year had lower productivity than their counterparts with lower turnover. One company located in a relatively rural area several hours from the capital city, Managua, reported that managing high rates of turnover was particularly challenging in the context of a small local labour market. Management at this factory had recently begun conducting exit interviews with workers, and found that many were leaving to pursue educational opportunities in Managua. Others migrated to Costa Rica

in search of seasonal agricultural work. Particularly in urban areas, managers regarded substantial rates of turnover as a typical and perhaps inevitable feature of the export sector. Those in Managua, where several large trade zones hosting multiple factories are located, have found it relatively easy to replace departing workers with new ones, many of whom already have experience in the industry.

Perhaps for this reason, some companies offer little in the way of formal training, and two of the firms manufacturing knit shirts reported that they provide none at all. Training varied across other factories from an average of two to ten weeks, with one outlier reporting that the training period for more complicated operations could be as long as 40 weeks. Nicaragua's national training institute – the National Institute of Technology (INATEC) – provides training and certification services for the workforce. Companies, including those in the free trade zone sector, pay fees equivalent to 2 per cent of their payroll to INATEC, which are intended to cover access for their employees to INATEC's technical education and training programmes. However, few of the companies interviewed were using INATEC's services at the time of this research. The consensus is that there is little connection between the kinds of skills that are in demand among apparel and textile firms, particularly of a technical or managerial nature, and the courses that INATEC offers. For example, several managers claimed they were constantly looking for supervisors and workers with technical skills, but these are not areas in which INATEC's programmes are strong.

Not all companies shared this assessment, however. Numerous firms reported that they had used INATEC's services in the past and found them satisfactory. The manager of a firm producing uniforms reported that his company had used INATEC for training new line supervisors. He further noted the significant pay increase associated with a promotion from sewing machine operator to line supervisor (from 4,500 cordobas to 10,000 cordobas per month). Although this company had three individuals on its managerial staff who began working in the factory as sewing machine operators, internal mobility was more the exception than the norm among local companies. In general, high turnover, paired with relatively modest levels of training, suggest that human capital formation and skills development among Nicaragua's garment workers are modest. This is an area of social upgrading with ample room for improvement.

The firms interviewed expressed concern about increasing labour costs, particularly in light of the minimum wage increases implemented by the government prior to 2009. However, they expected that increases in labour costs would be less dramatic in the immediate future, thanks

to the so-called Tripartite Agreement. This Agreement, which was negotiated between the Nicaraguan government and representatives of the private sector and organized labour, establishes a set schedule of minimum wage increases through 2013.<sup>6</sup> In exchange for locking in minimum wage increases, the Agreement also calls for the government and private sector to establish commissaries that provide workers with basic commodities, such as cooking oil, beans and rice, at below market prices. Companies were generally positive about the Tripartite Agreement, seeing it as a proactive effort on the part of the government to create a more predictable environment for local firms with regard to production costs.<sup>7</sup>

However, it is unclear to what degree workers benefit from the Agreement, which essentially removes wage determination from the market and potentially locks in increases lower than would be generated by a tighter labour market, or by continuing political and social pressures. Furthermore, when the first Agreement was signed in 2009, stakeholders feared that the industry was entering a protracted downturn caused by slumping demand from foreign buyers impacted by the US recession. However, the dip in exports that motivated this concern turned out to be temporary, and the current Agreement, which extends the schedule of pre-established minimum wage increases from two to three years, was concluded during a period of robust growth.

The Tripartite Agreement is not without its critics, who claim that the social programmes promised to workers in exchange for concessions on wage increases (e.g. an affordable housing programme) have not developed as promised (Rogers 2012). Yet, while there are complaints about the implementation of specific clauses, there is also widespread support for the principle of social dialogue and the tripartite structure in place to facilitate it. With the current Agreement set to expire in 2013, government officials in 2012 were optimistic that a new agreement would follow. It was not yet clear what the duration of it would be, however, since some parties are arguing for a five-year agreement, while labour leaders who are wary of locking in negotiated, automatic wage increases for a longer period of time, want another three-year deal.

In the authors' interviews with firms, labour representatives and a variety of apparel industry stakeholders, there was broad consensus that the industrial relations environment in Nicaragua has improved markedly in recent years. The previous administration was perceived as lax in its enforcement of labour law and tolerant of employer practices, such as union busting and blacklisting, which had a chilling effect on workers' associational rights. However, there are lingering concerns about the ability of workers to exercise their rights to freedom of association

and collective bargaining. Although it appears that violations of these rights, where they occur, are primarily a firm-level phenomenon and do not necessarily indicate a pervasive or industry-wide anti-union culture, compliance with these rights is now being assessed by Better Work Nicaragua and, thus, more data regarding the pervasiveness and severity of this problem may be available in the future.

#### Americas-based versus Asia-based segments in Nicaragua's apparel value chain

One of the most salient findings that emerged from this fieldwork is that Nicaragua participates in two different segments of the apparel value chain – one based in the Americas and the other in Asia. Unlike many other apparel exporting countries, such as the Dominican Republic, India, Mexico and Sri Lanka, domestic capital plays a negligible role in Nicaragua's export sector. Of the 27 firms interviewed, only one is locally owned. The majority are subsidiaries of parent companies located in North or Central America, including in Canada, El Salvador, Honduras, Mexico and Trinidad. In addition to this set of Americas-based firms, Nicaragua is also home to companies based in Asia. Korean investors are the most common among this group, although manufacturers with parent firms in Hong Kong Special Administrative Region and Taiwan (China) were also interviewed. This distinction between American and Asian ownership was significant in four respects.

First, the companies from Asia are concentrated in the knit segment of the apparel industry and manufacture mostly basic, low value-added garments, such as t-shirts, with the exception of two manufacturers of woven pants based in Taiwan (China). Korean manufacturers have a sizable presence in the knitwear segment, owning five of the 14 knitwear firms in Nicaragua. In contrast, companies from the United States dominate the production of woven apparel (eight of 13 firms).

Second, the Asian-owned companies are larger. The average number of employees reported by subsidiaries of firms based in Asia (3,638 workers) was more than double the size of subsidiaries with parent companies based in the Americas (1,560 workers). There is significant variation within each group, however, and the major dimension in terms of size appears to be type of apparel (knits versus woven) rather than ownership. The three largest employers in the free trade zone sector are all knitwear producers, and together they represent almost one-quarter of total apparel employment in Nicaragua's free trade zones.

Third, the Asian companies in the sample tended to be more global than their American counterparts. While many of the companies based

Table 11.3 Key indicators of firms in Nicaragua, 2011

Firm type <sup>a</sup>	Year est. <sup>b</sup>	Ownership <sup>c</sup>	Product type <sup>d</sup>	Fabric <sup>e</sup>	Product/week <sup>f</sup>	Emp. <sup>g</sup>
K1	n.a.	United States	OBM, M	55–60% United States, rest from Asia, Mexico, Central America	240,000	1,300
K2	2001	United States	FP	United States CAFTA countries	200–250,000	900–1,300
K3	2006	United States	97% FP, 3% CMT	very little US fabric, Milliken, El Salvador	100,000	1,400
K4	2004	Republic of Korea	FP		600,000	5,200
K5		Canada	OBM	Honduras (US yarn)	3 million	5,500
K6	1994	Republic of Korea	FP	60% Taiwan (China) and China, 40% Honduras, minimal Guatemala	n.a.	5,600
K7	2002	Hong Kong (China)	FP	100% China (own textile mill)	75,000	700
K8	2005	United States	FP	Honduras (US, Pakistani yarn)	750,000	1,250
K9	2010	Republic of Korea	FP	70% Asia (mostly China); 30% Honduras	125,000	2,100
K10	1999	Republic of Korea	FP	Republic of Korea and China	475,000	2,777
K11	2007	Honduras	FP	90% Honduras (own textile mill, some Pakistani yarn)	120,000	680
K12	2008	El Salvador	FP	China, El Salvador, Guatemala	15–20,000	1,075
K13	2008	United States	FP	China, US, Guatemala, Honduras	5,000	330
K14	2005	Republic of Korea	FP	Republic of Korea, China	125,000	1,250
W15	2009	Nicaragua	90% CMT, 10% FP	50% Asia, 50% US	125,000	3,900
W16	n.a.	United States	CMT	US, Mexico, China, Nicaragua (Alpha)	130,000	2,500
W17	2000	United States	FP	50% China, 50% US	120,000	1,200

(continued)

Table 11.3 Continued

Firm type <sup>a</sup>	Year est. <sup>b</sup>	Ownership <sup>c</sup>	Product type <sup>d</sup>	Fabric <sup>e</sup>	Product/week <sup>f</sup>	Emp. <sup>g</sup>
W18	n.a.	United States	FP	15% US, 85% Nicaragua (Alpha)	65–70,000	1,600
W19	n.a.	Mexico, US	CMT/FP	US, Mexico, Asia	100,000	1,600
W20	2008	United States	FP	United States, Nicaragua (Alpha)	100,000	2,000
W21	2007	United States	FP	50% China, 50% United States	105,600	800
W22	n.a.	United States	OBM	50% Pakistan and China, 50% US Mexico (<1%)	170,000	1,000–1,100
W23	2009	Mexico	Contract laundrer	n.a.	200,000	1,100
W24	1999	Taiwan (China)	CMT	Depends on client, some Guatemalan	105,000	1,200
W25	2005	Taiwan (China)	FP	Asia	90,000	3,000
W26	2009	Trinidad	CMT/FP	United States, local (Alpha Textil), China	15,000	200
W27	2004	United States	CMT	Asia, US	50,000	1,000

## Notes:

<sup>a</sup>K refers to knitwear manufacturers; W refers to wovens manufacturers.<sup>b</sup>Year of establishment.<sup>c</sup>Ownership of company.<sup>d</sup>Production model: M denotes maquila; FP denotes full package; OBM denotes own-brand manufacturing.<sup>e</sup>Origins of textiles.<sup>f</sup>Units per week.<sup>g</sup>Direct employment in owned and operated facilities.

Source: Firm interviews by authors.

(but not in Asia). One exception is the Nicaraguan subsidiary of VF Corporation, one of the world's largest blue jeans manufacturers, which is an outlier in the sample since VF owns many production facilities throughout Asia and Latin America.

A fourth and related finding pertains to the origins of the materials used in local production, and, therefore, the dependence of Asian versus American companies on the TPLs granted to Nicaragua. Although virtually every company interviewed used TPLs for at least some portion of their exports, the only companies that used TPLs for more than 50 per cent of their exports were those with Asian parent firms. In at least one case, all of the fabric used in Nicaragua was knitted in the company's owned-and-operated textile facility in China. The reliance of these firms on what may well prove to be short-term trade preferences, and the relative ease with which they can reorient orders across geographically extensive production networks, creates a serious challenge for economic and social upgrading in Nicaragua.

### The challenges of trade-dependent development

Nicaragua confronts a number of difficulties as it attempts to parlay its recent export dynamism into a longer-term trajectory of economic and social upgrading. Its principal challenge lies in compensating for the loss of the trade preferences it has enjoyed under the CAFTA. Although Nicaragua continues to offer the lowest labour costs among the CAFTA countries, it cannot compete with countries such as Bangladesh and Viet Nam for the cheapest needle. Therefore, as both government officials and industry actors acknowledge, cheap labour will not sustain the country's position in the global apparel market.

At the same time, Asian exporters are able to exploit a regional textile base that is lacking in Central America. Although geographic proximity to the US market provides some advantage to manufacturers in the Western hemisphere, the global geography of textile production, centred in Asia, lessens this benefit. Minimizing the distance between the apparel and textile links in the chain (as opposed to the distance between the site of apparel assembly and the final market) implies a shorter supply chain for apparel companies, which in turn translates into lower transport costs, faster delivery times and potentially fewer bottlenecks and delays in the production process.

At the same time that Nicaragua is competing with Asia's exporters, it also faces a challenge from within its hemisphere. Haiti's fledgling export processing sector has received substantial investment in recent

in the United States or elsewhere in the hemisphere do not have manufacturing facilities outside of the Americas, several of the Asia-based companies boast production networks that are decidedly global in scope. This is particularly true for the Korean multinationals. For example, Sae-A Trading has 17 subsidiaries in six countries around the world, while Hansoll has 12 factories, principally in Asia (Viet Nam, Indonesia, Cambodia and the Philippines). Several of the US companies active in Nicaragua have owned and operated facilities elsewhere in the Americas

years from multiple sources, including the International Monetary Fund (IMF), the US government and the Inter-American Development Bank (Sontag 2012). Efforts to develop the country's export sector received increased attention after the 2010 earthquake, but initiatives to promote Haiti's apparel industry have been underway for years. Although not a signatory of CAFTA, Haiti received TPLs as part of a CAFTA side agreement in recognition of its status as the least developed country in the region. Up to 400 million square metre equivalents of non-originating apparel can enter the US market from Haiti each year (a TPL benefit four times greater than Nicaragua's). Haiti's TPLs are not only greater than Nicaragua's, they are also of longer duration, extending through 2018 instead of 2014 (Hornbeck 2010). The competition between Haiti and Nicaragua is heightened by the fact that, as mentioned already, Haiti is the only other country in the Americas to participate in the Better Work programme.

Knit apparel is the traditional mainstay of the Haitian apparel industry, accounting for more than three-fourths of the country's apparel exports to the United States. At the time of this fieldwork, one knitwear manufacturer, Sae-A, was in the process of inaugurating operations in Haiti. With 5,200 employees in five factories, Sae-A is one of the largest firms in Nicaragua. Yet plans call for the company's Haitian facilities to employ some 20,000 workers – more than three times the size of its Nicaraguan workforce (Sontag 2012). A few of the other companies interviewed were either actively pursuing investment opportunities in Haiti or considering doing so, largely motivated by a desire to retain access to TPLs once Nicaragua's TPL benefit expires. Among the companies actively considering such a move was a large manufacturer of jeans, whose presence in Haiti would further develop that country's modest but increasing supply of woven pants.

Virtually all firms acknowledged that the elimination of the TPLs would have a significant impact on their Nicaraguan operations. Some industry actors, presumably hoping to pressure policymakers into action, have made such statements publicly.<sup>8</sup> At the time of writing, officials in the Nicaraguan government were working with foreign buyers to lobby US policymakers for some extension of TPLs, possibly on a bilateral basis outside the auspices of CAFTA. However, it was unclear if these efforts will prove successful, and both public and private sector officials recognize that Nicaragua will eventually have to adjust to a post-TPL environment.

Thus, one of the major challenges confronting the industry – not just in Nicaragua, but in Latin America more generally – is developing

a textile base that will enable exporters in the hemisphere to compete with Asia. To date, there is little evidence that the region's exporters are trying to coordinate their efforts in this regard. Although there is some regional supply of knit fabric in Central America, and Mexico manufactures a modest amount of denim, Nicaragua does not produce fabric. The country does have a large textile mill, however. US textile giant Cone Mills (part of the International Textile Group) built this facility, which opened in May 2008. It operated for less than two years and is currently closed, though the Nicaraguan government has been actively courting investors in the hopes that the plant may re-open. Aside from the Cone denim plant, the only other textile facility in Nicaragua is a converter that finishes imported greige goods (raw fabric that has not been dyed) as twill fabric.

But even if the textile base supporting Nicaragua's apparel manufacturers were strengthened, either domestically via investment in local fabric production or regionally via the purchase by Nicaraguan manufacturers of textiles being made elsewhere in the Americas, many apparel firms would continue to source some textiles from outside the region. Indeed, since in many cases it is the foreign buyer and not the local manufacturer that specifies the type and origin of fabric to be used in a particular order, this is not a decision over which apparel manufacturers necessarily have control.

Of course, if cost-competitive regionally produced textiles are available, manufacturers still have to be able to purchase them. Here one of the implications of the Americas-based versus Asia-based segments of the value chain is drawn out: most of the companies that were particularly concerned about financing were based in the Americas. These tended to be relatively small firms that had relocated production to Nicaragua, either from the United States or from elsewhere in Latin America (e.g. El Salvador or Mexico). Precisely because these companies lack an extensive network of owned-and-operated production facilities or global subcontractors in numerous countries, the Americas-based segment of the Nicaraguan apparel value chain may be less mobile than its Asia-based counterpart. In addition, while the Americas-based firms may be more closely tied to the future of Nicaragua's apparel industry than their Asian counterparts, their success may also be more contingent on broader factors such as access to cost-competitive textiles and the availability of credit, since they are less likely to be vertically integrated or have factories in Asia located close to that region's textile mills.

One notable development on the financing front is the extension to Nicaragua of the Global Trade Supplier Finance Programme (GTSPF),

which is a joint effort of Better Work and the IFC dating from 2010. This programme allows suppliers participating in Better Work to submit invoices for shipped goods to the Financing Programme, which then 'buys' the invoice in the form of an extremely low interest loan. This enables companies to manage the cash flow problems that result from the long delays between invoicing a buyer for delivered goods and receiving payment. Though currently it is unclear if a company's access to credit will be linked to its *performance* on the Better Work audit (as opposed to its *participation* in the programme), the Global Trade Supplier Financing Programme may offer the possibility for linking economic and social upgrading – a goal that has, until now, proven elusive.<sup>9</sup>

### **From factory compliance to social upgrading: the role of Better Work Nicaragua**

This final section reviews the possibilities for Nicaragua to pursue upgrading via participation in the Better Work Nicaragua programme. The Nicaraguan government, particularly the CNZF, actively lobbied to secure inclusion in the programme, as did the US government. In October 2010, General Baltodano, the presidential delegate for investment and director of the CNZF, and US Secretary of Labor Hilda Solis announced a US\$2 million grant to support Better Work Nicaragua.

During the authors' initial fieldwork in fall 2010, some scepticism was found among local manufacturers about the benefits of participating in Better Work. Some were worried that the programme's implementation in Nicaragua would send the wrong signal, causing the country to be perceived by foreign governments or global buyers as a 'problem case' in need of remedial attention. Because other Better Work countries lag in the area of protecting workers and enforcing labour laws, their concern was that Nicaragua's inclusion in the programme might indicate weakness rather than strength.

During the first year of the programme, Better Work Nicaragua staff worked hard to overcome these anxieties and enlist the participation of local firms, both through contacts with the local apparel industry association and by educating foreign buyers sourcing from Nicaragua about the project and encouraging them to secure the participation of their local suppliers. As of August 2012, Better Work Nicaragua had secured the participation of 11 factories, and was in the process of enrolling several more. Current plans call for the release of an initial Synthesis Report (an overall assessment of compliance at the country level) when

at least 15 factories have been audited, since this would represent well over 25 per cent of the total number of garment factories (54, as of August 2012) currently operating in Nicaragua's free trade zones.

Almost half of the 11 companies that have agreed to participate in Better Work Nicaragua so far are Asian-based multinationals with plants in Nicaragua. This suggests that Asian-owned companies are overrepresented among Better Work participating factories, since Korean- or Taiwanese-owned companies account for a little more than one-third of the total number of apparel plants in the country (though they account for a greater proportion of apparel output and employment since they are among the largest firms in the industry). This may reflect their greater familiarity with the Better Work programme due to their participation in other countries where they have plants, such as Viet Nam and Indonesia, and it mirrors the uptake of the programme in Lesotho, as described by Pike and Godfrey in Chapter 8 of this volume. In contrast, American-owned companies have been relatively slow to enrol. However, Walmart recently announced that it will make participation in Better Work Nicaragua mandatory for its Nicaraguan suppliers.

The most distinctive feature of the Better Work programme vis-à-vis conventional compliance approaches is the technical and advisory services that staff members (known as enterprise advisers) provide participating factories. Following a Better Work audit, participating factories develop Performance Improvement Consultative Committees (PICCs). These bodies, comprised jointly of labour and management representatives, are charged with developing and implementing remediation measures to address whatever problems were identified in the audits. In this sense, Better Work has the potential for working with industry stakeholders, including foreign buyers, to develop an understanding of the factors creating downward pressure on wages and working conditions in global supply chains.

Better Work is premised on the hypothesis that there is, or can be, a positive feedback loop between economic and social upgrading. The advisory services that Better Work offers, and the support provided to PICCs at the enterprise level, are designed to identify causes of non-compliance and address them at the source. Improved performance on the audit is not only an indicator of social upgrading (e.g. insuring that wage payments and working conditions are consistent with the law, insuring a safe and discrimination-free work environment, etc.), but it can also be a means to economic upgrading as well. By identifying and addressing the root causes of violations, Better Work Nicaragua hopes to directly affect productivity, thus, facilitating economic upgrading as

well. The factory-level data gathered in Nicaragua and in other Better Work countries provides a unique opportunity to test this hypothesis, and may yield evidence of a 'business case' for labour compliance that will incentivize companies to improve their performance. Thus, Better Work offers a unique opportunity to go beyond the standard approach to labour compliance represented by corporate code of conduct programmes, third party auditors or existing multi-stakeholder initiatives (see Anner 2012; Locke, Amengual and Mangla 2008; Locke and Romis 2010; Mayer and Gereffi 2010).

While the ultimate objective and design of the Better Work programme are consistent across all the participating countries, the criteria used to evaluate factories differ in each country. This is because the compliance assessment tool used by Better Work's auditors is based not only on the ILO's core labour standards but also on national labour laws. Consequently, Better Work's impact in a given country will depend on how much of an 'enforcement gap' exists between these standards and industry practices at the time of the programme's implementation. This presents a somewhat perverse challenge for Nicaragua, which is entering the programme at a relatively high baseline. As expected, the Better Work Nicaragua audits that had been carried out at the time of writing did not uncover any incidents of 'zero tolerance' violations (child labour, forced labour, etc.). Thus, demonstrating measurable improvement from this baseline will likely require progress on some of the issues that are more difficult to monitor and remediate.

One such example is freedom of association, which observers have noted is difficult to detect and remediate using conventional auditing methodologies (Anner 2012). In part, this is because the rights of workers to form unions and bargain collectively are likely to be more costly to employers and regarded as inimical to their interests, and the negative reputational consequences of non-compliance with workers' associational rights are perceived as lower than with other violations, such as child labour. However, freedom of association and collective bargaining are also more difficult to monitor and enforce because these are fundamentally dynamic *processes* rather than discrete *standards*, such as the number of fire extinguishers found on the factory floor or the hourly rate of overtime pay, which are, at least in theory, more easily verified during a particular audit (Rodríguez-Garavito 2005).

While evidence is still accumulating on Better Work Nicaragua, this project represents a challenge as well as an opportunity, not just in terms of achieving Better Work's aims of increasing labour compliance, but also in terms of Better Work's ability to advance the debate about

labour outcomes in global industries beyond a narrow compliance perspective. The institutionalized social dialogue that exists in Nicaragua provides a unique infrastructure that Better Work Nicaragua can build on. For example, one of the first tasks necessary to get Better Work off the ground in any country is the formation of a Project Advisory Committee (PAC), which includes representatives of the three core constituencies of the ILO: government, workers and employers. Rather than beginning this process by identifying the appropriate stakeholders and convincing them to participate in such a structure, as Better Work staff in other countries have had to do, the Better Work Nicaragua staff was able to assemble a PAC by enlisting the participation of the groups that had negotiated the Tripartite Agreement. These PAC members played an important role in developing the Compliance Assessment Tool for Better Work Nicaragua's factory audits, thus securing a degree of stakeholder participation and input in the process that was unprecedented for the Better Work programme.

While initial indicators of Better Work Nicaragua's efforts are promising, we want to end on a note of caution. Better Work provides an opportunity to go beyond a cosmetic approach to labour compliance by trying to identify and address the root causes of violations. While some violations undoubtedly occur due to managerial incompetence or oversight, buyer practices also play a role. Therefore, Better Work should move beyond the tripartite structure of the ILO narrowly conceived and include the brands and retailers that are placing their orders with developing country exporters. These companies are not the direct employers of garment workers in Better Work countries, but their policies and practices – particularly with respect to lead times and pricing – critically shape the production process at the factory level and, therefore, directly affect workers (Anner, Bair and Blasi 2012). Thus, while it is necessary for local stakeholders, including the Nicaraguan government, trade unions and the employers' association, to pursue the opportunities for economic and social upgrading that Better Work provides, the ultimate success of the project may be contingent on the meaningful participation of the brands that are the clients of Nicaragua's manufacturers.

The importance of global buyer participation was repeatedly underscored in the authors' interviews. Specifically, company representatives and industry officials expressed a strong desire to see a more active commitment to Better Work on the part of foreign apparel buyers. While local manufacturers were encouraged that some buyers promised to reduce or eliminate their audits of local firms participating in Better Work, they are hopeful that buyers might provide more incentives for

local factories to participate (e.g. by pledging to source only from Better Work factories). One informant expressed his view this way:

The brands have to understand that they need to be involved in this process. If it [Better Work] doesn't generate contracts for companies, no one is going to participate because it won't have any value added for them.

To date, the only concrete commitment made by brands is that they will reduce or eliminate the audits they would otherwise carry out in participating factories, meaning they will accept the results of the Better Work assessments in place of their own. This is far short of what the factories would like to see. While purchasing guarantees or other kinds of concrete commitments on the part of the brands will not be easy to achieve, it is critical that buyers do more than simply encourage their suppliers to participate. They need to be full and willing partners in a dialogue with suppliers in order to identify, and ultimately alter, buyer practices that contribute to non-compliance and inhibit more meaningful forms of social upgrading. Combined economic and social upgrading has the best chance of benefitting local workers and their families, not just in Nicaragua but all along the apparel value chain.

## Notes

1. The signatories of CAFTA – the United States, Costa Rica, Dominican Republic, Honduras, Guatemala, El Salvador and Nicaragua – ratified and implemented the treaty individually, which meant that it became operative in different countries at different times. In Nicaragua, CAFTA entered into force in April 2006.
2. The authors' research was part of a study commissioned by the Nicaraguan government, and specifically by the Secretariat of the National Free Zones Commission (CNZF). Officials at CNZF wanted a diagnostic study of the strengths and weaknesses characterizing the Nicaraguan apparel industry, and the prospects for improving its competitiveness, particularly in the context of the CAFTA-DR trade agreement with the United States. Through resources provided by the US Agency for International Development (USAID) and its local programme 'Nicaragua Empresas y Empleo' (carried out by CARANA), the Center on Globalization, Governance & Competitiveness (CGGC) at Duke University in Durham, North Carolina was commissioned to carry out this study in fall 2010 (Gereffi and Bair 2010). Ingrid Veronica Mujica and Stacey Frederick of CGGC contributed to the initial research and report. This chapter also draws from follow-up fieldwork in both Nicaragua and Honduras that was conducted by one of the authors in summer 2011, as well as subsequent updates from informants in summer 2012.
3. In addition, three other non-apparel companies within the free trade zone sector were interviewed: a call centre, a furniture manufacturer and a company producing disposable medical equipment.
4. Knit apparel accounts for a greater percentage of Nicaragua's total garment exports. In 2009, the value of knit apparel exports to the US market (US\$4.9 billion) was more than three times the value of woven apparel exports (US\$1.4 billion).
5. Although the fabric these companies use is produced in another CAFTA country (Honduras), the shirts sewn in Nicaragua do not necessarily qualify as CAFTA-originating because some of the yarn used in the Honduran mills comes from outside the region. For this reason, companies using this regional production model may still require TPLs for some portion of their production.
6. The Tripartite Agreement model dates from 2009, when dislocations in the export sector caused by the US recession and the consequent decline in apparel orders from foreign buyers led government officials to propose and negotiate with private sector and labour leaders an Emergency Economic and Labor Agreement in March 2009. This Agreement created the Free Zone Tripartite Labor Commission as a forum for dialogue and cooperation between the parties, with the goal of strengthening the industry and preserving jobs in the textile and apparel sector. It also established specific minimum wage increases for 2009 and 2010 (8 and 12 per cent increases, respectively). In January 2010, the same parties signed a new Agreement that outlined a schedule of minimum wage increases from 2011 through 2013 (8 per cent in 2011, 9 per cent in 2012 and 10 per cent in 2013).
7. The widespread perception is that the government was motivated to pursue the Agreement by a wave of job losses in the industry, most notably those precipitated by the decision of the large Taiwan-based multinational apparel manufacturer Nien Hsing to abandon its sewing operations in Nicaragua in 2008, leading to a loss of some 14,800 jobs.
8. For example, Randy Price, vice president of manufacturing for VF Corporation (a company which produces jeans and khaki pants in an owned and operated facility in Nicaragua), has stated that the TPL issue is 'imperative to VF's Western Hemisphere strategy'. Furthermore, because 'a company as large as VF needs 12 to 18 months to plan production and raw material input strategies', the parent corporation will make a decision about whether to maintain production volumes in Nicaragua well in advance of the 2014 expiration date, adding significant pressure and making the timely resolution of this issue critical (Nichols 2011).
9. The IFC pioneered a programme that links loan conditions to investments that enable environmental upgrading (the Climate Smart Trade Initiative); this provides a precedent for incentivizing social upgrading among suppliers participating in Better Work.