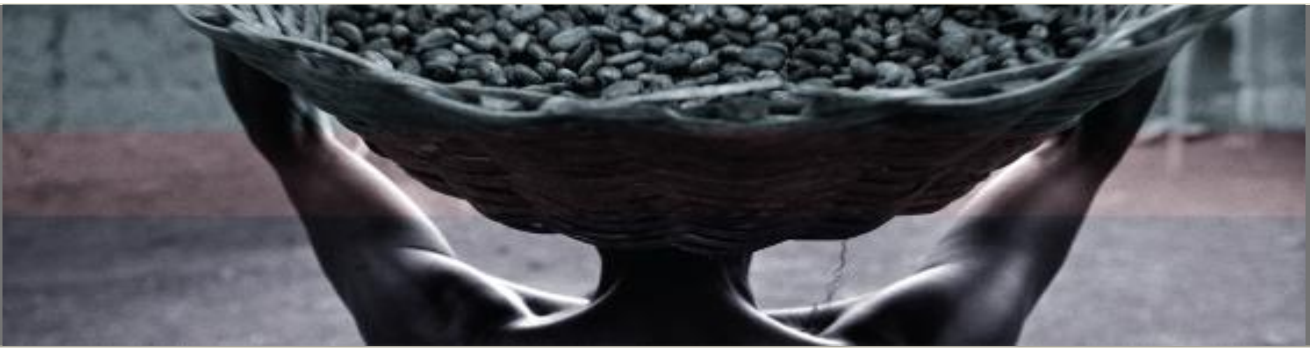

CAPTURING
THE
GAINS

economic and social upgrading
in global production networks

Better Work in Central America: assessing the opportunities for upgrading in Nicaragua's apparel sector

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February 2013

Working Paper 17

Capturing the Gains 2013
BN : 978-1-907247-83-5

Abstract

What can Better Work offer producers in a country like Nicaragua to alleviate the burden caused by the heavily trade-dependent nature of the industry's development, and how do the relatively high-level institutional development and work-place protections in the country affect the willingness of manufacturers to cooperate with Better Work Nicaragua? Drawing on data collected by the authors during fieldwork in Nicaragua, as well as from secondary literature, this working paper explores the contemporary context of the Nicaraguan industry, outlining the opportunities and challenges confronting the country's apparel sector. Nicaragua is the first and only Central American country to participate in Better Work. The second poorest country in the hemisphere, its manufactured exports are heavily concentrated in apparel. While Latin America's share of the US apparel import market has declined in recent years, Nicaraguan export growth has remained robust. Nicaragua's strong performance relative to other regional exporters reflects the special benefits it has received under the Dominican Republic–Central American Free Trade Agreement (CAFTA-DR) with the US, namely the tariff preference levels (TPLs) that permit apparel exports from the Dominican Republic to enter the US market duty-free even when these garments do not meet CAFTA rules of origin (RoO). Although these preferences have enhanced Nicaragua's competitiveness vis-à-vis other regional exporters, the TPL programme is set to expire in 2014. Better Work Nicaragua is thus being implemented during a period of uncertainty, therefore it is critical to understand what local stakeholders in both the public and the private sectors believe will be the consequences of this change in the regulatory regime, and how they are trying to respond to it. This paper concludes that there is a crucial need to craft a programme that reflects the specific conditions that characterize Nicaragua and differentiate it from other Better Work countries.

Keywords: Nicaragua, apparel, TPL, Better Work, CAFTA

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This document is an output from a project funded by the UK Department for International Development (DFID), the Sustainable Consumption Institute (SCI), the Chronic Poverty Research Centre (CPRC) and the Economic and Social Research Council (ESRC). However, the views expressed and information contained in it are not necessarily those of or endorsed by the funding organizations, which can accept no responsibility for such views or information or for any reliance placed on them.

Abbreviations

ANITEC	Nicaraguan Industry Association for Textile and Apparel Companies
ATC	Agreement on Textiles and Clothing
BWN	Better Work Nicaragua
CAFTA	Central American Free Trade Agreement
CAFTA-DR	Dominican Republic–Central American Free Trade Agreement
CECATEC	Central American–Dominican Republic Apparel and Textile Council
CGGC	Centre on Globalization, Governance & Competitiveness
CNZF	National Commission of Free Zones
COSEP	Superior Council of Private Enterprise
CPRC	Chronic Poverty Research Centre
DFID	Department for International Development
ESRC	Economic and Social Research Council
EU	European Union
FLA	Fair Labor Association
FTZ	Free Trade Zone
GAL	Guaranteed Access Level
GATT	General Agreement on Tariff and Trade
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
INATEC	National Institute of Technology
MFA	Multi-fibre Arrangement
MITRAB	Ministry of Labour
NAFTA	North American Free Trade Agreement
PAC	Project Advisory Committee
PICC	Performance Improvement Consultative Committee
RoO	Rule of Origin
SCI	Sustainable Consumption Institute
SME	Square Metre Equivalent
TPL	Tariff Preference Level
UK	United Kingdom
US	United States
USAID	US Agency for International Development
WRAP	Worldwide Responsible Accredited Production
WTO	World Trade Organization

Introduction

Changes in the geography and organization of apparel production are affecting garment workers and the companies that employ them throughout the world. While many countries were impacted by the phase-out of the Multi-fibre Arrangement (MFA) and the inauguration of quota-free trade in textile and apparel products in 2005, the implications are particularly critical for developing economies that are heavily dependent on the garment sector for export, revenue and employment creation. This chapter focuses on one such country: Nicaragua.

Nicaragua is typical of other low-income industrializing economies in terms of its high concentration of manufactured exports in the apparel sector. However, at least among the major garment-producing countries in the Western hemisphere, Nicaragua is unique because, unlike the vast majority of its neighbours in Latin America, it has seen strong growth in apparel exports since 2005. Nicaragua is thus an exception to the general trend in the global garment industry – an industry that has seen a decisive shift towards Asia in recent years, largely reflecting China's rise as the world's largest clothing exporter, and a concomitant decline in US apparel imports from the Americas.

Nicaragua is also the only country in Central America, and second in the Americas (following Haiti), to participate in the Better Work programme. Here, too, the Nicaragua case is exceptional because, unlike a number of the other Better Work countries, which are known to have pervasive or serious problems in the area of labour compliance, Nicaraguan garment factories are generally not associated with systematic abuses of workers' rights. Since the accession of former Sandinista leader Daniel Ortega to the presidency in 2007, Nicaragua's record of labour law enforcement, and the industry's compliance with those laws, has been relatively positive. In this context, the Nicaraguan government has viewed participation in the Better Work programme less as a way to improve working conditions in its free trade zones (FTZs) and more as an opportunity to publicize what it perceives to be 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 US, an agreement 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 CAFTA signatories an advantage vis-à-vis other apparel exporters, for most 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 US is the fact that country was granted preferential treatment under CAFTA in recognition of its status as least developed among all participating countries. Specifically, Nicaragua has been granted a limited volume of trade preferential levels (TPLs), which have enabled Nicaraguan exports that do not meet the yarn-forward rule of origin (RoO) established under CAFTA (e.g. items made from 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 fuel the sector's growth.

However, the TPL granted to Nicaragua under CAFTA is temporary, and set to expire in 2014. Although not a signatory of CAFTA, Haiti also received TPLs as part of a side agreement in recognition of its status as the least developed country in Latin America. The TPLs for Haiti are more generous than Nicaragua's in terms of quantity and duration, since they extend through 2018. The looming expiration of Nicaragua's TPLs, combined with the extension of TPLs to Haiti, is generating significant concern among industry stakeholders and the Nicaraguan government about how the industry will withstand the loss of this advantage, especially given the absence of a local textile base from which to source the fabrics US buyers require.

The current climate of uncertainty in Nicaragua 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 both the Nicaraguan government and the private sector. Throughout the second half of the 20th century, trade rules and regulations have been consequential for virtually every country in which apparel has been a leading export item. However, the nature of this regulatory dependence is changing as a result of the inauguration of quota-free trade. Since the elimination of quotas in 2005, Asia has become the undisputed epicentre of global apparel production. A handful of countries (most notably China and to a lesser extent India) are emerging as winners; the remaining countries, including Nicaragua, are scrambling for those trade preferences that secure them access to the lucrative Northern hemisphere markets on which they depend.

This situation raises important questions about the relationship between economic upgrading (which generates foreign exchange, creates jobs and increases competitiveness) and social upgrading (better job security and wages, improved working conditions, stronger labour rights and higher skills) in global industries. Nicaragua wants to use the apparel export sector to promote both economic and social upgrading, but its ability to do so is affected by the regulatory environment created by the CAFTA regime. If 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 have a negative impact on the broader agenda of social upgrading, since it is difficult to improve wages, working conditions and employment security in an industry that is either contracting or struggling to remain competitive.

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 foster labour compliance in global industries? Can Better Work strengthen the tenuous connection between economic and social upgrading by creating more stable export growth prospects with global 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 working paper provides answers to these and other questions, drawing heavily on field research in the country the authors conducted during the autumn of 2010 and the summer of 2011.[1] A total of 55 interviews were carried out; these interviews are the primary data source on which this paper is based. Of the total number of interviews, 32 were with companies; 13 with government agencies, including the National Commission of Free Zones (CNZF), the Ministry of Labour and PRONicaragua (the government's foreign investment promotion arm); and the remaining 10 with other stakeholders, including Better Work staff, the apparel industry association and other employer organizations, trade union officials and labour rights experts. Interviews were generally conducted in Spanish, though some were in English.

The paper is organized as follows: the following section locates the Nicaraguan case within the changing context of the Central American apparel industry, as it attempts to retain a US market share in the face of growing penetration by Asian exporters. In describing CAFTA and its impact on Nicaragua, we emphasize both Nicaragua's dependence on the TPLs granted to it under CAFTA, and the extent to which the pending expiration of these benefits is generating uncertainty about the future of the industry. The next section provides a brief sketch of the Nicaraguan apparel sector, including an introduction to several of the local institutional stakeholders involved in the development and implementation of Better Work. Next we summarize the results of our interviews, and then identify the major challenges Nicaragua faces in consolidating and upgrading its apparel industry.

In the final section of the paper, focus is on the implementation of the Better Work programme in Nicaragua. We suggest that Nicaragua presents a challenge as well as an opportunity for Better Work to move beyond a model of monitoring factory-level compliance, and towards an approach that identifies the root causes of non-compliance at the firm level. In order to meet this challenge and seize the opportunity 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 sustainable solutions to decent work. If Better Work Nicaragua opts for a narrow compliance agenda (i.e. monitors factories for compliance with international standards and domestic labour law but leaves other issues, like buyer–supplier relations, unaddressed), then the value of Better Work for the prevailing model of social audits is limited.

The CAFTA context: mapping Central America in the post-MFA industry

The global geography of apparel production has long been driven by trade policy. Historically, apparel has been one of the most protected of all industries, ranging from

[1] The research was part of a study commissioned by the Nicaraguan government, and specifically by the National Commission of Free Zones (CNZF). Officials at CNZF wanted a diagnostic study of the strengths and weaknesses of the Nicaraguan apparel industry, and the prospects for improving its competitiveness, particularly in the context of the CAFTA-DR trade agreement with the US. Through resources provided by the US Agency for International Development (USAID) and its local programme, Nicaragua Empresas y Empleo (implemented by CARANA Corporation), the Center on Globalization, Governance & Competitiveness (CGGC) at Duke University in Durham, NC, was commissioned to carry out the study in autumn 2010 (Bair and Gereffi 2010). Ingrid Veronica Mujica and Stacey Frederick of CGGC contributed to the initial research and report. This working paper also draws on follow-up fieldwork in both Nicaragua and Honduras conducted by one of the authors in summer 2011, as well as subsequent updates from informants in summer 2012.

agricultural subsidies on input materials (cotton, wool, rayon) to a long history of quotas under the General Agreement on Tariff and Trade (GATT) within the MFA and its successor pact under the World Trade Organization (WTO), the Agreement on Textiles and Clothing (ATC) (Adhikari and Yamamoto 2007). The MFA/ATC restricted exports to major consuming markets by imposing country limits (quotas) on the volume of certain imported products. The system was designed to protect the domestic industries of the US and the European Union (EU) by limiting imports from highly competitive suppliers in developing countries, such as China (Thoburn 2009).

The removal of quotas on 1 January 2005 marked the end of more than 30 years of restricted access to markets in the EU and North America. Retailers and other buyers became free to source textiles and 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 company strategies as they sought to realign their production and sourcing networks to accommodate new economic and political realities (Tewari 2006).

While the past decade has been characterized by the liberalization of global garment trade, regional trade agreements have also played a major role in strengthening competitive ties between the US, the largest apparel market in the world, and its main trading partners. The North American Free Trade Agreement (NAFTA), signed in 1994, and CAFTA, which came into effect in 2006, were intended to improve the competitiveness of the US textile industry as well as that of apparel exporters from Mexico and the Caribbean Basin, in the face of rapid growth in low-cost apparel exports coming primarily from Asia (Frederick and Gereffi 2011; Gereffi et al. 2002).

Table 1 shows the growth in US apparel imports from 1990 to 2011 and reflects the rise and fall of various apparel suppliers. Total US apparel imports more than tripled between 1990 and 2005, growing from $21.9 to $68.7 billion. Although imports fell between 2005 and 2009, reflecting the impact of the deep global economic recession in 2008 and 2009, by 2011 they had risen sharply to $77.7 billion. China was the leading exporter at the beginning of this period ($2.74 billion) but, collectively, the CAFTA countries were in second place, with 52 percent of China's apparel export total in 1990. By 2005, this percentage had increased to 60 percent. However, China's US apparel export industry accelerated much faster than those of its rivals, with its total share of the US market in 2011 nearly quadrupling the import market share claimed by the CAFTA countries. In the same year, China exceeded Mexico's US market share by a factor of eight.

From a regional perspective, 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 percent, while the share of the CAFTA countries, taken as a group, decreased from 16 to 10 percent. During this same period, China enjoyed dramatic growth in its share of US apparel imports, rising from 8 percent in 2000 to 22 percent in 2005 and 38 percent in 2011. Vietnam also burst onto the scene during the decade, going from no apparel exports to the US in 2000 to US import shares of 4 percent in 2005 and 9 percent in 2011. While the

CAFTA-DR countries and Mexico have been losing US import market share since 2000, China, Vietnam, Bangladesh and Cambodia have all gained ground.

Table 1: US apparel imports – regional and Asian suppliers 1990-2011

Partner	Value (in US$ millions)							% of Total Value			
	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				
China	2,739	3,518	4,499	15,143	23,503	27,975	29,392	12	8	39	38
CAFTA-DR	1,434	4,745	8,973	9,104	6,145	7,016	7,853	7	16	10	10
Vietnam	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	2	4	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	1	3	3
Total								**23**	**43**	**71**	**71**

Note: Imports by country by MFA category 1 – all apparel.
Source: US Department of Commerce, Office of Textiles and Apparel.

Apparel production has been a central manufacturing activity for the Latin American countries shown in Table 1. This is particularly true for the Central American and Caribbean countries, which lack Mexico's diversified industrial base. Exports from these countries, sometimes referred to as the Caribbean Basin region, have enjoyed preferential access to the US market under a variety of special trade regimes that have encouraged assembly for export (also referred to as *maquila* production). Traditionally, companies in the US were able to export cut parts of garments to lower-wage countries for assembly and reimport under a regime known as production sharing, or 807 production (the numbered clause of US trade law that governs this type of offshore assembly arrangement).

The 807 Trade Law (now Clause 9802) provides preferential access to US firms importing garments assembled offshore from fabrics cut in the US, with duty assessed only on the minimal value added through assembly abroad.[2] In the 1990s, new regional agreements superseded the 807 production/*maquila* model.

Since 1994, NAFTA has initiated free trade among Canada, the US, and Mexico for all products that meet NAFTA's North American RoO..A key provision of NAFTA is the RoO for a given industry that governs what kind of products qualify as originating within the trade bloc. In the case of NAFTA, any garment assembled in a NAFTA country is eligible for duty- and quota-free treatment to another NAFTA market as long as it contains yarn and fabrics produced in any of the signatory countries. The special access to US markets Mexico has enjoyed since NAFTA has led to a dramatic increase in its profile among the leading suppliers of apparel to the US. This is evident in Table 1, which shows that, at the height of

[2] A 1986 amendment of the 807/9802 Clause, known as 807A, further benefited some countries in the Western hemisphere by giving them virtually limitless quotas known as guaranteed access levels (GALs) if they exported apparel assembled from fabrics both cut and formed in the US. When it was created in 1986, the 807A revision applied to the countries of the Caribbean Basin, and was known as the Special Access Program. It was extended to Mexico's *maquiladoras* in 1988 under the name of the Special Regime.

Mexico's post-NAFTA export surge in 2000, Mexico's apparel exports to the US ($8.4 billion) far outpaced quota-constrained China's ($4.5 billion).

Manufacturers in the Caribbean and Central American countries worried that exclusion from NAFTA would hurt the competitiveness of their garment exports, which, unlike Mexico's, were still subject to value-added tariff (Bair and Dussel Peters 2006). The efforts of the Caribbean Basin countries to secure NAFTA parity resulted in the passing of the US Caribbean Basin Trade Partnership Act in May 2000, followed by successful negotiation of the CAFTA-DR in 2004. Countries participating in CAFTA, which include the US, Costa Rica, the Dominican Republic, Honduras, Guatemala, El Salvador and Nicaragua, ratified and implemented the treaty individually, meaning it became operative in different member countries at different times. In Nicaragua, CAFTA entered into force in April 2006.

One of the key questions posed by NAFTA and CAFTA was the degree to which these trade agreements, particularly with regard to RoO, would permit Mexico and the Caribbean Basin countries to move beyond the assembly subcontracting (or *maquila*) model of export production that historically prevailed throughout the region. This is important because lead companies coordinating the global value chain for apparel are increasingly sourcing via full-package production arrangements.

Under the full-package model, the company receiving the order from the buyer is responsible for financing the purchase of fabric and other raw materials. Full-package producers are also responsible for any additional operations beyond sewing (e.g. laundering, screen printing, embroidery), and are often asked to perform some pre-production tasks as well, such as creating a pattern or marker, or even contributing to the design of a garment. Full-package production requires more resources and more capabilities than *maquila* production, and is often, though not always, associated with greater security of orders and/or better returns. Thus, the shift from *maquila* to full-package production is considered a form of economic upgrading at the firm level (Gereffi, 1999).

Overall, CAFTA has helped maintain the position of Central American and Caribbean exporters among leading suppliers of apparel to the US, even though the value of the region's exports to the US fell from $9.1 billion in 2005 to $7.9 billion in 2011. Within CAFTA, the Dominican Republic and Costa Rica have witnessed significant declines in their exports to the US, but these have been offset by growth in shipments from Honduras, El Salvador and, most recently, Nicaragua. While the Dominican Republic was responsible for over a third of the CAFTA region's apparel exports in 1995, by 2011 its share of the regional total had fallen to 8 percent, making it second to last among CAFTA country exporters, ahead only of Costa Rica.

As Table 2 shows, in both 2005 and 2011 Honduras ranked first among CAFTA exporters to the US. El Salvador and Nicaragua currently rank second and third, with Nicaragua edging slightly ahead of Guatemala this past year. Nicaragua's exports to the US nearly doubled in value between 2005 and 2011; all other countries in the CAFTA region except El Salvador declined during this period. In 2005, Nicaragua claimed only 8 percent of the region's apparel exports to the US; by 2011, this had increased to 17 percent.

Table 2: US apparel imports from CAFTA countries 1995-2011

Country	Value (in US$ millions)					% of CAFTA-DR Value				
	1995	2000	2005	2010	2011	'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
Dom 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

Note: MFA category 1 – all apparel imports.
Source: US Department of Commerce, Office of Textiles and Apparel.

Nicaragua's strong export performance is particularly impressive given that CAFTA regulations have created an environment of uncertainty as a result of the pending expiration of TPLs and the possible implications of this change in trade rules. A few of the key regulations are summarized below.

RoO: The RoO for CAFTA are yarn-forward. This means CAFTA countries enjoy preferential access to US markets for all apparel sewn in a member country from fabric either woven or knit from yarn extruded within the CAFTA region. Even if Nicaragua hosted textile mills producing woven or knitted fabric, garments made from this fabric would meet CAFTA's RoO only if the yarn being used was also produced in the region.

TPLs: In recognition of the lower cost, greater availability and typically better quality of Asian fabrics, CAFTA allows Nicaragua to receive preferential access to US markets for a certain quantity of apparel, sewn in Nicaragua and using materials that do not meet CAFTA's RoO. Nicaragua is the only CAFTA country to have received these TPLs, and the maximum amount of non-originating garments permitted to enter the US under the terms of CAFTA is 100 million square metre equivalents (SMEs) per year. CAFTA also specified that TPLs would be granted for a 10-year period, meaning they are due to expire in 2014. This preference has been extremely important for Nicaragua, given the absence of domestic textile production in the country and the limited availability of cost-competitive fabrics being produced in the region.

The 'one-to-one' rule: To ensure a benefit in return for its concession on the TPLs, the US added an additional condition, for trousers made of woven fabrics. This condition is known as the one-to-one rule. Under this rule, each shipment of trousers made from woven fabrics (either cotton or man-made fibre) that is imported under Nicaragua's TPL allowance must be matched with a shipment of trousers made from fabric woven in the US from yarns extruded in the US.[3]

[3] The quantity of trousers subject to the one-to-one rule has grown over time, and in 2009 it applied to the first 50 million SMEs. Any shortfall in the commitment is then charged against the TPL for the succeeding year, thus reducing the volume of garments made from non-originating fabrics that can be given duty-free access to the US market.

In 2009, 83 percent of Nicaragua's exports to the US entered the country duty-free under a variety of different special trade agreements. Over one-third of exports (35 percent) entered under the regional RoO established by CAFTA, while 47 percent of exports were imported under the TPLs granted to non-originating exports. As these figures show, Nicaraguan manufacturers are heavily reliant on TPLs. A major concern is that the yarn-forward RoO, combined with the looming expiration of the TPLs, is creating significant uncertainty about the future of the industry and is generating alarm on the part of local stakeholders who worry that US buyers will shift orders to other factories, especially in Asia, when the TPL benefit expires. These fears are exacerbated by the fact that a sizable percentage of the companies active in Nicaragua are subsidiaries of foreign companies with a global presence, including a presence in Asia.

Nicaragua's textile and apparel value chain: key production models, market segments and institutional players

Apparel is Nicaragua's most important manufacturing sector. In terms of value, clothing accounted for just over one-third of the country's exports to the US in 2011. Although the government is aware of its high level of dependence on apparel production and is actively pursuing economic diversification, apparel is still the most important manufacturing activity in the country. In 2012, the 54 apparel factories operating in Nicaragua represented 34 percent of the total number of establishments in the FTZ sector, compared with 46 percent in 2010. In employment terms, the dominance of the apparel sector is even more striking. In 2012, the country's garment firms generated 69,000 jobs, accounting for 67 percent of employment in the FTZ. In an economy characterized by a high degree of informality (almost two-thirds of the workforce), these jobs are a critical source of formal employment.

In comparison with other CAFTA countries, such as Honduras and the Dominican Republic, Nicaragua's apparel export sector is heavily dominated by foreign firms. The apparel factories operating in Nicaragua's FTZ are owned primarily by US and Korean corporations, although the industry also hosts investors from elsewhere in Asia and the Americas.

Compared with other regional suppliers, Nicaragua's export sector weathered the financial crisis of 2008 and 2009 relatively well. Total exports dipped slightly between 2008 and 2009 but subsequently recovered. The number of new companies opening in recent years has more than offset the small number of closures that have taken place during the same period. Between summer 2010 and summer 2012, the number of apparel jobs in the sector actually increased by more than 14,000, growing from approximately 53,000 to 69,000.

Nicaragua's dominant apparel product is knitted garments, especially shirts, but in recent years its exports of woven apparel has grown more rapidly. In 2009, Nicaragua's exports of men and boy's cotton woven trousers outpaced those of the other CAFTA countries, including the Dominican Republic, a country once referred to as the 'Island of Dockers' for its dominant market position in cotton trousers. Despite the strong performance of its clothing exports in recent years, however, Nicaragua's participation in the apparel value chain is limited to the garment segment of the chain. To date, the country has not been able to develop a textile base to serve its apparel export industry.

In the remainder of this section, we describe the institutional players that are important stakeholders in the industry. Although these actors may be unfamiliar outside Nicaragua, their participation is critical in any effort to improve labour compliance and, in a broader sense, to promote social upgrading.

Nicaragua's trade unions represent the first of these stakeholders. Compared with other lower- or middle-income countries with large apparel-exporting industries, Nicaragua boasts a particularly active and independent trade union movement (Bickham Mendez 2005; Enriquez 1991). Of the 27 interviews conducted with apparel companies, more than half (15) reported the existence of at least one union in the factory, although it was not possible to verify which, if any, were company-sponsored unions. The percentage of workers belonging to unions varied dramatically across the factories in the sample, ranging from approximately 10 percent to 80 percent. In multiple cases, companies reported the presence of unions but the absence of a collective bargaining agreement.

The private sector is represented by the Nicaraguan Industry Association for Textile and Apparel Companies (ANITEC). ANITEC dates from the early 2000s, when a few owners of apparel companies started meeting in the context of the CAFTA negotiations; it was officially incorporated into the system in 2005. During the first two years that CAFTA was in effect, ANITEC played a key role in administering the TPL system and allocating TPLs among manufacturers. This role was subsequently assumed by a government agency. Although only half of the country's 70 apparel factories belong to ANITEC, in this sample of 27 apparel manufacturers only four reported not being members of the industry association.[4] Three of the four companies that do not belong to ANITEC are Asian-owned; the sample in this study included most of the large apparel firms in Nicaragua, so it is assumed both ownership and size are likely to influence membership in ANITEC.

The Nicaraguan government is the final institutional player relevant in understanding the local dynamics of the country's apparel industry. The government influences numerous aspects of the FTZ sector, including the enforcement of laws and regulations relating to labour, customs and trade. Several governmental bodies deserve specific mention. First, the governing body of the FTZ sector is the CNZF, which is responsible for granting permits and administering the FTZ regime; it also participates in negotiations of any trade agreements or international conventions affecting the export sector. Among government bodies, CNZF officials have the most extensive interaction and most cordial relationships with the private sector.

The Ministry of Labour (MITRAB) is in charge of enforcing the labour law and protecting the rights of workers. Since the administration of Daniel Ortega came to power in 2007, it has interpreted a few specific provisions of the labour law in ways that depart from the interpretations of the previous government, resulting in occasional tensions with the private

[4] ANITEC is the Nicaraguan representative of a relatively recent regional industry association, the Central American–Dominican Republic Apparel and Textile Council (CECATEC), and it also belongs to Nicaragua's main multi-sector business association, the Superior Council of Private Enterprise (COSEP).

sector.[5] The National Institute of Technology (INATEC) provides training and certification services for workforce development. Companies, including those in the FTZ sector, pay fees equivalent to 2 percent of their payroll to INATEC. These are intended to cover access for their employees to INATEC's technical education and training programmes; very few of the companies interviewed in this study reported using INATEC to train workers and staff.

In response to dislocations in the export sector caused by the US recession and consequent decline in apparel orders from foreign buyers, the three local stakeholders mentioned above negotiated and signed an Emergency Economic and Labour Agreement in March 2009. The signatories were, for organized labour, the leaders of the country's largest trade union federations; for the private sector, the president of ANITEC; and for the government, the Minister of Labour and the head of the CNZF. This agreement, known as the Tripartite Agreement, created the Free Zone Tripartite Labour 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 established specific minimum wage increases for 2009 and 2010 (8 percent and 12 percent, respectively). In exchange for locking in minimum wage increases, it also mandated the government and the private sector to work together to establish commissaries to provide workers basic commodities, such as cooking oil, beans and rice, at lower prices than can be found in retail outlets.

In January 2010, the same stakeholders signed the Social Labour Agreement of the Free Zone Tripartite Commission. In addition to committing the parties to a broader set of objectives, including a low-income housing programme designed to benefit FTZ workers, the new Agreement outlined a schedule of minimum wage increases extending through 2013. Under this Agreement, the minimum wage for workers in the FTZ is set to increase 8 percent in 2011, 9 percent in 2012 and 10 percent in 2013.

Results of company interviews

During fieldwork in Nicaragua, interviews took place with a total of 29 companies involved in the apparel value chain.[6] 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 dedicated to reviving Nicaragua's tradition of domestic cotton production), these companies were engaged in the manufacture of either woven or knit apparel. In numerical terms, they represented approximately 40 percent of the total number of establishments manufacturing apparel in Nicaragua under the CNZF regime at the time and 79 percent of total apparel manufacturing jobs.

[5] One example is the 4x4 work week. A company in this sample scheduled workers for four consecutive 12-hour days and then gave them four consecutive days off. The companies and the CNZF argued that this was consistent with Nicaraguan labour law, which sets a maximum 48-hour work week. The Ministry of Labour says this violates labour law because, although the law sets 48 hours as the maximum work week, it also mandates that people be paid overtime for hours worked in excess of eight per day.

[6] In addition, three other non-apparel companies were interviewed within the FTZ: a call centre, a furniture manufacturer and a company producing disposable medical equipment.

This section summarizes the main findings of company-level interviews. Significant differences exist between the knit and woven segments of the apparel industry in terms of product lines, client base and production model; this is reflected in the organization of the discussion in the first two subsections below. The final sub-section addresses more directly aspects related to social upgrading, including turnover and training.

Knit manufacturers

Of the 27 apparel manufacturers interviewed, 14 produce knit apparel. This group is composed of two different types of companies. The majority of companies produce large volumes of basic knit garments, mostly tops, for a range of clients, including discount retailers like Wal-Mart and Target, as well as established fashion brands like Ralph Lauren. Among this set of companies are the three largest employers in the FTZ sector, which collectively employ 16,300 workers. These three firms alone represent almost one-quarter of total apparel employment in Nicaragua's FTZ at the time of writing.

For the most part, the manufacturers of knit shirts interviewed have a global presence. All have production in at least one other country in the region (either Mexico or another CAFTA country) and most also have factories in Asia. Four knitwear companies in the sample differ from the shirt manufacturers described above because, although they also make knit apparel (specifically athletic wear and intimate wear), they are producing higher value-added products in smaller volumes. (One of these companies manufactures as many as 300 different styles a year; another reports minimum production runs of as few as 290 units.) Table 3 presents key indicators of the 14 knitwear firms included in the sample.

In terms of capabilities, the factories making knits perform a range of activities. At one end, there are basic cut-and-sew operations; in the case of one company, this is restricted just to sewing, since the parent company cuts the fabric in the same Honduran mill where it is knitted. However, a majority of the firms interviewed provide some kind of finishing services, such as embroidery and screen printing.

All companies in the knit sample are either full-package producers or they make their own brands of apparel in addition to doing some subcontracting of private labels (store brands) for retailers. Several companies reported that 2009 had been a difficult year as a result of the recession in the US and slumping demand, with one firm noting that production volumes dropped as much as 40 percent between 2008 and 2009. However, 10 out of 14 companies reported that their factories were operating at 100 percent production capacity at the time of interview. One company had grown substantially over the preceding year from 300 to 1,400 employees, and another three were planning expansions that would increase production volumes of between 20 and 50 percent. Several companies mentioned that, although business had been steady in terms of the volume of orders, there was intense pressure on price from buyers.[7]

[7] One t-shirt maker described a change in the industry beginning around 2005: 'Before I didn't have to work that hard to get orders. They came to me, and sometimes I would turn a client away because I didn't need it [the order]. Now, a buyer tells me, here is the price: do you want the order or not? It's like an auction.'

Table 3: Key indicators of firms producing knits in Nicaragua 2011

Firm	Year est.	Ownership[a]	Product type[b]	Fabric[c]	Prod./wk[d]	Emp.[e]
K1		US	OBM, M	55-60% US, rest from Asia, Mexico, Central America	240,000	1,300
K2	2001	US	FP	US, CAFTA countries	200-250,000	900-1,300
K3	2006	US	97% FP, 3% CMT	Very little US fabric, El Salvador	100,000	1,400
K4	2004	Korea	FP		600,000	5,200
K5		Canada	OBM	Honduras (US yarn)	3 million	5,500
K6	1994	Korea	FP	60% Taiwan and China, 40% Honduras, minimal Guatemala		5,600
K7	2002	Hong Kong	FP	100% China (own textile mill)	75,000	700
K8	2005	US	FP	Honduras (US, Pakistani yarn)	750,000	1,250
K9	2010	Korea	FP	70% Asia (mostly China), 30% Honduras	125,000	2,100
K10	1999	Korea	FP	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	US	FP	China, US, Guatemala, Honduras	5,000	330
K14	2005	Korea	FP	Korea, China	125,000	1,250

Notes:
[a] Refers to ownership of company.
[b] Refers to the production model: M denotes *maquila*; FP denotes full package; OBM denotes own-brand manufacturing.
[c] Refers to where textiles are produced.
[d] Refers to production per units week.
[e] Refers to direct employment in owned and operated facilities.
Source: Firm interviews by authors.

The availability and price of fabric emerged as an important issue during interviews with knit manufacturers. The relevant CAFTA RoO for companies manufacturing knits is yarn-forward. This means that garment exports to the US qualify for CAFTA preferences as long as the yarn used to knit the fabric has been produced in either the US or one of the CAFTA countries. With the exception of one company, all knit manufacturers interviewed rely on TPLs for at least some portion of the fabric they use.

Among the manufacturers of knit shirts interviewed, a pattern emerged of higher TPL reliance among companies based in Asia (the sample included five companies of Korean origin and one company with corporate headquarters in Hong Kong), as compared with those based in North America (five companies have headquarters in the US, one is based in Canada, and two are from elsewhere in Latin America). For the North American companies, the percentage of garments requiring TPLs ranged from 0 to 35 percent of total production. For the Asian companies, this percentage ranged from 25 to 100 percent. Relatively little of the knit fabric being sewn in Nicaragua is imported from the US (less than 10 percent),

although nine of 14 firms reported using at least some fabric from elsewhere in the CAFTA region.

Five of the six shirt companies are using a regional production model that involves Nicaraguan sewing factories and Honduran knitting mills. Although the fabric 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. Several of the companies we interviewed mentioned specifically that the future of their operations in Nicaragua depended on the renewal of TPLs. Thus, the limited availability of CAFTA-qualifying inputs remains a significant issue for knitwear companies.

Although a number of companies included in the sample of knit firms are vertically integrated backwards to knitting, the textile portion of this production process is not located within Nicaragua, but rather elsewhere in the region, or in Asia. The high cost of electricity in Nicaragua was cited as a factor impeding the domestic production of knit fabrics.

Woven manufacturers

A total of 13 companies interviewed manufacture woven apparel. For the most part, this production consists of denim jeans and twill pants, although the sample includes one company making woven men's shirts and another producing professional wear, including flight attendant uniforms for several major airlines. In terms of employment, the factories making woven apparel are, on average, smaller than the companies manufacturing knitted apparel. The largest of these firms is also one of the newest; employing 3,900 workers between three plants, it is the only company of Nicaraguan origin interviewed. Companies of US origin dominate this group (eight of 13): two companies have capital of Mexican origin (one is 100 percent Mexican-owned and a second is a US–Mexico joint venture); two factories are owned by Taiwanese parent firms; one is owned by a company based in Trinidad; and, as noted above, the remaining company is Nicaraguan (see Table 4).

In comparison with the knit group, this set of companies is somewhat less global. Of the 13 companies interviewed, five do not have any owned-and-operated production facilities outside Nicaragua, although one has a subcontractor in Mexico. Three have operations in Mexico, and four companies have manufacturing facilities in El Salvador, Honduras, China, and Cambodia, respectively. The remaining company, a Nicaraguan subsidiary of one of the world's largest blue jeans manufacturers, is something of an outlier, since its parent company has an extensive global manufacturing presence, including production facilities throughout Asia and Latin America.

The main US clients for this group of firms are varied and include Cintas, Levis, VF, JC Penney and Wal-Mart. As compared with the knits group, a greater diversity of production models is represented among the manufacturers of woven garments. Of the 13 companies interviewed, over half (eight firms) are doing some full-package production. Five of these eight are devoted exclusively to full-package production; the other three manage a mix of full-package and *maquila* production. Four companies are dedicated exclusively to *maquila*

production at the time of writing (one provides contract laundering services for a branded jeans manufacturer producing locally).

Table 4: Key indicators of firms producing woven apparel in Nicaragua 2011

Firm	Yr. est.	Ownership[a]	Prod. type[d]	Fabric[c]	Prod./wk[d]	Emp.[e]
W1	2009	Nicaragua	90% CMT, 10% FP	50% Asia, 50% US	125,000	3,900
W2		US	CMT	US, Mexico, China, Nicaragua (Alpha)	130,000	2,500
W3	2000	US	FP	50% China, 50% US	120,000	1,200
W4		US	FP	15% US, 85% Nicaragua (Alpha)	65-70,000	1,600
W5		Mex./US	50% CMT, 50% FP	US, Mexico, Asia	100,000	1,600
W6	2008	US	FP	US, Nicaragua (Alpha)	100,000	2,000
W7	2007	US	FP	50% China, 50% US	105,600	800
W8		US	OBM	50% Pakistan and China, 50% US, Mexico (<1%)	170,000	1,000-1,100
W9	2009	Mexico	Contract launderer	NA	200,000	1,100
W10	1999	Taiwan	CMT	Depends on client, some Guatemalan	105,000	1,200
W11	2005	Taiwan	FP	Asia	90,000	3,000
W12	2009	Trinidad	CMT/FP	US local (Alpha), China	15,000	200
W13	2004	US	CMT	Asia, US	50,000	1,000

Notes: As with Table 3, although CMT denotes cut-make-trim.
Source: Firm interviews by authors.

Contrary to the stylized upgrading trajectory within the apparel industry, which assumes a move from *maquila* to full-package production (Gereffi 1999), two of the companies interviewed have moved in the opposite direction, switching from full-package production to assembly subcontracting. Full-package production became too expensive for these companies to sustain, given the rising costs of woven fabric (reflecting an increase in cotton prices) and the lack of accessible, affordable credit to finance these textile purchases. Firms repeatedly mentioned the problem of finding adequate credit, including a company that is currently working as a subcontractor for larger local firms but would like to diversify into modest volumes of full-package production for new clients.

The majority of companies manufacturing woven apparel offer some services beyond cut and sew, most typically the laundering that is a standard part of the production process for jeans and some twill pants. Several companies also provide various pre- and post-production processes as well, including pattern marking, grading and some product development, all indicative of product and process upgrading in the apparel value chain.

In contrast to the situation described for knit apparel (i.e. a regional full-package model where fabric is formed in Honduras and sewn in Nicaragua), virtually all of the companies making woven trousers are importing CAFTA-qualifying denim from the US and denim from China under the TPLs plus the one-to-one rule for woven fabric. The companies spoken with uniformly emphasized their perception that the denim being produced in the Americas is not cost-competitive when benchmarked internationally, making the continued availability of TPLs critical for the future of jeans manufacturers in Nicaragua. Two firms implied that the

viability of their operations in the country was contingent on TPL renewal; two companies also implied that the availability of TPLs in Haiti, which are not scheduled to expire until 2018 (four years later than in Nicaragua), make Haiti an attractive alternative to Nicaragua.

Manufacturers of woven apparel, like the knit firms, emphasized the pressure of low prices on their profit margins, and attributed this primarily to the sourcing practices of buyers. Two companies put the decline in prices over the past two to three years at 10 to 20 percent. Full-package manufacturers, who purchase the fabric used in the production process, were absorbing a significant portion of the increase in cotton textile prices. Several companies also noted the rise in labour costs caused by the government-mandated minimum wage increases that occurred under the current presidential administration prior to the negotiation of the first Tripartite Agreement in 2009.

Labour-related findings from firm interviews

In general, labour issues seemed less significant than other issues, such as the availability of cost-competitive fabrics and the scheduled expiration of the TPLs in 2014. In particular, companies expressed relatively little concern about the costs and pressures of complying with either client codes of corporate conduct or Nicaraguan labour law. Half of the knit companies (7 out of 14) reported being certified with Worldwide Responsible Accredited Production (WRAP, an industry-organized certification system), one was a Fair Labor Association (FLA)-participating company and another was going through FLA certification at the time of interview. Several firms manufacturing woven apparel either belong to the FLA or are Nicaraguan subsidiaries of parent companies that are FLA-participating suppliers.

Manufacturers reported frustration with what they perceived as the redundancies inherent in the current compliance system; factories generally produce for multiple buyers, each of which have their own codes of conduct and their own procedure for monitoring compliance with these instruments, meaning many factories are audited 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 firm-level interviews with regard to labour was the relatively high rate of turnover. Turnover among production workers at knit firms is especially variable. On the low side, the company manufacturing intimate wear, which is a flexible factory organized around modular production, reported turnover of less than 12 percent per year. Three knit manufacturers reported turnover rates of between 120 percent and 180 percent annually with one firm reporting an annual turnover rate of 300 percent. Turnover among the factories producing woven apparel was generally lower. Four of the ten companies included in this sample reported annual turnover rates below 25 percent. Two more companies have annual turnover rates of 50 percent, while, at the higher end of the scale, one trouser manufacturer reported an annual turnover rate of 120 percent.

No clear pattern emerged with regard to a correlation between turnover rates and reported wages, presence or absence of a union or the location of a factory (urban versus municipal

town or rural area). Although the small sample size makes it difficult to generalize about factors that might explain either very low or very high turnover rates, it appears that, among this set of companies, those offering more generous fringe benefits, such as transportation to and from the factory and subsidized lunch in an on-site cafeteria, see lower turnover.

Unsurprisingly, there is a correlation between turnover rates and productivity: companies with turnover rates above 60 percent a year reported 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 more limited local labour market. Management at this factory began conducting exit interviews with workers to ascertain their reasons for leaving. They found many were leaving to pursue educational opportunities in Managua; others migrated to Costa Rica in search of agricultural work, although this tended to be more seasonal.

Managers viewed substantial rates of turnover among production workers, particularly in urban areas, as a typical and perhaps inevitable feature of the export sector. Especially in those companies located in Managua, where several large trade zones hosting multiple factories are located, managers 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; two firms interviewed that manufacture knit shirts reported that they provided none at all. Training periods vary across other knit factories from two weeks to four months, with the average training period being about one month. The amount of time invested in initial worker training is higher on average for companies manufacturing woven as opposed to knits. Firms reported significant variation in the amount of training provided to workers, ranging from one to forty weeks, depending on the type of job. Although two out of ten woven manufacturers reported training periods of two weeks or less, the average training period for production workers among this sample of firms was eight to ten weeks; one company reported that some workers assigned to the more complex operations could require up to 40 weeks of training.

Although Nicaragua has a national institute, INATEC (see above), whose ostensible purpose is to provide training to workers in various sectors, very few of the companies interviewed use this service: they prefer to carry out training in-house. One company reported INATEC had not been accepting new requests for training services since September 2010. The general impression of INATEC among several firms interviewed was that there was little connection between the kinds of skills in demand in apparel and textile firms, particularly those of a technical or managerial nature, and the kinds of courses INATEC offers. For example, several managers reported that they were constantly looking for supervisors and workers with technical skills, but INATEC's offerings in these areas were not strong.

Not all companies shared this assessment, however. Numerous firms reported that, although they were not using INATEC at the time of interview, they had used its 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. In this context, he went on to note the significant increase in pay associated with a promotion from sewing machine operator to line supervisor (from 4,500 to 10,000 cordobas per month). This company had three individuals on its managerial staff who had begun working in the factory as sewing machine operators, although this type of internal mobility appears to be more the exception than the rule among local companies. In general, high turnover, paired with relatively modest levels of training, suggest human capital formation and skills development among Nicaragua's garment workers is modest, and an area of social upgrading with ample room for improvement.

The firms interviewed expressed some concerns about increasing labour costs, but there tended to be a consensus that the Tripartite Agreement had in recent years brought a much-needed degree of clarity and stability to this area. Companies were generally positive about the Tripartite Commission and the two Agreements it had negotiated, seeing this as a proactive effort on the part of the government to create a more predictable environment for local firms. The widespread perception is that the government was motivated to pursue the Tripartite Agreement in response to a wave of job losses in the industry, most notably those precipitated by the decision of the large Taiwanese-based multinational apparel manufacturer, Nien Hsing, to abandon its sewing operations in Nicaragua in 2008, leading to a loss of some 14,800 jobs. The decision to negotiate an Agreement with the private sector and organized labour in the wake of these events was regarded as an indication of the government's commitment to the industry.

Labour costs could indeed become a more acute issue for Nicaragua in the future. Although Nicaragua has the second lowest wage rates in the hemisphere, labour costs there are more expensive than in Haiti, a country whose fledgling export-processing sector has received substantial investment in recent years from multiple sources, including the International Monetary Fund (IMF), the US government and the Inter-American Development Bank (Sontag 2012). In addition to Haiti's lower wage costs, the island nation also benefits from a generous allocation of TPLs. Up to 400 million SMEs of non-originating apparel can enter the US market from Haiti each year (a TPL benefit four times greater than Nicaragua's). The development of Haiti's apparel industry is a particularly serious threat to Nicaragua's knit manufacturers, since knit apparel is the mainstay of the Haitian apparel industry, accounting for more than three-quarters of its apparel exports to the US.

The parent company of one of the knit factories interviewed was in the process of inaugurating operations in Haiti at the time of writing; with a Nicaraguan workforce of 5,200 employees in five factories, it is one of the largest firms in Nicaragua. Yet, it was anticipated that its Haitian facilities would eventually employ some 18,000 workers, more than three times the size of its Nicaraguan operations. A few 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 in 2014. Among the companies actively considering such a move is a large manufacturer of woven trousers, whose presence in Haiti would further develop the country's modest but increasing supply of woven trousers.

Upgrading options and overcoming obstacles for Nicaragua's textile and apparel industry

This section highlights three issues relevant for understanding the opportunities and obstacles involved in strengthening Nicaragua's position in the global value chain for apparel, the goal being to underscore the conditions for linking economic and social upgrading in the context of Nicaragua's highly trade-dependent apparel sector, before turning to a more specific discussion of what the Better Work programme might contribute in pursuit of this objective.

The textile–apparel link: is there a future post-TPLs?

The most significant challenge the Nicaraguan industry will need to overcome in order to secure the viability of its apparel industry, especially if TPL preferences are not extended, is increasing access for local manufacturers to high-quality, cost-competitive textiles. The absence of a strong textile base, either in country or in the region, disadvantages Nicaragua against competitors such as China, India, Bangladesh and Vietnam, which are able to draw on Asia's well-developed textile base. These countries have relatively proximate textile suppliers, implying a shorter supply chain for apparel companies. This in turn translates into lower transport costs, faster delivery times and potentially fewer bottlenecks and delays in the production process.

Nicaragua is home to a woven mill built by the US textile company, Cone Mills (part of the International Textile Group). This facility, which opened in May 2008, operated for less than two years before closing. It remains closed at the point of writing, although the Nicaraguan government has been actively courting investors in the hope that it will reopen. Aside from the Cone Mills factory, the only other textile facility in Nicaragua is Alpha Textil, which produces twill from imported greige goods. 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 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.

The TPLs granted to Nicaragua under CAFTA-DR have been critical in allowing Nicaraguan manufacturers to use non-originating fabrics and remain competitive in the US import market. Thus, the expiration of the TPLs could seriously disrupt the industry's development. Virtually all firms acknowledged that the elimination of the TPLs would have a significant impact on their business. Some industry actors, presumably hoping to pressure policymakers into action, have made such statements publicly.[8] At the time of writing,

[8] For example, Randy Price, Vice-president of Manufacturing for VF Corporation (a company that produces jeans and khaki pants in a 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 need to make a decision about whether to maintain production volumes in Nicaragua well in advance of the 2014 expiration date, putting significant pressure on the company and making the timely resolution of this issue critical (Nichols 2011).

officials in the Nicaraguan government were working with foreign buyers to lobby US policymakers for an extension of the TPLs, possibly on a bilateral basis outside the auspices of CAFTA. However, it was unclear whether these efforts would prove successful, and both public and private sector officials recognized the possibility that Nicaragua's apparel firms would have to adjust to the post-TPL environment.

Company-level capabilities: competitiveness beyond cheap labour?

While Nicaragua continues to offer the lowest labour costs among CAFTA countries and the second lowest in the region (behind Haiti), it is unable to compete with countries such as Bangladesh and Vietnam for the cheapest needle. As both government officials and industry actors acknowledge, Nicaraguan firms need to increase the range of services they offer foreign buyers. Company interviews yielded some evidence that this was occurring. A sizable portion, though less than 50 percent, of companies reported the ability to handle full-package orders for foreign buyers, and some are providing pre- and post-assembly services such as pattern marking, grading and embroidery. The remaining firms continue to offer just basic cut-and-sew production.

The availability and price of credit is the single most important factor affecting viability of the full-package model at the company level. The challenge of financing full-package production is exacerbated by purchasing practices of many US buyers; these clients may take several weeks to pay their suppliers, thereby increasing the amount of working capital full-package manufacturers need. Several companies interviewed reported being unable to access credit from local banks; in addition, because their assets (namely, their factories) were located in Nicaragua, they were unable to secure financing from foreign banks.

One notable development on this front is the extension to Nicaragua of the Global Trade Supplier Financing programme – a joint effort of Better Work and the IFC. This programme is available to companies participating in Better Work; it allows them 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 can result from delays between invoicing a buyer and receiving payment from them, a process that often takes 60 days.

Industry and institutional context: making stakeholder engagement work for all?

Nicaragua boasts a number of strengths that distinguish it from its Asian competitors. Chief among these is a dramatically improved climate for the promotion and protection of labour rights, and the development of a mature industrial relations environment capable of sustaining effective labour rights compliance and enforcement. For lead firms committed to ethical sourcing, or those simply concerned about the negative publicity that labour rights violations can generate, this positive record of compliance is an asset. Nicaragua's institutional advantages have been strengthened further by the Tripartite Agreement, which is creating an on-going dialogue among the industry's main stakeholders about how to preserve and increase Nicaragua's competitiveness, while insuring workers benefit from the industry's growth.

However, it is unclear to what degree workers benefit from the Tripartite Commission's publicly announced schedule of minimum wage increases, which essentially removes wage determination from the market and potentially locks in increases lower than those that might have been generated by market forces, or by continuing political and social pressures. While the initial Agreement was negotiated during a period of alarm, generated by what turned out to be a temporary dip in apparel exports, the current one, which extends the schedule of pre-established increases from two to three years, was concluded during a period of growth, in which apparel exports were up 15 percent. The second Agreement also institutionalizes the Tripartite Commission, establishing, for example, a regular schedule of meetings among the signatories with the goal of evaluating the degree to which the Agreement's objectives are being met; such meetings provide an ideal opportunity to verify whether workers are receiving non-wage benefits outlined in the Agreement.

The current Tripartite Agreement is not without critics, who claim that social programmes promised to workers in exchange for concessions on wage increases (e.g. the initiative to construct affordable housing for workers mentioned earlier, a plan to provide workers with *canastas,* or baskets of food staples such as rice, beans and cooking oil at a reduced price) 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 one would follow, although it was not yet clear what its duration would be, since some parties are arguing for a five-year agreement whereas others, presumably labour unions that are wary of locking in negotiated, automatic wage increases for a longer period of time, want a three-year deal.

In all interviews, there was broad agreement 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 negative employer practices, such as union busting and blacklisting, which had a chilling effect on workers' associational rights. However, there are lingering concerns about the degree to which workers are able 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 company-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 (BWN). As such, more data regarding the pervasiveness and severity of this problem will be available in the future.

From factory compliance to social upgrading: opportunities for Better Work in Nicaragua

Nicaragua's participation in Better Work largely reflects the enthusiastic support for the programme by the Nicaraguan government, in particular the FTZ Commission. The US government has also expressed a high level of commitment to supporting BWN. In October 2010, General Baltadano, the Presidential Delegate for Investment and Director of the CNZF, attended a meeting in Washington, DC, to discuss the programme with US Secretary

of Labour Hilda Solis. At this event, the US Department of Labour announced a $2 million grant to support the programme's implementation in Nicaragua.

The research for this Working Paper was conducted during the very early stages of BWN's design and implementation. During initial fieldwork in autumn 2010, some scepticism among local manufacturers about the benefits of participating in the programme was found. Some worried the programme's implementation in Nicaragua would send the wrong signal, causing foreign governments or global buyers to perceive the country as a 'problem case' in need of remedial attention; because some of the other Better Work countries are seen as lagging in the area of protecting workers and enforcing labour laws, the concern was that Nicaragua's inclusion in the programme could be seen as an indication of weakness rather than strength.

During the first year of the programme, BWN staff worked hard to overcome these anxieties and enlist the participation of local firms. They worked with the industry association, ANITEC, and educated foreign buyers sourcing from Nicaragua about the programme, encouraging them to request or require that their local suppliers participate. As of August 2012, BWN 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, representing almost 25 percent of the total number of garment factories (54 as of August 2012) currently operating in Nicaragua's FTZs.

Almost half of the 11 companies agreeing to participate in BWN so far are Asian-based multinationals with plants in Nicaragua. This suggests that Asian-owned companies are overrepresented among factories participating in Better Work, since Korean- or Taiwanese-owned companies account for a little more than one-third of the total number of apparel factories in the country, but a significantly 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, and their participation in other countries where they have factories, such as Vietnam and Indonesia. In contrast, American-owned companies have been relatively slow to enrol, with the exception of Wal-Mart, which recently announced it would make participation in BWN mandatory for its Nicaraguan suppliers.

While evidence is still accumulating on BWN, it is clear that this programme represents a challenge as well as an opportunity, in terms not just of achieving Better Work's aims of increasing labour compliance but also of Better Work's ability to advance the debate about labour standards in global industries, beyond a narrow compliance perspective. Specifically, Nicaragua offers a unique opportunity 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, and to search for ways to reduce these pressures. In this sense, Better Work has the potential to go beyond the standard approach towards labour compliance, represented by corporate code of conduct programmes, third party auditors or existing multi-stakeholder initiatives (Locke and Romis 2010; Locke et al. 2007; 2008).

The most distinctive feature of the Better Work programme in comparison with conventional approaches is the technical and advisory services that staff members (known as enterprise advisors) provide to 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 arise in audits. The advisory services Better Work provide, and support provided to PICCs at the enterprise level, are designed to identify causes of non-compliance and address them at the source. Improved compliance is not simply a form of social upgrading (e.g. insuring that wage payments and working conditions are consistent with the law, ensuring a safe and discrimination-free work environment, etc.). It is hoped that, by identifying and addressing root causes of violations, there can be positive impacts in terms of both productivity and competitiveness. Data gathered on participating factories in the Better Work countries provide a unique opportunity to explore the relationship between economic and social upgrading, and ideally will yield evidence of a business case for improved compliance that will incentivize companies to improve their performance in this area.

While the ultimate objective and the basic design of the Better Work programme are consistent across all the participating countries, the criterion used to evaluate factories differs in each case. This is because the compliance assessment tool used by Better Work's auditors is based on not only the ILO's core labour standards but also national labour laws, which vary across countries. Consequently, Better Work's impact in a given country will depend on how much of an enforcement gap exists between these standards and conventional practice at the time of the programme's implementation. This presents a particular challenge for Nicaragua, because labour law enforcement has increased under the Ortega administration. As expected, BWN audits carried out by the time of writing did not uncover any incidents of 'zero tolerance' violations (child labour, forced labour, etc.). Consequently, demonstrating measurable improvement from this baseline will likely require progress on some of the issues that are the most difficult to monitor and remediate.

One such example is freedom of association, which observers have noted is one of the more difficult violations to detect using conventional auditing methodologies, as well as one of the most formidable to correct (Anner 2012). In part, this is because the rights of workers to form unions and bargain collectively are likely to be costly for employers and to be perceived as inimical to their interests. In addition, the negative reputational consequences of being found to be non-compliant with workers' associational rights are perceived as lower than those for other violations, such as child labour, which can precipitate a damaging scandal or sweatshop exposé. Freedom of association and collective bargaining are also more difficult to monitor and enforce because they are fundamentally dynamic *processes* rather than discrete *standards* that can be measured, 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).

Nevertheless, there is good reason to be optimistic that BWN is well-positioned to pursue issues of non-compliance beyond the more easily measured standards that have dominated many experiments in private governance to date. Of all the Better Work countries, Nicaragua

boasts a relatively high degree of institutionalized social dialogue, as represented by the Tripartite Commission. As a domestic initiative, this provides an existing institutional infrastructure on which BWN is able to build.

For example, one of the first tasks necessary to get Better Work off the ground in a new country is the formation of a project advisory committee (PAC) that includes representatives of the three core constituencies of the ILO: government, workers and employers. Rather than beginning by identifying the appropriate stakeholders and convincing them to participate in such a structure, BWN staff are able to build a PAC that mirrors the composition of the existing Tripartite Commission. Furthermore, the Compliance Assessment Tool for BWN's factory audits is developed in consultation with the PAC. The degree of stakeholder participation in and input into this process was unprecedented for the existing Better Work programmes.

While initial indicators of BWN's efforts are promising, they should not be taken without caution. It has been mentioned that 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 as a result of managerial incompetence or oversight, it is equally indisputable that buyer practices play a role. Therefore, Better Work should move beyond the tripartite structure narrowly conceived by the ILO and include brands and retailers that are placing their orders with developing country exporters. While these companies are not direct employers of garment workers in Better Work countries, their policies and practices, particularly with respect to lead times and pricing, critically affect aspects of production process at the factory level, and therefore have a direct impact on workers (Anner et al. 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 programme may be contingent on the meaningful participation of brands that are the ultimate clients of Nicaragua's manufacturers.

Interviews repeatedly underscored the importance of global buyer participation. 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 by some buyers promising to reduce or eliminate their audits of local firms participating in Better Work, they also hoped 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 that '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 brands have made is that they will reduce or eliminate the audits they would otherwise carry out in participating factories, meaning that they will accept the results of 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 concrete commitments on the part of brands will not be easy to achieve, it is critical that buyers do more than simply encourage their suppliers to participate. Rather, what is needed is a

dialogue between the brands and their suppliers, one that is capable of identifying and altering buyer practices that contribute to non-compliance and inhibit more meaningful forms of social upgrading that could benefit local workers and their families.

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Published by:

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