

# Who benefits from trade?

Findings on the link between trade and labour standards in the garment, footwear and electronics industries in Bangladesh, Cambodia, Pakistan, and Vietnam



CLS+

**Core Labour Standards Plus**

Linking trade and decent work in global supply chains

**FRIEDRICH  
EBERT  
STIFTUNG**

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## List of Abbreviations

AFWA	Asia Floor Wage Alliance	FY	Fiscal Year
BGMEA	Bangladesh Garment Manufacturers and Exporters Association	GSC	Global Supply Chain
BKMEA	Bangladesh Knitwear Manufacturers and Exporters Association	GSP	General System of Preferences
BLA	Bangladesh Labour Act	HDI	Human Development Index
CBA	Collective Bargaining Agent	HRW	Human Rights Watch
CCC	Clean Clothes Campaign	ILO	International Labour Organization
CLS	Core Labour Standards	IRA	Industrial Relations Act
CLS+	Core Labour Standards Plus	ITUC	International Trade Union Confederation
CMT	Cut, Make and Trim	LFMEAB	Leather-Goods and Footwear Manufacturers and Exporters Association of Bangladesh
CSR	Corporate Social Responsibility	MNC	Multinational Corporation
DIFE	Department of Inspection for Factories and Establishments	MW	Minimum Wage
EBA	Everything but Arms	OSH	Occupational Safety and Health
EC	European Commission	PWF	Pakistan Workers Federation
EOBI	Employment Old-Age Benefits Institution	RMG	Ready-Made Garment
EPZ	Export Processing Zone	SME	Small and Medium-Sized Enterprise
ERC	Research Center For Employment Relations	SMEDA	Small and Medium Enterprises Development Authority
EU	European Union	SOE	State-Owned Enterprises
EU-GSP	The European Union's General Scheme of Preferences	TIC	Treaty Implementation Cell
EVFTA	EU-Vietnam Free Trade Agreement	TPP	Trans-Pacific Partnership
FDI	Foreign Direct Investment	TTIP	Transatlantic Trade and Investment Partnership
FES	Friedrich-Ebert-Stiftung	VGCL	Vietnam General Confederation of Labour
FTA	Free Trade Agreement		

## Foreword

The changing nature of international trade, dominated by global value chains, has led to downward pressure on working conditions. Fundamental rights at work, such as the right to organise and bargain collectively, are not upheld. Child labour exists in many supply chains, and minimum wages, when paid, are not sufficient to ensure decent living standards. Forced overtime and lack of safety measures are also common.

This publication wishes to draw attention to the imbalances in international trade and the asymmetric power relationship in global value chains, and to initiate a discussion on how to tackle these challenges.

It is one of the outputs of the regional project Core Labour Standards Plus (CLS+), which was launched by Friedrich-Ebert-Stiftung in Asia in 2016. This project aims to promote and develop binding labour standards in trade and global value chains. With growing consumer concern and strong criticism of free trade agreements in Europe, there is momentum to push for binding social clauses in international trade. If governments can show that trade agreements contribute to making the life of workers in Asia better, the growing scepticism towards such agreements could be reduced.

The scope of the CLS+ project is ambitious in the sense that it goes beyond the ILO core labour standards. These core conventions are recognised as an important element of decent work and are used by the European Union (EU) in trade agreements, but they do not cover other important rights such as living wages, maximum working hours including overtime, and safe and healthy workplaces. A living wage is, for example, crucial to lift people out of poverty.

In the first phase of the project, four countries—Bangladesh, Cambodia, Pakistan, and Vietnam—were selected to explore the link between trade and labour standards in key industries characterized by global value chains, namely garments, footwear and electronics. These countries were chosen because they have experienced different schemes of trade preferences, notably with the European Union, but also with the United States.

The FES offices in Bangladesh, Pakistan and Vietnam have been instrumental in finding the lead researcher for each case study. Since FES does not have an office in Cambodia, this case study was completed by a team of researchers from the country with the support of the FES

Office for Regional Cooperation in Asia. These offices are also responsible for the publication of the full reports.

The publication at hand contains only the executive summary of each case study together with a synopsis by Hansjörg Herr and Christoph Scherrer summarizing the findings of the studies. They provide compelling evidence for the need to address the decent work deficit in global value chains.

In parallel with the country studies, two other studies have been undertaken. The first examines social clauses in trade agreements and the reasons for their ineffectiveness. The second study estimates the potential tariff savings for EU importing companies upon entry into force of the EU-Vietnam Free Trade Agreement.

In addition, the CLS+ project has commissioned a study to develop a model social clause that could be incorporated in future trade agreements. Although the future of the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) is uncertain, the EU is pursuing negotiations over bilateral free trade agreements with other countries in the world, not least in Asia.

The findings of the project could also be used to improve the schemes of generalised tariff preferences applied by the EU, both in terms of conditions to be met for the benefitting country and sanctions in case of non-compliance.

In the second phase of the project, once the research is finalized, a set of policy recommendations will be drafted for advocacy purposes. The office for regional cooperation in Asia and the national FES offices in the countries concerned will carry out a number of activities together with partners to disseminate the findings of the project, and continue to work on solutions to the challenges that have been identified.

Lastly, we would like to thank all those who have contributed to the project with their knowledge and insights, and helped shape this publication.

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# Part I

## Synopsis



## Trade, global value chains and working conditions

Hansjörg Herr and Christoph Scherrer

Organized by multinational corporations, global supply chains have lowered the entrance barriers to lucrative export markets for entrepreneurs with limited capital resources but access to abundant low-skilled labour. These lower barriers have led to impressive industrial employment growth in countries that previously had been integrated into the world economy primarily through the export of agricultural or mining products. However, the wages and working conditions for those employed in these “world market factories” are seldom in compliance with the decent work agenda as formulated by the International Labour Organization (ILO). While almost every country in the world is a member of the ILO and therefore has agreed to the decent work agenda (though has not necessarily ratified all conventions underpinning the decent work agenda), many lack the political will to implement it.

The naming and shaming strategy has proven to be insufficient for the better enforcement of its conventions. Therefore, trade unions and other human rights concerned actors have called for other enforcement instruments. Since modern trade agreements come with a rather effective dispute-settlement process, these actors favour the inclusion of labour rights, social or sustainability chapters in trade agreements. Since the pioneering labour rights chapter in the Caribbean Basin Initiative of 1983, such chapters have proliferated between many countries. They usually refer to all or some of the labour rights as formulated in the core conventions of the ILO: Freedom of association and the effective recognition of the right to collective bargaining,<sup>1</sup> elimination of all forms of forced and compulsory labour,<sup>2</sup> effective abolition of child labour,<sup>3</sup> and the elimination of discrimination in respect of employment and occupation.<sup>4</sup>

In light of the recent tragedies in the garment industry as well as recurring reports on massive labour rights violations, the questions arise why the obligations in the trade agreements are frequently not adhered to and whether they are actually sufficient for the realization of the decent work agenda. The why question necessitates

not only an inquiry into the effectiveness of the enforcement instruments but also into the motives of the relevant actors as well as the economic conditions in the particular industries. The question concerning the sufficiency of core labour rights calls for looking at the labour standards formulated by the ILO.

By linking trade to working conditions in global value chains, Friedrich-Ebert-Stiftung in Asia is addressing these issues through its project Core Labour Standards Plus (CLS+). Four countries—Bangladesh, Cambodia, Pakistan and Vietnam—have been selected for in-depth studies regarding the labour and trade nexus. Each case study examines the trade regime in place, the structure of global value chains and the compliance with labour standards in global supply chains in the most relevant export industries. Each study also proposes a set of recommendations to respond to the challenges that have been identified. In order to summarise the key findings, the authors have drafted an executive summary for each country exclusively for this publication. The following synopsis is based not only on the executive summaries, but discussions among the project partners as well, to provide a coherent analysis comparing the situation in the four countries and drawing conclusions for economic and social upgrading.

### **Global value chains, asymmetric power and low value added in developing countries**

The regulated type of capitalism that was created after the Great Depression dominated Western countries in the 1950s and 1960s. It went into crisis in the 1970s. In response, many sectors including labour markets were deregulated and cross-border activities became liberalized. These changes were spearheaded by the governments of the United Kingdom and the United States. They gave rise to ever more power for transnational corporations and financial actors. The result is a globalized as well as financialized capitalism.

In the 1990s, international trade changed its character fundamentally. The freedom of deregulated financial

and product markets together with innovations in transportation and information technology allowed new ways to organise production processes especially for multinational firms. In the case of global value chains, the production process is cut up into different tasks and these tasks are allocated all over the world according to the profit-motive of companies operating internationally. Trade in intermediate products and within global value chains became the most important type of international trade. In all four countries, the integration in global value chains plays an important role for export revenues and the economy in general. Producers for global value chains in the four countries sell their products to lead firms or big intermediate vendors sometimes themselves located in developing countries. Bigger producers in the four countries can outsource part of their production to smaller domestic producers and even self-employed households.

Analytically, the tasks performed at each step in the value chain produce separate products that are traded to the next production step. The international allocation of the different tasks depends on the comparative advantages of countries. Obviously, developing countries have a comparative advantage in low-productivity, low-skill tasks. Developed countries with their higher level of technology and higher skill levels have a comparative advantage in taking over high-productivity, high-skill tasks. A second motivation of offshoring by multinational companies is to gain more flexibility. In case of fluctuating demand for final products, the needed adjustment of production can be shifted to lower levels of the value chain.<sup>5</sup> The case studies clearly show that in the analysed global value chains the four countries take over the low-productivity, low-skill tasks whereas all more demanding tasks are taken over by lead firms or big intermediate traders.

But it is not only the international allocation of tasks which is a problem. Many vertical value chains are characterised by extreme asymmetric power. Many developing countries' firms are usually competing with many firms from other developing countries for orders from a small number of big and powerful firms. Powerful lead firms or big intermediate vendors can exploit their dominant position. Some of the lead firms and intermediate vendors act in oligopolistic markets—for example, fashion brands or mobile phone producers,

and earn high oligopoly profits—some act themselves in competitive markets, for example, big retailers. But, in all cases, there is huge price pressure for producers at the lower end of the value chains. In the case studies it is reported, for example, that in the garment industry demand for certain tasks prices and delivery date are posted in the internet and firms worldwide can apply for the offer. In case of bad quality or late delivery high penalties in the form of lower prices paid are due. The US-dollar price of one square metre of imported apparel dropped sharply with the phasing out of the Multi-Fibre Agreement in 1995. At the same time, working conditions in apparel global value chains in developing countries eroded.<sup>6</sup>

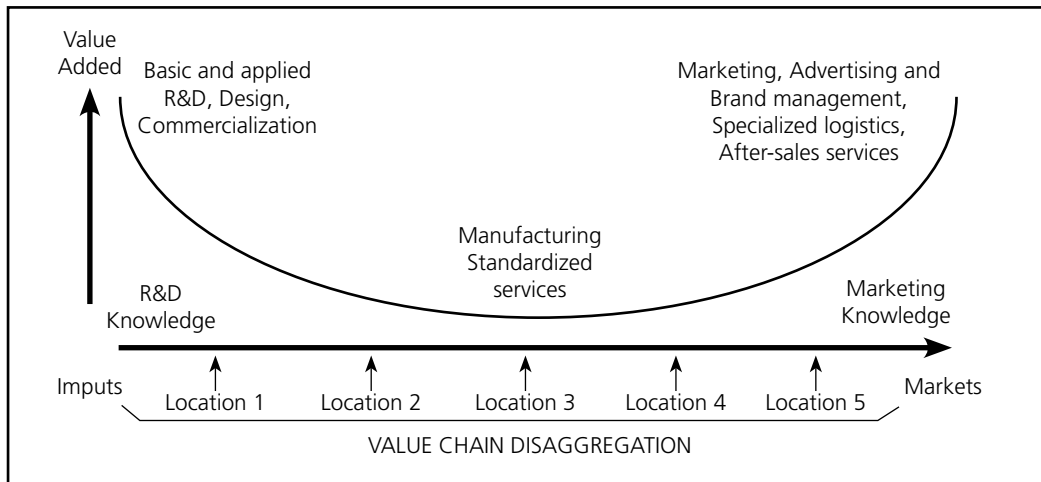
The logic of vertical global value chains can be expressed in what became known as the "Smile Curve",<sup>7</sup> but should more appropriately be called the "exploitation curve". Figure 1 shows the exploitation curve and the typical distribution of value-added in different stages of production. According to the exploitation curve, the upstream and downstream parts of value chain, which include research, design, marketing and after-sales service, produce the highest value-added and are largely kept in developed countries. Most offshoring to developing countries can be found in the fabrication stage, which is not the core competency of lead firms. Value-added in developing countries is low both for wages and for profits.<sup>8</sup>

### **The underdevelopment box**

The four countries analysed find themselves in a constellation of underdevelopment which is typical for a big number of developing countries. Figure 2 gives an overview of the "underdevelopment box". Firstly, as mentioned, producers in global value chains are carrying out low value-adding tasks and in addition are confronted with asymmetric power relationships within global value chains. This implies that lead firms and intermediate vendors earn most of the income created in global value chains and for the producers in developing countries relatively low income creation remains. Let us take the Samsung Galaxy S7 with a retail price of 809 US dollars in 2016. Costs for components like the touchscreen were 249.55 US dollars, manufacturing costs were not more than 10 US dollars and total factory costs not more than 260 US dollars.<sup>9</sup> Or for sports shoes with a retail price of 100 US dollars fabrication costs were 25 US



Figure 1: The exploitation curve



Source: Ram Mudambi, "Location, Control and Innovation in Knowledge Intensive Industries," *Journal of Economic Geography* 8 (2008): 707.

dollars, factory profit 1.5 US dollars and brand profit 45 US dollars.<sup>10</sup> The integration of developing countries in global value chains increases output and employment, but the low income earned does not only lead to low real wages, but also limits the spill-over effects via domestic consumption demand stemming from income earned in industries producing for global value chains.

Secondly, the market mechanism pushes developing countries into low-tech, labour-intensive, low-value-adding activities. This type of distribution of international labour increases the technology and knowledge gap between developed and developing countries for many reasons.<sup>11</sup> The case studies show that lead firms and intermediate vendors at least in the garment/textile, footwear and electronics sectors have no incentive to transfer much knowledge and technology to developing countries. They may be interested to increase the standard of the qualifications of workers and of technology to a certain low level; then they are happy with the situation as it is. The first and the last phases in a value chain, which create most of the income, remain in the hands of lead firms and intermediate vendors. In all four countries, there has been disappointment that no substantial technological upgrading and attraction of more value-adding tasks in existing value chains could be achieved. This was the case for foreign direct investment and in the case of subcontracting to legally independent firms. It fits into this picture that in Vietnam foreign firms respect core labour standards less than domestic firms and invest less in upgrading production. State-owned firms are here a positive example.

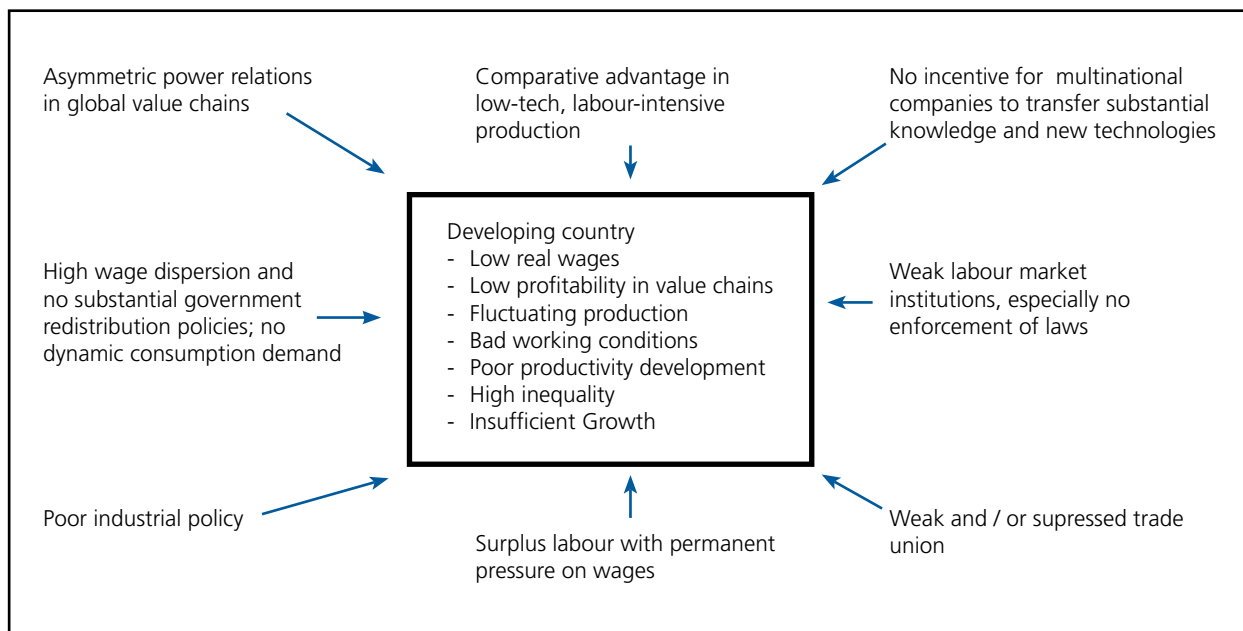
Thirdly, in all four countries and typically in most developing countries there is a huge surplus of labour. This means that underemployment is widespread and in urban areas and even more in rural areas a large workforce is waiting to get better employed or get employed at all. This situation causes pressure on the labour market and leads to a large low-wage sector and sectors in which a big part of the population frequently shifts between employment and self-employment both under precarious conditions.

Fourthly, institutions in the four countries are weak—as in many developing countries. In respect of labour markets, this leads to the situation that labour laws in most of the countries are relatively good and many of the core labour standards are realised, but enforcement of the law is incomplete and sometimes not even pushed by governments. Also, in other areas institutions are weak. For example, the level of corruption is high or tax collection and the provision of public goods are underdeveloped.

Fifthly, trade unions are weak and sometimes fragmented. In all four countries trade unions are not only not supported by governments, they are sometimes actively suppressed. Also, employers' associations are usually weak and do not organise a sufficient number of enterprises. And a big informal sector exists where laws do not apply or are not enforced anyway.

Sixthly, weak trade unions and weak labour market institutions lead to high inequality. Government

Figure 2: Developing countries in the box of underdevelopment



Source: Scherrer/Herr

redistribution policy in these countries is usually weak or does not exist. Global value chains do not contribute to more equality in developing countries. They are also not the main responsible agents for inequality in developing countries. But they add to global inequality. The old idea of Prebisch and Singer that developing countries will relatively lose when they concentrate their exports on production based on their comparative advantages is further supported by the increasing importance of global value chains.<sup>12</sup>

**Violation of labour standards in the four countries**

Given the weakness of the institutions and trade unions in developing countries and the size, power, strategic ability and the target of lead firms to maximise profits, it does not need much imagination to see that without counter-pressure global value chains lead to the exploitation of developing countries including bad working conditions and very low wages. Based on the case studies looking at core labour standards, the following summary can be given:

**Child labour**

Child labour is still common in Pakistan and Bangladesh and is not completely eliminated in Cambodia and

Vietnam. The main problem is the enforcement of laws prohibiting child labour, though Bangladesh has yet to ratify the ILO conventions banning child labour.

**No discrimination in respect of employment and occupation**

Discrimination is widespread in all four countries. The main problem is legal enforcement of laws; in Pakistan, in addition, the legal framework is insufficient. There is a gender gap in wages in all four countries. Women, who are the biggest group in garments, textiles, footwear and electronics, earn on the whole substantially less than men. Also, in recruitment and promotion women in all four countries are discriminated against. Most of the leading positions are occupied by men. Women are also exposed to harassment at workplaces. Contracts for pregnant women are in many cases not renewed. In addition, in some of the countries migrant workers as well as certain religious or ethnic groups are exposed to discrimination.

**No forced and compulsory labour**

In all four countries forced and compulsory labour is not allowed. However, in all four countries there is frequent pressure to work substantially longer hours to be able

to deliver fluctuating or, for the firms, attractive orders on time. Workers are sometimes forced to work in the night. Breaks are in many cases shortened and too short.

### **Freedom of association**

In all four countries, the creation of trade unions is difficult. In Vietnam, the state-controlled unions make it difficult to establish independent unions. In Bangladesh, serious restrictions exist for trade unions, for example, in planned export processing zones. A trade union can only be formed when 30 per cent of a firm's workers join it. In Pakistan, the trade union law only covers the small formal sector. In substance in all four countries collective bargaining is weak and usually does not take place on a sectoral level. But even on a company level collective bargaining is the exception. Statutory minimum wages in all countries to a large extent substitute for collective bargaining. In addition, there are active policies by employers to sanction trade union members, for example, by not renewing working contracts.

The case studies show that violations of core labour standards do not only depend on pressure from lead firms and intermediate vendors. Domestic conditions in all four countries in addition lead to the violation of core labour standards. It is the combination of the pressure within global value chains, the labour surplus and the lack of union power and functioning labour market institutions which are at the centre of the violation of core labour standards.

### **The need for economic and social upgrading**

An economic catching-up of a country including the possibility to pay substantially higher real wages and also realise living wages requires substantial productivity increases and an improved power to innovate.

Governments in all four countries understand that industrial policy is needed to develop the country. They are aware that all the economically developed countries in the world used protectionism and active government policies to trigger development.<sup>13</sup> Besides some limited industrial policy successes in Vietnam and Cambodia, however, the four countries' industrial policy efforts failed in upgrading and diversifying their economies. Bangladeshi firms in the garment and footwear sector have yet to widen the tasks they perform in the value

chain. Pakistan is still struggling with basic infrastructure problems such as a stable electricity supply. Some moderate productivity increases in the analysed sectors of the four countries suggest success in economic upgrading. According to the case studies, however, most of the measured productivity increases are based on the intensification of work. Real wages increased moderately in Vietnam and Bangladesh. In Pakistan, real wages stagnated. The substantial increases of real wages in Cambodia were not accompanied sufficiently by productivity increases and therefore undermined the competitiveness of the Cambodian garment industry. Cambodia's competitiveness problem is compounded by the dollarisation of its economy. Wages are paid in US dollars. Therefore, the use of the exchange rate is ruled out for improving the price competitiveness of Cambodian industry.

The reasons are manifold. Firstly, the challenges are quite immense given that all four countries start from a very small base: Their exports are concentrated in only a small number of industries and within the industries in a small number of tasks. Secondly, free trade and investment agreements have limited the space for industrial policy. Thirdly, these countries lack the institutions required for effective industrial policy.<sup>14</sup> Fourthly, the countries seem to underestimate the role of social upgrading in economic upgrading. Insufficient investment in education and health limit the productive capabilities of workers. Extremely low wages restrict domestic demand expansion, which in turn limits the achievement of economies of scale and thereby productivity increases.<sup>15</sup>

Despite significant challenges, economic and social upgrading remains possible. The governments could invest more in the physical and social infrastructure. They could also strive for the integration of foreign direct investments in an overall industrial development concept. This could include local content and especially skill transfer requirements to support the creation of industrial clusters. What is needed is a whole package of policies and a vision for the development process. From the outside, such a process can be supported, for example, by fair trade agreements and investment agreements that support development and do not focus on the short-term interests of firms from developed countries.

### **Labour rights chapters in trade agreements**

All four countries have trade agreements with labour rights chapters. At first sight these chapters seem to be of little consequence given the persistent decent work deficit in their “world market factories”. A closer look reveals a differentiated picture from which some lessons can be drawn for the design of a chapter for Core Labour Rights Plus.

Bangladesh’s trade agreements with the European Union and the United States feature labour rights chapters. While the United States removed Bangladesh from the General System of Preferences (GSP) scheme in 2013, the European Commission (EC) has not taken sufficient action to hold the government to account. Only very recently has the European Commission (EC) threatened to investigate reported violations. Given the European inaction, the sanctioning by the United States had little impact. Economic sanctions can have an effect in pushing forward legislative changes, but little impact on pushing through changes in attitudes, behaviours and beliefs. This backs up the claim that, although you can force ratification, this does not work in the case of enforcement, which is more complex. The brand companies and global trade union alliance in response to the Rana Plaza tragedy was more effective at least in relation to improvements of the safety of the buildings.<sup>16</sup>

In contrast to Bangladesh, the US-Cambodia textile agreement (1999-2005)—the Better Factories Cambodia programme—was fairly successful. It linked incentives in the form of increased quotas for Cambodian textile imports into the United States directly to the improvement of factory safety and labour rights in the sector. It has resulted in improvements in certain areas of working conditions and worker rights, most notably wages, some occupational health and safety issues and an increase in the number of trade unions. The end of the Multi-Fibre-Agreement in 2005, however, closed the door to the use of quotas as incentives. The Better Factories Cambodia monitoring became entirely voluntary and its effectiveness was substantially reduced.

In 2014, Pakistan was granted the status of GSP+ by the European Union. It is its first trade agreement with explicit social and labour clauses. Pakistan had to sign a statement of commitment to maintain ratification of the

relevant ILO conventions and to ensure their effective implementation. A noticeable effect has yet to be seen.

The pressure that free trade agreements can exert on countries during negotiations (ex-ante) has been shown in the recent side letter of the Trans-Pacific Partnership (TPP) between Vietnam and the United States. This extra pressure from the trade negotiations alongside lengthy dialogue and pressure campaigns may result in Vietnam ratifying some new ILO conventions and altering its domestic legislation to allow for increased freedom of association. Pre-ratification conditionality is seemingly more effective than conditions imposed after the ratification of an agreement. Since US President Donald Trump has stopped the ratification process of the TPP, the government of Vietnam is less inclined to implement the content of the side agreement. In other words, pre-ratification conditionality has to be followed by ratification.

With the exception of Vietnam, where the party-state trade union is politically well-connected, the trade unions are neither well-informed about the content of the labour rights chapter nor have they developed strategies for the utilization of this chapter to the benefit of the members. The reasons are manifold: Trade negotiators are not responsive to trade unions, the Directorate General for Trade of the European Union considers such chapters a necessary evil, the consultation processes stipulated in the trade agreements do not inspire confidence in remedial action and the trade unions in developing countries are in many cases fragmented and/or lack capacity for utilizing the chapters.

Learning from the case study findings and summarizing the literature on labour rights chapters in trade agreements, it can be stated that ultimately the enforcement of social clauses relies on smart design as well as on the more macro-level confluence between legal, political and development cooperation, and the need for legal resources to be combined with political pressure. Such chapters need to address the national legal framework and labour regulatory regime, national labour courts, freedom of association, collective bargaining rights, and the capacity for enforcement (i.e. inspectors, training, and clear legislation).

Civil society and social partners play a crucial role in the functioning of labour provisions. For this reason, they must be involved from the early stages, allowing for better implementation and increasing transparency of the procedures. Labour rights mechanisms will only work when there are domestic actors who can make use of them and where these processes can act as extra pressure points for transnational campaigns; they are not an end in themselves finishing at ratification. The agreements need to be coherent on numerous levels. They should all refer to the ILO Core Labour Standards. They are legitimate and allow both civil society groups and governments with limited resources to have some better understanding of what they need to implement. There must also be coherence among the relevant agencies responsible for the agreement at all signatory partners. A case in point are relevant EU agencies. Although the trade-labour linkage is accepted in a normative way, how this is to be actualized is not clear and seems to differ across agencies. The US approach where one department (Labour) has responsibility and plays an active and to some extent coherent role should be replicated. This will also counter the lack of political will, by limiting opportunities for denying responsibility.

Of equal importance is the need for agreements and labour chapters to be clear on what is required throughout the dispute-settlement procedures. Furthermore, timeframes and outcomes need to be prescribed in the agreement in the clearest and most direct language possible, to avoid miscommunication or different interpretations (on both sides). Following this, sanctions do not seem to be the determining factor of enforcement, instead it is consistency across the procedures and the use of incentives such as increased trade access, aid or capacity-building programmes that appear most effective. As such, some sort of mix of the three teamed with an unequivocal dispute procedure where the concerns of civil society groups, such as trade unions, are given real space may be most effective.

Critical for any social clause to work or have an impact there needs to be buy-in from civil society, which on a larger scale requires the re-building of trust in, and legitimacy of, the power of trade agreements to benefit workers and not just the wealthy few. This will require a re-socialisation of trade agreements, more transparent negotiation and opportunities for independent civil

society to participate and have power in the negotiation, implementation, and enforcement of the agreement. It will also require more detailed and compulsory impact assessments including human rights, the environment, and labour. The corporate agenda cannot be the driving force behind such agreements; rather, they must allow for policy space for states to regulate in the public interest, irreversibility clauses must be blocked, compensation schemes outlined, and participation mechanisms and accessibility issues addressed. Labour rights chapters need to be understood as one part of a policy mix rather than a solution in themselves.

### Endnotes

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## **Part II**

# **Executive summaries of four case studies: Bangladesh, Cambodia, Pakistan, and Vietnam**



## Linkages of trade and labour standards in global supply chains in Bangladesh

Jakir Hossain, Mostafiz Ahmed, and Jafrul Hasan Sharif

### Introduction

Bangladesh has a range of instruments including national laws, trade agreements, collective agreements, and codes of conduct to promote and protect workers' rights. A number of labour standards have been applicable to Bangladesh's workers due to the country's continued integration into the world economy. The country accepts some of the labour standards as requirements to access the markets of developed countries and/or to make use of trade preferences with its bilateral and multilateral partners.

The forms of labour standards reveal a broad dispersion of contents. The most pronounced division is between core and non-core labour standards. ILO standards pertaining to the Declaration on Fundamental Principles and Rights at Work—freedom of association, freedom from forced labour and from child labour, and non-discrimination in employment—are Core Labour Standards (CLS); other standards like minimum wage, working hours, occupational safety and health are termed non-core standards, in contrast. While these labour standards—both the CLS and beyond—have been applicable for Bangladesh, it is not known to what extent these standards have been reflected in the country's workers' rights provisions, and whether there have been differential outcomes to forms of workers' rights.

The current study explores whether and to what extent the CLS+ standards and rights nexus are in action for Bangladesh's industrial workers by juxtaposing provisions of Bangladesh's labour laws with international labour standards. The objective is to explore the patterns of global supply chains in Bangladesh's export-oriented sectors (garments and footwear) and the related labour conditions, and identify possible linkages to existing trade and preferential agreements that give leverage to the promotion of CLS+.

The study draws on secondary literature and 18 key informant interviews with representatives of government, employers, trade unions and buyers/brands, and five focus group discussions with garment and footwear industry workers.

The study is structured in five sections. The following section presents the trade regime in Bangladesh and the country's integration into the global supply chain. The third section focuses on the labour rights situation in Bangladesh's export-oriented garment and footwear industries. The fourth section assesses the interests and policies of the stakeholders—trade unions, government, and buyers and brands. The concluding section identifies common interests of stakeholders, and draws policy recommendations.

### The trade and labour nexus in Bangladesh

#### *Economic and policy settings*

Bangladesh has achieved strong economic growth in recent years, and the driving force for the steady GDP increase is the contribution of the industrial and service sectors. Between 2010 and 2015, growth of real GDP averaged 6 per cent per year.<sup>1</sup> The shares of both industry and the service sector have shown an increasing trend—the service sector's share increased from 49 per cent in 2000-01 to 53 per cent in 2015-16, and industry's share from 26 per cent to 32 per cent for the same period.<sup>2</sup>

Bangladesh has maintained export competitiveness in her major export items, and exports maintained growth rates of 10.7 per cent per year during fiscal years (FY) 2002-06 and 14.75 per cent during FY 2011-15. Merchandise exports increased from 10.53 billion US dollars in FY 2006 to 31.20 billion US dollars in FY 2015. In particular, the ready-made garments industry, now accounts for over two-thirds of export earnings. Over the years, the country has witnessed an increasing trade openness, from 34 per cent of GDP during FY 2002-06 to 38 per cent in FY 2015 (see Table 2.1).



Table 2.1: Trade openness as percentage of GDP in Bangladesh

Fiscal year	Average [FY02- FY06]	FY06	FY11	FY12	FY13	FY14	FY15	Average [FY11- FY15]
Exports plus imports as percentage of GDP	33.8	38.2	47.4	48.1	46.3	45.0	37.6	44.8

Source: General Economics Division<sup>3</sup>

The recent industrial development policy is in line with pro-market policy where liberalization and the development of the private sector have been given priority. This policy also commits to offer and maintain incentives to attract investment in export-oriented industries. With regard to foreign direct investment (currently 1.7 billion US dollars), the government plans to improve the investment climate by reducing constraints in infrastructure, the regulatory framework, and policy environment. Moreover, addressing the cost of doing business, encouraging regional investment in emerging sectors, and establishing special economic zones continue to be important policy options.

#### **Labour market dynamics and relevance for CLS+**

Bangladesh's substantial labour force of around 60.7 million is growing at around 3 per cent per year—adding about 2 million workers each year. During the period 1999-2000 to 2015, the population of the country increased by 34.2 million (from 124.30 million in 1999-2000 to 158.5 million in 2015), whereas the total working age population rose by 21.4 million.<sup>4</sup>

The sectoral share of GDP vis-à-vis the number of employed reveals an alarming account of disconnectedness between wealth creation and employment absorption. The share of agricultural labour in the broad economic sector has been declining; the participation of agricultural labour in 2015 was 44 per cent against 51 per cent in 1999-2000. The participation of non-agricultural (manufacturing, other industries and services) labour in the broad economic sector was 56 per cent and 49 per cent in 2015 and 1999-2000, respectively. Of the total employed, 44 per cent were engaged in agriculture, followed by 36 per cent in services and 20 per cent in the industrial sector.<sup>5</sup>

The vast majority of the labour force in Bangladesh is employed in the informal economy (about 87 per cent in 2013).<sup>6</sup> The conditions under which most informal workers operate are precarious, unhealthy and unsafe. Most workers in the informal economy are not recognized, registered, regulated or protected under labour legislation. The formal sectors e.g. garments and footwear, too, provide inadequate income and other benefits for the workers along with their families to participate with dignity in their communities. Also violated frequently are the long established standards/rights provisions to provide a voice for the workers both in the workplace and at the labour-market level. Since they are not normally organized, they have little or no collective representation in relation to employers or to the authorities.

#### **Trade and labour standards linkages**

Bangladesh's integration into the global supply chains is mainly attributed to its liberalised trade regime and access to and participation in trade agreements. With increased competition, trade-linked sectors of the country i.e. the ready-made garment and footwear sectors have witnessed standard conditionality in its major export destinations like the European Union and the United States.

Bangladesh currently receives Generalized System of Preference (GSP) facilities from the European Union (EU) along with 10 countries (Australia, Canada, Iceland, Japan, Kazakhstan, New Zealand, Norway, Russia, Switzerland, and Turkey). The EU GSP provisions of additional trade preferences (Everything but Arms, a duty-free, quota-free market access for LDCs on all products except arms and ammunition) are subject to compliance with UN Covenants and ILO core conventions. The US GSP has remained suspended for Bangladesh since 2013 due to the country's non-

adherence to statutory eligibility requirements related to workers' rights. While the EU GSP defines its core standards in relation to international conventions (including the ILO's), the US definition of internationally recognized workers' rights makes no reference to such standards, in particular, the ILO's 1998 Declaration on Fundamental Principles and Rights at Work. The US GSP scheme specifies five standards whose observance conditions a country's beneficiary trade status. The provisions are: (1) the right of association; (2) the right to organize and bargain collectively; (3) the prohibition of forced or compulsory labour; (4) the minimum age for the employment of children; and (5) acceptable conditions of work with respect to minimum wages, hours of work, and safety and health.

The country is part of various bilateral, regional and multilateral agreements. The South Asian Preferential Trade Arrangement and South Asian Free Trade Agreement offer capacity building in trade-related issues through training, export promotions, and trade policy formulation. Under the Asia Pacific Trade Agreement, Bangladesh has received tariff concessions from China and South Korea. The Preferential Tariff Arrangement group of eight developing countries supports Bangladesh in diversifying and creating new opportunities in trade. The eight regional agreements currently in force for the country, however, do not have any labour clauses.

#### *Garments*

The garments sector grew primarily as an export-oriented industry during the late 1970s and early 1980s, and has boomed over the last four decades. The sector is currently the second-largest exporter in the world after only China's. The export volume of this sector has increased from 31.57 million US dollars in 1983-84 to 21.53 billion US dollars in 2012-13, and exports crossed the 25-billion-US-dollar mark in 2014-15.

From just 50 factories in 1980, the garments industry has jumped to over 5 000 factories. The garments sector is the largest formal sector in Bangladesh and generates 59 per cent of total formal sector employment in the country.<sup>7</sup> The growth of employment in this industry is exponential—from a few thousand in 1980, to over 4 million people, of whom approximately 55 per cent are women—and indirectly supports as many as 40 million Bangladeshis.<sup>8</sup>

The EU is the largest destination for ready-made garment products. In the FY 2014-15, Bangladesh exported 61 per cent of its products to EU countries, and for the first time, in 2015, exports to the EU crossed the 15-billion-US-dollar mark. However, as a single country, the United States is the largest market for apparel, with a 21-per cent share of the garment exports.<sup>9</sup>

Four tiers of manufacturing chains are at work in the sector. Orders from large brand and international retailers come through their sourcing offices (buyers) and are contracted out to the large manufacturers. These large manufacturers subcontract either all or parts of the item to medium-sized manufacturers who again subcontract the work to small manufacturers and even to piece-rate home workers.

Although the garment sector contributes most of the export earnings, its value addition is low due to dependence on imported raw materials. Bangladesh's apparel industry represents a case of a "buyer-driven" global supply chain in that brands and retailers have the most significant control over supply chains.<sup>10</sup> The gains in the sector are hardly shared equitably with the workforce engaged in production and assembly units since the most important value-added stages are intangible services that occur before the manufacturing stage (e.g. research and new product development and design) and after the manufacturing stage (e.g. logistics, purchasing and distribution, marketing and branding, and services) in which the Bangladesh garment sector hardly contributes.

#### *Footwear*

Bangladesh has already become a popular country for exporting quality leather, leather goods, and footwear from its 110 export-oriented factories. Bangladesh currently ranks seventh among the top 10 footwear producers worldwide.<sup>11</sup> Footwear exports increased to over 19 million US dollars in 1993-94 from only around 2.5 million US dollars in 1990-91, and moved up to over 673 million US dollars in FY 2015. Bangladesh earned 1.29 billion US dollars from exports of leather, leather goods and footwear in FY 2014.<sup>12</sup> The amount accounts for 4.2 per cent of the country's total exports. Footwear alone fetched 550 million US dollars (out of which 378 million US dollars comprised leather footwear) in foreign exchange out of the leather sector's total export earnings.<sup>13</sup>

The leather and footwear industry provides direct employment to around 180 000 people. About two-thirds of the total labour force are women.<sup>14</sup>

Of the total exports from the leather industry, 60 per cent go to the European Union, 30 per cent to Japan and 10 per cent to the rest of the world. The top destinations for Bangladesh's footwear exports are Italy, New Zealand, Poland, the United Kingdom, Belgium, France, Germany, the United States, Canada, and Spain. Some other countries like Japan, India, Nepal and Australia are emerging as potential importers of Bangladeshi leather goods.<sup>15</sup>

The reasons for the upward trend in exports can mainly be attributed to the diverting of orders from China. The leather and footwear sector is highly promising because of its greater scope of value addition. Raw materials for this industry are locally available and therefore the opportunity of value addition is substantially higher than that of the garments sector.

### **Labour rights in global supply chains in Bangladesh**

#### ***Labour rights protection framework in Bangladesh***

The Constitution is the highest legislation of Bangladesh, and provides its citizens with the right to freedom of association, reasonable wages, equal opportunity in employment, social security and prohibits forced labour (Articles 7, 14, and 20). The Bangladesh Labour Act, 2006 (BLA 2006)—the most important labour legislation—regulates trade unions, working hours, minimum wages, employment and industrial relations. The enterprises in export processing zones (EPZs) are not under the purview of the BLA but governed through the EPZ Workers' Welfare Association and Industrial Relations Act (2010).

#### ***State of CLS+ in Bangladesh***

##### *Elimination of child labour*

Bangladesh has ratified one of the ILO core conventions related to child labour (C182—Worst Forms of Child Labour Convention, 1999) but not the other relevant ones (C 138—Minimum Age Convention, 1973 and C 59—Minimum Age—Industry Convention, 1937). Even though the conventions not ratified include another of the core conventions (C 138), the country is obliged to promote standards related to the minimum age for admission to employment. The ILO Declaration

on Fundamental Principles and Rights at Work 1998 states, "(A)ll Members, even if they have not ratified the Conventions in question, have an obligation arising from the very fact of membership in the [International Labour] Organization to respect, to promote and to realize, in good faith and in accordance with the constitution, the principles concerning the fundamental rights which are subject to those conventions."<sup>16</sup> But in practice, Bangladesh provides partial protection. The country's standard on the elimination of child labour makes use of the exemption provision of the ILO convention applicable to developing countries and allows children between 12 and 14 years old to work. The relaxation of the rule on the age of children for light work not harmful for health, development, and education, in effect, allows the employment of children in general since the law does not define what constitutes light work, and also because it is difficult to ascertain the age of workers due to non-availability of national identity documents for persons below 18 years of age.

The recruitment of children in garments factories has been strongly discouraged. Industry is yet to be fully free from their labour. In some small factories, which are not involved in exports directly and work mainly on a sub-contract basis, children do work, garments workers said.<sup>17</sup>

The issue of child labour in the leather and footwear industry has not drawn similar attention as in the case of garments and the conditions are worse in this sector. Leather and footwear workers, participants of focus group discussions, said about 20 to 40 per cent of the workers in their factories are under the age of 18. Similar to the situation of garments, child workers in the leather and footwear industry are mostly working in non-compliant and subcontracting factories.

##### *Protection against forced and compulsory labour*

Bangladesh has ratified the ILO conventions concerning forced and compulsory labour (C 29 and C105: The elimination of all forms of forced or compulsory labour), and the constitution of the country also prohibits forced and bonded labour. However, current practice of working hours, including overtime and night duty, and the attitude and conduct of the factory management in both the garments and footwear industries compels the practices to be non-compliant. There are widespread allegations about compulsory overtime and night duty.

Workers generally agree to work overtime because they do not want to lose their job. The factory management in most cases does not consider the question of consent from workers in engaging them for overtime and night duty (for women). The exemption from compulsory overtime and night duty depends on the discretion of the management concerned.

#### *Protection against discrimination at the workplace*

Bangladesh's law provisions relating to protection against discrimination are partly in line with the ILO core conventions (C100 and C111: Elimination of discrimination in respect of employment and occupation) to which Bangladesh is a signatory. The relevant national law provisions are focused on wages and gender. It mentions the principle of wage setting as "equal pay for equal value of work." However, the current provision leaves broad areas of discrimination (e.g. race, religion, and ethnicity) at workplaces unaddressed.

The minimum wages of private-sector workers are set by the Minimum Wages Board, not by collective bargaining. As such, the set wages for both male and female workers are never discriminatory. However, in practice while lower wages for female workers vis-à-vis male workers in the footwear sector are prevalent, gender-based wage discrimination is hardly evident in the garments sector. Nonetheless, discrimination prevails in the scope of promotion and work placement. Although there are no official statistics on the gender composition of workers according to their positions/grades, it is evident that from supervisor to upper positions the presence of women is minimal and there is a strong preference for male workers in the upper levels of jobs both in the garment and footwear industries.

#### *Freedom of association and collective bargaining*

While rights standards, in terms of availability, have reflected the international standards, the effectiveness criteria amply show that the standards are hardly in line. The existing pre-requisite—30 per cent of the total workers—to form a trade union does not correspond to the ILO Convention 87 to which Bangladesh is a signatory. Furthermore, the differential law regime in EPZs denies trade union and collective bargaining rights.

A trade union is allowed to work as a collective bargaining agent (CBA) in any establishment (Sec. 202),

but there is a pre-condition: A trade union to act as CBA requires membership of at least one-third of the workers. Support of at least three-quarters of members of the CBA is necessary to call a strike. Hence, on collective bargaining, rights provisions in terms of availability fully reflect those of the international standards, but on effectiveness standards are hardly applicable.

After the Rana Plaza tragedy, there has been an increase in the number of registered unions at the plant level, from 136 in December 2012 to 423. Nonetheless, the representation at the plant level is currently low. Yet many of the newly formed unions are considered to be employer-sponsored.<sup>18</sup> The right to organize in the footwear sector is even more negligible. During the same period after the Rana Plaza disaster, not a single basic union has been registered in the footwear sector. The non-availability of workers' participation mechanisms within workplaces both in the garments and footwear sectors has been identified as the prime reason for low membership in trade unions; the other important reason is the workers' reluctance to join unions due to fear of harassment and job termination.

#### *Working hours*

Violation of working hours provisions is still rampant in both sectors. A working day of 10-12 hours is common and there is no overtime limit in practice (in contrast to the legal limit of two hours). Workers have raised their concerns on the documenting of extra hours of work. Workers allege, "Two-hour overtime duty is mentioned on the pay-slip, and recorded on the attendance card; however, most factories maintain separate sheets for keeping records of overtime of more than two hours which is not shown to the buyers."<sup>19</sup> Thus, in terms of availability of rights provisions, while these reflect the international standards, the practice in both the sectors reveals broad violation of the rights provisions.

#### *Occupational safety and health*

Many improvements, especially in physical arrangements, have taken place in garments factories in the post-Rana Plaza period. However, there are examples of violations of safety provisions and insufficient arrangements. Workers complain that there are still factories where main exits from the building remain closed. A good number of focus group discussion participants say that they have not yet been trained in fire-fighting. Many

also allege the non-availability of a “safety committee” at their respective factories. Workplace environment related provisions are at most times acceptable to the workers, said focus group discussion participants.<sup>20</sup>

Safety measures in the footwear sector are rather poor, in contrast. Workers complained that authorities have not taken sufficient measures even after the Rana Plaza accident. There are allegations that main exit doors remain locked and many factories lack fire exits. Many factories have not trained their workers how to use the fire extinguishers and do not arrange fire-drills regularly.<sup>21</sup>

#### *Wage- and work-related benefits*

The current minimum wage in the garments sector was fixed in 2013 at 5 300 Bangladeshi taka (approximately 68 US dollars) of which 3 000 Bangladeshi taka (around 39 US dollars) is basic salary. The salary for a helper (seventh grade) is below the amount needed for maintaining a decent living—about five times lower than the amount (25 687 Bangladeshi taka) that the Asia Floor Wage Alliance calculates to be a living wage for a Bangladeshi garments worker and her or his family.<sup>22</sup> Although the practice of not paying wages on time and keeping overtime compensation due has decreased greatly, a few factories are continuing such practices. In workers’ perceptions, about two-thirds of the factories maintain timeliness and regularity in wage payment.

In the footwear industry, the minimum monthly wage was fixed in 2003 at 4 100 Bangladeshi taka (around 53 US dollars) of which basic salary is 2 770 (around 36 US dollars). The timeliness of wage payment is worse than in garments. Overtime compensation is not given together with wages—it is given at the end of the next month, or sometimes kept due for two months.<sup>23</sup>

#### *Social security*

Bangladesh’s labour law has provisions similar to the international standards in the areas of insurance, compensation, and maternity benefits, but does not provide any specific provisions on pensions. Instead, two other provisions—provident fund, and gratuity—intended to provide social security benefits to workers, are provided. Overall, the rights provisions reflect partly in terms of availability the standards provisions. Nonetheless, the inherent weaknesses of these laws and the lack of mandatory guidelines on many of these

provisions make these ineffective. Furthermore, the rights provisions on compensation are narrow, as well as discriminatory in terms of age. According to BLA 2006, an adult worker gets 125 000 Bangladeshi taka (around 1 565 US dollars) as compensation for complete permanent impairment whereas a child/ adolescent worker gets only 10 000 Bangladeshi taka (around 125 US dollars) on the same grounds. Hence, the standards are hardly in line with the international standards.

Garments workers allege that, except for a few factories, most do not have a provident fund, group insurance, and gratuity.<sup>24</sup> Footwear workers say that no single initiative of social protection is available at their respective factories, except maternity benefits in some of the large factories.<sup>25</sup>

#### *Employment contract*

Workers said that in the garments factories appointment letters and identity cards are mostly available. In footwear, the violation of the provisions on appointment letters is rampant. None of the footwear workers who participated in the focus group discussions had appointment letters, and many did not even have identity cards. For both the sectors, the provision of a service book is hardly maintained. The employment contract provision related to termination is often violated. Workers reveal that termination of workers without notice is quite common in both the sectors. Workers mentioned that the employers always or often terminate workers without any prior notice and without providing their due wages and benefits.<sup>26</sup>

### **Stakeholders’ policies and interests**

#### ***Government policies for sustainable industrial policies***

Towards a sustainable industry, the government’s interests are centred on a pro-market policy with the priority of market liberalization and private-sector development. Export-led growth has attracted the prime attention. In achieving export growth, promoting diversity of export products and export markets is a priority policy. To this end, the government has determined several approaches like integrating the country into global value chains, using FDI to promote exports, and the expansion of Export Processing Zones and Special Economic Zones.<sup>27</sup> The interests also relate to developing a skilled

workforce that would ultimately meet the demands of the industrial sector.

From the workers' rights point of view, the government aims at improving the occupational safety and health situation (Occupational Safety and Health Policy 2013, Industrial Policy 2016). The current initiatives of the government to promote labour standards across supply chains are concentrated in the areas of enabling the legal and policy environment, skill upgrading, and ensuring compliance through strengthened labour rights enforcement. The labour act (BLA 2006) has been amended several times (2009, 2010, and 2013), and the Labour Rules (2015) have been issued. In order to enforce the legal provisions effectively, efforts have been made to strengthen the labour administration. To this end, initiatives are ongoing in strengthening the two labour-law implementing bodies of the government—the Department of Inspection for Factories and Establishments (DIFE) and the Department of Labour. The number of inspectors increased from 92 in June 2013 to 390 recently.<sup>28</sup> Labour inspectors are now better equipped and trained. The government, too, has formed various high-powered committees to look after the condition of the garments industry. However, no such committee exists for the footwear industry.

#### ***Trade unions' vision of a sustainable and fair model of production***

In the post-Rana Plaza period, trade unions and civil society organizations are demanding stronger accountability from MNCs, with better standards of corporate governance and adequate supervision of corporate conduct from all stakeholders. Trade union responses include the promotion of social partnership and dialogue through the establishment of international framework agreements.

The trade union movement in the country is centred around demands for the promotion of CLS+. The charter of demands submitted by unions at different times to the government incorporated a broad range of issues including trade union rights, workers' wages, the issues of child and women workers, workers' safety at the workplace, and social protection of workers and their families. All of these demands are still highly pertinent considering the situation of the workers. The demand for a living wage, trade union rights, safety and social protection are at the centre of union activities.

In order to improve conditions for the workers, especially their safety situation, participating in multi-stakeholder initiatives is an important strategy of many trade unions. Considering the changing nature of production and power of the MNCs, unions emphasize building solidarity and networks among trade unions and civil society organizations, and call for sector-wide bargaining for rights.<sup>29</sup>

Unions highlight the issue of raising the awareness of consumers to make brands more responsible in respecting the rights of workers. They also want a national tripartite mechanism to bargain with brands. Unions consider that an international multi-stakeholder forum should be formed at a global level. They emphasize the necessity to review and update trade and labour rights-related instruments regularly to make those fully compliant with international labour standards provisions.<sup>30</sup>

#### ***Buyers' perspectives on promoting labour standards***

The garments supply chain is characterized by oligopsony—very few brands/buyers dominate the chain. Both garments and footwear supply chains show an asymmetric power relation in buying and pricing practice. About 70-80 per cent of garments exports go to a handful of buyers /retailers/ brands.<sup>31</sup> They use their market power to influence suppliers in the process of production and supply in the chain. Suppliers allege that buyers force them to produce more quickly, more cheaply and more flexibly.<sup>32</sup> Often buyers play off the suppliers against one another and thereby secure the price they want.<sup>33</sup> In such a system, a supplier cannot bargain and negotiate with pricing due to the fear of losing the contract, since business is competitive and they may have other suppliers who can accept a lower price.<sup>34</sup>

The suppliers have very little control over price determination, causing serious consequences for labour rights conditions in sourcing firms. In one estimate, when a garment product manufactured in Bangladesh is sold at 14 US dollars in a developed country market, 60 per cent of that value is grabbed by international buyers and brand retailers. Governments of importing countries also earn a significant cut as value-added or sales tax. Out of the remaining 40 per cent, the imported and local materials together with the establishment

costs take nearly 35 per cent leaving less than 1 per cent for workers at the bottom of the supply chain.<sup>35</sup> The unequal share of income that goes to workers is also evident in the value chain analysis of a polo shirt produced in Bangladesh: Labour amounts to a meagre 3 per cent of the total production cost in comparison to around 78 per cent for raw materials and 11 per cent for non-labour sewing and assembly.<sup>36</sup>

The sourcing and pricing practices are closely linked with wages, working hours and overtime and overall working conditions. In order to meet buyers' demands—supplying merchandise at a lower price—suppliers keep the wages of the workers as low as possible since they consider labour costs to be flexible and want to secure their profit margin. The pressure from buyers to ensure fast delivery and the fear of contract/order cancellation in case of failure of timely delivery increases the workload of the workers and forces suppliers to engage workers in overtime work. Besides, setting the price at a lower level and the pressure for fast-fashion delivery both compel suppliers to leave part of their contract to sub-contracting firms where workers' rights are poorly enforced.

Immediately after two tragic industrial catastrophes in the country, the Tazreen Factory fire and Rana Plaza Building collapse, the brands and buyers faced an image crisis and severe criticism since they were sourcing from factories that ignored workers' safety in their supply chains. Campaigns in the country and abroad were widespread, calling for brands and retailers not only to establish and implement responsible sourcing/purchasing practices, but also to prohibit the use of factories in the supply chain that do not comply with applicable laws, regulations and internationally accepted labour standards.<sup>37</sup> Brands and buyers started taking responsibility for improving workplace safety conditions and promoting labour standards by participating in multi-stakeholder initiatives such as the Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety.<sup>38</sup>

Nonetheless, the initiatives are still narrow: All are concentrated on workplace safety issues. The broad spectrum of labour standards which also includes workers' rights to organize unions, negotiate legally binding collective agreements, and social protection as well as to ensure workers earn living wages has not

been adequately covered by the initiatives of the brands/buyers.

### ***Employers' perspectives on promoting labour rights***

Employers are organized in their associations. The Bangladesh Garments Manufacturers and Exporters Association (BGMEA) and the Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA) currently have about 4 300 and 2 000 member factories respectively, and the Leather-goods and Footwear Manufacturers and Exporters Association of Bangladesh (LFMEAB) has 120 member factories.<sup>39</sup> The employers' associations are very influential. Sectoral minimum wage negotiation is an area where the associations every time prove their bargaining power. It is often alleged that fixing the minimum wage at a lower level for garments workers is the outcome of the associations' influence. The minimum wage amount is always set at a level which is much lower than the demand of the workers.<sup>40</sup>

Although employers, through their associations, influence policy decisions of the government and have strong bargaining power, the extent of their influence on buyers/brands in price negotiations is still limited. The decision to lower the price does not always come from the buyers' end; often supplying firms offer a lower price in order to leave their competitors behind in the race to grab the work order/contract.

Employers' associations, as part of corporate social responsibility activities, are providing health care, childcare, awareness raising, education support, workers' dormitories, and skill development. Apart from associations' initiatives, many employers individually have undertaken activities. A few exceptional initiatives of employers are worth mentioning, including employing workers with disabilities and ensuring congenial working conditions; providing food and/or food allowances to workers; and fair-price shops to provide garment workers with daily essentials at a fair price.

### **Common interests and policy recommendations**

#### ***Common interests***

*Labour rights enforcement:* Bangladesh is a signatory to many international conventions and covenants related to worker rights, and thus obliged to align labour law

with internationally recognized workers' rights as well as to enforce labour rights provisions. Ensuring coverage of Bangladesh's labour law for all workers including those of EPZs, and active enforcement of labour regulations for all involved in the supply chain are deemed necessary.

*Forms of regulations:* Nonstate-centred voluntary regulations have become a new form of enforcing labour rights, in addition to state-focused legal approaches. Trade and labour linkage regimes can utilize these tools of enforcement where the state enforcement coverage is low. The voluntary system of regulation may meet the needs of complex and dispersed supply chains. Nonetheless, strengthened government enforcement is considered the cornerstone of a viable response to workplace violations.

*Safety at the workplace:* Ensuring a safe workplace is part of the commitment from the government, brands and employers and part of the demand from the trade unions. There is an interest in initiating laws and regulations in promoting the rights of the workers to refuse unsafe work. If the workers are protected from retaliation by the employer, then workers will be able to refuse to do unsafe and hazardous work.

*Skill enhancement:* The government is envisaging a structural transformation of the economy where the manufacturing base will play a key role. A skilled workforce is thus instrumental to achieving the goal. Employers mainly link it with higher productivity. It also links to the trade unions because skills increase job and income security.

### **Policy recommendations**

*Align labour law with international standards:* Bangladeshi labour laws should be aligned with the international standards related to CLS+ issues. Ratification of the CLS+ related conventions is important to promote labour standards in the trade-linked sectors. Also, all workers, including the workers of the EPZs, should be brought under the purview of the labour laws of Bangladesh.

*Linking trade with labour for rights promotion:* The current trade conditionality imposed through the GSP regime is front-loaded—trade privileges granted by the trading partner are subject to conditions and can be

revoked in the event of violations. The US GSP was withdrawn following such claims. The trade privileges should be linked with improved labour rights. Tariff reductions or enhanced market access might be the incentive in return for verified compliance with internationally recognized labour standards.

*Upholding responsibility in supply chains:* Responsibility must be upheld for violations of standards and devising strategies for evading legal obligations as players in the supply chain. MNCs and their suppliers have a duty to obey national laws and respect international standards. A binding legal convention is needed regulating global supply chains including, among others, the imposition of liability in the supply chains and the establishment of a global labour inspectorate with monitoring and enforcement powers. Implementation of the labour standards needs to be monitored regularly, thus a proper monitoring mechanism should be developed.

*Strengthen regulation and enforcement:* New strategies should be adopted to address the current reality of industrial relations in the global supply chains. In this regard, pro-active investigation-driven enforcement rather than reacting to complaints should be introduced. Partnering with the trade unions and employers' associations could be a good vehicle for increasing the reach and effectiveness of enforcement. In addition, the enhancement of resources, powers and coverage is also necessary for effective enforcement.

*Increasing national negotiation capacity:* Negotiation with international buyers/brands must not be left in the hands of employers or employers' associations only. The state should take measures in the negotiation process that could be the part of foreign policy and economic diplomacy. It is important to bring about changes in the attitudes of buyers and brands, making them responsive to the conditions prevailing at the bottom of the supply chain. A national tripartite forum with strong legitimacy, covered by true representative mechanisms and at the same time which has a wide-ranging authority in ensuring the decisions taken for harmonious industrial and labour relations needs to be established.

*Strengthening the trade union movement:* Trade unions have not been able to reorient themselves to deal with the effects of trade agreements and the



changing dynamics of new production processes in global supply chains. Trade union strategy needs to be comprehensive and coherent to provide minimum rights and standards that will not be undercut in the quest for competitiveness. Bangladesh's trade unions need to establish a broad representation of workers, reorient policies towards representing the voices of the workers in the global supply chains through strong organization, actively engage with stakeholders and participate in global movements.

**Developing partnership and collaboration:** A number of actors are involved in the movement of making the supply chain more humane. In particular, trade unions, civil society organizations, global trade union movements, international labour rights NGOs, and global consumers and buyers have come forward with the same vision of making the world of work better. A strong collaboration and partnership among these actors that must cross national boundaries is necessary to make international consumers aware of the rights situation at the bottom of the supply chain and play an instrumental role in improving conditions.

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# The future of ethical production for Cambodia's garment and footwear industry: What role for free trade agreements?

Edlira Xhafa and Veasna Nuon

## Introduction

As part of the Friedrich-Ebert-Stiftung's Core Labour Standards Plus (CLS+) initiative of promoting compulsory compliance with core labour standards and other labour standards to address decent work deficits in global supply chains, this research focuses on the Cambodian garment and footwear industry in the context of its integration into the global production chain.

This research is based on an extensive review of literature and in-depth interviews with key informants conducted during the period August-October 2016. The key informants included representatives from: Two national trade unions (Cambodian Labour Confederation and Cambodian Confederation of Unions), two international trade unions (International Trade Union Confederation and IndustriALL), two government agencies (Ministry of Labour and Vocational Training and Ministry of Commerce), compliance managers from three garment factories (Star FuYa, GDM Enterprise and CHU HSing Factory), the H&M Office in Cambodia, and the US Embassy and the EU Delegation (officers in charge of labour and trade issues).

## The garment and footwear industry: an overview

The Cambodian garment and footwear industry developed in the mid-1990s, when after years of conflict and international isolation, the industry started to integrate into the global production chain. Since Cambodia was not part of the quota system under the Multi-Fibre Agreement, the industry grew in a context of limited competition from China and India. The growth of the industry benefited especially from the US-Cambodia free trade agreements of the late 1990s and early 2000s. The agreements contained labour clauses linking export quotas with improvements in working conditions and worker rights. The quota allocation decisions, which necessitated "reliable, timely and credible information", gave rise to a monitoring initiative which came to be known as the Better Factories Cambodia programme.<sup>1</sup>

As the preferential trade agreements with the United States came to an end and as Cambodia entered the World Trade Organization in 2004, the industry was exposed to greater global competition and more pressure on working conditions. Better Factories Cambodia monitoring became entirely voluntary and its effectiveness was substantially diminished. Subsequent agreements, such as the *Everything But Arms* (EBA) initiative under the EU's General Scheme of Preferences (EU-GSP), which has provided Cambodia's exports with preferential access since 2001, do not contain any labour clause or mechanism to monitor labour compliance.

Overall, the reputation of "ethical production hub" earned during the preferential trade agreements and the comparatively low and for a long time stagnant wages,<sup>2</sup> gave Cambodia's garment and footwear companies a competitive advantage that satisfied buyers' needs for low production costs and compliance with labour standards. This has facilitated the growth of the industry, the importance of which cannot be overstated (Table 1).

Not surprisingly, the *Industrial Development Policy 2015-2025* has included textiles and industries supporting the backward and forward linkages for the garment sector, among its priority sectors. At a general level, the *Policy* aims "to transform and modernize Cambodia's industrial structure from a labour-intensive industry to a skill-driven industry by 2025, through connecting to regional and global value chain; integrating into regional production networks and developing interconnected production clusters along with efforts to strengthen competitiveness and enhance productivity of domestic industries; and moving toward developing a technology-driven and knowledge-based modern industry."<sup>3</sup> The policy, however, sends mixed signals regarding compliance with labour standards and worker rights. On the one hand, the policy seeks to intensify the integration of the country into the global economy by promoting the development of industrial zones to attract investments. On the other, it aims at improving labour market and

Table 1: A snapshot of the garment and footwear industry (2015)

Garment & footwear exports as % of total merchandise exports	Employment in garment factories	Number of garment factories	FDI stock in garment & footwear as % of total FDI stock	Value added in garment & footwear as % of GDP
72%*	623 000** (7 % of total employment; 77% of total employment in manufacturing)	699**	20.5%***	10.6%**

Source: \* Data extracted from the World Bank (2016: 24-25)  
 \*\* Data extracted from the ILO Bulletin (2017: 9 & 10)  
 \*\*\* Data extracted from the World Bank (2016: 24) pertain to the year 2014

working conditions auditing, and “enhancing harmony in industrial relations based on the principles of positive union and kindness of employers towards their employees.”<sup>4</sup> The specific approach taken to achieve a vision of harmony in industrial relations may reflect not only the government’s serious concerns regarding the scale of industrial actions in 2013 and 2014, but also its authoritarian attitude towards industrial relations actors.

While the effects of the policy are yet to be seen, the key findings of this research show that striking a balance between trade liberalisation and improving working conditions and industrial relations is not an easy feat.

## Key findings

### **Economic and social upgrading**<sup>5</sup>

Between 1995 and 2015, the industry experienced a 200-fold increase in exports - from 27 million US dollars in 1995 to 6 279 million US dollars in 2015 – and has contributed an average of 2.0 percentage points to the annual real growth rate.<sup>6</sup> The expansion of the industry has, to some extent, resulted in economic and social upgrading.

In terms of *economic upgrading*, while the share of the country’s garment and footwear exports to the global market grew from 0.1 per cent in 1995 to 1.8 per cent in 2014, it remained lower than those of Bangladesh (5.5 per cent) and Vietnam (6.9 per cent) and much lower than China’s (54.5 per cent), which continues to dominate the global market for garments and footwear.<sup>7</sup> Between 2010 and 2015, the garment exports expanded at an average of 11 per cent per

annum in value terms.<sup>8</sup> Despite these achievements, which have to be understood in the context of a rather under-developed industry before its integration into the global production market, Cambodia’s exports continue to be dominated by Cut-Make-Trim operations, which use mainly imported materials and accessories such as fabrics, yarns, leather, etc.<sup>9</sup> The categories of garments are relatively unsophisticated and have not changed since the mid-1990s.<sup>10</sup>

In terms of *social upgrading*, there has been a progressive increase in employment from a mere 20 000 workers in 1996 to 623 000 workers in 2015, the great majority (around 90 per cent) of whom are women, mainly young women from rural areas.<sup>11</sup> While the sector has created an average of 40 000 new jobs per year between 2010 and 2015, the trend in job creation in recent years has been declining.<sup>12</sup> Moreover, the quality of jobs, remains very poor as most micro, small and medium-sized enterprises are informal,<sup>13</sup> and even formal enterprises are marked by serious violations of working conditions and worker rights.<sup>14</sup> Also, despite substantial wage increases in recent years,<sup>15</sup> they continue to be well below the living wage, which depending on estimates varies from 207 to 401 US dollars.<sup>16</sup>

### **Investment and export destinations**

More than 90 per cent of garment factories in Cambodia are majority owned by foreign investors from China, Taiwan, Hong Kong and Macau.<sup>17</sup> Only 7 per cent of a total of 600 factories are owned by a majority of Cambodian shareholders and only 5 per cent of them are 100 per cent Cambodian owned.<sup>18</sup> In terms of the type of buyers, in Cambodia, as in other countries

producing for the global market, there is a combination of *specialty retailers* who specialise in certain apparel products and target certain markets such as H&M, Nike, Levi, Old Navy, Adidas, Calvin Klein, Gap, Puma, Marks and Spencer, Tesco, Inditex, N Brown Group, Tchibo, Next, New Look and C&A; and *mass merchandisers* which offer a variety of products such as Walmart.<sup>19</sup> The EU and the United States are the top markets for Cambodia's garment and footwear exports, accounting for 76 per cent of the total garment exports.<sup>20</sup> Although the share of Cambodian exports to the US market in the last decade has remained fairly stable, the EU has increasingly become a more important destination (Figure 1). Meanwhile, as Figure 1 shows, the US market has become relatively less important mainly due to the taxes applied to the Cambodian exports.

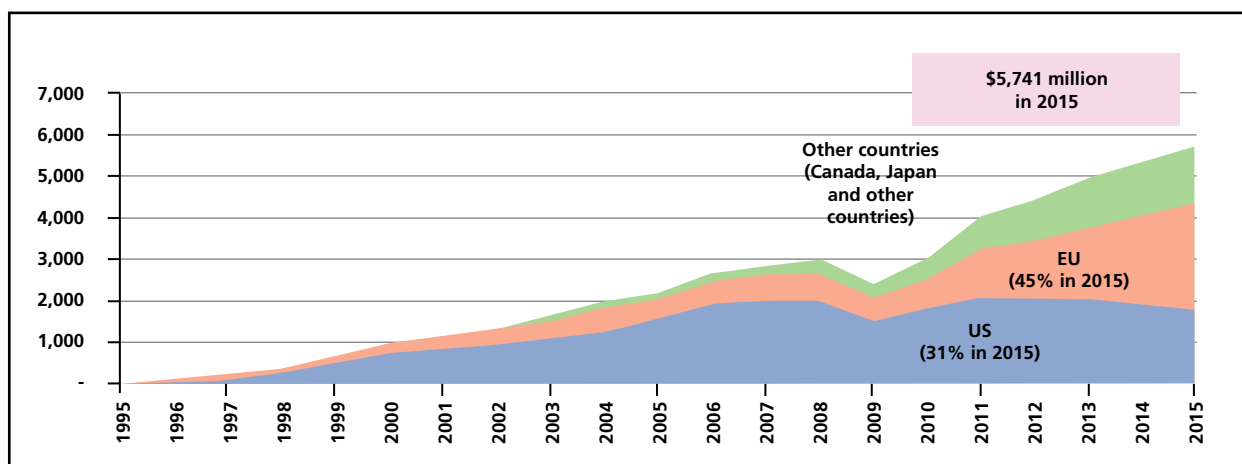
**Factors constraining industry competitiveness**

A number of factors have constrained the competitiveness of the industry. On the one hand, problems internal to the country, such as corruption, poor infrastructure, comparatively high energy costs (higher than those of their competitors in the region), and the lack of cheap, domestically produced raw materials have kept the production costs of Cambodian factories high<sup>21</sup> and have undermined the possibility for higher value added products.<sup>22</sup> On the other, the *monopsony* character of the supply chain—i.e. a relationship of highly asymmetric power between international players (international buyers and intermediaries) and local factories (vendor factories<sup>23</sup> and contract manufacturers<sup>24</sup>)—has

undermined the chances of developing backward linkages in the economy. Thus, decisions over pricing, countries for sourcing materials, components, and production are negotiated between international buyers and intermediaries; the latter being often large and powerful multinational companies with headquarters in China, Hong Kong, Taiwan or South Korea.<sup>25</sup> This process of negotiation excludes the local factories, the majority (70 per cent) of which are vendor factories, operating as subsidiaries or affiliates of these intermediaries, with little decision power over the inputs.<sup>26</sup> Not surprisingly, the material component is the largest in the cost structure of the garment products (Figure 2). Meanwhile, the high dollarization of the economy deprives the government of the possibility of using the exchange rate as a way of making its exports cheaper.<sup>27</sup>

In addition, the highly asymmetric power relationship in the production chain allows international buyers/intermediaries to transfer the effects of price fluctuations in the global market to local suppliers by the mere threat of switching production location. This has left supplier factories unable to negotiate better production prices and technology transfer. Indeed, between 2005 and 2015, local suppliers saw the average price of garments (per dozen) sold to the US market fall by 29 per cent and to the EU markets by 18 per cent.<sup>28</sup> The threat of easy relocation is indicative of yet another major issue with Cambodia's garment and footwear industry, i.e. "very limited initiatives for long-term capital investment and transfers of know-how" from international buyers/

Figure 1: Cambodia's garment exports (1995-2015)



Source: Ministry of Commerce, c.f. Samsen et al. (2016: 10), Figure 1

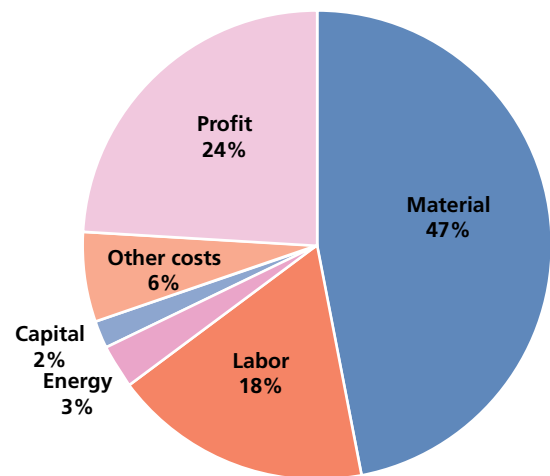
“We are not able to negotiate with the buyers although we have tried many times. The response from buyers is that they have other factories which can accept the prices they set. We have no choice but to accept these low prices.”

“Generally, they don’t transfer any technology. We have to study and make efforts on our own to use hi-tech equipment or methods.”  
Compliance managers from two factories, interview by authors, Cambodia 2016.

intermediaries<sup>29</sup> and low levels of skills and education, including low managerial skills. All these factors have undermined the possibility for productivity increases in the industry, which is reportedly lower than in Vietnam and China.<sup>30</sup> At the same time, the low production prices and limited productivity increases have put more pressure on wages leading to labour unrest, especially in the years 2012-2014, which in turn resulted in a further decline in productivity (Figure 3).

This general picture conceals some important differences in the behaviour of international buyers/intermediaries with *specialty retailers* offering better production prices and being more likely to invest in a relationship with suppliers than *mass merchandisers*, signalling a higher degree of reputation-consciousness.<sup>31</sup> These differences are important to consider not only in terms

Figure 2: Cost structure of garment industry in Cambodia



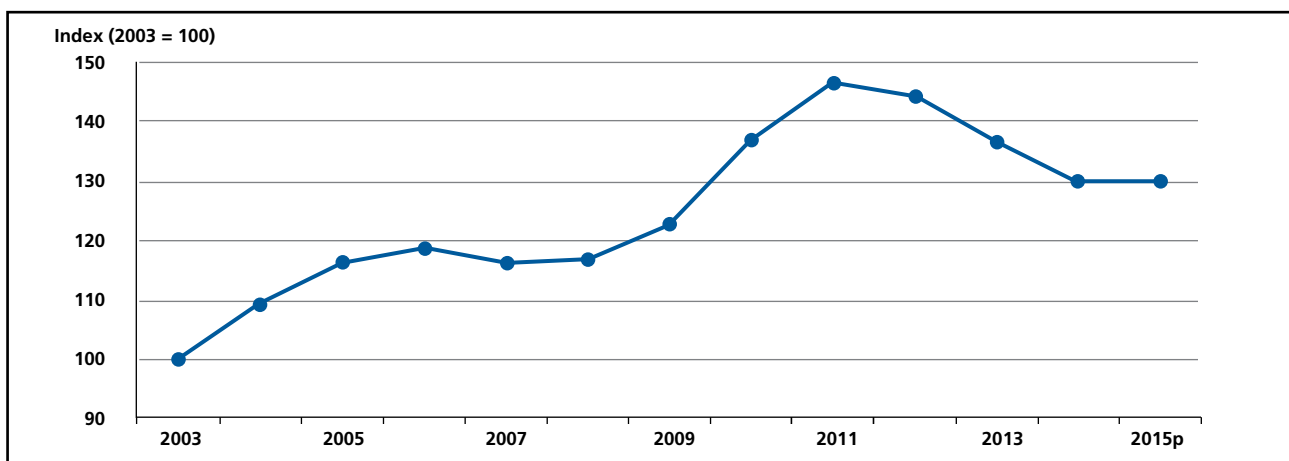
Source: EuroCham, Market Survey: The Textile Industry in Cambodia (2014) c.f. Samsen et al. (2016: 26) Figure 15

of predicting somehow the behaviour of these players - for example, specialty retailers may be less prone than *mass merchandisers* to relocate—but also in terms of policy measures and strategies.

### Increasing violations of labour standards<sup>32</sup>

Labour clauses in trade agreements and the mechanism monitoring compliance with labour standards (Better Factories Cambodia) have reportedly resulted in improvements in the payment of wages and other

Figure 3: Labour productivity in the Cambodian garment and footwear sector 2003-2015p



Source: Cambodian National Institute of Statistics, National Accounts, Ministry of Commerce c.f. ILO (2016b: 4), Figure 8

related benefits, some occupational health and safety issues, and freedom of association.<sup>33</sup> Other commentators, however, have argued that wages and basic job security have worsened during the operations of Better Factories Cambodia and that collective bargaining and basic elements of occupational safety and health remain elusive.<sup>34</sup> The latter view may be capturing developments over a longer time span: As the industry entered a more competitive phase that lacked any regard for labour standards, the modest improvements achieved under the preferential trade agreements and on working conditions more generally were put under increasing pressure. Responding to this pressure, local factories have engaged in a number of strategies to lower labour costs which have resulted in serious, interrelated violations of CLS+. These violations are exacerbated down the subcontracting chain, where casual and home-based work are prevalent.<sup>35</sup>

The most common violations of the CLS+ in the industry are:

- **Job insecurity** has increased dramatically as fixed-duration contracts have become the norm in the industry.<sup>36</sup> Abusing the ambiguity in the legislation regarding the maximum duration for which fixed-duration contracts can be used,<sup>37</sup> employers have intensified their use as a way of avoiding the payment of a minimum wage and various benefits such as maternity leave, seniority benefits, sick leave, special leave, annual leave and attendance bonuses.<sup>38</sup> The illegal use of fixed-duration contracts has resulted in widespread discriminatory practices against pregnant women workers and union activists.
- **Work intensification** has been another coping strategy with the increasing pressure in the industry. This is seen in the excessive use of overtime, denial of break time, shorter lunch breaks and increased production quotas, such as upward revision of the target system.<sup>39</sup> Workers are sometimes forced to consent to overtime either to supplement their meagre income or under the threat of dismissal, wage deductions, non-payment of benefits and other punitive measures.<sup>40</sup> Excessive use of overtime and the persistence of serious health and safety hazards have been identified as one of the main reasons behind the mass fainting in 2013-2014.

"It is more difficult to organise in EPZs than in other factories. These areas are often closed and there are security guards. Subcontractors are even more problematic."

Key informant, interview by authors, Cambodia, 2016.

- **Occupational health and safety hazards**, such as problems of heat, noise, poor lighting, uncontrolled and undeclared use of chemicals, excessive dust, poor ventilation, limited access to personal protective equipment and lack of preventive education are widespread.<sup>41</sup> Demands for substantial improvements to health and safety issues are met with marginal fixes by employers.<sup>42</sup> Meanwhile, most factories lack occupational safety and health committees.
- Violation of freedom of association and collective bargaining rights, in law and especially in practice, have placed Cambodia among the world's worst countries for workers.<sup>43</sup> These include, among others, mounting barriers to the operation of genuine trade unions, government and employer interference in union operations, discriminatory practices and increasing repression against union activists. The persistence of these violations has contributed to union proliferation and infighting, high levels of mistrust and conflictual labour relations. Such a context has also undermined the possibility of improving working conditions through collective bargaining, despite a relatively high unionisation rate, especially in formal companies. The structural power imbalances in the industry have further frustrated unions' attempts for collective negotiations. Confined to company level, collective bargaining coverage remains scattered and of low quality.
- **Discrimination practices** in the workplace are widespread. Not only do women earn less than men, but they are also discriminated against during the hiring process. Pregnant women workers are either not hired or their fixed-duration contracts are not renewed when their pregnancy becomes visible as a way of avoiding the payment of maternity benefits; they are also exposed to harassment, including sexual harassment, verbal abuse and bullying.<sup>44</sup> Meanwhile, independent mechanisms where workers could complain and seek redress for workplace sexual harassment are lacking.



- **Forced and child labour:** Despite a sound legal framework, some reports indicate the use of prison labour.<sup>45</sup> Additionally, in recent years, Better Factories Cambodia reported an increase in cases of child labour.<sup>46</sup> The number of underage workers in unregistered factories is allegedly much higher and the widespread use of fake IDs, means that the problem is likely underreported.<sup>47</sup>
- **Poor law enforcement** as the government has been unwilling to strengthen the institutions overseeing the implementation of the labour law. Despite the pervasiveness of the illegal use of fixed-duration contracts, labour inspectors have turned a blind eye to the monitoring and application of sanctions for the violators.<sup>48</sup> Insufficiently trained and underpaid labour inspectors have made the work of an understaffed labour inspectorate rather ineffective. Moreover, corrupt practices in the judiciary and labour inspectorate are reportedly widespread.<sup>49</sup> While Better Factories Cambodia has helped fill the gap in monitoring working conditions in the industry, it cannot replace the role of a strong labour inspectorate, especially since the major violations are found in smaller factories producing for larger export-oriented factories but which are out of the monitoring scope of Better Factories Cambodia.<sup>50</sup>

### Conclusions and policy considerations

Cambodia's sustained economic growth of recent decades has resulted in a general downward trend in poverty levels and in the Gini index for the period between 2004 and 2012, although income inequality remains high.<sup>51</sup> Also, while Cambodia has shown progress in terms of the Human Development Index (HDI) for the period between 1990 and 2014 (0.364 and 0.555), the index is still below the average for countries in the medium human development group and below the average for countries in East Asia and the Pacific.<sup>52</sup>

The garment and footwear industry has certainly had a positive impact on the country's progress in terms of economic growth, employment and poverty reduction. As elsewhere, this impact could have been more significant if the state and the trade unions had played a stronger role in ensuring an equitable distribution of the benefits generated through Cambodia's integration in the global supply chain of garment and footwear

products.<sup>53</sup> Moreover, as other research in this area suggests, the "MNC-led growth model, which most often takes the form of considerable tax and tariff breaks, raises the question as to whether workers in MNCs might even under some circumstances earn less than they might otherwise have done if tax and other incentives had been used to favour local businesses over foreign investment."<sup>54</sup>

Thus, while the sector will continue to be important for the future of industrial development in the country, there is a need to pursue a comprehensive policy package that engages with the main issues discussed in this research. Policy interventions will also need to consider some of the key lessons from the trajectory of Cambodia's garment and footwear industry in the last two decades. *Firstly*, while labour clauses in trade agreements may lead to some improvements in working conditions and worker rights, said improvements could be more significant and sustainable in a less competitive environment and under trade arrangements that reward compliance with international labour standards. *Secondly*, the achievements and challenges of the industry underscore the importance of investment in technology and know-how for productivity increases and consequently for improvements in working conditions. They also point to the critical role of a regional strategy for enhancing compliance with CLS+ in an industry that is characterised by a high mobility of production orders under the slightest pressure in production costs.

The main findings and insights from this research and policy discussion in various reports,<sup>55</sup> suggest a number of policy considerations in various policy areas. The focus here is mainly on policy measures at the national level.

### **Enhance compliance with international labour standards in law and in practice**

- a) Given the existence of legal provisions that violate international labour standards, there is a need to fully align the labour law with the principles deriving from international labour standards in the following areas:
  - *Job security* is critical to reducing discrimination in the workplace, especially in relation to protection for pregnant workers, maternity benefits and trade union rights. It is also important to increasing productivity as employers are more willing to train a stable workforce. Addressing the

legal gaps related to job security requires legal measures that: limit the number of times a fixed-duration contract can be renewed before it is converted to an undetermined-duration contract; set a minimum duration for fixed-duration contracts; require valid, business-related reasons for the non-renewal of fixed-duration contracts; and which provide for calculating seniority and length of continuous employment for the purposes of calculating statutory benefits, such as paid maternity leave and seniority bonuses, from the date of initial employment and not from each renewal of a fixed-duration contract. It also requires establishing adequate safeguards, including robust sanctions, to discourage the illegal use of fixed-duration contracts.

- *Violence-free and non-discriminatory workplaces* require the introduction of legal measures that forbid pregnancy-based discrimination in hiring and promotion, provide for reasonable accommodation of pregnant women's needs, and define clearly harassment and bullying in the workplace, including sexual harassment. The legal measures should also provide for complaints procedures for those affected by discrimination at the workplace, as well as substantial sanctions for the violators.
  - *Ensuring unionisation and collective bargaining rights* is critical especially in light of widespread repression against genuine trade unions. This requires revising the 2016 Trade Union Law provisions allowing for: Undue administrative and legal burdens on unions that undermine the process of union formation; government control of union finances; restrictions on who could be elected as union office bearers; dissolution of a union if individual officials act illegally upon a decision by the Labour Court; hefty penalties for unions found to have breached the law; broad scope of what constitutes unfair labour practice; and onerous restrictions on the right to strike which affect the exercising of collective bargaining rights. Finally, the Law needs to expand the scope of application to ensure that all groups of workers, including informal workers, have the right to form or join a union.
- b) Given that the major violations of the CLS+ are observed in the enforcement of the labour law, there is a need for the following:
- *Strengthening the Labour Inspectorate* by adequately staffing the institution with well-trained, well-paid and committed labour inspectors. The labour inspectorate also needs to systematically monitor and penalise both formal and informal factories for CLS+ related violations, such as cases of anti-union discrimination, disruption of collective bargaining, forced and child labour, and the illegal use of fixed-duration contracts, which thus far has been out of the scope of their work. There is a need also for mechanisms and speedy procedures that deal with cases of corruption among labour inspectors.
  - *Improving the monitoring system of Better Factories Cambodia* involves addressing some of the main concerns with the programme, that is broadening the scope of issues and factories to be monitored, including subcontractors, which often operate informally, with a stronger focus on worker rights; ensuring better responsiveness to complaints by workers and unions; improving the transparency of findings from the monitoring with the aim of holding accountable the names of non-compliant factories and buyers sourcing from these companies; and expanding its role in the remediation plans of factories found to violate the labour law.
  - *Training of independent trade union representatives*, to participate in the monitoring process can support the work of the Labour Inspectorate and Better Factories Cambodia.
  - *Establishing and/or strengthening of OSH committees* in all factories will be critical to enhancing the enforcement of occupational health and safety regulations. This needs to be accompanied with an intensive awareness-raising campaign and training of worker representatives and unionists on such regulations. Specific training and awareness-raising on women-related OSH issues is especially important given the sector is dominated by women workers.
  - *Enhancing complementarity of various monitoring schemes* such as the Labour Inspectorate, Better Factories Cambodia and international buyers

such as the H&M scheme of compliance on industrial relations for strategic suppliers. Here, occupational health and safety may be an area of experimentation to build a complementary strategy in monitoring and enhancing compliance.

- *Maintaining public pressure on the brands* given the evidence that suppliers of reputation-conscious brands perform better than other companies in terms of compliance with international standards. Here, international trade unions (IndustriALL and International Trade Union Confederation and others), as well as international and local NGOs (American Center for International Labour Solidarity, Clean Clothes Campaign, Friedrich-Ebert-Stiftung, Human Rights Watch, Workers' Rights Consortium, Solidarity Center Cambodia, Cambodian Human Rights and Development Association, Community Legal Education Center, Center for Alliance of Labor and Human Rights and others) can play an important role in pressuring the brands that their suppliers and subcontractors comply with labour standards, and in compelling them to engage in collective bargaining.

### ***Strengthen social dialogue and collective bargaining at industry level***

Given the highly asymmetric power relations in the global value chain of the garment and footwear industry, the space for improving working conditions at company level is very limited. Collective bargaining at industry level, instead, allows for improvements in working conditions for all workers in the industry. By establishing a wage floor and basic conditions of employment, industry bargaining removes labour costs from the competition and consequently pushes employers to invest in innovation and skills upgrading as a way of enhancing competitiveness. Industry bargaining helps improve compliance with labour standards in the industry as employers themselves are interested to ensure that they are not undercut by other employers who try to escape their obligations under the industry agreement. This is particularly important given the evidence that the working conditions of those employed in subcontracting factories are even poorer than in supplier factories. Finally, by taking the conflict out of the workplace, industry

bargaining provides more stability and predictability to buyers, factories and workers, which in turn may have a positive impact on productivity.

In this regard, there is a need to:

- *Strengthen social dialogue* on issues concerning the industry. Arrangements, such as industry forums, provide important support to industry bargaining. More specifically, negotiations for renewing the Memorandum of Understanding on Improving Industrial Relations in the Garment Industry need to be inclusive of independent unions and introduce schemes for monitoring and enforcing labour standards among suppliers and their subcontractors. Similar social dialogue forums can be established by the social partners also at the territorial or factory level. The international buyers and trade unions can support this process.
- *Experiments in industry bargaining* whereby social partners themselves engage in initiatives of multi-employer bargaining may be an effective strategy to kick-start the process of industry bargaining. Targeting employers for multi-employer bargaining needs to take into consideration their key features. For example, involving the Garment Manufacturers Association of Cambodia, where employers are currently required to associate to be able to export, needs to consider that the Association is dominated by Chinese investors who have shown little interest in compliance with labour standards. Also, to the extent that the local suppliers are producing for mass merchandisers, it may be more difficult to engage them in meaningful negotiations. Given the susceptibility of brands to image pressure, a more viable strategy would be multi-employer bargaining involving some of the major brands and their suppliers. Whereas data on the number of workers producing for specialty retailers and brands or mass merchandisers are lacking, multi-employer bargaining engaging some of the main brands may have a positive spill-over effect on the whole industry.
- *Support industry bargaining* through legal measures that support the establishment of ad-hoc joint bargaining committees and of industry bargaining councils. Additionally, regulatory measures that make the principal employer responsible for violations of

the labour law down the subcontracting chain, may facilitate multi-employer bargaining. The existing legal provisions that provide for the extension of an agreement reached by the main social partners to the whole industry may also prove helpful. This may provide an incentive for employers to associate and result in stronger employer organisations which is a critical condition for industry bargaining.

### **Support the transition of the industry to higher value-added activities**

The preferential, duty-free access of travel goods to the United States may be an important opportunity for Cambodia to both ensure higher compliance with labour standards and to engage in higher value added exports. The government, the Garment Manufacturers Association of Cambodia and international buyers (such as H&M) have established a number of programmes and institutions to improve the skills of the workforce, including managerial skills. While these steps may contribute to capitalising on the new preferential treatment opportunity, there is also a need to strengthen other policy measures that help facilitate the transition to higher value added products, such as:

- *Investing in the country's infrastructure and public services* would be critical to the process of industry's transitioning to higher levels of the value chain.
- *Reversing the declining trend in production prices* would require the international buyers and intermediaries to adopt production prices that factor in compliance with international labour standards, technology transfer and skills upgrading. Better Factories Cambodia can play a critical role in estimating fair production prices. At the same time, Better Factories Cambodia can deepen its engagement with key international buyers to whom it provides services of monitoring compliance, to ensure their commitment to long-term sourcing from suppliers that comply with international standards and for investment in technology transfer and skill upgrading. The industry bargaining can also take up the issue of technology transfer and skills upgrading. Finally, there is a need to keep up the public pressure on the international buyers and intermediaries by exposing the effects of low production prices on working conditions.

### **Regional strategies to enhance cooperation between countries and to improve working conditions and labour rights of all workers in the region**

Specific recommendations here include:

- *Strengthen Better Work programmes* in the countries in the region, taking into account the improvements and suggestions regarding Better Factories Cambodia discussed under the recommendations on compliance with core labour standards and on transition of the industry to higher-valued added activities.
- *Experiment in industry bargaining at regional or sub-regional level* to improve wages and working conditions simultaneously, thus excluding the possibility of shifting production from the country that improves wages and working conditions first. Similar to industry bargaining at the national level, a targeted approach that involves key buyers may prove more effective. Here, too, industry bargaining should include provisions that ensure technology transfer and skills upgrading.

### **Trade regimes that promote compliance with international labour standards and ensure technology transfer and productivity improvements**

Finally, this research engaged with the question of the potential role that trade agreements can play in the future of "ethical production" in Cambodia's garment and footwear industry. In this connection, it is suggested here that trade agreements can play a key role if they are combined with the other measures discussed in the previous recommendations and if they incorporate the following:

- *Establishing tariff incentives* for governments and employer(s) who comply with international labour standards.
- *Including provisions for production prices* that factor in compliance with labour standards, technology transfer and skills upgrading.
- *Incorporating a mechanism for fair taxation* which allows, among others, for the development of backward linkages in the national economies.

### **Endnotes**

1. Sandra Polaski, "Combining Global and Local Forces: The Case of Labor Rights in Cambodia," *World Development* 34, no. 5 (2006): 5.

2. The monthly wages have increased from 40 US dollars in 1997 to 61 US dollars in 2012. After mass protests in 2013-2014, the wages have grown annually to reach 153 US dollars in 2017.
3. Royal Government of Cambodia, *Industrial Development Policy*, 2015: ii.
4. *ibid.*, 30.
5. Economic upgrading is defined as the average of the percentage change in export market share and the percentage change in export unit value; social upgrading is the average of the percentage change in employment and the percentage change in real wages, see D. Taglioni and D. Winkler, *Making Global Value Chains Work for Development*, Washington, DC: The World Bank, 2016.
6. World Bank, "Enhancing Export Competitiveness Key to Cambodia's Future Economic Success," *Cambodia Economic Update*. Phnom Penh: World Bank Group, 2016.
7. ILO, "How is Cambodia's Minimum Wage Adjusted?" *Cambodia Garment and Footwear Sector Bulletin*, No.3 (2016a).
8. World Bank, "Enhancing Export Competitiveness Key to Cambodia's Future Economic Success," *Cambodia Economic Update* (Phnom Penh: World Bank Group, 2016).
9. *ibid.*
10. The four categories of garments—(a) sweaters/pullovers; (b) men's trousers; (c) women's trousers; and (d) t-shirts/singles—accounted for 75 per cent of Cambodia's total garment exports in 2015, see Neak Samsen et al., *Cambodia Garment Industry: Challenges Opportunities and Ways Forward* (Phnom Penh: Better Factory Cambodia, 2016).
11. See ILO, "How is Cambodia's Minimum Wage Adjusted?" *Cambodia Garment and Footwear Sector Bulletin*, no.3 (2016a); and ILO, "Recent Trade Policy Developments and Possible Implications for Cambodia's Garment and Footwear Sector," *Cambodia Garment and Footwear Sector Bulletin*, no.5 (2017).
12. *ibid.*
13. Royal Government of Cambodia, *Industrial Development Policy*, 2015.
14. See key finding on Increasing violations of labour standards in this chapter.
15. The gross monthly wage is subject to deductions such as health insurance and income tax. However, the new tax threshold (effective January 2017) has been increased from 200 to 250 US dollars, thus reducing the number of workers, including garment workers, who are liable to pay income tax.
16. Jeroen Merk, *Country Study Cambodia: Labour Standards in the Garment Supply Chain*, CNV International, 2016.
17. World Bank, "Enhancing Export Competitiveness Key to Cambodia's Future Economic Success," *Cambodia Economic Update* (Phnom Penh: World Bank Group, 2016).
18. *ibid.*
19. Chikako Oka, "Does Better Labour Standards Compliance Pay? Linking Labour Standards Compliance and Supplier Competitiveness," *Better Work Discussion Paper Series* no.5 (2012).
20. *ibid.*
21. Over 90 per cent of materials, from textiles and fabrics to packaging are imported mainly from the countries in the region. See G. Lopez-Acevedo & R. Robertson (eds.), *Sewing success? Employment, Wages, and Poverty following the End of the Multi-fibre Arrangement*, World Bank Publications, 2012.
22. Neak Samsen et al., *Cambodia Garment Industry: Challenges Opportunities and Ways Forward* (Phnom Penh: Better Factory Cambodia, 2016).
23. World Bank, "Trade Development. Improving Trade Competitiveness: Cambodia Garment exports," *Policy Note* no.83075 (2013). Vendor factories "are locally incorporated production units of foreign corporations. They are directly managed by their overseas headquarters, which allocate orders to factories according to capability, cost structure, and capacity."

24. Contract manufacturers are foreign-owned factories which operate as independent enterprises providing Cut-Make-Trim operations. See World Bank, "Trade Development. Improving Trade Competitiveness: Cambodia Garment exports," *Policy Note* no.83075 (2013): 1.
25. Neak Samsen et al, *Cambodia Garment Industry: Challenges Opportunities and Ways Forward*, 2016.
26. *ibid.*
27. ILO, "Recent Trade Policy Developments and Possible Implications for Cambodia's Garment and Footwear Sector," *Cambodia Garment and Footwear Sector Bulletin*, no.5 (2017).
28. ILO, "Trends in Cambodian Garment and Footwear Prices and their Implications for Wages and Working Conditions." *Cambodia Garment and Footwear Sector Bulletin*, no.4 (2016b).
29. Neak Samsen et al., *Cambodia Garment Industry: Challenges Opportunities and Ways Forward*, 2016.
30. *ibid.*
31. For the same product and style, the productivity of factories in Cambodia is 20-30 per cent lower than that of China while the productivity of factories in Vietnam is only 10-20 per cent lower than that of China, see Neak Samsen et al., *Cambodia Garment Industry: Challenges Opportunities and Ways Forward*, 2016; Chikako Oka, "Does Better Labour Standards Compliance Pay? Linking Labour Standards Compliance and Supplier Competitiveness," *Better Work Discussion Paper Series* no.5 (2012).
32. Cambodia has ratified only the following ILO conventions related to CLS+ : C87, C98, C29, C105, C138, C182, C06, C100, C111, C13, C04, C122, C150.
33. Sandra Polaski, "Combining Global and Local Forces: The case of Labor Rights in Cambodia," *World Development* 34, no.5 (2006): 5.
34. Stephan Sonnenberg and Benjamin Hensler, *Monitoring in the Dark*. Stanford, California: International Human Rights and Conflict Resolution Clinic, Stanford Law School: Worker Rights Consortium, 2013.
35. *ibid.*
36. It is estimated that about 90 per cent of the workers in the industry do not have a permanent contract, with many factories hiring 100 per cent of their workforce on FCDs, see Human Rights Watch (HRW), *Work Faster or Get Out: Labour Rights Abuses in Cambodia's Garment Industry*. Human Rights Watch, 2015; Dennis Arnold, *Cambodia Context Analysis*, 2015, unpublished.
37. See The clinic, *Tearing Apart the Seams*, 2011. Article 67 of the 1997 Labour Law states that: "The labor contract signed with consent for a specific duration cannot be for a period longer than two years. It can be renewed one or more times, as long as the renewal does not surpass the maximum duration of two years." The government issued a Draft Amendment replacing "the renewal" with "each renewal," a change that would give employers clear legal authority to keep permanent, full-time workers classified as FDC workers indefinitely, as long as they hire them under successively renewed FDCs having durations of two years or less.
38. See Jeroen Merk, *Country Study Cambodia: Labour Standards in the Garment Supply Chain*, CNV International, 2016; Human Rights Watch, *Work Faster or Get Out: Labour Rights Abuses in Cambodia's Garment Industry*, (Human Rights Watch, 2015).
39. *ibid.*
40. *ibid.*
41. Jeroen Merk, *Country Study Cambodia: Labour Standards in the Garment Supply Chain*. CNV International, 2016.
42. Chikako Oka, "Does Better Labour Standards Compliance Pay? Linking Labour Standards Compliance and Supplier Competitiveness," *Better Work Discussion Paper Series* no.5, 2012, in M. Reeve and H.S. Hwang, "Cambodian Industrial Relations," *ILO Working Paper* based on research commissioned to the authors by the International Labour Organization, 2015.

43. The ITUC Global Right Index has given the country a rate of 5 (1=best, 5=worst), that is policies that offer “no guarantee of rights” for workers (ITUC 2014), see ITUC, *Global Rights Index: The World’s Worst Countries for Workers* (International Trade Union Confederation, 2014).
44. Human Rights Watch, *Work Faster or Get Out: Labour Rights Abuses in Cambodia’s Garment Industry* (Human Rights Watch, 2015).
45. Stephan Sonnenberg and Benjamin Hensler, “Monitoring in the Dark,” (Stanford, California: International Human Rights and Conflict Resolution Clinic, Stanford Law School, Worker Rights Consortium, 2013).
46. Jeroen Merk, 2016.
47. Human Rights Watch, *Work Faster or Get Out: Labour Rights Abuses in Cambodia’s Garment Industry* (Human Rights Watch, 2015).
48. *ibid.*
49. *ibid.*
50. *ibid.*
51. Melisa R. Serrano and Veasna Nuon, *Trade Unions and Development in Cambodia*, forthcoming.
52. *ibid.*
53. Anner and Hossain, 2014.
54. *ibid.*
55. See Jeroen Merk, *Country Study Cambodia: Labour Standards in the Garment Supply Chain* (CNV International, 2016); Neak Samsen et al., *Cambodia Garment Industry: Challenges Opportunities and Ways Forward* (Phnom Penh: Better Factory Cambodia, 2016); Dennis Arnold, *Cambodia Context Analysis* (unpublished, 2015); Jenny Holdcroft, “Transforming Supply Chains Industrial Relations,” *International Journal of Labour Research* 7, no.1-2 (2015); Human Rights Watch, *Work Faster or Get Out: Labour Rights Abuses in Cambodia’s Garment Industry* (Human Rights Watch, 2015); Stephan Sonnenberg and Benjamin Hensler, *Monitoring in the Dark* (Stanford, California: International Human Rights and Conflict Resolution Clinic, Stanford Law School, Worker Rights Consortium, 2013); and The Clinic, *Tearing Apart the Seams*, (International Human Rights Clinic Yale Law School, 2011).

## Trade and labour standards in global supply chains in Pakistan

Muhammad Asif Iqbal

### Introduction

During the last couple of decades, Pakistan's economy has experienced a significant structural shift from a traditional agriculture-based economy to a modern production and service economy. Currently, the services and manufacturing sectors constitute 59 and 21 per cent of GDP, respectively. The corresponding share of agriculture is 20 per cent, which has gradually declined from 25 per cent in 1995. Despite the shift, the agricultural sector continues to be a major contributor to the country's economy. Sixty per cent of manufacturing is agro-based, 40 per cent of trade and transport is of agricultural products and some 90 per cent of export-oriented industries rely on agricultural produce such as the cotton and rice crops.<sup>1</sup>

International trade plays an important role in Pakistan's economy with a volume equivalent to about 30 per cent of GDP. The annual trade volume has increased twelvefold over the last two decades as a result of financial and trade liberalization reforms initiated by the government in 1988. Currently, the exports of goods and services constitute about 9 per cent of GDP, a figure that hovered around 11 per cent during the last decade.<sup>2</sup>

Over the last four decades, Pakistan has entered into several plurilateral preferential schemes along with regional/multilateral and bilateral trade agreements. In 2014, Pakistan was given the status of GSP Plus by the European Union (EU), which provided free market access to almost 87 per cent of Pakistan's exports for a 10-year period.

Integration of international labour standards into trade agreements and preferential schemes is becoming a common practice. Moreover, the emergence and rapid growth of global supply chains (GSCs) have transformed the systems of production and trade. All these developments have significant implications for the labour market and trade performance of a country.

As part of the Core Labour Standards Plus (CLS+) initiative, this case study analyses the status of

compliance with international labour and social standards, implications of non-compliance, and power relationships in global supply chains with a particular focus on the export-oriented industries of Pakistan. The textile sector was selected for detailed analysis since it accounts for about 60 per cent of Pakistan's exports (Figure 1), provides employment to 40 per cent of the industrial workforce, contributes nearly one-quarter of the total industrial output, and has the longest production chain.<sup>3</sup> Within the textile sector, the study focuses on the textile value-added sector, which includes home textiles (bedwear), towels, hosiery, knitwear and ready-made garments (including fashion apparel). Textile value-added constitutes two-thirds of the textile exports of Pakistan.

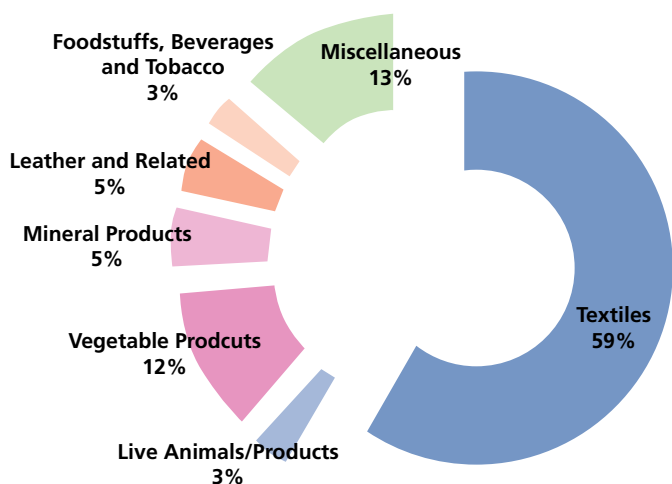
The methodology of the case study is based on a thorough review of literature and secondary data and interviews with key sources and stakeholders including government officials of concerned departments and ministries, managers of industrial units, industrial workers/labourers, and representatives of labour unions/federations, the hosiery manufacturers association, civil society and donors. These included one-on-one interviews as well as meetings/discussions with a group of people such as workers, managers, etc. Altogether, 56 interviews/meetings were held in Islamabad, Faisalabad, Lahore and Karachi. Interviews with industry and labour union representatives were mainly conducted in the later three cities where large clusters of textile industrial units are located. The fieldwork was carried out during October and November 2016.

### Overview of the textile sector

The textile industry has traditionally been the most important component of the manufacturing sector in Pakistan – a major source of export earnings, contributor to GDP and employer of skilled and unskilled workers. The industry consists of a large-scale organized sector and a highly fragmented small/medium-scale sector. Currently, textile exports are almost evenly distributed among cloth, hosiery, yarn, bedwear and garments (Figure 2).

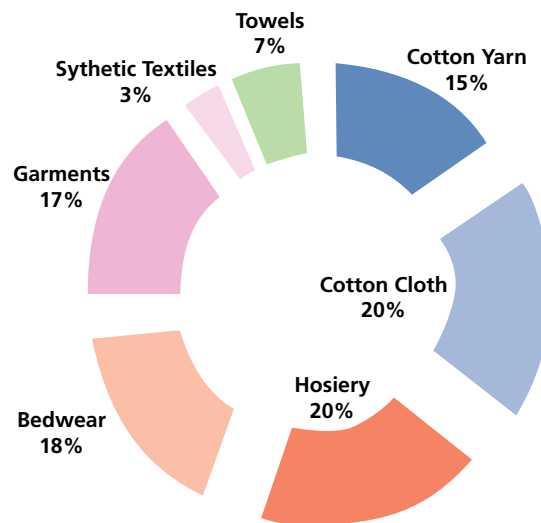


Figure 1: Composition of Exports



Source: State Bank of Pakistan, Annual Report, 2016

Figure 2: Composition of Textiles Exports



Source: State Bank of Pakistan, Annual Report, 2016

The expansion of the textile industry in Pakistan has been impressive over the last three decades. For instance, the number of industrial units increased from 149 in 1980 to 411 in 2016 while the installed capacity (in terms of number of spindles) increased from 5 million to 13 million during the same period. Major expansion, however, was witnessed during the 1990s.<sup>4</sup>

Significant changes have also occurred in the composition of textile exports where production and exports of high end value products increased substantially. For instance, the share of cotton yarn exports declined from 30 per cent in 1991 to 15 per cent in 2015. In contrast, the combined share of hosiery, bedwear, towels and garments increased from 33 per cent to 61 per cent. However, the textile sector is also confronted with a set of challenges in order to survive in a highly competitive global market. Textile exports as a percentage of GDP declined from 6.3 to 4.6 between 2012 and 2016. Some of the major internal challenges include energy shortages, high production costs due to high energy prices, fluctuations in cotton production, and lack of R&D within the industry.<sup>5</sup>

**Asymmetric power relationships**

The textile industry of Pakistan follows a pyramidal structure in terms of the number of units and scope of production—a small number of large units at the top

and a large number of small units at the bottom. For the sake of analysis, the textile manufacturing sector may be divided into three tiers (Figure 3 sketches the supply chain).

**Tier 1** consists of large-scale manufacturing units that export directly or through buying houses to the international buyers (brand/retailers). During the peak seasons, they also subcontract their production orders to medium (Tier 2) and low-scale (Tier 3) manufacturers. The firms in this particular category generally follow the norms of international labour standards in their own production processes. The core managerial and production staff are hired directly by the firm on the basis of employment contracts. However, a majority of production workers are hired through intermediate contractors. These workers are not employees of the firm and are remunerated directly by the contractors.

**Tier 2** comprises medium-scale manufacturing units. Due to their limited capacity (financial and production), they take export orders from small international buyers. They also take the CMT (Cut, Make and Trim) orders from Tier 1. The hiring of production workers is done largely through sub-contractors.

**Tier 3** consists of a large number of small units that mostly fall under the informal economy, implying that the

firms are not documented and regulated by the relevant state authorities and workers' rights are not protected. This also applies to a large segment of Tier 2. For instance, more than 80 per cent of the ready-made garment industry consists of small and medium-sized enterprises (SMEs), which are mostly informal enterprises.<sup>6</sup> Tier 3 firms do not export directly and mostly provide services to Tier 1 and Tier 2 for their export orders. They also cater to the domestic markets. Workers are hired directly and the compensation is either based on daily wages or piece rates.

The power relationship between buyers and producers is characterized by the price-setting behaviour of the upstream firms along the supply chain. It is mainly determined by the distribution of value-chain activities including product design, production, marketing, distribution, and support to final consumers. A small number of brand names and retailers govern the chain since high value-added activities (such as design and marketing/distribution) are performed by them while production is carried out by local manufacturers. Most of the production material (such as yarn and fabric) is produced locally. The buyers provide specifications for design and the material to be used. They also have their own monitoring and quality control procedures both for the products as well as for the compliance with labour standards.

The interviewees (managers of textile firms) reported a number of pressures from the buyers that are making the local suppliers more vulnerable to the increasing competition in the global market. These include low offered-prices, tight delivery schedules, fluctuations in the order, and penalties in case the order is not delivered on time. Due to intense competition in the market, suppliers have limited bargaining power on the price side. Therefore, they have to look for cost-cutting options since the profit margins are already on the edge. According to the data provided by four textile units, the average gross margin of these firms declined from 18.4 per cent in 2013 to 11.6 per cent in 2015 while the net margin went down from 9 per cent to 2.8 per cent during the same period.

The major impediment to reducing the production cost is the component of material, which accounts for almost three-quarters of the total cost. Material is the only

inelastic component of the manufacturing cost and is a major concern of a buyer from the quality perspective. Overheads and energy costs range between 7 and 10 per cent while the cost of labour is 5 to 7 per cent.

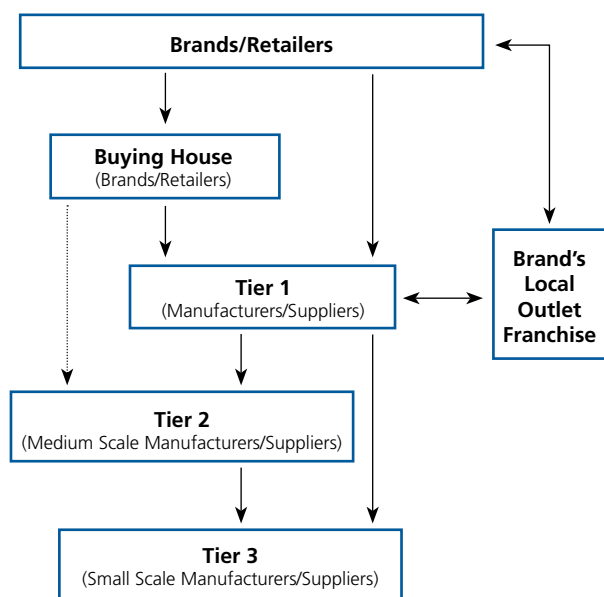
Given this scenario, cost-cutting becomes a daunting task for suppliers. As reported by the interviewees, firms start by compromising on the quality to a minimal extent. For instance, in the case of textile fabric and towels the buyers usually have a tolerance rate of  $\pm 3$  per cent in terms of the weight of the fabric. Therefore, the manufacturers reduce the weight but keep it within the tolerance limit. But this is a meagre attempt at reducing the cost.

In order to remain competitive, the firms use various organizational strategies by transferring the burden to the bottom of the chain. Sub-contracting is the most common strategy adopted by the manufacturers in Pakistan. Sub-contracting is only for CMT. All the material, accessories and designs are provided by the Tier 1 firms. During the peak seasons, CMT orders are also given to Tier 3 units. Although large firms generally abide by the labour laws for their own employees, they do not have any control over the sub-contractors. Workers are not provided with appropriate compensation and other legal rights and entitlements by the lower-tier enterprises.

In addition to the subcontracting of manufacturing, Tier 1 firms keep their employment level at the minimum and hire production workers for a short period through contractors. They employ staff up to the level of supervisor along with some 10 to 20 per cent of workers on a permanent basis. The rest of the bottom line workers are hired through contractors in order to reduce a firm's liabilities. These workers are brought inside the plant to perform the tasks related to production. They are not given a job contract by the firm; instead they work for the contractor on the basis of daily wages or piece rate. This arrangement allows the contractor to deprive the workers of legal rights, protection, and entitlements.

Tier 1 firms also face penalties for delayed deliveries, which sometimes are also passed down to lower tiers. Another consequence of delayed deliveries experienced by Pakistani exporters is that during the energy crisis in the country, the buyers shifted their orders to other countries i.e. India, Bangladesh and Sri Lanka.

Figure 3: Supply chain of Pakistan's textile sector



Note: Orders placed by buying houses to Tier 2 are largely for small buyers and not from big brands.

Figure 4: Cost components of selected products (%)

	Denim Jeans	Polo Shirt	Duvet
Raw Material	44.9	48.8	72.0
Trims	13.3	8.0	-
Labour	6.4	16.0	2.0
Lab Test	9.8	1.2	2.0
Overhead	9.6	10.0	6.0
Freight	3.0	0.8	3.0
Gross Margin	13.1	15.2	15.0
Cost of Goods Sold	\$10.7	\$2.0	\$8.8
Tag Price	\$52.0	\$8.0	\$40

Source: Author's calculations based on the data provided by factory managers.

The nature of power relationships in the value chain allows the lead firms to maximize their profits. As shown in Figure 4, the costs of goods sold are much lower than their retail prices. For example, the factory cost of a pair of jeans is estimated to be 11 US dollars as against the tag price of 52 US dollars. Similarly, a duvet with a tag price of 40 US dollars costs only 9 US dollars.

### Compliance with labour standards

As a member of the International Labour Organization, Pakistan has ratified 36 conventions—eight fundamental, two governance related, and 26 technical conventions. Ratification of conventions indicates political willingness on the part of the government, whereas the identification of the legislative framework needs to be followed by the required institutional arrangements for compliance with the relevant laws.

The eight fundamental conventions include all the Core Labour Standards (CLS) ratified by the Government of Pakistan. The compliance with labour standards and recognition of workers' rights are crucial for the improvement of working conditions and healthy labour and industrial relations. The two factors are considered essential for higher labour productivity. Thus, any

violation of labour standards and the existence of any inhuman working environment has a negative impact on the productivity of any business. Though Pakistan fulfils all the reporting obligations of the ratified conventions, it is the compliance and implementation of international standards that varies across different sectors and is more problematic for specific labour-intensive sectors such as agriculture and textiles.

### Freedom of association, the right to organize and collective bargaining

The constitution of Pakistan (article 17) ensures the right to form associations or unions whereas the structure and bylaws of trade unions are provided in the Industrial Relations Act (IRA) of Pakistan. Unfortunately, the IRA neither covers public-sector employees nor the industries located in Export Processing Zones. Furthermore, it lacks the provision to form trade unions by occupational sector or general unions to participate in collective bargaining, implying that union formation and wage negotiations take place at the firm level.<sup>7</sup> According to the ILO, the trade union density (union membership rate) in Pakistan was only 1.2 per cent in 2007.<sup>8</sup> One of the reasons for low unionization is that the largest proportion of the labour force is employed in the informal sector.

Another reason behind low unionization is that the relevant laws<sup>9</sup> do not allow workers to become members of more than one trade union (if they are engaged in more than one sector or occupation). Specifically, there is a restriction for workers doing part-time jobs or limited-hours jobs in two different workplaces.<sup>10</sup> The law also restricts the double employment of a worker.

Moreover, the law potentially restricts the formation of multiple unions. The membership requirement for registration of the first two unions in an establishment is at least seven. However, for registration of the third union the applicant needs to ensure membership of 20 per cent of the total workers. Generally, the first two unions are pocket/yellow unions supported by the management. This makes the registration of a third union more difficult and complicated.

#### **Equal value and remuneration and elimination of discrimination in respect of employment and occupation**

The constitution of Pakistan (article 38) ensures the promotion of the social and economic wellbeing of the people, irrespective of sex, caste, creed or race. There exists no discrimination whatsoever in the labour laws of Pakistan regarding sex of workers since the term 'worker' as defined under the laws legally includes both sexes. However, there is no specific legislative framework to address the conventions of equal remuneration and discrimination with respect to employment and occupation. At the provincial level, amendments to the Minimum Wage Act have been made by two of the four provinces<sup>11</sup> prohibiting discrimination (based on sex, sect, religion, colour, caste, creed, and ethnic background). Legislation in Sindh province<sup>12</sup> prohibits discrimination on the basis of actual, presumed, suspected or alleged HIV status in employment matters.

The sub-contracting of workers is also prevalent across all tiers of the high-end textile value added export sector. According to the 2015 report by the Pakistan Workers Federation, only a fraction (10-25 per cent) of formal-sector employees are registered with relevant labour authorities. There is no specific law to prevent this discrimination except in Sindh province, where a recently amended law states: "[...] no worker shall be employed through an agency or contractor or sub-contractor or

middleman or agent, to perform function relating to their contract of employment."<sup>13</sup> Effective implementation of the law is, however, questionable.

As far as equal remuneration is concerned, considerable wage differentials exist between females and males (Figure 5). The labour force participation rate for females is low in Pakistan (14.7 per cent). A majority (75 per cent) of employed women work in the agriculture sector, which is mostly categorized as an informal sector. Over the years, the wage ratio (female to male) has improved in agriculture but worsened in sectors like manufacturing as well as finance and insurance.

#### **Elimination of all forms of forced or compulsory labour**

Pakistan ratified the convention on forced labour (C29) in the late 1950s and the convention on the abolition of forced labour in the early 1960s. The constitution of Pakistan requires the state to eliminate all forms of exploitation and prohibits all forms of slavery, forced labour and child labour. The law on the bonded labour system (abolition) was enacted in 1992 but bonded labour continues despite this legislation.

Bonded labour in Pakistan is mainly due to non-repayment of debts by workers. There are no reliable available statistics on the number of bonded workers, but bonded labour is largely found in the rural economy. Pakistan ranks third in the global slavery index 2016.<sup>14</sup>

Figure 5: Wage Ratios (female to male) in %

Sector	2008-09	2014-15
Agriculture	59	70
Manufacturing	39	38
Construction	77	89
Wholesale & Trade	96	100
Finance & Insurance	89	62
Public Admin & Defence	67	92
Education	75	62
Health	75	78
Domestic Services	37	48

Source: Pakistan Labour Force Survey (2009: 2015)

**Minimum age for employment and effective abolition of the worst forms of Child Labour**

Pakistan ratified the convention for the Minimum Age for Employment in July 2006 and the convention on the Worst Forms of Child Labour in October 2001. The constitution prohibits child labour and a number of pieces of legislation are already in place. The legislative framework is in compliance with the conventions; however, the incidence of child labour<sup>15</sup> continues to be high despite a substantial decline from 13.3 per cent in 2008 to 9.6 per cent in 2015.<sup>16</sup>

In the area of hazardous work, there is a need for legislation to increase the minimum age to at least 18 years. There is also a need to revisit the existing list of hazardous work. For instance, the brick-making process is hazardous, but it is not placed on the list of hazardous work.

**Core Labour Standards Plus**

Pakistan has ratified six (out of 18) ILO conventions related to CLS+ as shown in Figure 6. Some important conventions having significant implications for labour welfare are yet to be ratified by Pakistan—included are the conventions on occupational safety and health (OSH), social policy, employment policy, and the protection and fixing of wages. Some of these areas, however, are partially covered through other related conventions. In some cases, domestic laws already exist despite the fact that the relevant conventions have not been ratified i.e. protection and fixing of wages.

**Occupational Safety and Health:** There are about 17 ILO conventions and recommendations which deal directly or indirectly with occupational safety and health. Pakistan has ratified 10 such conventions. The existing legislative framework also addresses the issue of OSH in the constitution and in various labour laws, but due to weak implementation the incidence of work-related injuries/disease is high. According to the 2015 Pakistan Labour Force Survey, 4 per cent of the workforce was reported as injured or affected with work-related diseases.

**Social Policy and Employment Policy:** The legislative framework provides social security to workers in the private sector through federal and provincial institutions. The coverage, however, remains low. For instance, 10-25 per cent of formal sector employees are registered

under provincial social security schemes. Similarly, the Employment Old-age Benefits Institution (EOBI), a federal institution, provides pensions to registered workers. Again, the coverage is low since only 20 per cent of employees are covered under EOBI.<sup>17</sup>

**Protection and Fixing of Wages:** Labour exploitation remains a huge problem in the country due to non-ratification of wage conventions and poor implementation of existing laws. The existing nominal wages are not sufficient to maintain decent living standards. According to the Asia Floor Wage Alliance (AFWA), the monthly minimum wage for three adults with one earner is 31 197 Pakistani rupees (298 US dollars) for the year 2015. Currently, the statutory minimum wage for 2016 is 14 000 Pakistani rupees (134 US dollars)—less than half of the living wage estimated by AFWA. In the textile sector, minimum wages for skilled workers range from 15 680 to 16 850 Pakistani rupees (150-161 US dollars).<sup>18</sup>

Even though the minimum wage is fixed by the government, there are considerable violations particularly in the industries where high end value products are manufactured (garments, knitwear, towels, bedwear). According to the ILO, about 37 per cent of the workers

Figure 6: States of Ratification of Convention – CLS+

Technical		
1. C155	Occupational Safety and Health (OSH)	No
2. C187	Promotional Framework for OSH	No
3. C095	Protection of Wages	No
4. C131/26	Minimum Wage-Fixing/Machinery	No
5. C001	Hours of Work (Industry)	Yes
6. C014	Weekly Rest (Industry)	Yes
7. C097	Migration for Employment (Revised)	No
8. C143	Migrant Workers (Supplementary Provisions)	No
9. C102	Social Security (Minimum Standards)	No
10. C117	Social Policy (Basic Aims and Standards)	No
11. C122	Employment Policy	No
12. C150	Labour Administration	No
13. C118	Equality of Treatment (Social Security)	Yes
14. C019	Equality of Treatment (Accident Compensation)	Yes
Governance		
1. C081	Labour Inspection	Yes
2. C144	Tripartite Consultation	Yes
3. C122	Employment Policy	No
4. C129	Labour Inspection (Agriculture)	No

Source: International Labour Organisation (ILO)

are paid below the minimum wage in Pakistan's garment industry.<sup>19</sup> Of those who are paid less than the minimum wage, almost half are paid less than 80 per cent of the minimum wage threshold (far below the minimum wage). There are wide differentials in non-compliance with respect to gender—about 27 per cent of all males and 87 per cent of all females are paid below statutory minimum wages.

**Hours of Work and Weekly Rest:** Pakistani law allows a maximum of 48 hours of work per week (6 days). The limitation of daily working hours is 9 hours (including a one-hour break). The overall spread per day is limited to 10 and a half hours including overtime (excluding break). However, the prevalence of overwork is alarming where more than one-third (40 per cent) of the employed labour force in Pakistan is engaged in work exceeding 48 hours per week. According to a survey conducted by the Pakistan Workers Federation in 2015, almost 50 per cent of male and female workers do more than eight hours in a day.<sup>20</sup> The trend is relatively worse in the textile industry where more than one-half of the workers do more than 8 hours in a day. Both male and female workers in industry are almost equally "overworked". About 64 per cent of male workers and 62.2 per cent of female workers are working more than 8 hours a day.<sup>21</sup>

### **Transfer of technology**

The textile industry in Pakistan is primarily involved in the design and production of yarn, cloth, clothing and their distribution on the domestic and global markets. Considering the scope of business in the textile industry, most of the production activities/processes involve low-tech or low-intermediate technology.<sup>22</sup>

However, most of the Tier 1 textile units are vertically integrated and there has been considerable transformation from labour-intensive to capital-intensive processes in the sector. Tier 1 producers in all segments of the textile industry are largely equipped with state-of-the-art technology and machines to produce high end value finished textiles and fashion garments.

Despite massive growth in the textile sector and continuous upgrades by local manufacturers, the local manufacturing of machinery has not been developed. Acquisition of modern technology for high-end production is mainly based on the import of machinery

from developed countries. Nevertheless, for operating the state-of-the-art machinery and equipment, skill development trainings are provided to a small number of senior-level employees and managers only. In this way, the transfer of technology is either very limited or does not happen at all.

### **The role of industrial policy**

Industrial policies in Pakistan have traditionally been formulated with the objective of gaining self-sufficiency in items of basic consumption and exploiting the country's perceived comparative advantage.<sup>23</sup> These policies were either formulated as a crisis response, or as part of the medium-term development plans.<sup>24</sup> The nature and imperatives of industrial policy have been changing over time, starting from import-substitution industrialization to a gradual growth from low-technology to a moderate-technology industry.

More recently, industrial policymakers have been concentrating on sector-specific policies, which include the Auto Development Policy, Textile Policy and Fertilizer Sector Policy. Under these policies, various measures have been announced from time to time for attracting foreign direct investment, importing technology, generating employment, and improving industrial productivity. However, the ultimate thrust of these policies has been to increase exports.

In a nutshell, the stated objectives of the policies have not been achieved since a declining trend has been observed in the country's exports during the last decade or so. Exports as a percentage of GDP have dropped from 13 per cent in 2005 to 9 per cent in 2015 while the data of fiscal year 2016-17 also confirm the same trend. More recently, the government announced the Textile Policy 2014-19, which included various incentives like special duty-drawback rates, duty exemption on plant and machinery, subsidies on long-term loans and development subsidies.<sup>25</sup> The impact of the policy is yet to be seen since the textile exports (as a percentage of GDP) have been in decline for the last few years and the trend could not be reversed.

### **Trade agreements**

Pakistan, over the years, has entered into a number of formal trade and investment agreements under plurilateral preferential schemes, besides concluding

several regional and bilateral arrangements both within the South Asia region and beyond. The multilateral/regional trade agreements mainly materialized through regional memberships of different cooperation schemes. The country is also a beneficiary of some 11 schemes of generalized system of preferences from various countries including the United States, Canada, Japan, and Russia plus the EU. Except for the GSP Plus arrangement with the EU, none of the agreements has any explicit social clause or side agreements.

Pakistan was granted the status of GSP Plus only in January 2014. It is, therefore, too early to assess any impact of the social clauses. However, there are some early signs of a positive response from the government. The government of Pakistan has constituted a Treaty Implementation Cell (TIC) to supervise and coordinate the implementation of various conventions and protocols including those of the ILO. Similar cells have also been formed at the provincial level.

Some important developments are also taking place on the legislation front. For example, the federal government has recently drafted a law to protect the rights of part-time workers. The provincial government of Punjab has promulgated a law prohibiting child labour at brick kilns. Moreover, the provincial governments of Sindh and Punjab are in the process of approving legislation on occupational safety and health and the provincial government of Khyber Pakhtunkhwa has made the necessary amendment to the existing law to increase the minimum age for hazardous work to 18 years.

### Conclusion

The textile industry in Pakistan consists of a large-scale organized sector and a highly fragmented small/medium-sized sector. Large-scale enterprises export directly or through buying houses to international buyers while small/medium-sized manufacturers mostly work for the large manufacturers as sub-contractors. The small/medium-sized manufacturers constitute the major segment of the industry and mostly fall under the category of the informal economy where workers' rights are not protected.

The power relationship between international buyers and producers is characterized by the price-setting behaviour of the upstream firms along the supply

chain. High value-added activities are performed by the international buyers while low value-added production is carried out by local manufacturers. Local suppliers are vulnerable to ever increasing competition in the global market and face various pressures from upstream including low offered prices, tight delivery schedules and fluctuations in orders.

In order to remain competitive, firms transfer the burden to the bottom of the chain—subcontracting of production and labour being the most common strategy. Under this arrangement, industrial workers are deprived of their rights by employers. Therefore, the benefits of trade are not shared equally among the various actors along the global supply chain.

As far the compliance with international labour standards is concerned, Pakistan rates fairly high on ratification of conventions and enactment of domestic legislation, though some significant legislative gaps regarding social clauses remain e.g. occupational safety and health. However, it is mainly the implementation of laws which is more problematic. A major reason for the ineffective implementation of laws is that the bulk of the industrial units operate as part of the informal economy.

Nevertheless, in the context of GSP Plus, there appears to be some early signs of a positive response from the government on the legislation related to social clauses. It is expected that the current wave of reforms on the legislative front will be followed by institutional arrangements for the effective implementation of laws resulting in social improvements for workers.

### Endnotes

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## The missing link in the chain? Trade regimes and labour standards in the garment, footwear and electronics supply chains in Vietnam

Do Quynh Chi

### Introduction

In Asia, countries with export-oriented industries such as Bangladesh, Pakistan, Cambodia, and Vietnam use cheap labour costs and a growing workforce to ensure their participation in the new global trade regimes. In these new global trade regimes, traditional forms of protectionism as a means to develop domestic industries (as used by their Asian peers, namely South Korea and Taiwan) may no longer be possible as a development trajectory. Preferential trade access and trade agreements are especially conducive to the growth of global supply chains (GSCs), since 80 per cent of world trade now takes place through GSCs.

However, trade liberalisation and trade agreements in their current form have unleashed hyper-competitive pressure in the manufacturing of products such as ready-made garments (RMGs), footwear, and consumer electronics. And social clauses linked to trade have provided little protection for workers on core labour standards, let alone safety, fair wages, or social protection. The power imbalance between the multinational corporations (MNCs) at the top of the GSCs and their suppliers below allows MNCs to impose low production prices that contribute to low wages, low profits and unsafe working conditions like dilapidated buildings. In the textiles and garment sector, there is empirical evidence for the period from 1989–2014 of a relationship between the declining respect of workers' rights and a fall in the price paid for apparel imported by international brands into the United States. The race to the bottom is therefore not a slogan but an economic reality.

Within the framework of the CLS+ project, the country study for Vietnam, coordinated by the FES office in Vietnam and conducted by the research team from the Research Center for Employment Relations (ERC), explores the labour standards in the GSCs of three key exporting industries of Vietnam: RMGs, footwear (focusing on sports shoes), and electronics (focusing

on mobile phones and parts), within the context of the industrial and labour relations systems of the country. Apart from an extensive review of the relevant literature, both in English and Vietnamese, the study is also based on multi-level empirical research (see Figure 1).

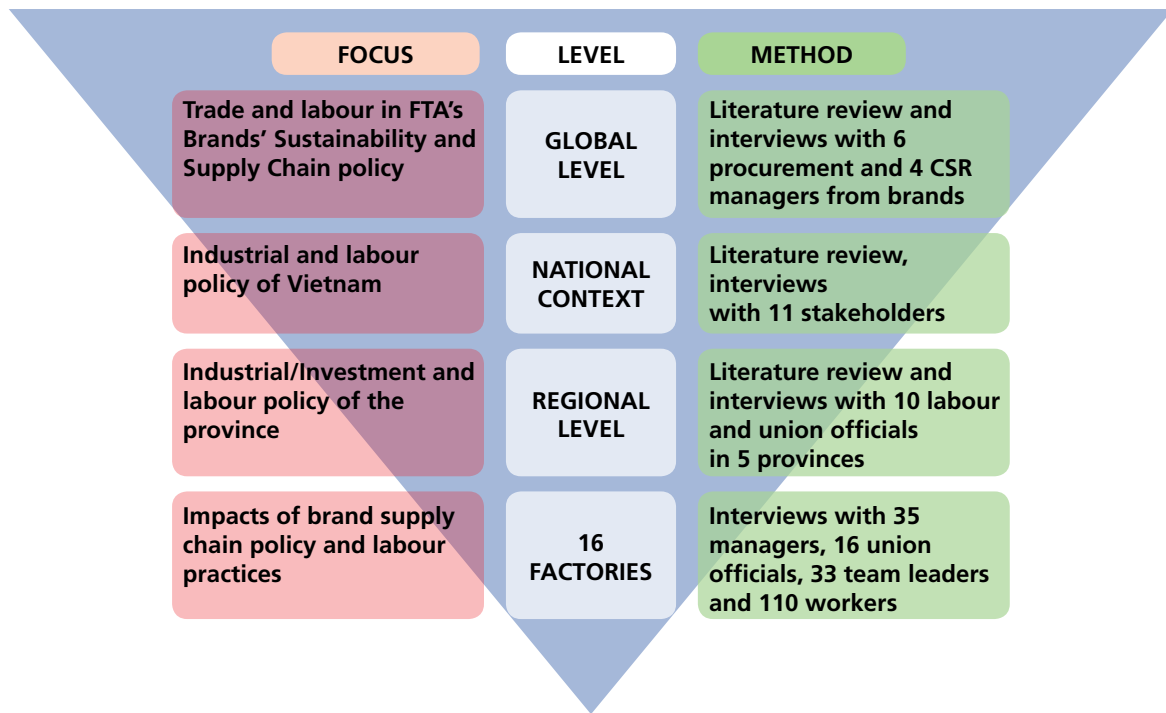
At international level, the research team conducted in-depth interviews with the corporate social responsibility (CSR) and procurement managers of major garment, footwear, and electronics brands that source their products from Vietnam. At national and provincial levels, the researchers interviewed 11 national and provincial labour administrators, labour inspectors, and union officials. At the workplace level, the research team visited 16 factories in four provinces, comprising Ho Chi Minh City, Long An, Da Nang, and Bac Ninh, interviewing 35 managers, 16 enterprise union leaders, 33 team leaders, and 110 rank and file workers.

This executive summary presents the key findings from the Vietnam country study. The full report was published in April 2017.<sup>1</sup>

### Overview of the RMGs, footwear and electronics supply chains in Vietnam

RMGs, footwear, and electronics are Vietnam's three biggest export industries. The country's export champion is electronics, which accounted for 28 per cent of total export value in 2015 (with mobile phones and parts alone making up 19 per cent of the national export value), followed by textiles and RMGs, which contributed 17 per cent. Footwear is the fourth largest export industry, accounting for 7 per cent of the total export value in 2015. The majority of exporting companies in the three industries, however, are small and medium-sized companies, employing fewer than 500 workers. Most of the large-sized companies exporting garments, footwear, and electronics are foreign-owned. Altogether, the three industries employ approximately 3 million people, 70 per cent of whom are women.

Figure 1: Research Methodology of the Vietnam Country Study



Despite their rapid growth, all three industries rely substantially on imported components and processed materials. In 2015, the RMG industry imported 60 per cent of its materials, while the footwear industry imported 55 per cent of its materials. The electronics industry imported nearly 90 per cent of its materials for mobile phones and parts. According to a 2015 report by the World Bank on the economic development in Vietnam, the electronics industry in the country imported nearly 90 per cent of its materials for mobile phones and parts. With the majority of components and materials imported, the manufacturers in Vietnam are participating at the lowest value-added stage of the global value chain—the assembly stage. As such, low labour costs have been the decisive factor in maintaining the profitability of these factories.

### Key findings

The RMG, footwear, and electronics supply chains are characterised by a “monopsony relationship” between the brands and the suppliers, in which the brands dictate the purchasing prices and in which suppliers participate in the value chain. The monopsony power of the brands is less intense in the garment and footwear industries, compared to the electronics industry, as there are more brands sourcing from Vietnam in the garment and footwear industries and each garment and footwear factory supplies to a number of different brands. In the electronics industry, however, there are fewer brands and these brands are also highly competitive. Therefore, most suppliers tend to supply to one or a very small number of brands.<sup>2</sup>

Table 1: Overview of RMG, Footwear and Electronics Industries in Vietnam (2015)

	Garment	Footwear	Electronics
<b>No. of exporting firms in Vietnam</b>	2,500	1,382	1,100
<b>Labour force</b>	2,500,000	930,000	325,583
<b>Contribution to export value (%)</b>	17.42%	7.41%	28.25%

Source: Compiled by the authors from various sources, updated by August 2016

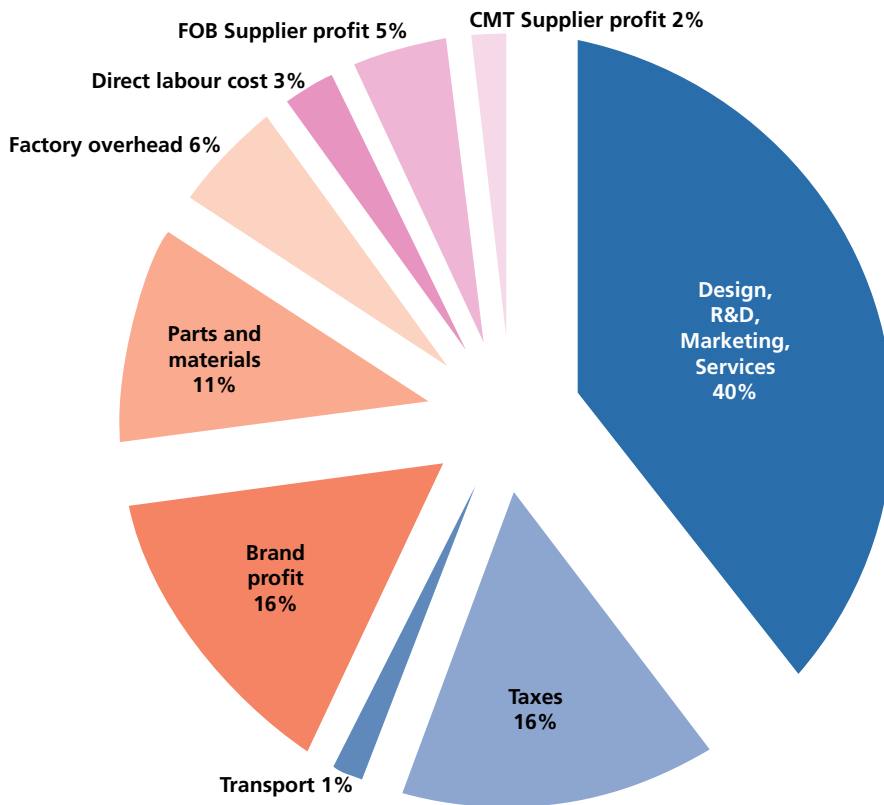
Because of the monopsony of the brands, the assembly supplier gets the smallest share in the global supply chains, which forces them to lower labour costs even more. The brands earn the largest share of the profits—ranging from 9 per cent in footwear, 16 per cent in garments, and 60 per cent in mobile phone production. The assembly supplier, which participates in the final and lowest value-added stage of the global value chain struggles with profit margins ranging from 2 per cent in garments, 3 per cent in footwear, and 6 per cent or lower (of the net selling price) in electronics. The direct labour cost, which includes the wages and other wage-related expenses for workers, makes up only 3 per cent of the net selling price in garments, 9 per cent in footwear, and 3.8 per cent in electronics.

Labour cost is a “take it or leave it” situation, rather than a factor of negotiations between the brands and suppliers in all three industries. All of the garment and footwear suppliers said that the purchasing prices for the brands had not increased for the past five years;

a few even faced pressure from the brands to lower their prices by 5-10 per cent each year. The prices for the electronics suppliers were mostly imposed by the brands and reduced every quarter. With purchasing prices frozen for the past five years, the actual wages of workers in a supplying firm have not been a factor in price negotiations between the supplier and the brand. However, all of the brands interviewed required their suppliers to comply with the minimum wage (MW) set by the Vietnamese government.

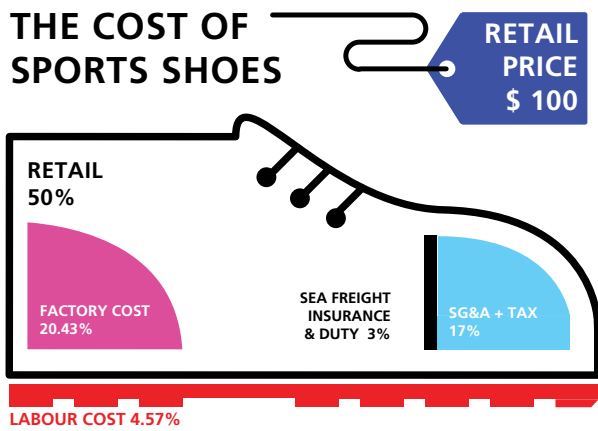
The suppliers responded to price pressure from the brands by increasing factory efficiency and minimising labour costs. Since the purchasing prices for brands have remained unchanged for the last five years, to maintain their profitability, the suppliers have had to increase their efficiency by increasing the level of automation; reducing the number of workers per line while increasing the total production; and minimising the actual wages paid to workers. The result was that many workers lost their jobs and those that remained

Figure 2: Price Structure and Profit margin of fashion brands, 1<sup>st</sup> tier suppliers and 2<sup>nd</sup> tier suppliers in Vietnam



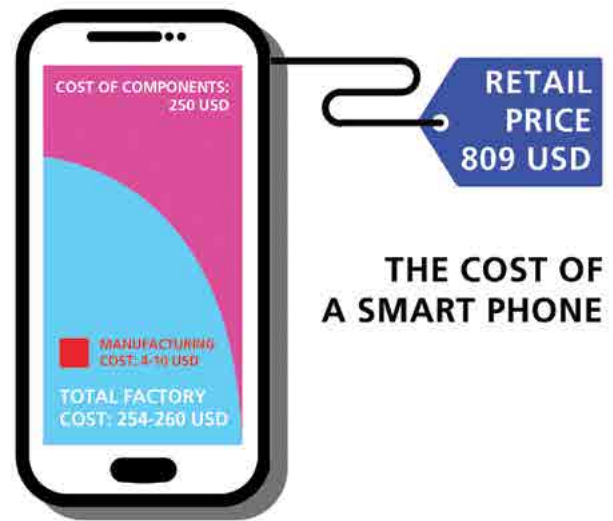
Source: Calculated by the authors based on interviews with the managers of apparel suppliers

Figure 3: Cost break down of a pair of sports shoes



Source: Compiled by the author based on interviews with footwear suppliers and information from UNIDO (2000) and Solereview (2015)

Figure 4: How much does a smart phone actually cost?



Source: Compiled by the author based on desk research including O. Hughes, "How much does a Samsung Galaxy S7 actually cost?" IBT, Mar. 16, 2016.<sup>3</sup>

had to work harder without a commensurate increase in pay. The following is an example of a foreign-owned footwear supplier: Between 2013 and 2015, the factory was able to double its monthly production value while reducing 25 per cent of their labour force per production line (Table 2). However, the wages paid to the rank and file workers were anchored to the minimum wages and workers' seniority without considering the increase in work intensity and workers' productivity.

The conflict between the business model of low-cost, fast-fashion brands and CSR standards prevents the brands from making genuine efforts towards improving sustainability standards in their supply chain. The study found little linkage between the brands' CSR policy and procurement strategy in all three industries. On the one hand, all of the brands require their 1<sup>st</sup> tier and 2<sup>nd</sup> tier suppliers to comply with Vietnam's labour legislation and the brands' CSR standards, and to monitor their own compliance through CSR audits. Compliance with CSR standards (with suppliers paying for the audits in many cases) results in rising costs for the suppliers. However, suppliers are rarely rewarded for their compliance with, or for doing better than, the standards. On the other hand, the brands put constant pressure on the suppliers to keep the same production prices, or to further lower prices. These conflicting pressures from the brands have

gradually driven out the suppliers with good labour practices (who were unable to keep costs down), while encouraging those with lower labour standards to minimise labour costs.

"If the minimum wage (MW) continues to rise at this rate and the Cut-Make-Trim (CMT) price stays frozen, our company can last for three more years at most." Deputy Director of a Vietnamese garment company, interview by author, Vietnam, July-September 2016

"We conduct CSR audits and inform the procurement team. We have no idea about how prices are determined. It's another department's job." Sustainability manager of an American garment brand, interview by author, Vietnam, July-September 2016

"Labour cost is just one of the factors that affect CMT prices. We also require the suppliers to raise productivity, reduce waste, and increase efficiency. That's why we do not have to raise our [purchasing] price." Regional procurement manager of a European footwear brand, interview by author, Vietnam, July-September 2016

Table 2: Cost minimisation in a footwear supplier

Year	2013	2014	2015
Monthly production (in US\$)	1.6 million	2.8 million	3.1 million
No. of workers per line	80	70	60
Wages	MW+5%/year	MW+5%/year	MW+5%/year

Source: compiled by the authors based on the interviews with the management of a footwear company, July 2016

Apart from the brands, the vendors and major 1st tier suppliers played a critical role in intensifying the downward cost pressure on their subcontractors.<sup>4</sup> While the brands have not adjusted the purchasing price for the last five years, the vendors and 1st tier suppliers pushed harder on the 2nd tier suppliers to lower costs. A Vietnamese garment subcontractor said:

We cannot work directly with the brands so we have to work through vendors, but the vendors are pushing too hard on us [to lower costs]. A few years ago, our profit margin was still higher than the bank interest rate, but now it is lower. But if we don't accept the prices, we don't have enough work for the workers.<sup>5</sup>

At the same time, the brands cannot ensure the monitoring of all the subcontracting activities within the supply chain.

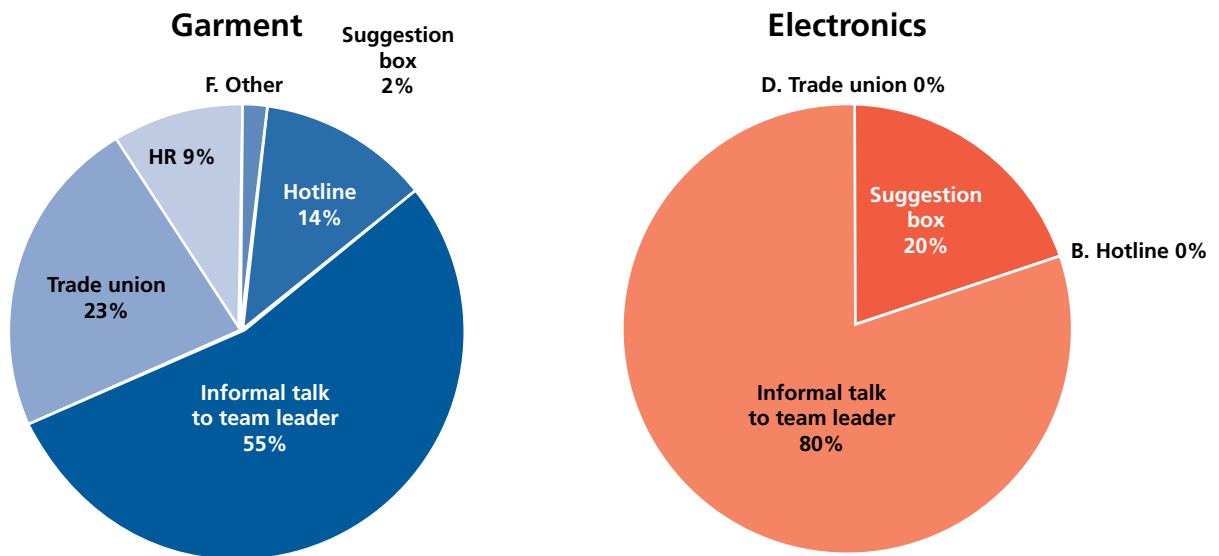
Despite the cost pressure from the brands, the domestic suppliers chose to adopt a more sustainable approach to labour standards than the foreign direct invested firms. The study found that the actual working conditions and wages of workers in the supply firms did not necessarily correspond to the factories' value added or profit margin. The Vietnamese enterprises, especially the former state-owned enterprises (SOEs), were found to have better labour practices than the foreign direct invested firms, despite their profit margin being the lowest in the supply chain. In particular, the former SOEs in the garment industry were paying workers higher than the foreign direct invested firms, invested more in labour upskilling, provided a wide range of labour-management communication and grievance mechanisms, and offered more generous welfare benefits. The rank-and-file workers in the foreign direct invested firms of all three industries had little chance or incentive to improve their

labour skills. The wages of workers in foreign direct invested firms depended more on attendance and seniority than on individual skills and productivity.

Compliance with labour standards was the best in the garment industry, followed by the footwear industry. The situation in the electronics industry was the worst, especially in the areas of occupational safety and health (OSH), working hours, and living wages. The workers in the electronics industry were faced with forced overtime of up to 100 hours/month. The overtime worked accounted for up to 50 per cent of their take-home income, while their basic wages were tied to the minimum wage. Compared with the firms in the other two industries, the electronics firms are at the infancy level in terms of social dialogue. The electronics industry workers had so few effective formal communication and grievance handling channels that 80 per cent of them relied on their production team leaders as an informal alternative (Figure 5). Conversely, the garment workers had many more formal and informal options for voicing their feedback. The study also found signs of systematic gender-based discrimination in employment and occupation in the electronics firms surveyed, which all had policies of only recruiting female workers for the rank and file work, while appointing mostly men for managerial positions.

The supply chain in the garment, footwear, and electronics industries in Vietnam was dominated by the East Asian suppliers, while the domestic firms participated mostly at the 2nd tier level. Prior to 1997, foreign direct investment (FDI) projects had to take the form of joint ventures between the foreign investors and SOEs. Since 1997, ownership restrictions have been removed, which has had a lasting impact on the ownership structure of FDI. In 2006, joint venture projects decreased to just 42.5 per cent of total

Figure 5: Most trusted channel for grievance handling by garment and electronics workers



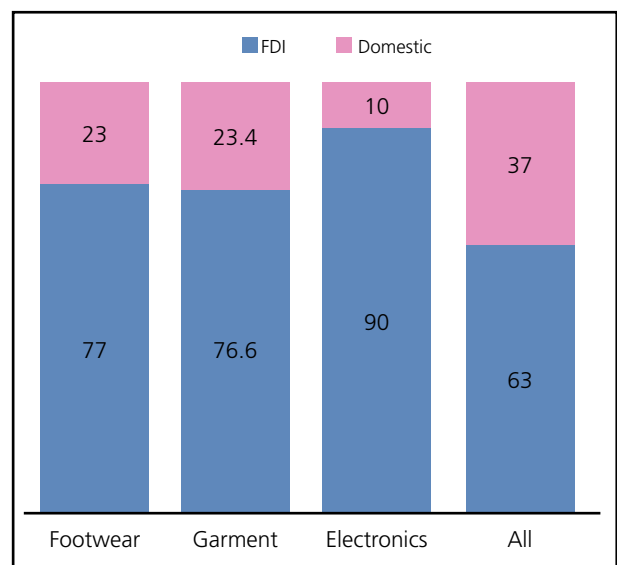
Source: Do Quynh Chi, *The Missing Link in the Chain?*, 2017

registered foreign capital, while projects with 100 per cent foreign capital accounted for 45.5 per cent.<sup>6</sup> While the model of joint ventures has faded, both the national and provincial governments have offered incentives to encourage FDI at the expense of domestic investors. For instance, the national government offers a reduction in corporate income tax for projects of over 300 million US dollars, for which mostly FDI projects are eligible as few domestic firms are able to make such large-scale investments.<sup>7</sup> In addition, to attract FDI, provincial governments have been offering even bigger incentives to foreign investors, as in the case of Samsung in Thai Nguyen Province.<sup>8</sup> In other words, the FDI policy at national and provincial levels has been discriminatory towards domestic investment while granting advantages to FDI projects, without any obligation for technological transfer. Consequently, the GSCs in RMGs, footwear, and electronics in Vietnam have been dominated by the foreign direct invested firms, mostly consisting of East Asian investors (Figure 6). The prevalence of FDI is most extensive in the electronics sector, with domestic firms accounting for only 10 per cent of the sector's export value.

However, as this study found, while most FDI firms in the three surveyed industries showed little interest in labour upskilling and kept wages and working conditions at minimum levels, the domestic firms are more committed

to the local labour force and tend to have a more sustainable approach to labour standards. Increasing the participation of the domestic firms in the GSCs in the key exporting industries, therefore, tends to have positive impacts on the labour quality and labour standards for workers in these sectors. This is also reinforced by the fact that the former state-owned garment sector

Figure 6: FDI and domestic sectors' contribution to export value (%)



Source: Vietnam Customs Office, 2015

under the conglomerate Vinatex tends to invest more than foreign direct invested firms into upstream and downstream segments like spinning, weaving, and dyeing, thus increasing the national value-added.

Vietnam's industrial policy has been largely ineffective. Vietnam's growth model is heavily reliant on trade in natural resources. Crude oil accounts for 20 per cent of total exports. The proportion of exported services in relation to total exports went down from 11.6 per cent in 2005 to 7.6 per cent in 2012, and was again at 7.6 per cent in 2014. In the industrial sector, Vietnam mainly exports low-tech, labour-intensive products such as garments, furniture, footwear, and electronics. The domestic content of these products, however, remains low, ranging from 40-55 per cent.<sup>9</sup> In the meantime, the domestic private sector faces a lot of difficulties, including limited access to bank credits, land, etc., resulting in discriminatory treatment compared to the FDI sector. Without an effective industrial policy, more international trade threatens to deepen under-development and prevent economic catching-up.<sup>10</sup> One of the key reasons for the ineffectiveness of Vietnam's industrial policy has been the high level of decentralisation.

Strong industrial policies and selective investment strategies are conducive to better labour standards. By comparing the investment and industrial policies of Long An and Da Nang Provinces, the study found significant differences between the two provinces which have led to diverging approaches to labour standards. On the one hand, Long An Province strived to attract FDI quickly and unselectively, while not investing enough into the strengthening of labour administration, inspection, and trade unions. On the other hand, Da Nang Province took a high-road approach. The province had strong industrial policies with a clear and selective investment approach, while still maintaining high FDI flows and encouraging more investment into cleaner and higher-technology industries. At the same time, in order to prevent labour problems that may damage the investment environment of the city, the authorities in Da Nang Province have been active in building the capacity of labour inspectors while also strengthening the local trade unions.

By the end of 2015, after years of negotiations, Vietnam concluded two important free trade agreements (FTAs) in parallel: the Trans-Pacific Partnership (TPP) with the

United States, and the FTA with the European Union (EVFTA). Both FTAs are considered to be "new generation agreements" as they are not only comprehensive but also contain detailed sustainability (environmental and labour) chapters. However, while the European Union has taken a promotional approach, as it has always done, in handling the sustainability issues associated with the FTA with Vietnam, the United States opted for a sanctions-based approach in the TPP. At the time of publication of this report, the EVFTA still awaited ratification while in January 2017, President Donald Trump withdrew the United States from the TPP. Still, the two agreements have shown some initial impacts, as the Vietnamese government is committed to changing the legislative framework, including recognition of independent unions in the revision of the Labour Code, in compliance with international labour standards so as to integrate deeper into the global value chain.

### **Policy recommendations**

Although what has been found by this study showed a downward trend in labour standards in the global supply chains in Vietnam, the good practices found also prove that it is possible for the stakeholders to embark on a high-road strategy. Steps towards such a strategy include:

International trade regimes:

- A combination of the sanctions-based and promotional approaches in FTAs will encourage genuine commitments by exporting countries to improve their sustainability performance.
- The domestic advisory group should include independent civil society organisations. In countries where freedom of association is suppressed, the trading partner should put pressure on the exporting country's government to allow for independent members of the domestic advisory group.
- Support to the exporting countries in developing stronger industrial policy and industrial upgrading strategy.

National government of Vietnam:

- Revise the industrial and investment policy by providing better financial and policy support to the domestic sector, limiting FDI investments into polluting, low-tech industries, obligating the FDI to make technological transfer, investing into labour upskilling and industrial upgrading

- Reform the labour system, particularly by strengthening the labour inspection system, reforming the Vietnam General Confederation of Labour (VGCL) to make it more responsive to members, revising the strike provisions, and allowing for independent unions
  - Acknowledge and open up the space for civil society to grow
  - Foreign firms should not be privileged in comparison to domestic firms
  - More common rules for FDI to prevent a race to the bottom by competing regions in Vietnam to attract FDI
  - Government should systematically search for opportunities to support the upgrading of value chains
  - Government should strengthen employers' organisation in addition to unions
  - Government should create institutions that organize free information flow between all stakeholders and discuss strategies and policies for upgrading
  - Strategies should be checked continually and such institutions should be free of corruption
  - Industrial policy should be the responsibility of the prime minister or a leading ministry.
- Brands:
- Link the sustainability performance of suppliers to the allocation of production orders, that is the suppliers with better sustainability performance should receive more orders
  - Develop the core supply chain and invest in supporting the suppliers in industrial upgrading and upholding labour standards (through training and coaching)
  - Participate in dialogues/bargaining with trade unions and suppliers
  - Increase third-party/independent monitoring of the supply chain, especially the indirect suppliers.
  - Increase skill and technology transfers
  - Coordination among different Asian countries to enforce common standards for suppliers at different levels of the value chains.

## Endnotes

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2. The electronics brands tend to stick to the same supplying companies in different countries. In exchange for such loyalty, the brands ensure a profit margin that is acceptable for the core suppliers.
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4. Vendors are the intermediaries that take orders from the brands and subcontract to different factories.
5. Interview by the author, Vietnam, July-September 2016. The bank interest rate in Vietnam in 2015 and 2016 ranged from 6-7 per cent per year.
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