

## **II. 2005 FEATURE ISSUE**

### **THE EXPIRATION OF THE MULTI-FIBRE ARRANGEMENT (MFA) AND ITS CONSEQUENCES FOR GLOBAL LABOR STANDARDS**

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The expiry of the Multi-Fibre Arrangement (MFA) in December 2004 heralded the end of the quota system that had governed global trade in apparel for over forty years. Apparel industry analysts predicted that the elimination of the quota system would lead to a shift of production to China and other countries where production costs -- and labor standards -- are low. Labor rights commentators warned that such shifts would put pressure on other countries to reduce the degree of labor law enforcement in order to encourage or retain investors and buyers. This would be to the detriment of labor standards and working conditions globally.

In this Chapter we explore how the end of the quota system in textile and clothing (T&C) trade in particular, and geographic shifts in production more generally, will affect labor rights – both in individual countries and world-wide – and how the FLA should respond to this new environment. Specifically, we seek to address the following question: has the increase in the percentage of market share achieved by China led to an improvement or a decline in the respect for labor rights in China and other countries?

The Chapter is structured as follows. In the first section, we provide some background information on the MFA, some early statistics on trade patterns after the end of the MFA, and a discussion of the factors responsible for China's ascent in the T&C market. In the second section, we assess the consequences of the MFA phase-out for labor rights. Based on the FLA's on-the-ground work experience in China we will present an assessment of the situation in that country that attempts to capture the many facets of its complex labor rights environment. In the third section we discuss the role of the FLA in China, emphasizing changes in FLA monitoring methodology and how that methodology might be relevant in analyzing changes in worker rights in China.

#### **BACKGROUND ON THE MFA**

International trade in textiles and clothing has been "managed" in one way or another since 1961. The system of quotas began with the Short-term Cotton Arrangement, which was followed by the Long-term Cotton Arrangement and then by the Multi-Fibre Arrangement (MFA).

The MFA, which came into being in 1974, allowed the USA, Canada, and European countries to impose quantitative restrictions on T&C imports of cotton, wool, or man-made fiber when they caused, or threatened to cause, serious damage to the industry of the importing country. It was motivated principally by the fear of the industrialized nations that their national T&C industries would be adversely affected or wiped-out by the growing competition from (low-cost) developing countries. The MFA allowed importing countries to negotiate bilateral agreements with individual supplying countries setting quantitative limits (quota levels) on specific categories of T&C exports. The system of bilateral trade agreements and specific quota limits pursuant to the MFA allowed industrialized countries to manage the risk to their domestic T&C industries.

Although the MFA was originally intended to be a transitional arrangement that permitted countries to depart temporarily from the laws of the international trading system (e.g., the most-favored-nation principle, the principle of no quantitative restrictions) in order to allow structural adjustment in the industrialized countries, very little was done in this regard by importing countries, and by exporting countries for that matter, during the thirty-year existence of the agreement. Thus, when the MFA regime expired on December 31, 2004, both importing and many exporting countries were unprepared for quota-free trade.

For over thirty years the pattern of investment and trade in the T&C sector was strongly determined (some would say skewed) by the MFA. It led to increased investment in countries that had little or no comparative advantage in T&C production, such as Bangladesh, the Dominican Republic, Honduras, the Maldives, and Sri Lanka. That investment often involved quota-seeking enterprises from highly competitive countries that had exhausted their own quotas (such as Hong Kong, Korea, and Taiwan) and were seeking new export platforms for T&C products, although it also had the effect of creating some local garment production. In Bangladesh, for example, the export garment industry grew from nothing in 1970 to a peak of some 3,000 locally-owned factories in 1999 that employed more than 1.5 million workers (mainly women), which accounted for over 75 percent of the country's total exports. This had a major effect on Bangladesh society, drawing young women out of the home and into wage employment for the first time. The growth of the industry was so rapid it outstripped the available infrastructure and regulatory mechanisms. Many of the factories were improvised facilities in commercial buildings not designed for industrial production, with workers often unprotected by basic labor laws. There have been a series of highly unfortunate fires, and most recently a building collapse, that can be directly traced to the unregulated growth of the industry and the lack of adequate labor inspection. In this sense the allocation of quota sometimes produced situations in which workers' rights and working conditions were neglected in the rush to fill export quotas.

In 1995, after the conclusion of the Uruguay Round Agreements the year before, the members of the WTO agreed that the MFA would be phased out and a 10-year, four-phase transitional program was specified in the Agreement on Textiles and Clothing (ATC). At first sight, it appeared that the developing countries would gain from this liberalization process in T&C trade, given their competitive advantage over the industrialized countries in labor-intensive sectors. The developing countries had campaigned strongly for the abolition of the MFA on the grounds that the system of quotas restricted their development. For example, the International Textiles and Clothing Bureau (ITCB), an alliance of developing country T&C producers, endorsed IMF and World Bank research that showed that MFA quotas were costing developing countries over \$20 billion dollars a year in export earnings and that some 27 million jobs could have been generated in developing countries had T&C sectors not been restrained.<sup>i</sup> However, as the expiry date drew closer, many developing countries started to view the prospect of trade free of quotas as a threat to their industries and campaigned for the continuation of the quota system in some form. Textile and Clothing Associations from over 70 countries signed the Istanbul Declaration in March 2004 that argued that the entry of China into the WTO and its rise as an exporting nation altered the rationale for the elimination of T&C quotas and called for their extension to 2007.<sup>ii</sup>

The reality is that neither developed nor developing countries used the 10-year MFA phase-out period to adjust. This meant that they faced the open trade system that came into effect on 1 January 2005 with largely the same T&C industry that they had under the old quota system. As a result, most of the countries involved in T&C trade were not equipped to respond to the new competitive environment, especially the rise of China as the dominant producer. Countries that had always competed on price were still located in the price-sensitive segments of the market and hence exposed to new levels of competition from previously quota-constrained countries. Too few countries developed new capacities and attributes to enable them to compete for higher value-added business, where they would face less competition from lower-cost producers. This was especially true of the countries bordering the US and EU markets, where producers could exploit their proximity to market to the full by producing high-fashion (and high value-added), time-sensitive items.

When the quotas were finally eliminated on January 1, 2005, many foresaw a "doom-and-gloom" scenario, in which US and EU markets would be flooded by cheap Chinese imports, while hundreds of thousands of workers lost their jobs in countries that could no longer compete with China. By the end of the first quarter of 2005, several alarming statistics started to surface that suggested that imports from China had indeed surged. These statistics strengthened calls for authorities to act to curb imports by invoking the temporary safeguard

mechanism provided for in the agreement governing China's accession to the WTO which allows WTO Member Governments to restrain imports in specific categories in case of "market disruption" caused by Chinese exports of textile products. This safeguard mechanism lasts until the end of 2008.<sup>iii</sup> The EU and US announced measures to curb imports of certain categories of Chinese textile and clothing products from mid-2005. The expectation of curbs led many buyers and suppliers to accelerate orders by working longer hours than usual. Having worked themselves to the limit for six months, many Chinese exporters then ground to a halt as the quota limits were reached. The result was that workers who had worked excessive overtime were then laid-off as orders stopped.<sup>iv</sup>

It may still be too early to draw conclusions about the validity of EU and US actions to curb Chinese imports, but a number of observations are worth making.

The first concerns the market threat posed by Chinese imports. Influential lobbies in the United States and Europe claimed that their markets had been swamped by Chinese products and they therefore called for safeguard measures to contain the increase of Chinese exports. But had there been a "flood" of imports? While there was undoubtedly a surge in imports from China, the increases came off low bases since China had previously been constrained in many key categories. Further, the surge did not necessarily mean that there was significantly more product entering the US and EU markets. Rather, it meant that Chinese products had displaced other exporters, that is, other exporting countries had lost market share to China. Although imports from China have increased, EU data show that over all, EU clothing imports shrank 9.7 percent in the first five months of 2005, compared with the same period a year earlier.<sup>v</sup> In the light of those figures it might well be that the import curbs were not justified, at least in strict economic terms. Overall imports of clothing and textiles into the United States did rise nearly 10.8 percent in the first six months of 2005, compared with 2004. Imports from China grew 57.7 percent, mainly at the expense of those from Mexico, South Korea, Taiwan, and Japan.

The second observation concerns the target group the measures are meant to protect. The market or product segments in which China (and other developing countries) compete have largely moved offshore in recent years and very few developed country companies still produce those products at home. Curbing imports is therefore not likely to bring production back to the US or EU. By imposing limits on imports from China, the authorities forced importers to shift production to other developing countries. Supply may be temporarily disrupted, but sources would eventually be found elsewhere and those products imported in any case. This begs the question – if the restrictive measures imposed on China were not protecting US and EU jobs, who were they trying to protect, and what were they trying to achieve?

The logic may well have been political rather than economic, since the main export and job losses following the phase-out of the MFA have not been in Europe or the United States, but in other developing countries. There is still significant production of low value-added commodity items in countries like Mexico, Honduras, the Dominican Republic, Morocco, Turkey, Tunisia, and some Eastern European countries -- countries where the export garment industry is a major source of employment and foreign-exchange earnings. Any decline in that industry in those countries would potentially lead to increased immigration pressure on the US and the EU and increased demands for development aid.

The only way to protect the Textile-Clothing-Footwear (TCF) export industries of countries bordering the US and EU in the longer term is to equip them to cater to higher value-added production that exploits their proximity to market. In other words, while Mexico cannot compete with China on price in the manufacture of commodity items for the US market, it could compete on high-fashion items where time-to-market is vital. The same applies to Morocco and Tunisia with respect to the EU market. These countries are all closer to main markets than China and other cheaper Asian producers and they will fare best when catering to product sectors where response time is the major factor.

The countries that enjoy proximity to large markets, however, have generally not invested in the quick-turn, flexible production systems necessary to capture the high-fashion niche market. They have also not developed the skill and technology to produce high-value added, non-commodity items (such as suits, for example). Instead, they have remained stuck in the assembly and commodity end of the value chain, where price is the dominant factor. The reasons for their lack of adjustment and specialization are complex, but the fact that they did not make the necessary adjustments despite the ten-year transition period provided by the ATC makes it questionable whether they could make the shift in the next two or three years (the time-frame in which the US and EU can impose special safeguard measures on imports from China). Many T&C exporters were never sufficiently competitive and failed to develop their competitive advantages, partly because quota guaranteed them orders and market share. The end of the quota system only served to reveal those existing shortcomings, and as such it is not the sole source of their present difficulties.

It was predicted that as soon as quotas lapsed, production would go to the lowest cost production platforms. Contrary to popular belief, China is not the cheapest location, and the country's competitive edge does not depend on low wages alone.<sup>vi</sup> To understand China's export strength one has to look beyond nominal wage costs and examine additional factors that add up to their competitiveness. China possesses a number of favorable characteristics.

- China's labor force is not only inexpensive but also highly productive and large.
- Low production costs are bolstered by an undervalued currency.
- The Chinese government has strongly favored the textile and apparel industries, steadily investing in these areas.
- China benefits as well from near self-sufficiency in the raw materials required for textile production, and the large textile industry provides the clothing sector with significant advantages in lead times and cost.
- China also enjoys advanced business networks and good shipping connections.

To be sure, China has benefited from the end of the quota system. But the reasons for its dominant position in the global marketplace can neither be explained by the end of the quota system nor by wage levels.

### **THE PHASE-OUT OF THE MFA AND WORKER RIGHTS**

The FLA's main concern is respect for labor rights and the question that we are grappling with concerns the impact on workers rights of the shifts in trade and production described above. The FLA Board of Directors has adopted a resolution expressing its concern over the implications for labor rights of the end of quotas and has discussed guidelines that companies can follow in preparing for, or dealing with, the results of production shifts. The resolution states:

"The FLA Board urges FLA companies to adopt guidelines to ensure they fulfill their commitment to manage shifts in sourcing in a manner consistent with the FLA Charter, [FLA Workplace Code of Conduct] Code, and national law..."

The FLA was also a founding member of the MFA Forum, a multi-stakeholder group established to understand and address the consequences of the phase-out of the MFA.

### **A Race to the Bottom?**

Countries have reacted differently to the end of the MFA quota system. At least two strategies can be identified. The first is sometimes described as "the race to the bottom," in which countries lower their labor standards in order to attract investment and orders. The reasoning is that lower labor standards and lax enforcement will provide a more flexible labor market and enable employers to cut costs. The lower levels of law enforcement may apply to issues like minimum wages, hours of work, overtime (O/T), rest days, occupational health and safety, and termination obligations. This is especially relevant to labor-intensive production processes like clothing and footwear where labor costs may represent

as much as 25% of the total cost and, more importantly, the most malleable of the cost factors. Some companies have responded to increasing price pressures by hollowing-out the wage since their materials, rent, and utilities costs are less negotiable.

No country would admit that it is undertaking a "race to the bottom," and most do not make explicit changes to their regulatory framework to introduce greater flexibility. Standards are simply not enforced, either because of conscious strategy choices or because the enforcement agencies lack the resources to carry out their functions. There are, however, some countries who have advertised their export processing zones on the basis of their exemption from various laws, including labor laws. To this day Bangladeshi investment promotion agencies boast that their EPZs have "production oriented labor laws" in which the law "forbids formation of any labor union in EPZs. BEPZA is vested with responsibility to administer labor matters for all enterprises in EPZs."<sup>vii</sup> Another example can be found in the countries that provide explicit flexibility in terms of hours of work. Bangladesh and Thailand both have laws allowing workers to work in excess of 60 hours per week, although the Government of Bangladesh says the measure is temporary. The Indian Government has announced that it plans to allow EPZs to by-pass labor laws, although the left-wing parties have declared their intention to oppose the legislation. In Guatemala, a recent court decision in response to a challenge brought by the employers' federation has resulted in the labor inspectorate being stripped of its powers to impose sanctions for labor rights violations. While this was not the result of a government policy decision, it is an example of the push for greater flexibility in some quarters.

The second strategy is sometimes called the "high-road" or the "race to the top," in which countries try to raise standards to attract investors/buyers on the basis of high levels of law enforcement that provide certainty and security. Such countries would not only offer an environment in which the risk of labor rights abuses is diminished, but also one in which a stable, long-term workforce can be trained and developed, and in which increased value-added production involving higher quality and productivity can be attained.

Cambodia is an example of a country trying to take the high road. The entire export garment industry is covered by an ILO monitoring project that was set up to verify whether the national labor laws were being respected.<sup>viii</sup> The U.S.-Cambodia bilateral textile agreement granted bonus quota to Cambodia based on the ILO's confirmation that the labor laws were being observed. The ILO monitoring program, together with the commitment from the Cambodian Government and garment exporters to turn the country into a safe haven for labor standards and good working conditions, prompted a number of major buyers to shift or increase their purchases from Cambodia. Other countries have set up certification systems to try to raise labor standards and provide an assurance to foreign investors and buyers regarding their implementation. For example, Thailand introduced the Thai Labor Standard 8001-2003, and the Joint

Apparel Associations Forum (JAAF) in Sri Lanka had a Committee on Labor Initiatives that was looking into reforms to existing labor laws and ways of improving compliance with international standards. The Committee identified working hours, holidays, and recognition of trade unions as key issues that needed to be addressed. Unfortunately the JAAF does not appear to be able to agree on a clear initiative in this regard and it is unclear at this stage which road Sri Lanka will take.

### **Labor Rights in China**

China provides an extremely interesting example of a country characterized by both widespread non-observance of the labor law and increasing efforts to improve standards. China has widely been regarded as the main beneficiary of the end of quotas. We noted above, however, that the rise of China's textile and apparel industry was due to more than just the end of quotas. China has other characteristics that have made it a fiercely competitive export platform and an extremely complex labor market. It is worth summarizing these and other complex features of the Chinese labor market before we assess the situation of labor rights.

**The Chinese Economy:** China is in the process of developing a Socialist Market Economy with a number of unique characteristics. The centrally planned socialist system made huge advances in terms of providing for the basic needs of China's more than one billion people, managing to feed, house and educate virtually everyone. Workers had a right to a job – the so-called "iron rice bowl" – and that provided a certain social stability. In order to achieve full employment, however, the government was obliged to tolerate overstaffing at many State Owned Enterprises (SOEs) and government offices, and SOEs were heavily subsidized to prevent them from going bankrupt.

The government decided in the late 1970's to "open up" -- that is to say, to embrace market economics. It launched a series of experimental "special economic zones," enclaves in which it encouraged foreign investors from Hong Kong, Taiwan, and elsewhere to develop capitalist export industries. It gradually increased the number of zones and allowed market economics to spread throughout the economy. For close to a decade, China has been the largest recipient of foreign direct investment after the USA and EU, and it has recorded growth in GDP of over 9 per cent per annum for the last 15 years.

By the mid-1990s the government began to accelerate the pace of reform and to scale down the public sector – both the bureaucracy and the state-owned enterprises (SOEs). Large numbers of workers were made redundant in the restructuring process. From 1990 to 2003, 34.7 million workers were laid-off by SOEs and the government hoped that they would be absorbed into the booming private sector, in particular export industries. Fortunately, the private sector managed to create 36 million jobs in the same period. As with any restructuring



process there were mis-matches in the labor market and only about 18.5 million, or 67 per cent, of the workers made redundant have been re-employed (figures from the State Council and MOLSS).

The private sector has also had to employ the five million people leaving the rural economy each year to seek work in the industrial centers. This was absolutely necessary if the country was to avoid social conflict as a result of large-scale unemployment, something the Chinese economy has not experienced for decades. When we bear in mind that employment in the Chinese economy reached 744.32 million in 2003, 256.39 million (34.4 percent) of them in urban areas, and that some 7.45 million jobs were created per annum, we get an idea of the scale of the challenge. The T&C sectors have played a major role in this employment growth. According to China's Textile Information Centre there are over 50,000 firms with total direct employment of 19 million, with another 40 million indirectly employed. About 38,000 T&C firms are involved in export trade and some 8,000 of them have foreign investment.

The social implications of such large-scale restructuring are grave. The Chinese economy has over 100 million surplus workers who may flood urban areas in search of work, overwhelming urban infrastructure. There are also real concerns about under- and unemployment and the lack of social security benefits for many workers. Finally, the growing income gap has led to glaring disparities in wealth and social resources. The tensions that come with these features of the transition to market economics have led the government to stress the need for a harmonious society and we expect to see more measures introduced to cushion the impact of the restructuring.

**Labor Relations in the Private Sector:** The labor relations situation in China's private sector is unique. Given that the economy was entirely state-run until 1979, the labor market had been administratively regulated and workers were allocated jobs by the Labor Bureau. Most SOEs had a branch of the party-aligned All China Federation of Trade Unions (ACFTU) that served the interests of both workers and employers (the employer being the State). As the economy opened-up, however, it became clear that this system would have to evolve and include elements of the labor market and labor relations systems typical of a market economy. Private enterprises, for example, wanted to freely decide on who they hired and fired and could not commit themselves to providing an iron rice bowl. The identity of interests between State, enterprise, trade union, and worker no longer held in the private sector, and the differing interests of capital and labor required new mechanisms to handle grievances, consultation, negotiation, and dispute resolution.

In response to these pressures, the Labor Law of the People's Republic of China was adopted in 1994 and took effect in January 1995. This law was a major step

forward for the Chinese government in that it was the first time it acknowledged the possibility of different interests between capital and labor – a radical departure for a system that had always been based on the identity of interests between the two. The 1994 Labor Law provides the framework for the promotion of employment, contracts of employment, collective agreements, working hours, wages, special protections for female and juvenile workers, vocational training, social insurance and welfare, labor disputes, inspection, and occupational health and safety issues. However, a number of the provisions relating to key issues, for example collective bargaining and strikes, were not sufficiently rigorous, and detailed provisions remained to be worked out. Provincial and city authorities therefore interpreted the Labor Law and developed their own labor regulations and practices. These local regulations varied in the degree to which they reflected the spirit of the national Labor Law and there were even greater variations in the degree of enforcement. The result was significant inconsistency in the interpretation and application of the Labor Law.

This inconsistent enforcement of labor law left certain sectors and groups of workers exposed to abuses and the result has been a series of high-profile accidents and strikes. Over 2,700 people died in mine accidents in the first eight months of 2005, despite the attention paid to this sector after the spate of accidents in 2004. Wage violations and lax safety standards in the construction sector also attracted government and media attention, as did a series of labor disputes, mostly relating to the late or non-payment of wages and controversies over benefits following the down-sizing or closure of state-owned enterprises.<sup>ix</sup> Since the Regulation on the Handling of Labor Disputes was promulgated in 1993 the official number of collective labor disputes referred to arbitration rose from 684 to over 11,000 in 2002.<sup>x</sup>

Between January 1995 and December 2003, 635,000 collective agreements were signed in 1.27 million enterprises, covering 80 million employees. Of those, some 293,000 enterprises, employing 35.79 million workers, signed collective agreements containing wage clauses. Many of the agreements, however, were administrative acts and not the result of a bargaining process between labor and management. As such, they simply reproduced model collective agreements supplied by the Ministry of Labor. This was partly because the Trade Union Law had not adapted to the realities of market economics to the same extent as the Labor Law had, and the All China Federation of Trade Unions still reflected the state-owned system in its structure and functioning. Real collective bargaining can only take place when there are two representative parties at the table, and in most Chinese enterprises the trade unions have not re-modelled themselves to play the role of workers representative.

The ACFTU is the only trade union recognized in China and it exercises a legal monopoly over all subsidiary trade union organizations and activities. The Trade

Union Law of 1992, as amended in 2001, clearly sets out the corporatist role envisaged for the ACFTU. Article Four explicitly requires the ACFTU to “observe and safeguard the Constitution, take it as the fundamental criterion for their activities, take economic development as the central task, uphold the socialist road, the people’s democratic dictatorship, leadership by the Communist Party of China, and Marxist-Leninism, Mao Zedong Thought and Deng Xiaoping Theory, persevere in reform and the open policy, and conduct their work independently in accordance with the Constitution of trade unions.”

In the SOEs the ACFTU saw itself representing the common interests of the government, the Party, management, and workers. Much of the time its role was that of a welfare committee, organizing social activities for workers. To this day the program of work issued by the ACFTU consists largely of activities such as tug-of-war competitions, cultural events, and social outings for the workers. In accordance with the identity of interests between capital and labor implicit in the socialist system, it is common for union representatives to be appointed by factory management, and even in cases where union elections are held, management staff are often elected to union leadership positions. It is not unusual to find managers also holding posts in the Communist Party, so some people wear three hats: management, party, and trade union.

As the market economy strengthened, both the ACFTU leadership and the government realized that the ACFTU had to expand its presence in the private sector, especially in Foreign Invested Enterprises (FIEs). The ACFTU reports that 160,000 FIEs, 33% of all such enterprises, have unions, with a membership of 6.14 million workers, some 38% of the total workforce in the sector although some observers believe that the ACFTU presence in foreign-invested enterprises is lower than that. The bulk of these unions still function according to the traditional Chinese model designed for the SOEs.

Things are changing however. In recent years the government has promulgated two important pieces of legislation that could facilitate the development of democratic structures to represent workers in consultations and negotiation. The first is the Amended Trade Union Act of October 2001 (Order of the President No. 62) and the second is Decree No. 22 of the Ministry of Labor and Social Security which provides for new “Regulations on Collective Contracts,” adopted on December 30, 2003. These two laws are important steps in the ongoing process of developing a labor relations system in China appropriate to a market economy in that they provide for more effective functioning of trade unions, worker representatives, and collective bargaining.

**The Trade Union Act:** The amendments to this Act envisage a significantly different role for trade unions. Instead of the passive, facilitation role they traditionally played, they are now expected to actively safeguard the rights and interests of workers by participating in consultation and collective bargaining

processes. The amendments go further by requiring that trade union officials be representative of, and accountable to, workers. Article 9 makes it clear that trade union committees must be democratically elected at assemblies or congresses of members and that "no close relatives of chief members of an enterprise may be candidates or members of the basic level trade union committee of the enterprise." Article 16 provides for the convening of assemblies or congresses of the members at regular intervals to discuss major issues related to the work of the union and the leadership of the union may be recalled by majority vote at an assembly. Article 20 provides that trade unions may negotiate collective agreements but must submit the draft to a workers congress "for deliberation and approval" before signing. This should help ensure that collective agreements reflect the needs and demands of workers rather than simply reproducing the provisions of the pro forma agreements supplied by the Ministry of Labor. Article 21 provides a role for the trade union in representing workers in disciplinary and termination procedures and Article 22 empowers the trade union to make representations to the enterprise for any violations of law that infringe the labor rights or interests of the workers in areas including wages, safety and health, and extended working hours. If the enterprise refuses to rectify the situation, the union may make representations to the local authority. Article 53 makes it illegal for the employer to refuse to consult without providing a reasonable justification.

**The Regulations on Collective Contracts Decree:** Having laid the foundation for more representative and effective trade unions, the government moved to improve the system of collective bargaining. The first step in that direction had been taken in 1995 but had resulted in largely symbolic gestures in which "agreements" were adopted rather than negotiated. The Regulations on Collective Contracts Decree replaced the 1994 regulations of the same name. They provide for collective negotiations leading to the signing of binding collective agreements covering one or more specific subjects, including wages, hours, rest and holidays, occupational safety and health, benefits, hiring, and firing. It is interesting to note that the law provides for the signing of single subject collective agreements on topics such as occupational safety and health.

The Decree recognizes that agreements are most effective when negotiated by representative parties and thus requires that the worker delegates must be nominated by the union, and in the absence of a union in the enterprise, nominated by a democratic procedure in which at least 50% of the workers endorse the delegates. Similarly, negotiating delegates may be recalled by the union or by a decision of at least 50% of the workers and the worker representatives cannot sign an agreement without first securing the endorsement of 50% of the workforce in a general meeting attended by at least 66% of the workers. The Decree also attempts to preclude the situation in which management staff represent the union in negotiations by clarifying that no negotiating delegate may represent both workers and employer.

At this point we have found that very few enterprises are applying the recent Trade Union or Collective Bargaining provisions and many managers and trade unionists are unfamiliar with the details. It will no doubt take some time for these two reforms to achieve sufficient traction to change the shape of labor-management relations at the factory level. It is also clear that the Chinese government still has a number of important labor law reforms to make in order to reach the standards set by ILO Conventions, particularly in the field of associational rights.

The ILO Committee on Freedom of Association has found on a number of occasions that Chinese workers do not have sufficient freedom to form or join organizations of their own choosing, and that the ACFTU has a monopoly on trade union organization. They have also urged the government to take the necessary steps to amend the labor law so as to ensure the autonomy of the parties to collective bargaining and that any requirement for prior authorization of collective agreements be limited to procedural flaws or the violation of minimum labor standards established in the legislation. They recommend that the government adopt measures to ensure that workers and their organizations are not punished for exercising the right to strike in defense of their social and economic interests. Some of these issues have been addressed in the recent amendments and laws. The amended Trade Union Law, for example, acknowledges that strikes may occur, in which case the union is to reflect the views and demands of workers in seeking a resolution of the strike.<sup>xi</sup>

## **THE FLA AND CHINA**

As has been discussed above, there are both structural and systemic issues to be addressed in China if compliance with ILO standards, Chinese labor laws, and the FLA Code of Conduct is to be achieved. The structure of the labor market, with its huge supply of workers, many of them young, female, and migrant, and the rapid growth of industry, exports, and employment, does little to support the maintenance of labor standards. There are parts of China where the over supply of labor has produced a market-clearing wage that is clearly below the minimum wage. This in turn obliges workers to work longer and harder to boost their earnings. At the same time, the fact that many of the workers are young migrants with no family and few social opportunities in the industrial areas further encourages long hours and work on weekends. Many of them only intend to work in industry for a few years to earn money for a specific purpose and want to reach that target as quickly as possible. They are therefore susceptible to work extra hours and days. The factories often have the orders to warrant the overtime work so the result is almost inevitable.

A further structural feature generating noncompliance lies in the rapid pace of enterprise creation and growth. Some 480,000 FIEs and over 2 million domestic private enterprises have been launched since the opening-up began in 1979. A large number of the companies in the private sector were recently created and many of the managers do not have professional qualifications, particularly in fields such as human resource management and labor relations. Add to that the fact that they often have more orders than they can handle, and you have a recipe for noncompliance – probably in more than just the labor sphere. This is not unique to China. We encounter this scenario in many developing countries, but it is magnified both by the scale of China and by the fact that the socialist system did not place a premium on many of the management skills required of a competitive export firm. Human resource development and management, for example, was simply not a priority in a labor market that was organized by government administrators and in SOEs that could not go bankrupt, but that lack of training and experience in the area of human resources now means that many companies do not have the policies, procedures, and trained human resources staff to ensure that they do not violate workers rights. Legal and code violations are therefore inevitable.

Discipline is a case in point. In our work in Chinese factories we are often told by workers that the arbitrary exercise of discipline is a major source of discontent. When we investigate the reasons for this we usually find that the factory has no policy on discipline, inadequate procedures, and no specific training for those responsible for exercising discipline, mainly guards and supervisors. In addition, the necessary controls are missing and the general awareness of what can and cannot be done is low. The result is inevitable – each guard or supervisor does what he or she thinks appropriate without any formal knowledge of how to ensure procedural fairness. Given the pressure-cooker environment in which they often work, harsh or unfair treatment is common. We recently came across a case where a worker who was being sexually harassed by a colleague lost her temper and slapped him. The supervisor called the guard who promptly fired both workers since fighting is a zero-tolerance offense. The victim was therefore wronged twice. Because there were insufficient controls over the exercise of discipline, no manager intervened, and the lack of any right of reply or of appeal meant that the worker could not challenge the automatic sanction and lost her job.

The Chinese government has yet to develop the regulatory environment commensurate with a market economy, let alone a major export power. These regulatory shortcomings show up, for example, in the controversies over intellectual property rights, protection of the environment, corruption, and labor law. It is important to note that the gaps lie at all levels – sometimes the law does not exist, sometimes it is not adequate, and often it is not enforced in a consistent or comprehensive way.

Once again, the same issues are present in many other developing countries but they are more pronounced in China because of its size and the fact that it is still in the midst of a transition to a socialist market economy and there are important components of that system that have yet to be developed or implemented. Labor law enforcement is weak in many of the countries where the FLA is active, and labor inspectors are frequently under-paid and under-resourced. In some countries the government agencies responsible for labor law enforcement do not even have the power to do their jobs, even if they had the will. This is not the case in China. The government has authority and resources and the political will to improve labor standards. This stems partly from the fact that it is a socialist system and protecting workers is at the heart of the socialist mission, and partly because they know that improving respect for law is one of the conditions for participation in the global economy.

China is a very big country with very large numbers of enterprises and workers and the government clearly has some way to go to catch up to the regulatory issues that plague the labor market. Unlike governments in many ex-quota countries, however, the Chinese government is showing a determination to catch-up. In 2001, the Chinese government signed an MOU with the ILO that included a provision to "strengthen institutional capacity in labor inspection to promote the effective application of ILO Conventions..." and in December 2004 it published a new Regulation on Labor and Social Security Inspection. The disturbingly frequent number of well-publicized accidents involving mines, fireworks factories, and aircraft has prompted the government to step-up enforcement of safety regulations. The problems encountered with migrant workers in the construction sector have led to concerted government action to improve health and safety and regular payment of wages. The government has also supported the creation of some 2,500 legal aid centers to assist workers seeking compensation or other redress.

To date these measures have not been effective, and the government has admitted that some have not been applied, but the important point to note is that the Chinese government is reacting to some of the urgent compliance issues in the labor market. As a socialist country, and as a market economy, China cannot afford to have workers exposed to large-scale violations of the labor law and they can be expected to act whenever these reach a level where they threaten social harmony or economic efficiency. The degree and consistency of law enforcement will continue to be a challenge but the government is working on the corruption and inefficiency that plagues some levels of government.

One of the clearest signs of the movement in China towards improved labor law and code compliance is the development of the CSC9000T compliance initiative. Launched in 2005 by the China National Textile and Apparel Council, the industry association that was previously the Ministry of Textiles, it provides a Code of Conduct and basic guidelines for Chinese T&C enterprises to follow. Chinese

authorities hope in this way to provide a more consistent platform for compliance work and auditing. If widely accepted, this would reduce the number of duplicate audits conducted by foreign buyers and the different, sometimes contradictory, corrective action plans. There are a number of questions that need to be clarified before the potential of CSC9000T can be assessed, including:

- The code is based solely on Chinese labor law and hence falls short of international standards. To achieve full international acceptance it would have to be based on the relevant ILO Conventions.
- As an initiative of government/industry to monitor the industry, it is limited by an inherent conflict of interest. In order to overcome this limitation the initiative would need to be multi-stakeholder and independent.
- It has no independent or external verification, something that is central to any system of compliance.

The China National Textile and Apparel Council is aware of these concerns and can be expected to address them. Whatever the final form of CSC9000T, it is a further demonstration of the attention being paid to international expectations in the labor rights field.

Given the global market situation prevailing in the post-quota environment, sourcing has become both more and less flexible at the same time. It is more flexible in terms of the lower barriers to trade and investment that allow foreign investors and buyers to choose between any number of countries and suppliers when deciding where to source goods. At the same time competitive pressures are restricting the number of real choices, both in terms of countries and suppliers. Any company involved in a highly competitive sector (such as textiles, clothing, or footwear), where market share is small and margins are thin, will be virtually obliged to follow their competitors to the cheapest locations in the world. By this we do not mean cheap in terms of nominal wages but in terms of unit labor costs. Right now that means a handful of countries in Asia, with China the leading option.

In addition, the post-MFA sourcing scene is increasingly going to be dominated by global contract manufacturers (GCMs) who are capable of sourcing fabric, having the items produced, and then delivering them anywhere in the world, store-ready if necessary. These GCMs will save buyers time and money by offering an increasing number of services, from design and development all the way through to warehousing and delivery. T&C products are not only going to be made in Asia – the whole process, from conception to delivery, is going to be managed by Asian GCMs. This will further focus the T&C industry in a few Asian countries. The footwear industry is already highly concentrated in a few Chinese, Korean, and Taiwanese companies producing primarily in China, Vietnam, Indonesia, and Thailand.



With the manufacturing center-of-gravity shifting to China, many commentators conclude that the “race to the bottom” in terms of labor standards has accelerated.<sup>xii</sup> This conclusion appears to be too hasty, for a number of reasons.

- First, our monitoring results show that China is no closer to the bottom than a number of other sourcing destinations.
- Second, whereas a number of the other key sourcing countries or regions are characterized by defunct or failed systems of regulation, the Chinese government is still actively seeking to improve its system of labor market regulation and labor law enforcement. Most commentators agree that the performance of the Chinese government in this regard has been inconsistent, but there can be no doubt about the fact that the government is determined, and has the political will, to act to improve labor standards. Unlike many other countries, China is not overwhelmed or despondent and is in a strong position to improve its regulatory mechanisms.

The Chinese government knows that the eyes of the world are on it and what the expectations are. They are members of enough UN agencies to know what needs to be done and they are actively seeking technical assistance from a number of multi- and bilateral agencies. The private sector is also under constant pressure to improve on a number of fronts from business partners in other parts of the world. We therefore expect that China will continue to take measures to improve labor relations and working conditions all the way to the Olympics in Beijing in 2008. That is not to say that the measures will all be implemented or effective, nor that the movement will all be forward. The history of the opening-up process in China has been one of experimentation and innovation in the economic realm, coupled with extreme prudence in the political realm. All the indications are that this remains the course chosen by the authorities. If so, there is likely to be further controversy about the pace and direction of political change, even if the economic changes continue to progress.

**The Way Ahead:** Given the host of systemic and structural issues presented by China, how do the FLA and its constituents go about trying to ensure code compliance? The short answer is – the same as anywhere else. In all of the sixty-plus countries in which FLA-affiliated companies source, the requirements are the same – they must install the code, make workers and managers aware of it, conduct regular internal monitoring to identify and address compliance issues, and submit to independent external monitoring of a random sample of factories to check whether the compliance system is working. In China, as in other countries, we found that the compliance system was not working properly because of significant capacity gaps that led to repeated breakdown of the system. This realization provided a major impetus to the development of a process designed to identify root causes and achieve sustainable compliance.

The review of monitoring results from the first two years of FLA Independent External Monitoring (IEMs) revealed a number of shortcomings, both on the part of the accredited monitors and in terms of the improvements at the factory level. Monitors were not picking up violations of some of the less easily observed rights (such as freedom of association) and factories were continuing to violate the most common issues (such as hours of work and occupational health and safety). The FLA responded by introducing a number of measures to improve the quality of the monitoring, including more stringent accreditation criteria, specific terms of reference for each audit, additional guidance on topics like freedom of association, regular observation of audits for quality control purposes, and meetings with monitors and participating company compliance staff in key regions to discuss issues and approaches. The FLA also improved the audit instrument and provided additional tools to the auditors.

At the same time we confronted the key question: why were the same compliance issues still occurring after a decade of monitoring? Despite all the efforts made to improve monitoring techniques, company compliance staff and FLA monitors keep finding the same violations (often in the same factories). Many companies have now come to realize that compliance auditing is a necessary but not sufficient measure to achieve compliance and that even further improvements and refinements to the current auditing tools will not lead to changes that could make compliance sustainable.

A major problem of the compliance auditing approach is that it does not delve into the root causes of noncompliance. The checklists commonly used ask yes/no questions that tell us "what" problems exist but not "why" they occur. Hence, even a well-done, comprehensive compliance audit only tells us which issues are not in compliance but provides no understanding of the contributory causes or the risks of future non-compliance. As a result, FLA and PC staff often spend a considerable amount of time trying to work out what sort of remediation would be appropriate. The results, however, have often been disappointing because the remediation was aimed only at the effects and not the root causes.

Therefore, to induce real improvement in labor rights and working conditions the root causes of non-compliance issues need to be understood. These issues are often complex and exposing them requires time and skill. While some technical issues, "fire safety" for instance, can probably be addressed through compliance audits and corrective action plans, others like "overtime" which have more complex social underpinnings can neither be understood nor remedied with a compliance audit alone. For a sustainable solution to be possible, the root causes would need to be laid bare and the remedy would almost certainly require capacity-building to address those causes. A well-done assessment would reveal the capacity gaps provoking non-compliance and the remedial responses to the findings would involve not only corrective actions but capacity building to develop or enhance the ability of the managers and workers to ensure compliance in their workplace.

It was for this reason that we introduced the concepts of strategic monitoring and sustainable compliance at the FLA Board meeting in July 2003. Strategic monitoring is designed to assess the capacity deficit and the remedial plan that follows is specifically intended to build sustainable compliance (that is to say, code self-sufficiency) at the factory level. A number of clarifications of the concept and tools involved may be in order. Compliance auditing checks for compliance against a specific law or code element whereas strategic monitoring checks not whether the company is in compliance but whether it is achieving its strategic goals in terms of social and labor policy – defined for our purposes as the ability to manage and maintain code compliance in a sustainable manner. In so doing it asks questions about “why” the company is falling short of its policy goals and “what” needs to be done to achieve them.

It is important to point out that a strategic assessment is not just a compliance audit on steroids. It is an entirely different animal that involves a different analytical approach, tools, and response. It does not just measure against a specific benchmark but rather describes and assesses the state of the employment relationship in that facility. To take the example of a grievance procedure, a compliance audit would tell us whether or not there is a grievance procedure in a factory, whereas a strategic audit would tell us whether it is achieving its goals of surfacing and resolving grievances to the satisfaction of all concerned. The strategic monitoring instrument that we have developed does not use a checklist approach to compare conditions in the facility against specific benchmarks. It is designed to understand and assess the capacity of the factory to conduct the employment relationship in a manner that respects its code and legal obligations.

The concept of sustainable compliance involves the development of systems and relationships at factory level that enable them to reach and maintain compliance in a self-sufficient way. This speaks to the fact that no external agent -- be it the labor inspectorate, the company compliance department, or civil society – can ever visit the factory often enough to ensure compliance, especially if the will and/or the systems are not there. We have to develop internal mechanisms to do so, beginning with an awareness (and hopefully, a consensus) of what has to be done and how to do it. Too many factories still see the code of conduct as a requirement imposed by external stakeholders and many believe that it is not appropriate or viable in their context. In such circumstances it is inevitable that factories will try to game the system rather than change their way of doing business. The sustainable compliance approach we are using in the FLA therefore acknowledges the fact that managers and workers are the agents of compliance and that they will have to be equipped with the knowledge, skills, and tools required to achieve it.

Just as sustainable compliance (or indeed any type of compliance) cannot be imposed from outside, it cannot be imposed internally. It is essential that all levels of the organization, from top management, through the administrative and supervisory levels, to workers, understand and agree to what has to be done. The disincentives to compliance are many. To take just one example: personal protective equipment (PPE), such as gloves and masks, is often cumbersome and uncomfortable. Workers can work faster without it, so if they are paid on piece rate they, and their supervisors, may opt to work without protection, particularly if they do not experience any obvious negative effects. When inspectors or monitors arrive workers will quickly don the PPE and wear it until they leave. It is therefore naïve to believe that workers will protect themselves if they do not fully appreciate the health and safety implications of the processes they are involved in and if they do not have an internal mechanism for ensuring compliance. Ideally, the factory would have engaged all levels of the organization in the development of a health and safety policy and procedures and trained all the relevant personnel in how to follow it. They would then appoint or elect safety stewards who would be responsible for maintaining a healthy and safe workplace on a day-to-day basis. The external agents would support this through capacity building and check periodically to verify that their system is working.

One of the advantages of an association like the FLA is that we bring together some of the most serious and committed parties in the compliance effort and we can provide a common platform for the development and implementation of best practices. By uniting behind those practices, FLA constituents can create a critical mass in support of improvements in labor rights and working conditions all over the world. This is particularly important when dealing with structural or systemic issues in countries like China. In order to maximize those benefits and to mainstream the strategic monitoring approach we developed a new, third-generation monitoring methodology with the working title of "FLA 3.0."

FLA 3.0 starts by pooling the compliance information available to the FLA and its constituents in order to produce a Monitoring Matrix – a profile of the compliance issues and their root causes – for each country or region. We then prioritize those and propose remedial strategies before conducting consultations at the local level in order to secure stakeholder input to the matrix. This will enable us to combine the perspectives of companies, civil society, and workers and on that basis to compile a more complete picture of the compliance situation. For the first time we will be able to involve civil society in the definition of the compliance issues, priorities, and remedial strategies. It is also hoped that they will be able to provide services in the implementation of those strategies.

One of the key features of the FLA's approach to remediation is to stress the need for capacity building. This requires a more profound and longer-term commitment to bringing about improvements at factory level and the scale of the

task makes cooperation imperative. Going forward we will develop combined capacity building programs that address common compliance issues and capacity gaps. These will be provided by local service providers in order to ensure that they are accessible and affordable to suppliers.

FLA 3.0 is not only designed to avoid duplication and combine resources at the level of the big brands. It also provides new opportunities for university licensees as well as smaller companies because it allows them to benefit from their involvement in the FLA by sharing in the pool of compliance information available. At the remedial level they can participate in the combined remedial programs that 3.0 would promote. For very large companies with long supply chains FLA 3.0 provides a means to concentrate resources on remediation rather than on compliance auditing. FLA 3.0 therefore enables companies of all sizes to use their scarce compliance resources more effectively to address the root causes of noncompliance rather than listing the noncompliances time and again.

The FLA will of course continue to conduct due diligence on the compliance programs of participating companies and licensees by auditing the internal records of their compliance program, conducting IEMs, and through the annual reports that the FLA prepares for the Public Report. Companies will still be required to go through an implementation period during which they ensure code implementation throughout their supply chains and undergo IEMs to measure that progress. Under the new system, however, we will replace checklist questionnaires with new tools that identify root causes and measure the impact of remediation in both qualitative and quantitative terms.

Currently, the FLA is in a transition period in which some aspects of 3.0 are being phased-in on the basis of voluntary projects. Through these projects, companies get experience with the new mechanism and they can re-mold their systems and train their staff according to the new requirements.

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i See for example the statement of the ITCB Chair at <http://www.itcb.org/Documents/ITCB-I35.pdf>

ii See for example <http://www.itkibusa.org/Istanbul-Declaration.pdf>

iii For more information on China and the WTO see [http://www.wto.org/english/thewto\\_e/countries\\_e/china\\_e.htm](http://www.wto.org/english/thewto_e/countries_e/china_e.htm)

iv See for example <http://news.bbc.co.uk/1/hi/business/4205900.stm>

v See <http://www.iht.com/articles/2005/08/30/business/clothes.php>

vi See wage comparison tables in Abernathy, F.H./ Volpe, A./ Weil, D. (2004): *The Apparel and Textile Industries after 2005: Prospects and Choices*. Harvard Center for Textile and Apparel Research.

vii See [http://www.epb.gov.bd/bangladesh\\_epz.htm](http://www.epb.gov.bd/bangladesh_epz.htm)

viii See ILO report (2005): "Promoting fair globalization in textiles and clothing in a post MFA-environment". Available at: [www.ilo.org/public/english/dialogue/sector/techmeet/tmtc-pmfa05/tmtc-pmfa-r.pdf](http://www.ilo.org/public/english/dialogue/sector/techmeet/tmtc-pmfa05/tmtc-pmfa-r.pdf)

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ix See for example Cody, Edward (2005): A Chinese Riot Rooted in Confusion. Washington Post, July 18, 2005. Available at: <http://www.washingtonpost.com/wp-dyn/content/article/2005/07/17/AR2005071700931.html>

<sup>x</sup> See **China Labour and Social Security Yearbook, 1994-2003**

xi For more information on ILO Freedom of Association cases concerning China, please see the ILO website at <http://www.ilo.org/ilolex/english/casframeE.htm>

xii See for example. Anita Chan (2003): A "Race to the Bottom". Globalisation and China's labor standards. China Perspective, No.46 (March-April), p. 41-49.