Weathering the Storm

A guide for FWF member companies sourcing from China during the global financial crisis

FAIR WEAR FOUNDATION

We currently face a global crisis of proportions most of us have never seen before. For garment companies worldwide, the crisis has implications for sales and profits, order sizes, and sourcing strategies. For garment workers, the crisis threatens layoffs, cuts in pay, and declining workplace conditions. Questions abound about the impact the crisis will have on companies' sourcing decisions and workplace conditions.

This report focuses on the effect of the crisis for China's garment industry. China is the world's largest producer of garments, supplying 45% of the EU's clothing (in volume as of July 2008), and employs more than 20 million workers. Aside from its sheer scale, what sets China's garment industry apart are the resources the Chinese government has on hand to support and shape the industry. Indeed, the government's efforts to counteract this economic storm could have ramifications far beyond China, given the intertwined supply chains that characterize global garment production. And yet, despite frequent, often shrill, news reports about China, it is not easy to ascertain what is really happening there.

In this report, we endeavor to provide a timely assessment of what is happening in China. It is based on discussions with various experts on China's garment industry and a review of dozens of written sources in English and Chinese. We recognize that the situation in China is evolving at a fast pace. So FWF will continue to monitor events in coordination with local partners and will keep members updated on new developments.

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I. Contextualizing the Financial Crisis in China

How hard is the crisis hitting China, according to the figures?

The global financial crisis has deeply affected China, an economy perceived until just months ago to be experiencing unstoppable growth. From 2003-05, China grew an average of 10% per year, and it grew more than 11% in both 2006 and 2007, with early projections for 2008 nearly as high. Even in October 2008, when other economies were beginning to tank, China's exports grew by 19% compared with the same month a year before. Against this backdrop, the rapid decline of November exports, shrinking by 2.2% compared with the previous year, was a shock for China. The decline continued in December, which ended with a 2.8% year-on-year drop in exports, and in January 2009, which saw exports decline by 17.5% compared to the previous year. February 2009 saw the most severe drop yet, with 25.7% fewer exports than February 2008.

"Most factories are reporting 30-50% percent drops in orders and production."

The news about the real impact of the crisis in China is often confusing. How has the crisis affected garment orders in China?

Judging from the most recent trade data available, the garment industry does not seem to be faring as poorly as other industries in China. According to February 2009 figures from China's General Administration of Customs, China's garments exports rose by 4.1% in 2008. January 2009 built on those gains with exports of clothing and accessories rising 5.7% year-on-year. February 2009 garment export data were not available at the time of writing.

While these growth rates are not as high as in previous years, demand for Chinese garments has hardly dissipated. In Europe, where imports from China grew 10.2% in the first half of 2008, there are some indications that Europe's lifting of the safeguard quotas in 2007 will fuel continued gains for at least some kinds of Chinese garments this year. Likewise, despite a 3.05% drop in Chinese garment imports into the US in 2008, the recent elimination of safeguard quota for Chinese garments may also lead to gains for certain kinds of Chinese-manufactured garments in 2009.

It is important to note, however, that a lag time often exists in the garment industry between the time orders are placed and export numbers are published. The rate of current orders may therefore provide a better indication of the current economic reality for Chinese garment manufacturers. The consensus among all of the experts consulted was that orders in most factories are shrinking. Charles Li of Compliance & Capacity Building Ltd. based in Hong Kong reports that he visited 30 garment factories in the past 2 months. "All factories had reported a decline in orders compared with previous years," he explained. "Most factories are reporting 30-50% percent drops in orders and production." Such cuts in production lead to two main outcomes: factory closures and/or worker layoffs.

How many factory closures should we expect in China?

There are no official, up-to-date data currently available for Chinese garment factory closures. The experts consulted for this report all confirmed that they have observed a considerable increase in garment factory closures, but it is unlikely that these will match the high rate observed in China's toy, furniture – or even textile – industries in the past year. The coming months will likely bring significantly more closures, however. Indeed, Dr. Kai-Ming Liu of the Institute for Contemporary Observation in Shenzhen believes that more than 20% of garment factories will need to close in the next two months. Most of these are small factories of 100 or fewer workers, and they often serve as subcontractors to larger factories. In the current climate, when large firms no longer have extra business to share, these small factories' orders simply dry up. While considerable drops in orders are the main reason cited for closures, access to capital by way of bank loans and rising operating costs are also common causes. We will discuss these factors in more detail below.

What about worker layoffs?

Even if they have some orders coming in and have capital to stay afloat, many factories have laid off workers. Dimitri Kessler, the Ethical Trading Initiative's representative in China, recently reported visiting a factory which formerly employed 3,000 to 4,000 workers. It has since laid-off approximately half of these workers. Likewise, of the 30 garment factories Charles Li visited in recent months, all report that they have downsized their workforce by 20-30%. Interestingly, however, many factories report that lean times in the garment industry started a couple of years ago, long before the worst of the financial crisis hit.

II. The Clouds Gathered Before the Storm

Did the financial crisis alone force widespread closures?

No. The financial crisis and the resulting drop in sales is only the latest, and probably most severe, factor making China's garment industry a far more competitive and challenging environment to do business. As President and CEO of the Fair Labor Association Auret van Heerden points out, "A lot of companies that had been operating in China's garment industry had a short term attitude towards their business. Industry people have been talking to these people for some time, urging them to restructure or get out of the business."

Only 10% of China's garment companies made 80% of the industry's profits in 2007. Twenty percent received 94% of the profits, leaving the remaining 80% of companies to share 6% of the profits.

In a September 2008 report, May Wong of Globalization Monitor in Hong Kong considers key developments and trends in the Chinese garment and textile industry. According to Wong, the China Textile Industry Development Report 2007/08 details how 20% of China's 14,000 registered apparel companies were already running deficits in the period between January and November 2007. She observed that a major bifurcation had taken place among China's garment producers, despite surges in production in recent years. Only 10% of China's garment companies made 80% of the industry's profits in 2007. Twenty percent received 94% of the profits, leaving the remaining 80% of companies to share 6% of the profits.

Wong goes on to report the China Textile Industry Association's assessment of the Chinese government's strategy for the garment industry prior to the financial crisis. In order to relieve the labor shortage among garment firms, the government allowed most of the small and medium enterprises with less than 100 workers to fail. As the reasoning goes, as workers in failing small factories lost their jobs, they would seek work in the larger, more efficient factories. Wong reports that as many as 15% of garment firms were closed in some regions during this period in 2007–long before the global crisis took hold.

What challenges did factories encounter prior to the financial crisis?

Since 2003, economic developments and changes in government policy have led to increased costs (and associated lower profits) for producers. According to Kan Wang, a researcher at Renmin University of China, there is no single factor that has been causing factory closures. "It's typically a chain reaction, including the rise of the RMB, heightened labor costs and more costly environmental requirements, which are then exacerbated by the shrinking of global demand." Martin Ma, who manages China programs for Social Accountability International (SAI) and Solidaridad , explains, "This can all add up to an estimated 10 to 15% rise in operating costs for factories along the coast – which, in the apparel industry where margins are tight, could be enough to make it unprofitable for some to stay in business." The leading challenges for garment factories were:

- *Increased labor costs:* Cheap labor fuelled China's growth story. Yet, as demand for skilled labor grew, average annual wages nationwide tripled to 24,700 RMB ($3,600) from 1999 to 2007, according to government statistics. While labor experts in China are quick to point out that workers' wages are still far from a living wage standard, wage increases in China's coastal manufacturing zones rose to a level 3 to 5 times higher than wages in other garment-producing countries.

- *Increases in RMB:* Since early 2005, the RMB has increased more than 20% against the dollar. As noted by FWF's East Asia Verification Coordinator Ivo Spauwen, "When considered against the relative decline in the currencies of garment competitor countries, such as India, Indonesia and Mexico, the rise in China's currency has that much more potential to undermine price competitiveness for Chinese suppliers."

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- *Increased material, energy and overhead costs:* Various commodities increased in price in 2006-7, including oil (affecting the cost of materials like nylon), cotton, wool, plastics, and coal. For those factories based in coastal zones, electricity, transportation, and living costs have also risen substantially in recent years.

- *Environmental regulations:* Due to electricity and other energy shortages, China's regulation is improving, which means that cheap and dirty production, energy, and waste disposal are being phased out. New technologies aimed at decreasing pollution are being ushered in, but these require cash investments by companies.

- *Decreased tax rebates for garments:* The rebate on the VAT for garment manufacturers dropped considerably between 2004 and 2006. Where garment manufacturers enjoyed a rebate of 17%, this was reduced to 11% by 2006. This created a 6% increase in VAT payments within a span of 3 years. (Note: Since 2008, the rebates have been raised – see more below.)

- *The tightening of credit:* In 2008 the government tried to rein in inflation by restricting credit, and China's central bank raised the cost of borrowing several times throughout the year. Garment producers rely heavily on loans to cover production costs prior to delivery and client payment. If companies are unable to access loans because the threshold for equity increases or the interest rates are too high, it is impossible to maintain business operations.

III. The Impact on Workers

How has the economic downturn affected employment levels in China?

In January 2009, China's Ministry of Human Resources and Social Security announced that unemployment levels across all sectors were at their worst since 1980, with an estimated 670,000 factory closures in the past year. The urban jobless levels are estimated at 9%, while the rural level may reach 20%. Currently, an estimated 20 million migrant workers have lost their jobs. Labor economists in China predict the number will continue to rise, perhaps by 10 million or more.

But China was recently experiencing a labor shortage. Taken together, how has this affected employment levels in the garment industry?

Up until the middle of last year, there was a serious shortage of experienced garment workers. It was a "seller's market" for workers, who would shop around to find the factories that paid best. Parry Leung of Students and Scholars against Corporate Misbehavior (SACOM) in Hong Kong explained: "There is a problem of unemployment in China. Yet, as recently as January 2009, there were job openings in the garment industry." He referred to the Chinese government's survey "Employment Tendency After 2009 Lunar New Year" which was conducted early in 2009 and revealed that 65.4% of factories still had recruitment programs; vacancies had decreased 20% since last year; and only 12% fewer companies sought to find workers within two weeks of Chinese New Year. While Leung emphasized that the survey did not involve enough factories to be representative or reliable, it does indicate that demand continues in places like Dongguan and Shenzhen. Charles Li agreed, explaining, "I have not seen layoffs affecting the highly experienced workers in garment factories yet. The concern is for the millions of unskilled workers who are often migrants and do not have a lot of experience." Indeed, according to Martin Ma, "the most vulnerable workers are those who have been working for fewer than 2 years. They are the first to be laid off and the last to be hired."

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How does this affect working conditions?

The experts contacted for this report shared a view that the factories that seek to remain in business despite the crisis would likely hold onto a core workforce and try to weather the storm. While this means that fewer workers will lose their jobs, it presents a significantly different work environment for them. For instance, overtime is likely to be less pronounced now, because there are too few orders to require longer hours. Yet, as Auret van Heerden points out, "factories will have a smaller workforce so in the event that an order arrives above a factory's current capacity, the workers will be at their machines 18 hours a day."

When these efforts to maintain workforce levels mix with decreasing orders, it can lead to the opposite of overtime: idle hours for workers. Martin Ma explains: "In China, where the practice of piece-rate is very common, cuts in work can spell real losses for workers. So the minimum wage laws will apply more than ever. Wages that were previously not in jeopardy of dipping below minimum wage now may well be at risk." Wages for less experienced workers have already declined significantly in several regions. Van Heerden also predicts that "the traditional issue of late payment will now be chronic in the industry, due to cash flow challenges that currently plague it."

Despite such shifts in emphasis, the experts believed that the same compliance issues that have been known to exist in China will persist, and that most are likely to become more pronounced. Auret van Heerden and Ivo Spauwen anticipate that managers in the current climate are likely to be more reluctant to sign proper contracts with workers, and to violate the labor contract law and social security payment requirements. In an effort to reduce rent and material costs, it is likely that that the quality of food served in canteens and dormitories will decline, and that restrictions will be placed on hot water and energy use. “Wherever possible, expenses are likely to be reduced to the minimum,” Spauwen explains. “We can expect to see an increase in health and safety abuses, as factory owners postpone improvements to workplace infrastructure or investment in protective equipment.”

Will the crisis lead to more worker demonstrations? Should we expect to see more strikes?

Yes. Employment relationships in this climate are likely to be more ridden with friction, the experts predict. As a result, we can expect to see a rise in spontaneous demonstrations in workplaces around the country. Worker demonstrations have in fact been on the rise for the past decade. The Ministry of Public Security reported an eightfold increase in “mass incidents” between 1994 and 2005. Eighty-seven thousand demonstrations took place around China in 2005, the majority of them linked to labor disputes.

While such data is not available for more recent years, experts agree that workers and others are increasingly registering their discontent in the public sphere. Parry Leung explains that a rise in wildcat strikes and demonstrations is directly linked to discrepancies between the labor law and what is actually implemented. Workers are inspired by the law and often use it to structure their demands – whether they opt to settle disputes through arbitration and the courts or seek redress through demonstrations and wildcat strikes. Leung reports a steady increase in national arbitrated labor disputes, which increased at an annual rate of 18% between 2000 and 2005. And since the enactment in 2008 of the New Labor Contract Law and the Labor Dispute Mediation and Arbitration Law, which will be discussed below, labor bureaus have been swamped by the staggering increase in worker complaints.

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Now, according to recent reports, workers have been experiencing serious delays despite provisions of the law that seek to “fast track” cases involving unpaid wages. Many prefectures lack the staff to process these complaints, while others lack the will in the current climate. If such backlogs continue alongside rising layoffs and closures, worker demonstrations and strikes will surely spike in number.

IV. Chinese Labor Law Today

Is China’s new labor law relevant to the current crisis?

Yes. If workplace abuses are on the rise, effective legal protection is all the more necessary – so it is important to understand China’s labor laws.

Two important pieces of labor legislation were enacted in 2008: the Labor Contract Law and the Labor Dispute Mediation and Arbitration Law. These laws build on China’s 1994 Labor Law, which is the foundation of labor standards in China. The two new laws together seek to address the enforcement gap that has existed in China’s labor regime since 1994 and to regulate employment relationships. In short, the Labor Dispute Mediation and Arbitration Law makes it easier for workers to seek legal redress for workplace violations, while the Labor Contract Law focuses on employer-employee relations within the workplace.

In order to incentivize implementation among companies, the Labor Contract Law details high penalties for compliance failures. For instance, a company must pay twice the monthly wage for each month of employment without a written contract (Article 82). The law is notable in its ambition to transform labor relations in China. While many aspects of the law have yet to be enforced, it has thus far led to a significant rise in contracts throughout the country (although many workers continue to work without contracts). What’s more, the campaign to raise awareness about these two new laws has reached millions of workers. As Charles Li observes, "workers generally have a secure feeling about the law now, whether their understanding of the law is strong or very superficial."

I have heard different ideas about various provisions of the new Labor Contract Law. What's the reality?

There is a great deal of information circulating in China about the new Labor Contract Law, and some of it is not accurate. FWF's [*China Country Study*]() provides a comprehensive review of the law and how it pertains to FWF standards. Here are a few relevant aspects of the law to keep in mind:

- *On trade unions:* Given the Chinese government's characteristic distrust of collective rights for workers, it is not surprising that there are no provisions of the new law that recognize the right to form independent trade unions or the right to strike. It does, however, focus substantially on the role to be played by trade unions in the workplace – including provisions that require enhanced consultation and information-sharing with trade unions. Most noteworthy are Articles 51 through 56, which specifically authorize collective bargaining of a binding nature at the enterprise- or industry- level and outline the legal recourse that trade unions can take if employers do not uphold the contract.

- *On contracts:* The law seeks to transform the common practice in China of using fixed, often short-term contracts to avoid personnel costs and responsibilities. Under the new law, a maximum of two fixed-term contracts can be used with any single employee. For any employee who has completed two fixed-term contracts or who has been with the company for ten years or more, the law requires the provision of an "open-ended," or permanent, contract, creating more job security for the worker. Open-contract workers can only be removed for just cause, such as a serious violation of internal rules or fraud.

"Workers generally have a secure feeling about the law now, whether their understanding of the law is strong or very superficial."

- *On layoffs:* Contrary to some rumors among factories, the new labor contract law does allow firms to lay off workers in case of business need. In the event of layoffs, severance is required at a rate of one-month's salary for every year worked. It is important to note, however, that the clock for severance pay started ticking on January 1, 2008. Therefore, even if a worker has been with a company 20 years, he/she would only be entitled to one month's severance if he/she were laid off on January 1, 2009. It is for this reason that the new law would not instantaneously increase costs for companies.

Does the new law increase operating costs?

Minimally, if at all. A common complaint among companies resistant to the new Labor Contract Law is that it significantly increases their costs and is therefore not practicable. The experts whom we consulted were doubtful, however, that the law has increased the cost of doing business much at all. Parry Leung, who has studied the law and its implications, explains that the law is about a long-term commitment between a factory and a worker. "This will not affect short-term costs. The big severance fees factories fear are years away, because the clock only started ticking in January 2008. It will take some time to observe any trends in costs or employment relations evolving out of these strengthened contractual protections."

Charles Li has made a similar observation. In his recently-completed informal survey of 30 companies, 80% of the companies told Mr. Li that the law had not increased their costs. "These tended to be larger companies," he explained. On the other hand, he observed that some smaller companies still maintain a view that the law brings costs to a level that makes them unprofitable: "These companies often seek the means to avoid the law." Martin Ma considers that harsher fines included in the Labor Contract Law have likely increased pressure on companies to uphold already existing labor standards. "Laws for paid overtime and minimum wage have been on the books since 1994," he explained. "A claim that this law has significantly increased production costs beyond a percentage point or two is more about the impunity that has been practiced rather than any meaningful reflection on the law today."

I have heard that the new law has been suspended in the current context. Is that true?

No. The law is still in effect, and, in accordance with FWF standards, must be respected. Still, confusion about law's implementation is understandable. On several occasions Beijing has stated its ongoing commitment to the law, yet the law's application has been narrowed by various policies at the national and provincial levels in response to the current crisis. For example, the central government has cancelled this year's planned increases to the minimum wage and postponed companies' social security payments. At the provincial level, various governments have communicated their willingness to overlook noncompliance with the law in factories maintaining large workforces. Even the ACFTU has communicated a moratorium on collective bargaining. Experts foresee that coming months will bring inconsistent application of standards, depending on the province and the particular company involved.

V. Government Intervention in the Garment Industry Since the Crisis

The news mentions a large government stimulus package in China. Will any of that impact the garment industry?

"The industry absorbs a lot of employment. And this is important for social stability."

Yes. As Sun Ruizhe, vice president of the China National Textile and Apparel Council (CNTAC), told the New York Times recently: "The industry absorbs a lot of employment. And this is important for social stability." As a result, government plans for aid to the garment industry abound. On 4 February 2009, China's State Council unveiled its plan to support the garment industry, which aims to provide short-term fixes needed to survive the current economic climate, while spurring improvements to ensure that the industry emerges even stronger. Below are relevant plans announced by the government:

- *Textile and garment export tax rebate:* On 1 February 2009, the government lifted the rebate on VAT paid by garment exporters to 15%, meaning that garment exporters now only pay 3% in VAT. Parry Leung estimates that this is a 7 billion RMB loss of tax revenue for the government, but also cuts costs for factories. Because profit margins in garments are not large, such savings can be very meaningful. The government has said that it will lift the rebate to as high as 17%, if needed.

- *Loans for factories:* As mentioned above, loans play an important role for many garment manufacturers, yet became difficult to access in 2008. The government has therefore created a special fund, which aims to pump funds back down to the grassroots of the economy.

- *Industrial upgrading:* The government will support the purchase of better equipment and technology to improve productivity levels and quality in textiles and garments. Many in the industry suspect that this program may only target the large factories, which remains to be seen.

- *Development of domestic brand names:* When Chinese manufacturers make an article of clothing, they only receive a fraction of the total sale and a miniscule proportion of the profits. If successful, this support of domestic "famous brands" would significantly boost the industry's place in the value chain and, as a result, its profit margins.

- *Relocating old factories to new regions:* The Chinese government seeks to phase out outdated, inefficient garment factories that are located in major cities like Dongguan and Shenzhen and move them inland, where labor and energy are more affordable. The plan is to create specialized production clusters to enhance efficiency and profitability.

- *Reduced tax and social security payments:* The central and provincial governments are planning to reduce the tax load of businesses. Likewise, a lapse in social security payments by companies has decreased their payroll costs for the time being.

- *Worker training:* Beijing has communicated its intent to provide worker training, but we were not able to access details about the shape this takes for garments. The experts consulted believed trainings would largely target unemployed workers and would not overlap with the kinds of in-factory compliance training some FWF companies are planning.

- *Intervention in, and prevention of, factory closures:* In cases where factories have gone bankrupt and left workers unpaid, provincial and municipal governments have used special funds to offer at least a portion of the back pay to laid-off workers.

VI. What All of This Means for the Future of China's Garment Industry

How do all these changes in China affect the direction of the development of its garment industry?

Interestingly, many of the planned stimulus programs correspond with the development plans China had been discussing prior to the crisis. In places like Guangdong, the "Two-Wheel Driven" strategy (which focuses on upgrading the manufacturing and service sectors there) and the "Empty the Cage for New Birds" strategy (which focuses on closing down labor-intensive, highly polluting, energy-consuming industries) were being laid out before the downturn. It is clear that China sees its next step in economic development to be industrial upgrade in the Pearl River Delta and nearby regions and building low-level industry in regions that are currently rural.

What has changed in recent months is the pace of this transition. China will be balancing its desire to develop against the need to maintain stability by way of employment. While the government will do its best to control the rate of change, various factors will fall outside of its control. For this reason, FWF will continue to watch China closely in coming months.

Will factories relocate? If so, to where?

Some will, but not all. Experts have observed that some smaller companies have closed shop and moved to Vietnam, where the labor costs are significantly lower. But they observe that most factory owners doing business in China want to stay there, claiming China offers macroeconomic stability and superior infrastructure.

But where are factories locating in China? For the time being, our survey of experts found that factories are by no means in the process of a mass migration westward. Some factories are staying along the coast, either in the Pearl River Delta or the Yangtze River Delta. Owners of many of these factories have already opened large factories in inland provinces, such as Hunan, Jiangxi, and Guangxi but have also maintained their presence in coastal cities so as to keep up with trend-sensitive orders. Other companies have chosen a middle road: they are leaving Dongguan and Shenzhen and moving their factories to smaller districts in the province of Guangdong – often near the border with other provinces, such as Hunan province.

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Dimitri Kessler observes that some companies shop around different districts before relocation. Their decision is based upon factors such as tax load/rebates, government support for construction of new buildings, rent, provision of utilities, and access to transportation. But increasingly, Kessler finds, factories are also consulting with local leaders to determine the level of labor law implementation by the local labor bureau. “If the enforcement promises to be too strict, some firms will look elsewhere.”

What will our supply chain in China look like in the future?

Dimitri Kessler points out that the industry is changing before our eyes. “When the dust settles, the bigger manufacturing groups will tend to win out, with serious implications for the power dynamic between international apparel buyers and domestic suppliers in China.” Indeed, if China’s garment production continues to improve in terms of productivity and quality, and if garment production is consolidated among far fewer large producers, it will be a very different buyer-supplier relationship, with implications for price negotiations and labor compliance.

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Nonetheless, FWF advises against hasty changes in sourcing strategy due to these predictions. “Despite the trend towards larger, more powerful companies in China, many small and medium firms will survive, based on their ability to compete,” says FWF Director Erica van Doorn. “In a crisis where factories are eager to please buyers, FWF companies can influence factories in new ways. So if a company partners with a factory, regardless of its size, and they together develop effective management and compliance systems, all parties in that relationship will emerge stronger.”

VII. What FWF Companies Can Do in the Face of the Current Crisis

Considering the points raised in previous sections, what should FWF companies do to uphold their FWF responsibilities in China? Based on conversations with FWF’s Director Erica van Doorn, FWF’s Verification Coordinator for East Asia Ivo Spauwen, and the experts we consulted, here are five areas where FWF companies can focus their efforts in China.

1. Maintain labor standards despite the crisis.

The need for worker rights in China is as pressing as ever. As Kan Wang explains, “If labor standards can be implemented now, during the hard times in China, they are much more likely to become engrained in factories’ long-term workplace culture. But, if this crisis undermines recent labor developments, it will undermine faith in the rule of law. We will have a far harder time making up that lost ground – even after China emerges from this crisis.”

While FWF companies have an obligation to respect the FWF Code and China’s labor law, here we highlight a few noncompliance issues to keep in mind during the crisis:

- *Freedom of association:* FWF companies are obligated to promote workers’ freedom of association, and China is no exception. Ivo Spauwen explains, “As labor disputes mushroom in China, the need for better social dialogue is clear. While China’s new law still fails to acknowledge workers’ freedom of association, it does offer new opportunities for worker representation and participation in decision-making. FWF companies should take advantage of this legal development – for the good of workers and their own business interests.” Indeed, strong industrial relations in a factory enhance factory stability with attendant benefits for buying companies. According to Spauwen, “Training is key.” To this end, FWF will be hosting a seminar on best practices in worker training in China this month, March 26 and 27. “We need to work with local stakeholders to identify the training tactics that are most effective. With this information, companies can help initiate a process that gives workers real voice.” For more detailed guidance on freedom of association, access FWF’s *Guidance Document on Freedom of Association*.

- *Excessive overtime and payment of overtime premiums.* As mentioned above, decreased orders can mean smaller workforces, which experience slower workdays punctuated by periods of long hours when large orders do arrive. This will make FWF Code enforcement even more challenging. Struggling factories are likely to be less inclined to pay overtime premiums for these periods, and workers receiving inadequate pay for low periods will be eager to acquire additional hours when they become available. “Neither excessive overtime nor failure to pay overtime are new compliance issues for in China,” says Erica van Doorn. “But a slowdown in factory orders presents an opportunity for FWF companies to think more strategically about buying practices like order forecasting and stock production. Now is the time to work with factories to make improvements that can help smooth these production peaks and valleys.”

- *Written labor contracts.* “Be very attentive to precarious contracts,” warns Auret van Heerden. “Companies will use a variety of tactics to avoid having a large permanent workforce.” This includes contracting third-party firms to provide interim or “dispatched” workers, using subcontractors, or failing to register workers. While these are not new practices in China, the crisis further incentivizes noncompliance here. And without contractual protections, workers are much more vulnerable to exploitation as jobs become scarce.

- *Child labor*: In 2008, FWF observed a number of cases of child labor in factories, which were linked to the labor market shortage. “Because legal workers were unavailable or too expensive, factories resorted to hiring workers under the legal age of 15,” reports Ivo Spauwen. Such practices may continue or even rise in the current climate as factories seek to cut costs. “Of course, the end of labor shortages may also mean a decline in this practice. We still do not know how it will play out, so it is important to keep an eye on this.” FWF has been working on guidance to uncover and redress child labor in China, which will be available in the coming year.

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- *Wages*. As reported earlier, lulls in factory orders can mean significant pay cuts for garment workers in China, many of whom work on a piece-rate system. Minimum wage payment and transparent pay schemes are especially important at times like these when there may be real swings in factory orders (see FWF’s Country Study of China for a comprehensive listing of current regional minimum wage levels). It is important to monitor and maintain communications about wage levels and to continue efforts to raise wages towards FWF’s standard of a living wage. Moreover companies should appreciate the impact of their pricing on workers’ wages.

These and other common noncompliance practices are usually hidden from view, so effective monitoring remains an important part of FWF’s prescription for compliance. Ivo Spauwen advises, “Keep going with good quality monitoring. Even if your monitoring budget gets cut, focus on a few, strategic suppliers and work in partnership with them. Invest the time in developing a strong understanding of the real situation and set to work to improve conditions there.” For FWF, good monitoring results hinge on strong offsite worker interviews. We invite companies to access the *FWF Audit Manual* for more in-depth monitoring guidance.

2. Develop long-term, transparent relationships with factories.

"The global financial crisis creates added tension and distrust to factory-company relationships," explains Lynda Yanz of Maquila Solidarity Network. "Companies are concerned that factories will go out of business before shipping products, while factories are concerned companies will go bankrupt before paying for orders." In this context, it is difficult to conduct trade, let alone factory compliance improvements. Here, Auret van Heerden considers that candid conversations with companies are a key for making real progress in developing sustainable changes. "Be straight," van Heerden advises. In order for factories to trust a company enough to share key information about its longevity or compliance challenges, it needs to believe the buying company will provide relevant information in good faith.

"As soon as a company engages in a true partnership with a factory, doors for compliance open wide," Erica van Doorn believes. This requires a company to look beyond the factory to address noncompliance issues, asking: "Are we providing reasonable lead times to avoid squeezing workers into overtime? Are our prices adequate for payment of minimum wage, with plans to progress to a living wage?"

These questions run contrary to current industry reports of some brands and retailers reacting to slumps in sales by renegotiating lower prices with factories and calling for even tighter delivery times for products. But van Doorn explains that such company practices are short-sighted and undermine stability, both for factory workers and the company itself. "In an economy where factory closures are common, is it wise to depend on a product's delivery without first confirming that the price you are paying adequately covers wages and other costs?," van Doorn asks. "The answer is 'no'. Working with factories to ensure that workers receive adequate pay for reasonable hours of work is the right thing to do. And it is also what's best for your business."

> *"Working with factories to ensure that workers receive adequate pay for reasonable hours of work is the right thing to do. And it is also what's best for your business."*

Such collaboration is far easier to achieve if the relationship is long-term, Ivo Spauwen explains. "In the current climate, factories cannot persist without adequate commitment from buyers. Likewise, companies' impact is limited if their orders are spread across so many suppliers that they have no voice vis-à-vis any given factory." Spauwen advises companies to begin to consolidate their lists of suppliers and focus on building relationships. "A smaller sourcing base is simpler to manage, while promising real possibilities to improve workplace conditions."

For more on sustainable supply chain management, access the *FWF Management System Requirements*, available on request from Fair Wear Foundation.

3. Work with factories to prevent irresponsible layoffs.

Martin Ma counsels taking a realistic view on factory closures in China. "We make no claim that we can control factories, but we need to make clear that there is a bottom line," Ma explains. "FWF cannot stop layoffs or closures. But those workers who stay at a factory deserve basic protection. And those who are laid-off deserve legal remuneration." Ma points out that it is common for factories to lay off workers without paying back pay, severance, or other contractual benefits. So it is important for companies to take action now to ensure that factories have retrenchment policies in place and are utilizing them. Companies should also seek to gain information about recent layoffs during monitoring visits in order to verify that the policies have been enforced. Again offsite interviews play a key role here.

Ivo Spauwen also advises companies to prepare for the unfortunate cases where factories shut down. "Companies need to have a clear view on their position and their responsibilities." Spauwen recommends that companies access advice provided in the MFA Forum *Responsible*

Transitions draft guidance document (pp 13-17), which provides further details on good practice in such cases.

4. Strengthen communication and complaints channels for workers.

When asked what he thought FWF companies could do to improve workplace conditions during the current crisis, Dimitri Kessler pointed to the work that FWF is already doing to make its complaints system – or compliance hotline – accessible to workers. Kessler encouraged further work on this strategy, observing that such hotlines can create a release valve in a context where labor disputes can quickly escalate to strikes, disruptions of production and delivery – general workplace instability.

In tandem with FWF's complaint system, companies can lay the groundwork for effective social dialogue by helping factories institute functioning grievance systems. Ivo Spauwen explains, "We want to build systems where workers are able to lodge complaints, the complaints are heard, and a solution is found. The main port of call should be at the factory level, with FWF's local complaints handler in China as a back-up." For Spauwen, developing factory capacity to handle grievances requires skill development that corresponds with what is required for effective social dialogue: worker training, improved worker representation, and management capacity to engage in social dialogue. "That's where we need to bring supply chains," Parry Leung of SACOM maintains. "With solid industrial relations within a factory, workers and managers can together work through the challenges presented by this crisis, and whatever else will come."

"In a crisis where factories are eager to please buyers, FWF companies can influence factories in new ways."

5. Realize your company's potential to influence factory practices in the current climate.

Dr. Kai-Ming Liu reminds FWF companies of the paradox presented by the financial downturn in China. "The potential for small international companies to have an impact is even greater in this environment," Dr. Liu says. "The factories are eager for your business, so your voice will come through more strongly." Previously, when companies were flooded with orders they had limited incentive to change. But now there is space to engage factories in dialogues about real improvements. And, in an environment of heightened competition, factories that have effective management systems and uphold the labor law are likely to attract even more business. As Martin Ma points out, "It may be counterintuitive, but now is the best time to make the case for CSR."

VIII. Where We Are Going from Here

Given the dynamism in China – and the garment industry worldwide – the future remains unclear. At FWF, we will continue to maintain close contacts with our partners in China and around the world and work with them to analyze what is unfolding for garment workers, factories, and companies.

Our work in China continues apace. Here's what we will be up to in coming months:

- Seminar on best practices in worker training in China: Hong Kong, 26-27 March 2009.
- Auditor training seminar: Shenzhen, 30-31March 2009.
- Study on living wages in China in cooperation with Beijing University, April through September 2009. Paper with results and recommendations forthcoming in Autumn 2009.
- Guidance paper on effective remediation of child labor forthcoming in 2009.

At the same time, FWF will continue our ongoing programs in China and beyond. We encourage FWF member companies to contact us to discuss their particular compliance and sourcing strategies in the current climate. As Erica van Doorn points out, "Now is a time of a crisis and a time of opportunity. By remaining informed of what's happening locally and working innovatively globally, we can have a real impact for workers worldwide."

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- Charles Li, Executive Director, Compliance & Capacity Building Ltd., Hong Kong
- Kai-Ming Liu, Executive Director, Institute of Contemporary Observation
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- Auret van Heerden, President and CEO, Fair Labor Association (FLA)
- Kan Wang, Researcher, Renmin University of China

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This report was written by Anne Lally (independent researcher/consultant) with oversight by Ivo Spauwen (Fair Wear Foundation).

Other Relevant Sources about the Global Financial Crisis and Its Impact on the Garment Industry

- "How Will the Global Financial Crisis Affect the Garment Industry and Garment Workers?" By Maquila Solidarity Network, February 2009.

- "Impact of the Economic Crisis on China's New Labor Law." By Auret van Heerden, March 2009.

- "Development and Trends in the Chinese Garment and Textile Industry." By May Wong, Globalization Monitor, Hong Kong, September 2008.

- "Managing Labor Relations in China: the Labor Contract Law Legislation." By Parry Leung Pak Nang, August 2008. Contact FWF to access document.