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How will the global financial crisis affect the garment industry and garment workers?

Maquila Solidarity Network
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Context



The global financial crisis now underway is expected to have major impacts on North American and European workers and consumers, including massive job losses and reductions in spending power. It will have even more serious consequences for workers in the global South.

The financial crisis will undoubtedly reduce US and EU demand for at least some categories of apparel imports from the South as economic uncertainty (about job security, income, and savings) leads Northern consumers to cut back on purchasing and brands and retailers to cut back on production in anticipation of shrinking consumer markets. Consumers will look for sharply-discounted apparel, which will favour some brands and retailers and not others, but in both cases will affect prices paid to suppliers.

In this economic climate, in which the only consistent pattern is that things have been worse than earlier predicted, we hesitate to make predictions. What we can do is outline some of what we do know, some of the questions we have about the future, and some of the things to watch for in the coming year.

What we know

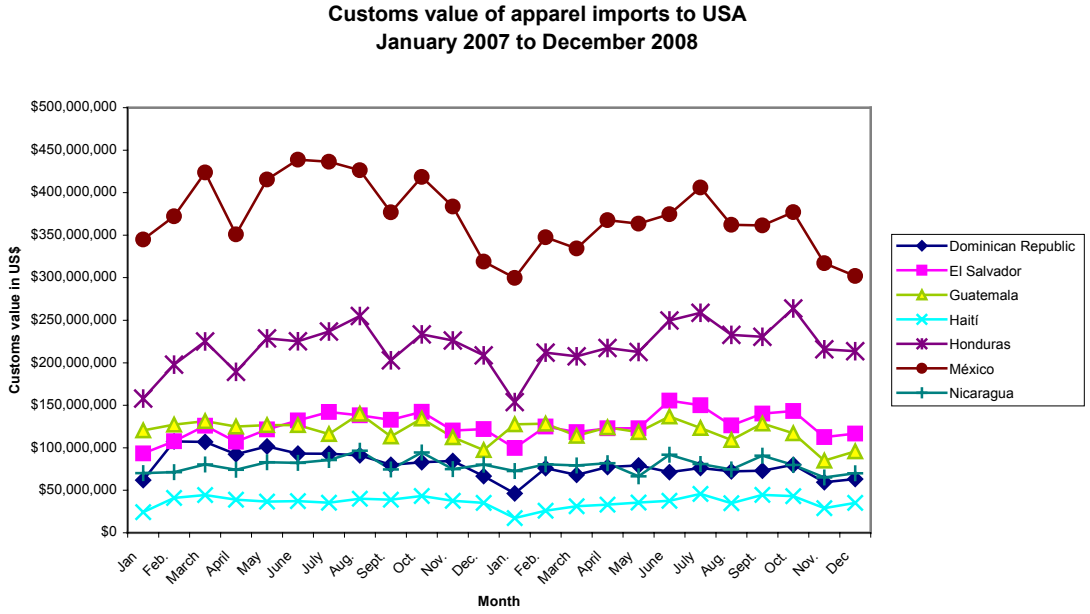
1 Apparel sales in North American stores are declining compared to previous years. Gap Inc. saw a 12% decrease in December sales and a 19% drop in January; Abercrombie and Fitch saw a 24% decrease in December sales; The Limited saw December sales decrease 10% and January sales decrease 5.4%; and American Eagle Outfitters saw a decrease of 17% in December and 15% in January. H&M's November sales were already down 4% from the previous year.

2 Price appears to be the major issue for shoppers, which means that all retailers are focusing heavily on price reductions to sell off inventory. In general, discount chains seem to be surviving the crisis better than middle or high-end retailers. But even most discount chains saw a drop in sales in December. For example, Wal-Mart saw a 1.7% increase in December of its year-on-year sales, which was lower than their anticipated 2.8% increase. However, in January Wal-Mart reported a 6.1% sales increase over January 2008. In December, Target saw a 4.1%

decline, Costco a loss of 4%, Sears (Kmart) a 7.3% slump, and TJX (Winners) came in at 5% lower sales than the previous year. By January, TJX had dropped 6% compared to the previous January, while Target and Costco managed to stay relatively even.

3 All retailers report having to slash prices considerably in order to sell anything during the pre-holiday shopping season, which suggests that higher-end stores will face increasing difficulties in the year ahead – in part because consumers will now expect continued huge markdowns in price. And even discounters faced price pressure over the last few months.

4 The volume of apparel imports to the US is just starting to take a hit, but that's largely because orders were made months ago, before consumer spending dropped dramatically. In October 2008, the volume of apparel imports to the USA was still 2.4% higher than the same period (January - October) in 2007. In the most recent data – for December 2008 – overall apparel imports by volume had decreased 2.73% from the same period (January-December) in 2007. Further, these annual rates hide a sharper decrease in imports in November that may signal worse times to come. In November 2007, the USA imported over 1.77 billion SMEs



(Square Metre Equivalent) of apparel, while in November 2008 the USA imported just under 1.67 billion SMEs, a year-on-year drop of 5.7%.

5 The pattern of trade, as always, was uneven. The top apparel supplier to the U.S. in 2008 was still China, but the volume of Chinese apparel exports to the USA had dropped by 3.05% compared to 2007, while Vietnam, Bangladesh, Honduras, Nicaragua and Indonesia all saw increases in the volume of exports to the USA compared to the previous year. Vietnam's apparel exports to the USA were up almost 20% from 2007. Mexico, however, saw a 14.48% drop in the volume of apparel exports to the USA compared to 2007, Guatemala a decrease of 9.29%, and the Dominican Republic a 5.95% drop.

6 The world supply of cotton has dropped in the last year and is expected to decline further during 2009. The demand for cotton has also declined as a result of an overall slowing of demand for finished textiles, so that cotton prices are also declining despite the restrictions in supply. That said, until now cotton consumption had been increasing dramatically over the last decade and still remains high by historical standards.

Questions looking to the future

It is not possible to predict with accuracy just how the economic situation is going to affect apparel sourcing and impact on workers worldwide. However, we can point to some questions and possible trends to watch for.

Will lower consumer prices mean lower prices at the factory level?
The most likely trend amongst apparel brands and retailers will be to download risk and costs to other parties wherever possible. Further, some buyers may re-negotiate or cut orders or payments on orders mid-way through production. This will impact on workers in the form of increased demands for increased labour flexibility and pressure for reductions in wages, bonuses or other financial benefits.

Will lower sales mean less volume of orders?
US imports hadn't fallen off as of October, but we started to see imports decline in November which, for the most part, carried on dropping in December. It's very likely that we will see more decreases in the very near future. New orders are likely declining significantly, although the data is not in yet, so it's impossible to see just how significant a decline we can expect.

What is more alarming for Southern manufacturers in the immediate term is the collapse of trust in trade financing. Retailers are seeking guarantees that manufacturers won't go out of business before shipping orders, while manufacturers are worrying about retailers going bankrupt before paying for orders. Banks are reluctant to back up either side – all of which makes it difficult to sustain a global trading system.

What kind of suppliers will maintain and attract orders in this climate?
This is difficult to predict. On the one hand, buyers will have even greater motivation to seek full-package suppliers, not only because of the downloading of logistical responsibility for production, but now also because full-package suppliers will be taking the risk in buying materials – rather than the brand buyer – for orders which may later be cancelled.

On the other hand, it's exactly these kind of full-package and high-tech facilities that will be having the most financial difficulty in this economic climate, for the same reason – they are carrying the inventories, the risk, and the debt for equipment investments made in anticipation of higher order volumes, which put them at greater financial risk compared to relatively low-cost cut, make and trim (CMT) factories.

Whether or not the brand buyers favour these full-package suppliers, they may still have trouble staying afloat in this economic climate.

Under these conditions, manufacturers will be increasingly unwilling to make major new investments in their factories – either because credit is unavailable or because they're unwilling to risk new investment without assurances of continuing orders.

As well, manufacturers that made investments in new equipment prior to the financial crisis in anticipation of continued orders may have difficulty making payments on their investments; yet manufacturers that did not make such investments may now find themselves unable to catch up to using more productive technologies and systems favoured by brand buyers.

Manufacturers looking to reduce costs may be tempted to outsource more production to smaller, fly-by-night subcontractors. Buyers will also have to be vigilant about the use of unauthorized subcontracting to ensure that production sourced from audited facilities isn't coming in through the back door.

What impact will exchange rates have on future sourcing patterns?
Since August of last year, the exchange rate for the US dollar is up in

comparison to the Mexican Peso. Depending on the direction the US dollar takes, it may mean that Mexican imports will be cheaper for US brands, making it a more attractive destination for sourcing.

Concurrently, the higher cost of the US dollar relative to the Peso may make Mexican national brands more attractive to Mexican consumers, although external inputs may be more expensive for Mexican manufacturers.

Some analysts point out that changes in the value of China's currency have likely had more impact on sourcing from that country than changes in labour costs. That is, the upswing in the value of the Chinese Yuan made apparel produced in that country more expensive compared to Bangladeshi or Vietnamese apparel, notwithstanding the lower wages in those countries.

With the value of the US dollar in flux relative to other currencies, the attractiveness of various producing countries can change. However it is hard to predict where this will go in the near future.

What impact will lower oil prices have on future sourcing patterns?

The price of oil has dropped considerably during the last six months, which reduces the cost of shipping – something that was becoming a factor in sourcing decisions earlier last year. It's not clear whether this is having implications for sourcing decisions at this point. Likely it will remove the price of oil as a major factor in sourcing decisions (notwithstanding environmental concerns), which eliminates some of the competitive advantage Mexico and Central American were developing in comparison to Asian countries, although there may still be an advantage in proximity to market based on the time it takes to get orders to market.

What impact will the crisis have on brand CSR programs?

Predictions on whether brands will continue to pay attention to ethical considerations in sourcing and continue to fund CSR departments within their companies are mixed. Some analysts fear that any gains made in corporate social responsibility will be considered "luxury" items by brands and that CSR departments will be shed while the brand focuses entirely on price.

Others note that when a brand is already struggling, it cannot afford a public scandal related to violations of workers' rights, and therefore strong CSR programs are still necessary.

Still others predict that any advances in CSR programs in this climate will be based on models that have a solid business case and can reduce costs at the same time; some examples include reducing costs by reducing energy use and material waste, or increasing collaboration with other brands on auditing to reduce audit costs.

As well, labour rights improvements that reduce employee turnover can increase productivity and therefore reduce costs, however, in a tightening labour market employee turnover may be reduced in any event as workers have fewer alternatives for employment.

Even where these kinds of efficiencies are welcomed, it's not certain that companies will see themselves as able to innovate when they're struggling to get by.

"In these difficult times," says CSR consultant Doug Cahn, "the question is whether or not large global brands will have the bandwidth and the wherewithal to evolve to more efficient and effective systems -- both in terms of the process used by companies to address workplace issues and the positive results these efforts are intended to have on workers."

What is very likely, in any event, is that advances in wages or improvements that produce *extra* costs for buyers will be strongly resisted.

Will trade liberalization continue?

With a new US administration and increasing pressure to create jobs at home, the effort to increase trade liberalization through new trade agreements or continuation of the Doha Round of World Trade Organization talks may suffer. Obviously this is a mixed blessing since some of the effects of past trade agreements have been particularly damaging to developing countries. But

for the apparel industry, duty-free access or reduced tariffs can mean the difference between sourcing in one country or another.

While the Obama administration is unlikely to demand the renegotiation of current trade agreements, despite all the campaign rhetoric, it is likely to refrain from signing new trade agreements in the near future while a study of the impacts of trade agreements on US workers and the US economy is undertaken.

Meanwhile, the new administration will be under pressure from US unions to take a tougher stand on the implementation of the NAFTA labour side agreement. This could offer some space for labour right groups in Mexico to pressure for improved enforcement of labour laws and regulations.

Indicators to watch for

Changes in US and EU imports
In particular, we should be on the lookout for signs of reduced order volumes overall, and from various countries. The most useful tool currently available to measure changes in order volumes is government data on the volume of imports into the EU and USA. In addition, groups in each producing country could be tracking local or national media and other business information sources for indications of how local or national manufacturers are faring in the new climate. (This is especially important for countries that have other significant markets besides the USA, e.g. national markets, the importance of which will not be picked up in US import data.)

We should also pay attention to the impact, if any, of the removal of US safeguards on imports from China, which was completed at the end of 2008. The question of whether this removal will affect the share of US imports that come from China will not be clear until well into 2009. The US still has the option to impose additional safeguards up until December 10, 2013, or it can initiate anti-dumping investigations or countervailing duties if it suspects that China is subsidizing exports to the USA.

It seems likely that there will be some continued attempts to limit Chinese exports to the USA. In December, 2008, for example, the Office of the United States Trade Representative (USTR) and Mexico launched a dispute at the WTO claiming that China still offers a range of subsidies for branded exporters across a wide range of industries including apparel and textiles, which they say include "cash grant rewards for exporting, preferential loans for exporters, research and development funding to develop new products for export, and payments to lower the cost of export credit insurance."

Differences in price versus volume of US imports
Tracking prices paid for units of apparel by brand buyers is always difficult – but we can track general trends in the coming period by watching whether the customs value of particular types of imported items (e.g. cotton pants) changes relative to the volume being imported from each country into the USA. This could indicate either that consumers are switching to lower-priced items or retailers, or that brands and retailers are squeezing suppliers even further on price.

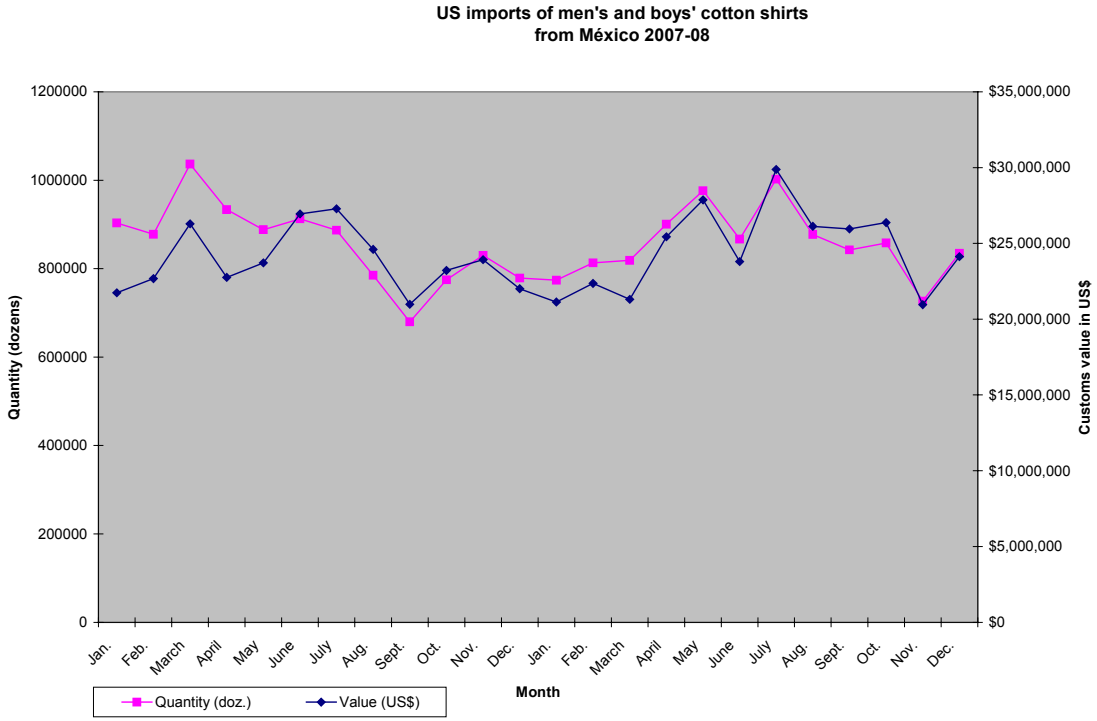
Changes in government subsidies for domestic production
Countries that seek to support domestic production may provide subsidies to their suppliers, which may make orders from those factories more competitive internationally – unless other countries follow suit.

China, for example, had been reducing supports for garment and

textile production, but has recently reinstated export tax rebates in the textile sector and is promising more tariff and trade policies to support the industry.

Alternately, some governments may seek new trade barriers to protect domestic industries. Indonesia has recently instituted new barriers to imports of garments, shoes and electronics, aimed at limiting the effect of Chinese imports on local producers.
Changes in the volume of the national Mexican apparel market
Labour rights groups in Mexico may want to watch – through media, government or business sources – for any news on the state of the national apparel market in Mexico. We had earlier predicted that it was growing in importance for consumers and that a growing number of suppliers were producing for the Mexican market rather than for export. This may be especially true if imports become more expensive.

Changes in currency exchange values
In a financial crisis, the relative value of various currencies can change dramatically. When currencies rise in value relative to the US dollar, a country's exports become more expensive for US buyers. When they fall in value, a country's exports become less expensive – and therefore more attractive for sourcing.



CSR reports due this year from major brands
Gap, Nike, adidas, Wal-Mart and others are planning to release CSR reports this year. Undoubtedly they will make reference to how they plan to maintain CSR programs and practices in a changing economy. Such reports may shed some light on how they see the role of good labour practices in bad times as well as in good times. Some of the key reports due include: Levi-Strauss: late February 2009; Gap: June 2009; Nike: September 2009; Adidas: March 2009; Wal-Mart: April 2009

What kind of products are selling?
Will fast fashion products with short turn-arounds be less important in the current economic climate? Will there be a shift to basics? While these are near impossible to predict at present, the type of apparel most in demand will also impact where sourcing is done.

Pushing for workplace improvements

Much of the so-called "business case" for improvements in wages and working conditions has previously been made by calculating the value of retaining satisfied employees for longer – which reduces training and recruitment costs, increases productivity, and increases quality.

Where general unemployment increases dramatically, employee retention may be less difficult for manufacturers and therefore we can anticipate that employers will be even less willing to improve conditions based solely on the "business case".

However, there is still an argument to be made that better productivity and quality control could be a critical factor in maintaining orders in an increasingly competitive environment, therefore arguments for workplace improvements that can be related to improvements in productivity and quality could still be made.

Making the case for improvements in the minimum wage and/or factory wage will be increasingly difficult in the current climate for obvious reasons. However the argument could still be made (largely to governments) that better wages in the hands of low-income workers is the surest and most productive form of economic stimulus.

We anticipate that there will be more use of short-term contracting and flexibilization, not less. Demands for the elimination of short-term contracting will become difficult – and yet will be even more critical, so that workers have the full legal protections and job security (such as it is) that is available to permanent workers.

In the event of factory closures – which we expect will increase in number – it seems even more likely that adequate financial provisions for severance payments or other benefits will not be made, as companies around the world are trying to reduce pension obligations or other regulations which require them to tie up funds; and, even where they have tied up funds, those funds were often invested in markets that have seen huge losses. We anticipate that the fight to ensure legal obligations are met and that manufacturers provide transitional assistance for displaced workers will be increasingly necessary.

Pressure on unions in light of increasing factory closures will become more intense – either to eliminate existing unions, prevent unions from forming, or to resist worker demands in collective bargaining. It will also be more difficult to prove that a particular closure was motivated by the existence of a union or a union organizing effort. Yet the need for organized efforts by labour has never been greater.

Lastly, Northern consumer and union movement support for worker rights improvements in the South may fall off as attention shifts to domestic unemployment and other concerns. Efforts to effectively illustrate the need and efficacy of international solidarity in a period of worldwide economic crisis will be increasingly important for organizations committed to labour rights.



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