STRENGTHENING NICARAGUA'S POSITION IN THE TEXTILE-APPAREL VALUE CHAIN: UPGRADING IN THE CONTEXT OF THE CAFTA-DR REGION

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Executive Summary

This study examines the competitiveness of the textile-apparel sector in Nicaragua, with the objective of producing a diagnosis of the textile – apparel industry in Nicaragua and the United States, an assessment of the opportunities and obstacles to upgrading, and concrete proposals for steps to be taken in the short and medium term. The research team from the Center on Globalization, Governance & Competitiveness at Duke University (Durham, North Carolina, USA) carried out field research in Nicaragua between September 30 and October 12, 2010, which included interviews with 19 textile and apparel companies in the country, as well as interviews with numerous governmental, labor, and other institutional actors connected with the industry. The results of this fieldwork, and extensive statistical and background analysis, are presented in this report.

The textile and apparel industry has been one of the pillars of export-oriented industrialization throughout the world since the 1970s. However, the industry has experienced two shocks in recent years that have intensified international competition in this sector. The first shock is regulatory: the Multi-Fiber Arrangement (MFA), which established quotas and preferential tariffs on apparel and textile items imported by the United States, Canada, and many European nations since the early 1970s, was phased out by the World Trade Organization (WTO) between 1995 and 2005 via its Agreement on Textiles and Clothing. This elimination of quotas facilitated the expansion of large, low-cost suppliers in the global apparel industry, most notably China. The second crisis is economic: the global recession that began in 2008 has dampened demand in the United States and other advanced industrial economies, leading to production slowdowns and plant closures in most apparel-exporting economies.

The geography of apparel trade has been changing as a result of the MFA phase out and the rise of regional trade agreements such as NAFTA (1994) and the CAFTA-DR agreement (2006). While China has been dominant in the global apparel market, some CAFTA-DR countries have been among the leading second-tier suppliers. Nicaragua has gained substantial ground within CAFTA in the last several years in specific segments like woven cotton trousers, largely because it was the only CAFTA country to receive Tariff Preference Levels (TPLs) that guarantee preferential access to the U.S. market for a certain quantity of apparel sewn in Nicaragua from materials that do not meet CAFTA's rules of origin. These TPLs were granted to Nicaragua for a 10-year period, due to expire in 2014. While Nicaragua's exports to the United States have increased since the implementation of the CAFTA-DR agreement, other countries within Central America and Mexico as well have seen substantial declines in their exports.

The apparel industry is known as a "buyer-driven" value chain, which is an international subcontracting model in which the most valuable activities in the apparel chain are not related to manufacturing per se, but are found in the design, branding, and marketing of the products. These activities are performed by lead firms, which are large global retailers and brand owners in the apparel industry. In most cases, these lead firms outsource the manufacturing process to a global network of suppliers. A key feature of the apparel value chain in recent years is that global buyers have been demanding their suppliers to have “full-package” capabilities that go beyond the assembly or “*maquila*” model that has been common in Mexico and Central America in the past. Thus, one of the objectives of our research project was to assess the degree to which firms in Nicaragua possess the full-package capabilities that many lead firms tend to require of suppliers. More broadly, our aim was to identify Nicaragua’s position in the apparel value chain in terms of the kinds of relationships that exist between local firms, foreign buyers, and either local, regional, or international suppliers of inputs such as textiles.

The Duke research team carried out interviews with 19 firms that collectively represent 30% of the companies in the apparel sector, 66% of apparel employment in the Nicaraguan Free Zone System, and 47% of total Free Zone employment. Interviews focused on the two main segments of Nicaragua’s apparel industry: the manufacturers of knit apparel and woven apparel. There are various distinctions to be made between knit and woven producers: for example, knit manufacturers are more global, they are growing faster, and they do mainly full-package or own-brand manufacturing. The manufacturers of woven apparel that are active in Nicaragua are less global than their knit counterparts and they display a greater diversity of production models.

The knit manufacturers in Nicaragua tend to produce large volumes of relatively basic knitwear products, such as t-shirts and polo shirts, for a range of clients, including discount retailers like Wal-Mart and Target as well as established fashion brands like Ralph Lauren. Among this set of companies are the three largest employers in the free trade zone sector, which collectively employ 16,300 workers. These three firms represent almost one-third (29%) of total apparel employment in the country’s free trade zones. The woven apparel manufacturers in Nicaragua focus on trousers, mainly denim jeans and twill pants. In terms of employment, the factories making woven apparel are, on average, smaller than the companies manufacturing knits. The largest among this set of firms is also one of the newest; employing 3,900 workers between three plants, it is the only company of Nicaraguan origin that we interviewed. Companies of U.S. origin dominate this group (6 of 10): two companies have capital of Mexican origin; one factory is owned by a Taiwanese firm; and the remaining company is Nicaraguan. Our sample of firms is generally representative of the Nicaraguan free trade zone sector, though Asian-owned companies are somewhat underrepresented in our sample. Overall, 29% of the factories operating in the free trade zone sector are Korean-owned and an additional 5% are Taiwanese owned.

We identify several challenges as well as opportunities confronting the Nicaraguan apparel industry. Nicaragua already enjoys a number of institutional advantages that distinguish it from the Asian countries such as Bangladesh and Vietnam that are considered to be its main competitors. Chief among these is a more mature industrial relations environment and a better record of labor rights enforcement. These institutional advantages have been strengthened by the Tripartite Agreement in Nicaragua’s Free Trade Zone System, which is creating an ongoing dialogue among the industry’s main stakeholders about how to preserve and increase Nicaragua’s competitiveness while simultaneously ensuring that workers benefit from the industry’s growth. The very existence of the Tripartite Agreement, and the degree to which it is viewed as a positive development among all the relevant stakeholders---industry, organized labor, government—is again indicative of Nicaragua's unique position among the many developing countries competing in the global apparel industry. Nicaragua should continue to emphasize its positive industrial relations environment, the cooperative relationship forged between the private sector, the unions, and government, and the institutional capacity of government organizations, such as CNZF and ProNicaragua, which were widely praised in our firm interviews.

Given these strengths, Nicaragua should take advantage of the opportunities provided by the International Labor Organization's (ILO) Better Work Program, which could increase Nicaragua's profile among the ranks of global apparel exporters. The rationale behind Better Work is that there is not an inherent trade-off between competitiveness and labor compliance, but rather that improving worker-management cooperation and working conditions and encouraging social dialogue, along with technical support, can improve efficiency and thus enhance competitiveness. Nicaragua should use the ILO's Better Work Program to improve the competitiveness of its factories, and to encourage a "race to the top" rather than avoid a "race to the bottom" by going beyond simple compliance with minimum labor standards. An important element of this relationship is to encourage the ILO to work with global buyers who import from Nicaragua to provide more tangible incentives for social upgrading, but doing so in a way that more fully enlists local stakeholders. In addition, as we note in our recommendations, there is a need for the Nicaraguan government to work in conjunction with the ILO and its U.S. government supporters to tailor the Better Work Nicaragua program to the more advanced industrial relations environment that Nicaragua enjoys relative to some of the other countries in which Better Work is being implemented.

The single most important challenge facing the industry in terms of upgrading Nicaragua's position in the global value chain for apparel, and therefore the issue receiving the greatest detail in terms of our specific recommendations, is developing a regional textile base capable of sustaining a competitive apparel industry. This is linked to the growing importance of full-package production as an increasingly dominant production model that more and more U.S. buyers want to use as global supply chains become increasingly consolidated. From the vantage point of the apparel manufacturer, the implications of full-package are twofold. First, under the full-package model, suppliers are expected to finance the purchase of the piece goods and other inputs required to fill an order from the buyer. This underscores the importance of manufacturers having access to adequate and affordable credit so that they can finance the purchase of fabric and other inputs. Second, the manufacturer needs to be able to access high quality, cost competitive textiles for its full-package orders. When a country's exports are receiving preferential access to an import market under a special trade regime, as is the case with Nicaragua's exports to the U.S. under CAFTA-DR, then manufacturers must also ensure that the fabrics they are using comply with the rules of origin established in the relevant trade agreement.

There are multiple issues at stake in terms of shoring up the textile segment of the value chain, and these are discussed in Section VI of our report, and also alluded to in the specific recommendations listed below. Overall, what is needed is a multi-pronged strategy with the goal of deeper CAFTA-DR integration, both in terms of relationships among countries within the region and in terms of the region's relationship with the United States. This goal should be pursued via several complementary action items, which focus on strengthening Nicaragua's textile base at multiple levels.

While our report discusses in detail the findings that lead us to these conclusions, our specific recommendations for strengthening Nicaragua's position in the apparel value chains are as follows:

1. **Working with other countries in the region to strengthen the regional supply chain via an overall strategy of CAFTA-DR Integration.**

2. **Strengthen the textile base on which Nicaragua's apparel manufacturers depend**. This includes several specific proposals.

    - **Actively pursue the extension of tariff preference levels (TPLs).** The TPLs that Nicaragua received under the CAFTA-DR are set to expire in 2014. Their renewal, and preferably expansion, are critical for Nicaragua's apparel manufacturers, for the U.S. buyers sourcing from Nicaragua, and for the U.S. textile firms that benefit from the "one to one" policy that incentivizes the use of U.S.-formed bottom-weight fabrics, as explained in our report..

    - **Make more aggressive use of existing opportunities within the CAFTA-DR framework.** These include: 1) the commercial availability mechanism, which allows for the use of non-originating fabrics that are determined to be in "short supply" within the CAFTA-DR signatory countries; and 2) cumulation with Mexico, which permits woven fabrics formed in Mexico to qualify as originating under the CAFTA-DR.

    - **Pursue the possibility of developing local textile production.** The main objective is to establish textile plants in Nicaragua that fit the needs of the apparel firms exporting from the country. The government's investments in alternative sources of electricity are a step in the right direction of developing the infrastructure necessary to sustain an internationally cost-competitive textile industry within Nicaragua.

3. **Support the development of full-package production among local firms.** This recommendation includes two proposals:

    - Policymakers within Nicaragua, perhaps working with counterparts in other CAFTA-DR countries, should work to make financing available to creditworthy companies so that they can afford to finance full-package production for the U.S. buyers that are looking for this option.

- Increased cooperation between the public and private sector so that the government training program, INATEC, is responsive to the needs of the local industry. Particular emphasis should be placed on increasing the supply of individuals with skills that are in high demand, such as mid-level managers and supervisors.

4. **Market your institutional strengths.** Government officials as well as private sector actors need to aggressively market the advantages that Nicaragua offers investors and clients. These include well-regarded organizations such as the CNZF and ProNicaragua, and innovations such as the “ventanilla única” system. Reform of existing procedures should be considered where there is room for improvement (e.g., Customs regulations and procedures).

5. **Continue to improve the industrial relations environment and promote social dialogue.** The marked progress that Nicaragua has made in improving labor rights enforcement and promoting a mature industrial relations regime should be sustained, as should the efforts of the Tripartite Commission to promote cooperation between the government, organized labor, and the private sector.

6. **Support the creation of a Better Work Program Nicaragua that reflects local conditions and enlists stakeholders in its development and implementation.** The opportunities that Better Work offers to simultaneously increase the productivity of the workforce as well as the quality of the work experience should be embraced, but the Nicaraguan government should also work with supporters of Better Work to ensure that the program builds on the strengths, and addresses the weaknesses, that are specific to the Nicaraguan context.

7. **Pursue economic diversification.** Nicaragua should pursue opportunities for expanding its manufacturing and service sector into other activities, while simultaneously working to increase the competitiveness of its textile and apparel sector.

I. Background and Objective of the Consultancy

The current study was conducted at the request of the Nicaraguan government, and specifically of the Secretariat of the National Free Zones Commission (CNZF). Officials at CNZF wanted a diagnostic study of the strengths and weaknesses characterizing the Nicaraguan apparel industry, and the prospects for strengthening the competitiveness of the industry, particularly in the context of the CAFTA-DR trade agreement with the United States. Through resources provided by the U.S. Agency for International Development (USAID) and its local program "Nicaragua Empresas y Empleo" (carried out by CARANA), the Center on Globalization, Governance & Competitiveness (CGGC) at Duke University in Durham, North Carolina was commissioned to carry out this study.

It is important to highlight the relevance of the textile – apparel sector within the Nicaraguan Free Zone System. At the end of 2009, this sector accounted for 51,850 jobs, the equivalent of 72.6% of all employment generated by the System. Furthermore, 64 out of 138 companies (46.4% of all companies) in the Free Zone System belong to the textile – apparel sector, and in 2009 alone they invested an additional US$15.2 million (25.5% of the total investment for the Free Zone in 2009). During that year, nine new apparel manufacturing firms were established in free zones across the country.

In 2009 the Free Zone Commission took concrete measures and critical action oriented towards strengthening the investment climate in Nicaragua and improving the competitiveness of its export sector. Among these were the creation of a One Stop Shop for Free Zone Services (known as "ventanilla única") to improve customer service, facilitate processing and simplify procedures for investors, and the signing of an emergency economic and labor agreement aimed at saving jobs and promoting labor stability in the System, and attracting responsible investment that guarantees the creation of more and better jobs.

The objective of the current study is to produce a diagnosis of the situation of the textile-apparel industry in Nicaragua, including an assessment of Nicaragua's position within a regional apparel value chain, which includes other apparel-producing countries in Latin America exporting to the U.S. market. It concludes with an assessment of the opportunities and obstacles to upgrading the textile-apparel industry in Nicaragua, and concrete proposals for steps to be taken in the short and medium term. Implementation of these recommendations is expected not only to improve the competitiveness of the industry in Nicaragua, but more broadly to strengthen the apparel value chain in the Americas, including the textile and apparel sector in the United States.

II. The Global Apparel Industry: Recent Trends

Textiles and apparel rank among the most important export industries in the world. They also are among the most global of industries because the majority of nations produce for the international textile and apparel market. Apparel production is a springboard for national development, and often is the typical starter industry for countries engaged in export-oriented industrialization due to its low fixed costs and emphasis on labor-intensive manufacturing (Gereffi and Memodovic, 2003).

Although the global apparel industry has been expanding at a rapid rate since the early 1970s and providing employment to tens of millions of workers in some of the least-developed countries in the world, the industry has experienced two major crises in the past five years. The first crisis is regulatory. The Multi-Fiber Arrangement (MFA), which established quotas and preferential tariffs on apparel and textile items imported by the United States, Canada, and many European nations since the early 1970s, was phased out by the World Trade Organization (WTO) between 1995 and 2005 via its Agreement on Textiles and Clothing. The concern of many poor and small developing economies that relied on apparel exports was that they would be pushed out of the global trading system by much larger, low-cost rivals, such as China, India, and Bangladesh.

The second crisis is economic. The recent global recession, which was sparked by the banking meltdown in the United States in 2008 and quickly spread to virtually all of the major industrialized and developing economies, brought the world to the brink of the most severe economic crisis since the Great Depression of the 1930s. Plant closures and worker layoffs in the industrialized nations led to slumping consumer demand, which resulted in fewer orders and shrinking markets for export-oriented economies in the developing world. The recession hit the apparel industry especially hard, leading to factory shutdowns, sharp increases in unemployment, and growing concerns over social unrest as displaced workers sought new jobs (Gereffi and Frederick, 2010).

Global expansion of the apparel industry historically has been driven by trade policy. Apparel is one of the most protected of all industries, ranging from agricultural subsidies on input materials (cotton, wool, rayon) to a long history of quotas under the General Agreement on Tariff and Trade within the MFA and its successor pact under the WTO, the Agreement on Textiles and Clothing (ATC) (Adhikari & Yamamoto, 2007). The MFA/ATC restricted exports to the major consuming markets by imposing country limits (quotas) on the volume of certain imported products. The system was designed to protect the domestic industries of the United States and the European Union (EU) by limiting imports from highly competitive suppliers in developing countries, such as China (Thoburn, 2009).

The removal of quotas on January 1, 2005 marked the end of over 30 years of restricted access to the markets of the European Union and North America. Retailers and other buyers became free to source textiles and apparel in any amount from any country, subject only to a system of tariffs and a narrow set of transitional safeguards that were set to expire at the end of 2008. This caused a tremendous shift in the global geography of apparel production and trade and a restructuring of firm strategies, as companies sought to realign their production and sourcing networks to accommodate new economic and political realities (Tewari, 2006).

While the last decade has been characterized by the liberalization of global garment trade and the restructuring of production networks between importers and developing-country suppliers, regional trade agreements have also played a major role in strengthening competitive ties between the United States, the largest apparel market in the world, and its main trading partners. The North American Free Trade Agreement (NAFTA), which was signed in 1994, and the U.S.-Central America and Dominican Republic Free Trade Agreement (CAFTA-DR), which went into effect in 2006, were both intended to improve the competitiveness of the U.S. textile industry as well as apparel exporters from Mexico and the Caribbean Basin, in the face of the rapid growth of low-cost apparel exports coming from Asia and other regions in the developing world (see Gereffi, Spener and Bair, 2002).

Table 1 shows the growth of U.S. apparel imports from 1990 until 2009, and it reflects the rise and fall of various apparel suppliers in response to the factors outlined above. Total U.S. apparel imports more than tripled between 1990 and 2005, from $21.9 to $68.7 billion. Although China was the leading exporter at the beginning of this period ($2.74 billion), the CAFTA-DR countries collectively were in second place with 52% of China's apparel export total in 1990. By 2005 this percentage had increased to 60%. By 2009, however, China's U.S. apparel exports accelerated much faster than its rivals, and were nearly four times those of the CAFTA-DR countries, and seven times greater than Mexico's apparel exports to the U.S. market in the same year.

Total U.S. apparel imports fell from a peak of $68.7 billion in 2005 to $63.1 billion in 2009. This reflects the impact of the deep global economic recession in 2008-09. From a regional perspective, Mexico and CAFTA-DR both experienced sharp declines in their share of U.S. apparel imports between 2000 and 2009: Mexico's exports fell from 15% to 5%, while the exports of the CAFTA-DR countries, taken as a group, decreased from 16% to 10%. During this same period, China enjoyed dramatic growth in its share of U.S. apparel imports, from 8% in 2000 to 22% in 2005 and 37% in 2009. Vietnam also burst onto the scene during the past decade, going from no apparel exports to the U.S. in 2000 to U.S. import shares of 4% in 2005 and 8% in 2009. While CAFTA-DR and Mexico have been losing import market share since 2000, China, Vietnam, Bangladesh and Cambodia were all gaining ground.

[Table 1 about here]

Given the intense competition revealed by these international trade shifts, upgrading strategies in the global textile and apparel value chain are extremely important for the long-term viability of the industry in developing countries. The apparel industry has been characterized as a "buyer-driven" value chain, marked by power asymmetries between the producers and global buyers of final apparel products (Gereffi and Memodovic, 2003). The most valuable activities in the apparel value chain are not related to manufacturing per se, but are found in the design, branding, and marketing of the products. These activities are performed by lead firms, which are large global retailers and brand owners in the apparel industry. In most cases, these lead firms outsource the manufacturing process to global networks of suppliers.

Beginning in the 1970s, East Asian suppliers extended their upgrading opportunities in the apparel value chain from simple assembly to a series of new roles that included OEM (full-package) production, ODM (design), and OBM (brand development) stages (Gereffi, 1999). As intangible aspects of the value chain (such as marketing, brand development, and design) have become more important for the profitability and power of lead firms, "tangibles" (production and manufacturing) have increasingly become commodities. This has led to new divisions of labor and hurdles if suppliers wish to enter these chains (Bair, 2005).

The main stages of functional upgrading in the apparel value chain are described below (Gereffi & Frederick, 2010):

- **Assembly/CMT/"*maquila*":** A form of subcontracting in which garment sewing plants are provided with imported inputs for assembly, most commonly in export processing zones (EPZs). CMT stands for "cut, make and trim" and is a system whereby a manufacturer produces garments for a customer by cutting fabric provided by the customer and sewing the cut fabric into garments in accordance with the customer's specifications. "*Maquila*" is a term widely used in Latin America to refer to this same assembly process. In general, companies operating on a CMT basis do not become involved in the design of the garment, but are merely concerned with its manufacture. Under CMT, a factory is simply paid a processing fee, not a price for the garment, and uses fabric sourced by, and owned by, the buyer.

- **Original Equipment Manufacturing (OEM)/Package Contractor:** A business model that focuses on the manufacturing process. The contractor is capable of sourcing and financing piece goods (fabric) and trim, and providing all production services, finishing, and packaging for delivery to the retail outlet. In the clothing industry, OEMs typically manufacture according to customer specifications and design, and in many cases use raw materials specified by the customer.

- **Original Design Manufacturing (ODM)/Full Package with Design:** A business model that focuses on design rather than on branding or manufacturing. A full package garment supplier carries out all steps involved in the production of a finished garment—including design, fabric purchasing, cutting, sewing, trimming, packaging, and distribution. Often, a full package supplier will organize and coordinate: the design of the product (typically in collaboration with the buyer); the approval of samples; the selection, purchasing and production of materials; the completion of production; and, in some cases, the delivery of the finished product to the final customer.

- **Original Brand Manufacturing (OBM):** A business model that focuses on branding rather than on design or manufacturing; this is a form of upgrading whereby companies move into the sale of own brand products. For many firms in developing countries, this marks the beginning of brand development for products sold in the home or neighboring countries.

The desire of buyers to reduce the complexity of their own operations, keep costs down, and increase flexibility to enable responsiveness to consumer demand has spurred the shift from CMT to OEM and ODM package contractors. For developing economies, the shift from assembly to full-package production is an overarching objective in order to maintain competitiveness in today's global economy, especially in terms of being able to supplier particular kinds of buyers.

III. The CAFTA Context

For several decades, apparel production has been a central manufacturing activity for countries in Central America and the Caribbean. Exports from these countries, sometimes referred to as the Caribbean Basin region, have enjoyed preferential access to the U.S. market under a variety of special trade regimes with the United States that encouraged assembly subcontracting networks (also referred to as *maquila* production). Traditionally, companies in the United States were able to export cut parts of garments to lower-wage countries for assembly and re-import under a regime known as production-sharing, or ''807 production'' (for the numbered clause of the U.S. trade law that governs this type of offshore assembly arrangement).

The 807 trade law (now clause 9802), provides preferential access to U.S. firms importing garments assembled offshore from fabrics cut in the United States, with duty assessed only on the minimal value-added abroad. A 1986 amendment of the 807/9802 clause, known as 807A, further benefitted some countries in the western hemisphere by giving them virtually limitless quotas known as Guaranteed Access Levels (GALs) if they exported apparel assembled from fabrics both cut and formed in the United States. When it was created in 1986, the 807A revision applied to the countries of the Caribbean Basin, and was known as the "Special Access Program." It was extended to Mexico's maquiladoras in 1988 under the name of the "Special Regime."

In the 1990s, however, the 807 production/*maquila* model began to be superseded by new regional agreements. Beginning in 1994, the North American Free Trade Agreement initiated free trade among Canada, the United States, and Mexico for all products that meet NAFTA's North American rules of origin. A key provision of NAFTA are the rules of origin in a given industry that govern what kind of products qualify as "originating" within the trade bloc. In the case of NAFTA, any garment assembled in a NAFTA country from fabric is eligible for duty- and quota-free treatment to another NAFTA market as long as it contains yarn and fabrics produced in any of the signatory countries. The special access to the U.S. market that Mexico enjoyed after NAFTA led to a dramatic increase in Mexico's profile among the leading suppliers of apparel to the United States. In the late 1990s, Mexico even briefly eclipsed China as the number one exporter of apparel to the U.S. market.

Manufacturers in the region's other major apparel-exporting nations, the Caribbean and Central American countries, worried that exclusion from NAFTA would hurt the competitiveness of their garment exports, which were, unlike Mexico's, still subject to the value-added tariff. The efforts of the Caribbean Basin countries to secure “NAFTA parity” resulted first in the passage of the United States–Caribbean Basin Trade Partnership Act in May 2000, and finally in 2004 culminated in the successful negotiation of the Dominican Republic-Central America Free Trade Agreement (hereafter CAFTA-DR). The countries participating in the CAFTA, which include the United States, Costa Rica, Dominican Republic, Honduras, Guatemala, El Salvador, and Nicaragua ratified and implemented the treaty individually, which meant that it became operative in different member countries at different times. In Nicaragua, CAFTA-DR entered into force in April 2006.

Overall, CAFTA has helped maintain the position of Central American and Caribbean exporters among leading suppliers of apparel to the United States. Within CAFTA, the Dominican Republic and Costa Rica have witnessed significant decline in their exports to the United States, but these declines have been more than offset by growth in shipments from Honduras, Guatemala, and, most recently, Nicaragua. While the Dominican Republic was responsible for over a third of the CAFTA-DR region’s apparel exports in 1995, by 2009 its share of the regional total had fallen to 10%, making it second to last among CAFTA country exporters, ahead only of Costa Rica.

As Table 2 shows, in both 2005 and 2009 Honduras ranked first among CAFTA exporters to the United States. El Salvador and Guatemala continue to rank second and third behind Honduras and ahead of Nicaragua, but it is important to underscore that **Nicaragua is the only country in the CAFTA region whose exports to the United States increased in value between 2005 and 2009.** While in the former year Nicaragua claimed only 8% of the region’s apparel exports to the United States, by 2009 that percentage had almost doubled to 15%.

[Table 2 about here]

There are several key dimensions of CAFTA that are necessary to summarize here:

Rules of origin: The rules of origin for CAFTA are yarn-forward. This means that CAFTA countries enjoy preferential access to the U.S. market for all apparel that is sewn in a member country from fabric either woven or knit from yarn extruded within the CAFTA region.

De minimus: The yarn-forward rule of origin allows that qualifying apparel articles may contain materials that are not from the CAFTA region, and those products are still considered as originating from CAFTA, providing that the weight of the non-qualifying material does not exceed 10% of the total garment by weight.

Tariff Preference Levels (TPLs): Given the lower cost, greater availability, and in some cases better quality of Asian fabrics, an additional provision of CAFTA allows Nicaragua to receive preferential access to the U.S. market for a certain quantity of apparel sewn in Nicaragua from materials that do not meet CAFTA’s rules of origin. Nicaragua was the only CAFTA country to receive these co-called Tariff Preference Levels (TPLs), and the maximum amount of non-originating garments that are permitted to enter the United States under the terms of CAFTA is 100 million square meter equivalents (SMEs) per year. The CAFTA also specified that TPLs would be granted for a 10-year period, meaning that they are due to expire in 2014. This preference has been extremely important for Nicaragua, given the absence of domestic textile production in the country and the limited availability of cost-competitive fabrics being produced in the Americas.

The "one to one" rule: To ensure a benefit in return for its concession on the TPLs, the United States added an additional condition to the TPLs for trousers made of woven fabrics. This condition is known as the "one-to-one" rule. Under this rule, each shipment of pants made from woven fabrics (either cotton or man-made fiber) that is imported under Nicaragua's TPL allowance must be matched with a shipment of pants made from fabric woven in the United States from yarns extruded in the United States. The quantity of pants subject to the one-to-one rule has grown over time, and in 2009 it applied to the first 50 million SMEs. Any shortfall in the commitment is then charged against the TPL for the succeeding year, thus reducing the volume of garments made from non-originating fabrics that can be given duty-free access the U.S. market.

Cumulation: The mechanism of cumulation with Mexico and Canada allows garments made in Central America or the Dominican Republic from fabric woven in these countries to qualify as originating under the CAFTA. The amount of Mexican- or Canadian-made fabric that can be used in CAFTA-qualifying garment is limited to 100 million SMEs, although the provision allowed for the possibility that this cap could be increased to 200 million SMEs, contingent on growth in CAFTA trade volumes.

Commercial Availability Provision (also known as "short supply"): This mechanism allows the apparel and textile industry to petition for duty-free access for garments that do not meet the CAFTA rules of origin on the grounds that the fabric or yarn used in the garment cannot be supplied in the region in an adequate and timely manner or is unavailable from regional suppliers in sufficient quantity.

In 2009, 83% of Nicaragua's exports to the United States entered the country duty-free under a variety of different special trade regimes. Over a third of exports (35%) entered under the regional rules of origin established by CAFTA, while 47% of exports were imported under the TPLs granted to non-originating exports. Only 1.3% of exports were eligible for duty-free treatment under the short supply list, and less than 1% of Nicaragua's exports used the cumulation provision of the CAFTA.

IV. Nicaragua's Textile and Apparel Value Chain: Key Production Models, Market Segments, and Institutional Players

In order to assess the opportunities and challenges of the Nicaraguan apparel sector, it is necessary to identify the various actors and institutions involved in the industry, their relationships with each other, and their linkages to other key players in the textile and value chain, including clients and suppliers. We highlight two kinds of apparel factories:

those that produce knits and those that manufacture woven fabrics. This distinction is significant because the value chains for these two types of apparel products are quite distinct.

Some elements of this contrast are visible in Table 3, which shows leading exporters of both woven and knit apparel to the United States. In 2009, China was the leading supplier of both kinds of garments to the U.S. market, although the value of woven clothing imported by the U.S. exceeded the value of knit garments. In rank order, the next five largest exporters of knit apparel to the United States in 2009 were CAFTA-DR (all countries combined), Vietnam, Indonesia, Cambodia and India.

[Table 3 about here]

The composition and rank order of leading exporters of woven apparel varies, however. After China, the leading exporters of woven apparel are Bangladesh, Mexico, Vietnam, Indonesia and India. The six CAFTA-DR countries, taken together, rank seventh among exporters of woven apparel, just after India. Thus, two countries that are not among the leading exporters of knit apparel are nevertheless among the most important suppliers of woven apparel (Mexico and Bangladesh), while two suppliers that are among the top five exporters of knit apparel do not appear among the leading exporters of woven products (the group of CAFTA-DR countries and Cambodia).

A more detailed portrait of knits versus wovens, and the trends in each, emerges in Table 4, which shows U.S. imports of knit shirts from leading suppliers. As in the case of woven imports, China is the number one exporters of knit apparel to the United States. The set of CAFTA-DR countries is the second largest exporter of cotton knit shirts to the United States after China. In value terms, China and the CAFTA countries are far ahead of the third and fourth largest exporters of knit shirts, Vietnam and Indonesia, respectively. In addition, the CAFTA-DR countries' import market share increased between 1995 and 2009 from 14% to 19%. However, this growth rate is far less spectacular than the increase in market share that China achieved over the same period (4% to 22%). Table 4 also shows that U.S. imports of knit shirts from CAFTA decreased between 2005 and 2009, while imports from China more than quadrupled. As the bottom of Table 4 indicates, among the CAFTA countries, Nicaragua is the third most significant exporter of knit shirts, behind Honduras and Guatemala.

[Tables 4 & 5 about here]

In woven apparel, the most significant category of apparel exports is men's and boys cotton trousers, which consists primarily of jeans and twill pants. The CAFTA countries rank fourth among leading exporters of woven pants, behind China, Mexico, and Bangladesh. As Table 5 illustrates, the region has witnessed a sharp decline in its share of this U.S. import market. In 1996, the CAFTA countries collectively claimed 27% of the market, whereas by 2009, that percentage fell to just 5%; China and Bangladesh are the main beneficiaries. Among the CAFTA countries, Nicaragua is the largest exporter of woven trousers to the United States, having surpassed the Dominican Republic whose U.S. exports collapsed since 2005.

The distinction between woven and knit apparel is also relevant for understanding backward linkages from apparel manufacturers to textile suppliers. This distinction is represented in Figure 1, as indicated by the arrows showing the flow of fabric from textile mills in various countries to the two main types of Nicaraguan apparel factories.

[Figure 1 about here]

Figure 1 represents a simplified, schematic version of the key actors and relationships in the Nicaraguan value chain. At the top of Figure 1 are three key actors that influence the organization and geography of the textile and apparel value chain globally, including Nicaragua's participation in it. As discussed above, the global garment trade has long been influenced by a variety of different trade regimes negotiated multilaterally (e.g., the MFA, and more recently, the World Trade Organization's Agreement on Textiles and Clothing), regionally (e.g. the CAFTA-DR and NAFTA treaties), or bilaterally (e.g., the U.S.-Cambodia Textile Agreement). The U.S. government is included here because of the importance of trade policy in shaping the apparel value chain. U.S. policymakers have the power to negotiate certain provisions to agreements, such as the TPLs that are a major theme of this report, and in this sense critically affect where the United States' apparel imports come from and how they are produced.

Of course, U.S. trade policy for textile and apparel products affects industry actors, and these companies try to influence government officials to pursue policies that are consistent with their interests. The branded manufacturers and retailers that have established global sourcing networks for apparel in every region of the world are represented in Figure 1 as U.S. buyers, and they are critical players in the global value chain for apparel. As shown by the dotted arrows in Figure 1 extending from the Nicaraguan apparel factories to the U.S. buyers, these companies also provide the orders that generate production and employment in Nicaragua.

The last key actor included in the U.S. portion of the diagram are textile mills, which have been significantly impacted by the liberalization of the global garment trade and, given the decline in U.S. domestic apparel production, they are increasingly dependent on sales to apparel manufacturers abroad. For manufacturers of woven fabric, Central America and Mexico are major markets, as the solid arrow extending from the U.S. textile mills to the woven apparel manufacturers in Nicaragua suggests. This arrow is labeled "1 to 1" to refer to the CAFTA requirement that each SME of non-originating woven fabric exported to the United States under CAFTA's TPL provision be matched by an SME of U.S.-formed woven fabric.

Finally, the double-headed arrow from the U.S. government to the Better Work program of the International Labor Organization (ILO) indicates that the United States has been an active supporter of this program, which seeks to promote the competitiveness of low-income countries in global apparel value chains by improving efficiency and compliance with best labor practices. As we will discuss in greater detail below, Nicaragua is one of the countries in which the Better Work program is being implemented, and funding for this initiative is provided by the Department of Labor in the United States. (The Better Work program is described in Appendix F.)

Moving from the top to the left side of the diagram, we have included a number of countries that are important for the Nicaraguan apparel industry, both as competitors and also as suppliers of textiles. Mexico, which has enjoyed free trade with the rest of North America since 1994, has a large textile and apparel sector, although it is overwhelmingly concentrated in the production of denim bottoms (blue jeans), and to a lesser extent, denim fabric. While Nicaraguan apparel manufacturers compete with Mexican clothing firms for orders from U.S. buyers, they also import denim (albeit in relatively small amounts) from Mexican mills, as suggested by the arrow extending from the Mexican textile factory to the Nicaraguan woven apparel manufacturer.

While Nicaragua currently lacks a domestic fabric base to support its apparel industry, it is able to import fabric from textile mills elsewhere in the CAFTA region. Of particular importance is Honduras, which is not just a major exporter of apparel to the U.S. market (and thus, like Mexico, a competitor for Nicaragua's apparel firms), but also supplies Nicaraguan companies with fabrics. Unlike Mexico, which is home to numerous mills producing denim, Honduras is strong in knit fabrics, as indicated by the arrow representing fabric exports from Honduras to the manufacturer of knit apparel in Nicaragua.

To the right side of the diagram are firms in Asia, the region that has emerged as the center of gravity in the global garment trade (see Section II above). Like other countries in Latin America, Nicaragua is competing with various Asian countries for the orders of U.S. buyers, especially since the phase-out of the MFA quota regime in 2005. Of particular importance for Nicaragua are Bangladesh, Vietnam, and Cambodia. However, Asia is also critically important for Nicaraguan textile and apparel value chain because its highly diverse and cost-competitive textile industry supplies a significant percentage of both the knit and woven fabrics used for the production of apparel in Nicaraguan factories (see Sections V and VI below).

One important player in the Nicaraguan value chain with a strong Asian connection is Alpha Textil, a Taiwanese-based company that converts and finishes greige goods[1] into twill fabric, which is then sold to companies making pants in Nicaragua. As the arrows in Figure 1 demonstrate, some of the fabric that Alpha converts is imported from U.S. manufacturers of greige goods, while Alpha also imports this raw material from countries in Asia. It is important to note here that the twill fabric that Alpha produces from greige goods formed in Asia do not meet CAFTA's rule of origin. When apparel manufacturers export garments made from this non-originating source, they must either use TPLs or pay duty.

[1] Textiles that have not received any bleaching, dyeing or finishing treatment after being produced by a textile process (pronounced as "gray" goods).

Last but not least, the bottom of Figure 1 lists local stakeholders that are also important players in the Nicaraguan value chain, and ones that directly impact the experience of workers, another set of stakeholders who are illustrated in Figure 1 by the people located beneath each of the factories. Workers are most directly represented by unions. Nicaragua has a vibrant labor movement, and multiple unions represent workers within the apparel sector. Of the 19 interviews we conducted with firms (see Section V below), more than half (11 companies) reported the existence of at least one union in the factory, although the percentage of workers belonging to unions varied dramatically across plants, from approximately 10% to 80%. Compared with other lower- or middle-income countries with large apparel-exporting industries, Nicaragua boasts a particularly active and independent trade union movement. We return to the theme of organized labor and industrial relations below in our discussion of the ILO's Better Work program and its implementation in the Nicaraguan context.

The private sector is represented by the Nicaraguan industry association for textile and apparel companies, ANITEC (Asociación Nicaragaüense de Industria Textil de Confección). Of the 19 companies we interviewed, only two were not members of ANITEC. The majority of companies evaluated membership positively. Most regarded the organization to be an effective representative of the industry's concerns and an important source of information about developments affecting the sector, although this view was not unanimous. In addition, ANITEC itself is a member of a relatively recent regional industry association, CECATEC (Consejo Empresarial Centroamericano de Textil y Confección), and it also belongs to Nicaragua's main multi-sector business association, COSEP (Consejo Superior de la Empresa Privada en Nicaragua).

The final institutional actor in Figure 1, the Nicaraguan government, influences numerous aspects of Nicaragua's apparel value chain, including through the enforcement of laws and regulations relating to labor, customs, and trade. Although we will not discuss in detail the numerous bodies and officials that together comprise the government stakeholders represented in Figure 1, we have included brief appendices that summarize the primary roles and responsibilities of four organizations that our research suggests are particularly important. The information contained in these indices is based largely on interviews we conducted during our fieldwork in Nicaragua with officials from these organizations: Comisión Nacional de Zonas Francas (CNZF) (Appendix B), Ministerio de Trabajo (Appendix C), Instituto Nacional Tecnólogico (INATEC) (Appendix E), and ProNicaragua (Appendix F).

In response to the dislocations to the industry caused by the U.S. recession and the consequent decline in orders from foreign buyers, the Nicaraguan government, private sector, and organized labor signed an Emergency Economic and Labor Agreement in March 2009. This agreement created the Free Zone Tripartite Labor Commission as a forum for dialogue and cooperation between the parties with the goal of strengthening the industry and preserving jobs in the textile and apparel sector. The Agreement was signed by seven labor leaders, two representatives of the private sector, and two government officials. It established specific minimum wage increases for 2009 and 2010 (8% and 12% increases, respectively). It also mandated the government and private sector to work together to establish commissaries that will provide workers basic commodities, such as cooking oil, beans, and rice, at lower prices than could be found in retail outlets.

In January 2010, the same stakeholders signed the Social Labor Agreement of the Free Zone Tripartite Commission. In addition to committing to the parties to a broader set of objectives than were included in the initial agreement, and establishing a regular schedule of meetings for the Commission to evaluate the degree to which these objectives are being met, the Commission established increases in the minimum wage levels for workers employed in the free zone sector for 2011 (8%), 2012 (9%), and 2013 (10%). A copy of the January 2010 Tripartite Agreement is included as Appendix G of this report.

V. Results of Firm Interviews

During our fieldwork in Nicaragua, we interviewed a total of 19 companies. With the exception of one, which is a converter of woven fabrics, all were engaged in the manufacture of either woven or knit apparel. In numerical terms, these 19 companies represent approximately 30% of the total number of companies manufacturing apparel in Nicaragua under the CNZF regime. However, these companies represent 47% of all jobs in Nicaragua's free trade zone sector, and if we consider apparel-only CNZF employment specifically, this set of firms accounts for 66% of the total. The firms we interviewed were selected in consultation with officials from the CNZF, and every effort was made to interview a sample of firms that was representative of the sector in terms of ownership and product type.

In this section, we summarize the main findings of our firm-level interviews, focusing on the main firms that populate Nicaragua's apparel industry, the type of production activities that are carried out locally, and how the supply chains of local firms are organized in terms of sourcing the fabrics that are being cut, sewn, and finished in Nicaraguan factories. As noted above, the apparel industry can be divided into knit and woven segments, and we have organized the discussion of our sample of firms accordingly.

Knit Manufacturers

Of the 19 companies that we interviewed, eight are manufacturers of knit apparel. This group is composed of two different types of companies: The majority of companies (six firms of eight) produce large volumes of relatively basic knit garments, mostly tops, for a range of clients, including discount retailers like Wal-Mart and Target as well as established fashion brands like Ralph Lauren. Among this set of companies are the three largest employers in the free trade zone sector, which collectively employ 16,300 workers. These three firms alone represent almost one-third (29%) of total apparel employment in the country's free trade zones. For the most part, the six manufacturers of knit shirts that we interviewed have a global manufacturing presence. All have production in at least one other country in the region (Mexico or another CAFTA country) and four of the six have manufacturing in Asia as well. Two firms in our sample of eight knit companies differ from the shirt manufacturers described above because, although they also manufacture knit apparel (specifically athletic wear and intimate wear), they are producing a very large number of higher value-added products in small volumes. (One of these companies manufactures as many as 300 different styles a year.) Table 6 presents key indicators of the eight knitwear firms included in our sample.

[Table 6 about here]

All of the companies in the knit sample are either full-package producers or manufacture their own brands of apparel in addition to doing some subcontracting of private label (store brands) for retailers. Several reported that 2009 had been a difficult year, due to the recession in the United States and slumping demand, with one firm noting that production volumes dropped as much as 40% between 2008 and 2009. However, six of eight companies reported that their plants were operating at 100% production capacity at the time of our interviews in late September-early October 2010. One company had actually grown substantially over the preceding year from 300 employees to 1,400 employees. Another was in the process of an expansion that will add 500 workers and increase production volumes by 50%. However, several companies mentioned that although business has been steady in terms of the volume of orders, there is intense pressure on price from buyers. One t-shirt maker described a change in the industry beginning around 2005: “Before I didn’t have to work that hard to get orders. They came to me, and sometimes I would turn a client away because I didn’t need it. Now, a buyer tells me, here is the price—do you want the order or not? It’s like an auction.”

In terms of capabilities, the factories manufacturing knits perform a range of activities. At one end, there are basic cut-and-sew operations, and in the case of one company, this is restricted just to sewing, since the parent company is cutting the fabric in the same Honduran mill where it is knitted. However, a majority of the firms we interviewed provide some kind of finishing services, such as embroidery and screen printing. At least one company reported that it also does pattern-marking, although no firms reported design capabilities or other kinds of pre-production activities. Half of the companies (four out of eight) reported being WRAP-certified (Worldwide Responsible Accredited Production is an industry-organized certification system).

In terms of interactions with local stakeholders, companies generally reported positive interactions with CNZF and ProNicaragua, while assessments of Nicaraguan Customs were more mixed. One manager that we interviewed praised these organizations, and said his only advice to them was “please continue.” However, two companies expressed dissatisfaction with the time and cost of Customs procedures. In addition one company was highly critical of the uneven administration of the various industrial parks that house free trade zone companies, some of which are privately owned. In this case, the factory felt that the owner of the park had been unresponsive to the needs of his tenants, but the companies producing in the park had no real recourse. In addition, two companies made reference to recent changes in the interpretation of Nicaraguan labor law regarding the policy for indemnification (i.e. does a worker have the right to pro-rated indemnification if he or she has worked for less than a year?), and the so-called 4x4 work model, which is currently used in one company. Under this system, production employees work four consecutive 12 hour days, followed by four days off. Although the previous administration did not object to this practice, officials at the current Labor Ministry (Ministerio de Trabajo) believe that it is inconsistent with legal protections mandating an eight hour workday and requiring overtime pay for additional hours. All companies that expressed a view regarding the Tripartite Agreement approved of it, declaring it a positive development that is already helping to stabilize the industry.

Turnover among production workers at the knit firms we interviewed varied dramatically. On the low side, the company manufacturing intimate wear, which is a flexible plant organized around modular production, reported turnover of less than 12% per year. Two manufacturers of knit shirts reported turnover rates of between 120% and 132% annually. No clear pattern emerged with regard to a correlation between turnover rates and reported wages, the presence or absence of a union, or the location of the factory (urban versus more municipal town or rural area). Although the small sample size makes it difficult to generalize about the factors that might explain either very low or very high turnover rates, it appeared that among this set of companies, those offering more generous fringe benefits, such as transportation to and from the factory and subsidized lunch in an on-site cafeteria, enjoyed lower turnover.

Unsurprisingly, there was a correlation between turnover rates and productivity: companies having turnover rates above 60% a year reported lower productivity than their counterparts with lower turnover. One company reported that it had begun conducting exit interviews with workers to try to understand the reasons that they left, and on the basis of these interviews concluded that some workers left to pursue educational opportunities while others migrated to Costa Rica in search of agricultural work, though this tended to be more seasonal. The practice of “pirating” workers from near-by companies did not appear to be as serious a problem in Nicaragua as it has been in the export-processing sectors of some other countries in Latin America.

Due to the relatively high degree of overall turnover in the industry, companies are able to find workers with sewing experience. Two of the firms manufacturing knit shirts reported that they provide no training to operators. Training periods varied across other factories from two weeks to two months, with the average training period lasting for about one month. In one of the factories we visited, training varies from four to as many as 16 weeks, depending on the operation. Training was carried out in-house. Although several companies reported using INATEC (see Appendix D) in the past and expressed general satisfaction with its training services, none seemed to be doing so at the same time of our interviews. One company reported that INATEC has not been accepting new requests for training services since September 2010.

The availability and price of fabric emerged as an important issue during our interviews with the knit manufacturers. The relevant CAFTA rule of origin for companies manufacturing knits is yarn-forward. This means that garment exports to the United States qualify for CAFTA preferences as long as the yarn used to knit the fabric was produced in either the United States or one of the CAFTA countries. With the exception of one company, all of the knit manufacturers that we interviewed rely on TPLs for at least some portion of the fabric they use. However, the percentage of garments requiring TPL varies substantially by company. The company in our sample making intimate wear uses large amounts of Lycra-based fabrics, and a majority of the textiles that it needs are sourced in the United States (55-60%), with the remainder coming from Asia, Mexico, and Central America. The firm whose major product is sportswear reports requiring synthetic fabrics that are not readily available in the United States, though it does have one supplier in El Salvador, which uses a mix of both CAFTA-originating (i.e. regional) and non-regional yarns.

Among the six manufacturers of knit shirts that we interviewed, a pattern emerged of higher TPL reliance among companies based in Asia (our sample included two companies of Korean origin and one company with corporate headquarters in Hong Kong), as compared with those based in North America (two companies are headquartered in the United States, and one is Canadian). For the North American companies, the percentage of TPL needed ranged from 0% to 30% of total production. For the Asian companies, this percentage ranged from 50% to 100%. In the latter case, all of the knit fabric used in the Nicaraguan assembly operations is produced by the parent company's textile plant in China.

Interestingly, four of the six shirt companies are using a regional production model that involves Nicaraguan sewing factories and Honduran knitting mills. In other words, the knit fabrics sewn in Nicaragua are produced in Honduras, either in owned-and-operated facilities belonging to the parent company or by an independent supplier. This fabric is shipped by truck from Honduras to the Nicaraguan factories, which typically involves about a day of transportation time. Although the fabric is produced in another CAFTA country (Honduras), the shirts sewn in Nicaragua do not necessarily qualify as CAFTA-originating because some of the yarn used in the Honduran mills comes from outside the region. For this reason, companies using this regional production model may still require TPLs for some portion of their production.

Relatively little of the knit fabric being sewn in Nicaragua is imported from the United States (less than 10%). As Table 7 suggests, Asian suppliers are the most important sources of the knit fabric sewn in Nicaragua's factories, accounting for 80% of the total in 2009 (and over 90% of the total earlier in the decade). Although the value of fabric imports from Hong Kong has fallen in recent years, shipments of knit fabric from Korea and China have increased. Between 2005 and 2009, China's exports of knit fabric to Nicaragua grew from $19.2 million to $63.2 million—an increase of 229% in five years. However, Asia's share of knit fabric imports as a percentage of the total has actually declined over the same period, as regional exporters gain import market share. The percentage of total knit fabric imported from regional suppliers (U.S. and other CAFTA countries) increased from 12% in 2005 to 20% in 2009.

However, the percentage of knit fabric provided by regional suppliers is almost certainly underreported here. Some Central American countries have inconsistently reported their exports, and this table is based on individual country-level data regarding exports. For example, although we know that Honduras is an important source of knit fabric for Nicaraguan manufacturers, exports from Honduras to Nicaragua are not reported in the United Nations Comtrade trade data we used for this report.

[Table 7 about here]

In spite of the growth of regional suppliers of knit fabric in Nicaragua's import profile, local manufacturers remain heavily dependent on non-originating fabric. Three of the eight companies in our sample of knit firms mentioned specifically that the future of their operations in Nicaragua depended on the renewal of TPLs. In conclusion, the limited availability of CAFTA-qualifying inputs remains a significant issue for knitwear companies. Although this problem is perhaps less acute for knit apparel than for wovens because of the availability of some regionally produced and CAFTA-qualifying fabric, each of the firms we interviewed acknowledged that the TPL issue was critical. Although a number of the companies included in our sample of knit firms are vertically integrated back to knitting, the textile portion of this production process is not located within Nicaragua, but rather elsewhere in the region, or in Asia. The high cost of electricity in Nicaragua was cited as a factor impeding the domestic production of knit fabrics. .

Looking ahead, Nicaragua will likely confront stiffer competition from Haiti in the future, particularly since the TPLs for Haiti (which at 400 million SMEs per year are four times greater than those granted to Nicaragua) extend until 2018. Historically, knit apparel has been the mainstay of the Haitian apparel industry; currently 77% of its apparel exports to the United States consist of knit garments, although the production of woven pants is increasing. One of the companies in our sample of knit manufacturers already has sewing operations in Haiti in addition to its factory in Nicaragua, and another of the knit manufacturers that we interviewed is planning a major investment there.

Wovens Manufacturers

Ten of the companies that we interviewed manufacture woven apparel, specifically denim jeans and twill pants. In terms of employment, the factories making woven apparel are, on average, smaller than the companies manufacturing knits. The largest among these firms is also one of the newest; employing 3,900 workers between three plants, it is the only company of Nicaraguan origin that we interviewed. Companies of U.S. origin dominate this group (6 of 10): two companies have capital of Mexican origin (one is 100% Mexican-owned and a second is a U.S./Mexico joint venture); one factory is owned by a Taiwanese firm; and, as noted above, the remaining company is Nicaraguan (see Table 8).

In comparison with the knits group, this set of firms is somewhat less global. Of the 10 companies interviewed, four do not have any owned-and-operated production facilities outside Nicaragua, although one has a subcontractor in Mexico. Of the remaining six, three have operations in Mexico, one has a factory in El Salvador, one has a factory in Honduras, and the other has a factory in Cambodia. The remaining company, which is the Nicaraguan subsidiary of one of the world's largest blue jeans manufacturers, is something of an outlier, since its parent company has a global manufacturing presence, including production facilities throughout Asia and Latin America.

[Table 8 about here]

The main U.S. clients for this group of firms are varied and include Cintas (2), Levis (2), VF (2), JC Penney (2), and Wal-Mart (2). As compared with the knits group, a greater diversity of production models is represented among the manufacturers of woven garments. Of the 10 companies we interviewed**,** just under half (four) are doing 100% full-package production. One is a manufacturer engaged in own-brand production, and the remaining five work as subcontractors (*maquilas*) for their clients. Three companies are dedicated exclusively to *maquila* production at this time (one provides contract laundering services for a branded jeans manufacturer producing locally), and the fourth company's business is currently divided between *maquila* (50%) and full-package production (50%).

Contrary to the stylized upgrading trajectory within the apparel industry, which assumes a move from maquila to full-package production, two of the companies we interviewed have moved in the opposite direction (i.e., to lower levels of processing, which can be considered a form of downgrading), and switched from full-package production to assembly subcontracting. Full-package production became too expensive for these companies to sustain, given the rising costs of woven fabric (reflecting an increase in cotton prices) and the lack of accessible, affordable credit to finance these textile purchases.

The problem of finding adequate credit was repeatedly mentioned by firms, including by a company that is currently working as a subcontractor for larger local firms, but would like to diversify into modest volumes of full-package production for new clients. Although most companies expressed the view that full-package capabilities have become a necessary but not sufficient condition for success in the apparel industry (see Section II), one pants manufacturer stressed that his company had no interest in making the transition to full-package production.

The majority of companies manufacturing woven apparel offers some services beyond cut and sew, most typically the laundering that is a standard part of the production process for jeans and some twill pants. However, not all companies perform laundering in-house. Some subcontract this out to other local firms, and one manager we interviewed reported that the pants his company sews in Nicaragua are laundered in Honduras. Several companies also reported providing various pre- and post-production processes as well, including pattern-marking and grading and some product development – all indicative of product and process upgrading in the apparel value chain. The manager of a company manufacturing uniforms reported that his facility in Nicaragua is one of the only factories in the global sourcing network of its main client, a large U.S. uniform company, that is used for product development, and that this is a major source of the firm's competitive advantage vis-à-vis low cost rivals in Asia. Five of the 10 companies in the sample of wovens manufacturers are WRAP-certified, and this includes both maquila and full-package firms.

Four out of 10 companies in this group reported that current production volumes are less than 100% capacity. Like the knits manufacturers, several firms reported significant declines in production over the past 12 to 18 months. However, there was significant variation within this group in terms of production and employment trends. Over the course of 2009, one company consolidated production from six factories into two. Another firm, which makes woven bottoms (pants and skirts), experienced a sharp drop in employment between 2004 and 2010 (from 2,400 to 1,200 workers). However, some companies report recovery and even expansion during 2010. Two firms are currently planning to increase production volumes and employment levels by 25% and 50%, respectively.

We asked one of the companies that experienced robust growth during 2010 how it managed to double its production volume over the course of the last year. The manager of this firm, which makes uniforms, replied that during the period of economic crisis, it increased the number of styles it was producing fivefold: “We are producing more, with more complicated styles, but also a higher value-added product…Send it and we will make it. We don’t say no to anything.” Another manager echoed this sentiment, explaining that his company’s strategy has been to become “faster, flexible, and [produce] more styles.”

The manufacturers of woven apparel, like the knit firms, emphasized the pressure of low prices on their profit margins, and attributed this primarily to the sourcing practices of buyers. Two companies put the decline in prices over the last two to three years at 10%-20%. Full-package manufacturers, who purchase the fabric used in the production process, remarked that they are absorbing a significant portion of the increase in cotton textile prices. Several companies also commented on the rise in labor costs caused by the government-mandated minimum wage increases that have occurred under the current presidential administration. Two companies emphasized the implication of rising wages for their competitiveness; both are firms dedicated exclusively to maquila production, meaning that labor is their most significant production cost.

Amidst these concerns about the implications of the minimum wage increases for labor costs, several companies also noted the positive development of the Tripartite Agreement (Appendix G). Companies that commented on the Agreement regard it as a proactive effort on the part of the government to help bring stability and predictability to the environment in which firms are operating. A widespread perception is that the government was motivated to pursue the Tripartite Agreement in response to a wave of job losses in the industry, most notably those precipitated by Nien Hsing’s decision to abandon its sewing operations in Nicaragua in 2008, leading to a loss of some 14,800 jobs. The decision to negotiate an Agreement with the private sector and organized labor in the wake of these events is regarded as an indication of the government’s commitment to the industry.

Similar to the knit firms, companies reported that, among government agencies, they had the most interaction with the CNZF and to a lesser degree ProNicaragua. These organizations were evaluated positively, while some concerns were expressed about the speed of Nicaraguan Customs. One company with production in Honduras as well as Nicaragua observed that the same paperwork for Customs processing takes approximately four to five times longer in Nicaragua than Honduras. One manager described his relationship with officials from the Labor Ministry as “not great.”

As was also the case with knit manufacturers, few companies reported using INATEC’s services. In both industry segments, the general impression of INATEC is that there is little connection between the kind of skills that are in demand among apparel and textile firms, particularly of a technical nature, and the kind of courses that are offered. Some of the major needs that firms expressed (for example, the objective of reducing turnover through better training of supervisors) are not well addressed. One manager with extensive experience in the industry remarked that INATEC offers “loads of training programs, but most of them are not very good,” going on to note that workers with particular technical skills, such as mechanics, are difficult to find in the local labor market. However, another company expressed a positive impression of INATEC, noting that of the five requests for training that it had submitted to the organization, only one had been denied. The manager of a firm producing uniforms reported that his company has made periodic use of INATEC’s services, including for the training of line supervisors. In this context, he went on to note the significant increase in pay associated with the promotion from sewing machine operator to line supervisor (from 4,500 cordobas to 10,000 cordobas per month). This company has three individuals on its managerial staff that began working in the factory as sewing machine operators, although this type of internal mobility appears to be more the exception than the rule among local companies.

Most companies provide training in-house, and the amount of time invested in initial training appears to be higher, on average, for the companies manufacturing wovens as compared with knits. Firms reported significant variation in the amount of training provided to workers, ranging from one to 40 weeks, depending on the type of job. Although two of ten companies interviewed reported training periods of two weeks or less, the average training period for production workers among this sample of firms is approximately eight to ten weeks. On average, turnover among this set of firms was lower than for the companies manufacturing knits. Four of the ten companies included in this sample reported turnover rates below 25% yearly. Two more companies have yearly turnover rates of 50%, while on the high end one pants manufacturer has a yearly turnover rate of 120%.

The companies we spoke with uniformly emphasized their perception that the denim being produced in the Americas is not cost-competitive when benchmarked internationally, making the continued availability of TPLs critical for the future of jeans manufacturers in Nicaragua. Two firms implied that the future of their operations in the country is contingent on TPL renewal, while two companies also implied that the availability of TPLs in Haiti, which aren't scheduled to expire until 2018 (four years later than in Nicaragua), make Haiti an attractive alternative to Nicaragua.

In contrast to the situation we described for knit apparel (i.e. a regional full-package model with fabric being formed in Honduras but sewn in Nicaragua), virtually all of the companies making woven pants are importing CAFTA-qualifying denim from the United States and denim from China under TPLs plus the one-to-one rule for woven fabric. Two companies reported using fabric produced in Mexico, although in general the cumulation provision of CAFTA that permits Nicaraguan manufacturers to use fabric woven in Mexico in CAFTA-qualifying garments appears to be dramatically underused, as shown in Table 9.

[Table 9 about here]

Companies that are manufacturing twill pants report buying at least some twill from the local converter, Alpha Textil. However because some of the greige goods Alpha imports and then finishes come from Asia, TPLs may be required for this fabric. Asian countries supply the majority of the cotton woven fabric used in Nicaragua's garment exports, although this percentage has declined in just the last five years from 81% to 63%. In contrast, the percentage of textiles imported from regional suppliers has increased dramatically over the same period, from 15% to 37%, with most of that increase driven by growth in imports from the United States. The United States increased its supply of Nicaragua's imports of cotton woven fabric from 2% in 2005 to 20% in 2010.

VI. Upgrading Options and Overcoming Obstacles for Nicaragua's Textile and Apparel Industry

In this section we highlight various issues that are relevant for understanding the opportunities and obstacles involved in strengthening Nicaragua's position in the global value chain for apparel. This analysis sets the stage for the specific recommendations that we make in the seventh and final section of this report.

The textile-apparel link: Where are the fabrics sewn in Nicaragua coming from and how is this relevant to industry competitiveness?

The most significant challenge that the industry in Nicaragua will need to confront in order to upgrade its position within the global value chain for apparel is increasing access of local manufacturers to high-quality, cost competitive textiles. Since a chain is only as strong as its weakest link, and the ability to afford and access fabrics and other inputs is an important component of the full-package production model increasingly favored by U.S. buyers, it is necessary to shore up the textile segment of Central America's apparel value chain so that Nicaragua and the other CAFTA-DR countries can more effectively compete with their Asian counterparts. It is critical to underscore that the objective of strengthening the textile link of the value chain is critical not just for Nicaragua's apparel manufacturers, but for all the CAFTA-DR countries, especially since the countries with which hemispheric exporters are competing, such as China, India, Bangladesh and Vietnam, are able to draw on the Asian region's well-developed textile base.

Currently, there is minimal textile production in Nicaragua. This is a disadvantage for Nicaragua vis-à-vis competitors because having local or domestic textile suppliers means a shorter supply chain for apparel companies, which, in turn translates into lower transport costs, faster delivery times and potentially fewer bottlenecks and delays in the production process. Nicaragua is home to one woven mill that was built by the U.S. textile company, Cone Mills (part of the International Textile Group). This facility operated for less than two years and is currently closed, though there are reports that it may reopen in the near future. Aside from the Cone Denim plant, the only other textile facility in Nicaragua is Alpha Textil, which produces twill from imported greige goods.

During our research in Nicaragua, we learned that plans are underway to stimulate cotton production. If this succeeds, it would be a valuable source of raw material for cotton textile producers in the country and in the broader CAFTA-DR region. Perhaps the most significant obstacle to the development of textile manufacturing in Nicaragua, however, is not necessarily the availability of the raw material, but rather the high cost of electricity. The government is well aware of this problem and is currently pursuing several ambitious projects to increase the amount and diversify the type of power generated in the country. Pursuing the development of alternative energy sources such as hydroelectric power reflects the government's commitment to developing more environmentally sustainable industries, and eventually these efforts may succeed in addressing the addressing the present problem of high energy costs.

Although there is virtually no domestic textile capacity in Nicaragua, the greater CAFTA region does not lack a textile base, as Table 10 indicates. There are a total of 33 textile mills located in Honduras, Guatemala, the Dominican Republic, and El Salvador. Although the CAFTA countries are stronger in knit fabric than in wovens, Mexico is home to 10 mills producing woven fabrics, and a great deal more of this fabric could be used in Nicaraguan exports to the United States under the terms of the cumulation provision of CAFTA. Admittedly, some of this regional textile capacity may be owned by vertically integrated manufacturers that are using most or all of the fabric to feed their own sewing operations. However, locating all possible sources of cost-competitive, quality fabrics that will qualify as CAFTA-originating should be a top priority for apparel exporters in Nicaragua and in the other CAFTA-DR countries.

[Table 10 about here]

To the extent that the competitiveness of other producers in the region is also contingent on the strength of the region's textile base and the preferential access to the U.S. market that CAFTA provides, it should be possible to forge collaborative relationships with neighboring countries. So far, however, little progress appears to have been made in this regard. For example, one of the arguments for the cumulation provision of the CAFTA-DR is that although the Central American countries are relatively weak in woven textiles, Mexico has a large number of mills producing woven fabric, mostly denim. Yet while the objective of the CAFTA-DR cumulation provision is to strengthen the textile and apparel industry in the Americas vis-à-vis Asian competitors, the use of the cumulation allowances provided in CAFTA has been dramatically underutilized thus far by Nicaraguan manufacturers. A similarly underexploited opportunity is the CAFTA-DR Agreement's commercial availability or "short supply" mechanism. As noted above, in 2009 less than 1.5% of Nicaragua's apparel exports entered the United States duty-free under the short-supply mechanism.

Even if the textile base supporting Nicaragua's apparel manufacturers was strengthened, either domestically via investment in local fabric production, or regionally via increased purchase by Nicaraguan manufacturers of textiles being produced elsewhere in the Americas, it is likely that many apparel producers would continue to source some textiles from outside the region. Indeed, since in many cases it is the foreign buyer and not the local manufacturer that specifies the type and origin of fabric to be used in a particular order, this is not a decision over which apparel manufacturers necessarily even have control, For this reason, it is important to underscore both the current dependence of Nicaragua's manufacturers on non-originating apparel, and the likelihood that these fabrics will continue to be important for local apparel firms.

The TPLs granted to Nicaragua under the CAFTA-DR have been critical in allowing Nicaraguan manufacturers to use non-originating fabrics and still remain competitive in the U.S. import market. Currently the TPLs are set to expire in 2014, and given long planning cycles, some companies indicated that they will begin to make future location decisions based on TPL availability as early as 2012. Although the ultimate decision regarding the renewal of TPLs will be made by U.S. policymakers, lobbying for their extension is critical. Several companies pointed out that the one-to-one rule may be useful in articulating the mutually beneficial nature of the U.S.-Nicaragua trade relationship. As one manager explained, in order to win the support of the U.S. textile industry for the extension of the TPLs, it is necessary to point out to the makers of woven textiles that "if the TPLs go away, so does the one-to-one rule. If you don't extend the TPLs, then you won't be able to make us buy your fabric."

Although some U.S. mills oppose the extension of TPLs because it permits non-originating fabric to receive duty-free access to the U.S. market, the best opportunity for the U.S. textile industry to strengthen its position vis-à-vis Asian competitors is to support apparel exporters in the Americas, since these countries are far more likely than Asian apparel exporters to use U.S.-made fabrics. Thus, the TPL plus one-to-one rule is a way to help Nicaragua compete for U.S. import market share with countries such as China and Bangladesh, which export garments made from Asian-formed fabrics, while at the same time helping insure a market for U.S. woven fabrics.

Given recent trends in U.S. textile exports, U.S. mills need strategies that can help stabilize their sales in foreign markets. Over the last five years, U.S. exports of cotton denim woven fabric have fallen by more than half from $443 million in 2005 to $214 million in 2009. As Table 11 illustrates, Nicaragua's imports of $14 million make it the

United States' third largest import market for cotton denim fabric, behind Mexico ($148 million) and Guatemala ($18 million). More importantly, Nicaragua is the only CAFTA country whose imports of U.S. textiles increased between 2005 and 2009. In 2005, Nicaragua's imports accounted for 1% of the total value of cotton denim fabrics CAFTA countries imported from the United States.

As Table 12 shows, Nicaragua's $14 million of imports represented 36% of the total imports of cotton denim fabric by all CAFTA countries in 2009. Again, it is important to underscore that growth in Nicaragua's imports is occurring in the context of an overall decline in fabric imports by the set of CAFTA-DR countries. U.S. exports of cotton denim to the CAFTA-DR region peaked in 2004 at $128 million; by 2009, total exports to the region had fallen precipitously to $39 million.

[Tables 11 & 12 about here]

As with cotton denim, the CAFTA countries are a critical market for exports of other fabrics knit in the United States; in 2009, CAFTA's imports of $365 million made it the second largest recipient of U.S. textiles, just behind Mexico ($367 million). Unlike in woven fabrics, Nicaragua is not among the major CAFTA importers of U.S. knit fabric. Nicaragua's $20 million of imports put it in last place among CAFTA countries. However, while imports from countries such as El Salvador and Honduras appear to have fallen in recent years, Nicaragua's imports remained steady.

[Table 13 about here]

In general, the U.S. textile industry has been severely impacted by trade liberalization, which has not just increased the quantity of garments that are manufactured abroad, but even more importantly, the phase-out of the MFA quota regime has led to dramatic increases in apparel imports from countries that are unlikely to use U.S. fabrics. With the exception of Hong Kong, no Asian country appears in Tables 11 and 13 as a major importer of U.S. woven or knit fabric.

Rather than view Nicaraguan TPLs as a zero-sum game in which third-country exporters benefit at the expense of U.S. textile firms, a strong case can and should be made to the United States that any measures that strengthen regional exporters are likely to strengthen the U.S. textile industry as well. Although many of the companies we interviewed pointed out that the one-to-one rule limits the access of local manufacturers to fabrics that may be less expensive than those made in the United States, a willingness to accept some version of the one-to-one logic may help cultivate a more cooperative relationship with the U.S. textile mills, and ultimately with the policymakers that will decide the TPL issue.

Firm-level capabilities: How prevalent are full-package capabilities in the Nicaraguan apparel industry?

Nicaragua cannot remain competitive on the basis of its labor costs alone. While it continues to offer the lowest labor costs among the CAFTA-DR countries and the second-lowest in the region (behind Haiti), it is unable to compete with countries such as Bangladesh and Cambodia for the cheapest needle. One way to differentiate Nicaragua from the other lower-wage countries with which it is competing is to increase the range of services that local firms are able to offer foreign buyers.

Our interviews with local firms yielded mixed results in terms of the capabilities manufacturers have developed and the services they can offer clients. A sizable minority of companies reports the ability to handle full-package orders for foreign buyers, and some are providing pre- and post-assembly services such as pattern-marking and grading and embroidery. Other companies, however, continue to offer basic cut-and-sew production.

The availability and the price of credit is the single most important factor affecting the viability of the full-package model at the company level. The challenge of financing full-package production is exacerbated by the purchasing practices of many U.S. buyers; these clients may take several weeks to pay their suppliers, thus increasing the amount of working capital that full-package manufacturers need. Full-package also entails greater risks for the manufacturer since the manufacturer, and not the client, owns the fabric throughout the entire production process and will therefore absorb any losses (for example, due to quality, problems with delivery, etc.). Several of the companies we interviewed reported that they were unable to access credit from local banks, and because their assets (namely, their factories) were located in Nicaragua, they were also unable to secure financing from foreign banks.

It is particularly important to understand the challenges that are confronting manufacturers seeking to make the full-package transition because, as discussed earlier, full-package production is becoming an industry standard, especially in certain market segments. For example, the ability to fill full-package orders is a necessary condition for accessing the sourcing networks of some leading jeans brands. This does not mean that there is no place in Nicaragua for companies engaged in *maquila* production. Indeed, in some niches of the market, such as uniforms, the *maquila* model may continue to be viable. However, our research suggests that even companies that are not offering full-package services (i.e., are not financing fabric purchases) are nevertheless trying to offer services beyond the traditional cut and sew model. These may include pattern marking and grading, or working with clients on product development.

In short, our assessment is that the traditional model of cut-and-sew subcontracting cannot sustain a viable apparel industry in Nicaragua. This does not mean that all companies must be able to finance full-package production, or that all manufacturers in Nicaragua need to offer the full range of firm capabilities associated with industry best practice. Some local companies can remain viable by serving as contract providers of particular services (e.g., laundering, screen printing) for own-brand or full-package manufacturers. However, this presumes a strong core of full-package companies that are able to generate demand for such services.

In addition to the challenge of securing adequate credit, firms seeking to make the full-package transition also need a local labor market with potential employees possessing relevant skills. In this sense, firm-level upgrading also depends on appropriate workforce development. There is already a well-funded training institution in Nicaragua in INATEC (see Appendix D). However, as noted above, our interviews suggested that most companies make sporadic use, if any, of its training services, which are not felt to adequately address the needs of the industry.

Industry and institutional context: Sustaining an improved environment for firms and workers through stakeholder engagement

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

In our interviews with firms and labor representatives, as well as in conversations with a variety of stakeholders, there was broad agreement that the industrial relations environment in Nicaragua has improved markedly in recent years. However, some concerns remain regarding freedom of association. Although it appears that these problems, where they occur, are primarily a firm-level phenomenon and do not necessarily indicate a pervasive or industry-wide anti-union culture, they nevertheless merit attention.

In keeping with the theme of building on Nicaragua's existing strengths, the ILO's Better Work program represents an opportunity to increase Nicaragua's profile among the ranks of global apparel exporters. Currently the Better Work program has been implemented in Cambodia, Haiti, Jordan, Lesotho and Vietnam in a variety of industries including apparel, agribusiness, construction, and light manufacturing. The United States has expressed a high level of commitment to supporting Better Work in Nicaragua. In October 2010, General Baltadano, the Presidential Delegate for Investment and director of the CNZF, attended a meeting in Washington D.C. to discuss the program with U.S. Secretary of Labor Hilda Solis. At this event, the U.S. Department of Labor announced a $2 million grant to support the program's implementation in Nicaragua.

The rationale behind Better Work is that there is not an inherent trade-off between competitiveness and labor compliance, but rather that improving worker-management cooperation and working conditions and encouraging social dialogue, along with technical support, can improve efficiency and thus enhance competitiveness. Nicaragua should use the ILO's Better Work Program to improve the competitiveness of its factories, and to encourage a "race to the top" rather than avoid a "race to the bottom" by going beyond simple compliance with minimum labor standards. An important element of this relationship is to encourage the ILO to work with global buyers who import from Nicaragua to provide more tangible incentives for social upgrading.

While we believe that the successful implementation of Better Work can heighten Nicaragua's profile among apparel exporters, we recommend two specific goals for the further development and implementation of this program, which is still in its early stages in Nicaragua. First, it is important to note that Nicaragua is not participating in this program because it is perceived by foreign governments or global buyers as a problem case in need of remedial attention. Because some of the other countries participating in Better Work, which are widely perceived as lagging in the area of protecting workers and enforcing labor laws, there is a danger that Nicaragua's inclusion in the program could be seen as an indication of weakness rather than strength. The Nicaraguan government has already indicated that it is aware of this risk, and while a certain part of the responsibility for clarifying the status of new entrants rests with the ILO, government officials and industry stakeholders in Nicaragua should continue to be proactive in distinguishing Nicaragua from other countries participating in Better Work.

Second, our research suggests that it will be necessary to more actively enlist the participation of local firms in the Better Work program. Buy-in from local manufacturers, not just from the foreign buyers and from the government, is critical for the success of the Better Work project. In July 2010, the first Better Work international buyers' forum was held in Nicaragua, and while the willingness of foreign brands to commit to the project's implementation in Nicaragua is important, it is equally important to enlist local firms as active stakeholders in the project. Our interviews with firms yielded very little evidence to suggest that local firms are meaningfully engaged in the development or implementation of Better Work. Several of the managers we interviewed were unaware of the program, while others were highly skeptical that it will produce any benefits for the industry, other than a possible decline in the number of compliance audits to which they will be subjected.

Finally, we would note the absence of the International Finance Corporation's (IFC) participation in the Better Work Nicaragua program. In principle, Better Work functions as a joint program of the IFC arm of the World Bank and the ILO, and the IFC is able to support new investment opportunities in countries that follow Better Work guidelines. Unless the Nicaraguan Better Work program takes full advantage of IFC participation in this model, the status of the program is diminished and the benefits of participating in

Better Work are less attractive. Since Better Work Nicaragua is still evolving, there is time to address these multiple concerns and build broader and deeper support for the program among the private stakeholders going forward.

VII. Going Forward: Proposals for Strengthening Nicaragua's Position in the Apparel Value Chain

Our final recommendations draw on the analysis presented in the preceding sections of the report. While they reflect our review of secondary literature, including trade data and published reports of trends within the apparel industry, both globally and in the CAFTA-DR region, they have been formulated with particular attention to the results of our fieldwork and firm-level interviews in Nicaragua during fall 2010.

1) **Integrate the textile and apparel value chain in the CAFTA-DR region and develop a long-term vision for sustaining the region's competitiveness.** Government officials and industry representatives in Nicaragua should take the lead role in encouraging, and if possible initiating, a dialogue with other governments and private sectors in the region about a long-term strategy to maintain the competitiveness of the textile and apparel value chain in the Americas. This will require a commitment by senior government officials of the CAFTA-DR countries to work with several key actors in the region's apparel value chain: the U.S. producers of yarn and fabrics; the yarn, fabric and apparel producers within the CAFTA region and Mexico; and the apparel brands and retailers who are their common customers.

2) **Strengthen the textile base on which Nicaragua's apparel manufacturers depend.** This recommendation includes four specific proposals:

   A. *Actively pursue the extension of TPLs*. It is critical to make the case to both U.S. government officials and the U.S. textile industry that any policy helping to keep apparel production in the Americas ultimately benefits the United States. More generally, the United States government has an interest in supporting export-oriented development in Nicaragua. This objective, and the progress that has already been made towards that goal, may be compromised if the TPLs are not extended.

   B. *Pursue the development of local textile production.* Although it will not be possible to make locally all the different types of fabrics that manufacturers may need, developing a domestic textile base is the best way to ensure the availability of at least some of the main fabrics that apparel makers in Nicaragua require. The government's plans to encourage cotton production and invest in new energy projects are promising steps that will eventually help make domestic textile production viable, but given the medium- to long-term nature of major infrastructural investments, temporary measures, such as providing electricity at concessionary rates to textile mills, may help address this problem in the near term.

C. *Make more aggressive use of CAFTA's short supply mechanism.* Though there are costs involved in attempting to have a fabric included on the short supply list (specifically the amount of time and money needed to present convincing evidence of limited commercial availability of a fabric or yarn), this option may be worth pursuing for certain manufacturers, especially those using fabrics made from man-made fibers.

D*. Explore the possibility of purchasing more fabric from Mexican mills under the cumulation provision of the CAFTA-DR.* Like the short-supply mechanism, this is an underused opportunity to access fabric that does not require TPLs.

3) **Support the development of full-package production among local firms.** This recommendation includes three specific proposals:

   A. *Improve local manufacturers' access to affordable credit.* Consistent with our overall recommendation to better integrate the textile-apparel value chain at the regional level, we would encourage a discussion of this issue at the regional level, perhaps as the first step in developing a CAFTA-DR program to address the challenge of credit and financing for local firms.

   B. *Address the workforce development needs of the industry by enlisting private sector stakeholders in the development and implementation of training.* Dialogue between the private sector and INATEC, which is an underused resource, would help improve INATEC's ability to support the industry. While we recognize that INATEC's institutional mandate is broader than simply servicing apparel firms or the free trade zone sector more generally, a transition to a more demand-driven model in which INATEC develops courses in consultation with companies would improve its contribution to all sectors in the economy.

   C. *Promote Nicaragua's market advantages for clients.* In addition to the lowest labor costs in the CAFTA-DR region, Nicaragua's geographic proximity to the United States and speed to market allows it to offer a combination of low-cost and quick-turn capabilities that few suppliers can match.

4) **Promote Nicaragua's institutional strengths.** Nicaragua should continue to emphasize its positive business environment and the institutional capacity of government organizations, such as CNZF and ProNicaragua, which were widely praised in our firm interviews. One area of concern that did emerge in our interviews was the complicated and time-consuming nature of Customs regulation and enforcement. Efforts to streamline these procedures where possible without weakening enforcement capacity would help insure that the government is seen as responsive to the needs of the private sector.

5) **Continue to improve the industrial relations environment and promote social dialogue.** Nicaragua has taken many positive steps to increase the cooperation of the government, private sector and trade unions. Given the institutional advances

already attained, it is important to sustain the progress that has been made on this front, and address remaining challenges, such as freedom of association, especially since participation in the Better Work program will bring increased attention to the question of labor rights and compliance.

6) **Support Better Work and Enlist Local Stakeholders.** Educating local manufacturers about the logic of the ILO-IFC Better Work program and explaining the opportunities that it provides for increasing competitiveness is important for securing their participation in the program. Building support among local stakeholders for the program is, in our view, a crucial condition for the success and sustainability of the program, but so is the fuller utilization of the World Bank's involvement in Better Work through its IFC financial arm.

7) **Pursue economic diversification.** While the textile and apparel industry is an important source of employment in Nicaragua's manufacturing sector, the intensification of international competition in this sector, and the shrinking role of CAFTA-DR in U.S. apparel imports, leads us to encourage an aggressive strategy of economic diversification. Some of these activities may be linked directly to textiles and apparel (like cotton), while others are only indirectly related (e.g. other types of light manufacturing and some services). ProNicaragua (see Appendix E) is a key local institution that is already pioneering these objectives.

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Table 1: U.S. Apparel Imports: Regional and Asian Suppliers, 1990-2009

Partner	Value (in US$ millions)					% of World Total Value				
	1990	**1995**	**2000**	**2005**	**2009**	**'90**	**'95**	**'00**	**'05**	**'09**
World	21,937	34,649	57,232	68,713	63,105					
China	2,739	3,518	4,499	15,143	23,503	12	10	8	22	37
CAFTA-DR	1,434	4,745	8,973	9,104	6,145	7	14	16	13	10
Vietnam	0.0	17	47	2,725	5,068	0	0	0	4	8
Bangladesh	429	1,067	2,116	2,372	3,410	2	3	4	3	5
Mexico	508	2,566	8,413	6,078	3,391	2	7	15	9	5
Cambodia	0.1	0.5	808	1,713	1,871	0	0	1	2	3
Total						**23**	**34**	**43**	**54**	**69**

Source: U.S Department of Commerce, Office of Textiles and Apparel (OTEXA): Imports by Country by MFA Category: Category 1: All Apparel.

Note: % represents a country or region's market share of the total value of U.S. imports of apparel from the world in a given year.

Table 2: U.S. Apparel Imports from CAFTA-DR, 1995-2009

	Value (in US$ millions)				% of CAFTA-DR Value			
Country	**1995**	**2000**	**2005**	**2009**	**'95**	**'00**	**'05**	**'09**
CAFTA-DR	4,745	8,973	9,104	6,145				
Honduras	919	2,323	2,622	2,032	19	26	29	33
El Salvador	582	1,583	1,619	1,298	12	18	18	21
Guatemala	682	1,487	1,816	1,103	14	17	20	18
Nicaragua	74	336	716	893	2	4	8	15
DR	1,731	2,425	1,849	613	36	27	20	10
Costa Rica	757	819	482	206	16	9	5	3

Source: U.S Department of Commerce, Office of Textiles and Apparel (OTEXA): MFA Category 1: All Apparel Imports.

Table 3: U.S. Apparel Imports, Knitted versus Woven, 2009

Partner Country/Region	Knitted Apparel		Woven Apparel	
	Value (US$ millions)	% World Total	Value (US$ Millions)	% World Total
World	**34,668**		**32,127**	
China	11,924	34%	13,442	42%
CAFTA-DR	4,930	14%	1,444	4%
Vietnam	3,022	9%	2,203	7%
Indonesia	2,226	6%	1,805	6%
Cambodia	1,340	4%	606	2%
India	1,307	4%	1,747	5%
Mexico	1,284	4%	2,224	7%
Pakistan	996	3%	--	--
Bangladesh	896	3%	2,614	8%
Thailand	786	2%	--	--
Sri Lanka	--	--	720	2%
Italy	--	--	761	2%
Top 10 Total		**83%**		**86%**

Source: UN Comtrade: HS 61 and 62 as reported; U.S. imports (CIF value).

Note: Top 10 countries in 2009; % represents a country or region's market share of the total value of U.S. imports of knitted or woven apparel from the world in a given year.

Table 4: U.S. Imports, Cotton Knit Shirts, 1995-2009

Partner Country or Region	Value (US$ millions)				Share (Value)	
	1995	2000	2005	2009	% '95	% '09
World	**4,301**	**9,079**	**12,382**	**12,492**		
China	180	208	636	2,786	4%	22%
CAFTA+DR	601	2,245	3,009	2,362	14%	19%
Vietnam	1	13	610	1,357	0%	11%
Indonesia	105	153	300	1,055	2%	8%
India	217	328	614	727	5%	6%
Cambodia	0	142	368	584	0%	5%
Pakistan	347	483	593	512	8%	4%
Mexico	279	1,374	950	497	6%	4%
Peru	99	313	644	447	2%	4%
Bangladesh	62	99	188	348	1%	3%
Top 10 % Total					**44%**	**85%**
Individual CAFTA Countries						
Honduras	236	882	1,115	729	5%	6%
Guatemala	83	531	899	678	2%	5%
Nicaragua	14	70	222	438	0%	4%
El Salvador	131	459	587	432	3%	3%
DR	91	260	183	84	2%	1%
Costa Rica	46	43	3	1	1%	0%

Source: U.S Department of Commerce, Office of Textiles and Apparel (OTEXA): 338/339 Total: M&B and W&G Cotton Knitted Shirts.

Note: % represents a country or region's market share of the total value of U.S. imports of M&B & W&G cotton knit shirts from the world in a given year.

Table 5: U.S. Imports, Men's & Boys' Cotton Woven Trousers, 1996-2009

Partner Country or Region	Value (US$ millions)				Market Share (Val)	
	1996	2000	2005	2009	% 1996	% 2009
World Total	**2,937**	**5,052**	**5,282**	**4,853**		
Mexico	754	1,671	1,441	1,073	26%	22%
China	125	159	414	933	4%	19%
Bangladesh	108	197	324	931	4%	19%
CAFTA + DR	783	1,067	913	265	27%	5%
Vietnam	--	--	143	254	--	5%
Egypt	--	--	--	195	--	4%
Pakistan	--	--	--	176	--	4%
Cambodia	--	155	132	161	--	3%
India	--	--	138	158	--	3%
Sri Lanka	62	91	--	125	2%	3%
Hong Kong	247	293	235	--	8%	--
Indonesia	116	124	134	--	4%	--
Colombia	60	84	166	--	2%	--
Philippines	95	108	--	--	3%	--
Canada	50	--	--	--	2%	--
Top 10 % Total					**82%**	**88%**
Individual CAFTA Countries						
Nicaragua	60	106	177	103	2%	2%
DR	324	499	363	92	11%	2%
Honduras	122	145	131	38	4%	1%
Guatemala	118	114	137	31	4%	1%
El Salvador	11	35	15	1	0%	0%
Costa Rica	149	169	91	0	5%	0%

Source: U.S. International Trade Commission: U.S. General Imports: CIF value (HS 6203.42).

Note: Trousers includes Breeches, Overalls, & Shorts (includes Jeans). Top 10 same for 2000 & 2005. (--): not in top 10 in year.

Table 6: Key indicators of firms producing knits in Nicaragua, 2010

Firm	Yr. Est.	Ownership[a]	Prod. Type[b]	Fabric[c]	Prod./wk[d]	Emp.[e]
K1		U.S.A	OBM, M	55-60% US rest from Asia, Mexico, Central Amercica	240,000	1,300
K2	2001	U.S.A	FP	US CAFTA countries	200-250,000	900-1,300
K3	2006	U.S.A.	97% FP, 3% CMT	very little U.S. fabric, Miliken, El Salvador	100,000	1,400
K4	2004	Korea	FP		600,000	5,200
K5		Canada	OBM	Honduras (U.S. yarn)	3 million	5,500
K6	1994	Korea	FP	60% Taiwan & China, 40% Honduras, minimal Guatemala		5,600
K7	2002	Hong Kong	FP	100% China (own textile mill)	75,000	700
K8	2005	U.S.A	FP	Honduras (U.S. , Pakistani yarn)	750,000	1,250

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

Source: Firm interviews by authors.

Table 7: Top Knitted Fabric Exporters to Nicaragua, 2009

Year	Asian Suppliers				Regional			World	
	Korea	China	Hong Kong	Asia % Total	USA	CAFTA	Regional % Total	World	Top % World
1995	10.5	0.1	0.0	93%	0.7	0.1	6%	11.4	99.5%
1996	15.1	--	1.4	90%	1.7	0.0	9%	18.5	98.8%
1997	18.2	0.5	3.8	94%	1.3	0.0	5%	23.8	99.8%
1998	15.9	0.1	4.7	96%	0.6	0.2	4%	21.5	99.8%
1999	17.3	--	1.8	99%	0.1	0.2	1%	19.4	99.9%
2000	27.3	0.5	0.5	99%	0.2	0.1	1%	28.7	99.8%
2001	37.5	0.1	1.5	92%	3.0	0.3	8%	42.3	100.0%
2002	59.1	0.6	3.0	95%	2.9	0.4	5%	66.2	99.8%
2003	40.6	3.0	6.9	86%	7.8	0.3	14%	58.6	100.0%
2004	70.6	12.3	14.9	96%	2.9	0.5	3%	101.5	99.8%
2005	72.0	19.2	23.0	88%	10.5	5.6	12%	130.5	99.9%
2006	84.2	26.1	47.5	91%	11.7	2.6	8%	174.0	99.0%
2007	82.5	44.4	36.7	85%	20.1	6.5	14%	193.5	98.3%
2008	76.4	53.0	18.3	78%	22.7	14.2	19%	190.0	97.1%
2009	102.8	62.3	11.7	80%	20.0	24.1	20%	221.4	99.8%

Source: UN Comtrade: HS60 as reported for Select Countries and World (Aggregate).

Note: Values are in US$ millions. (--): no value reported by the country for that year

Table 8: Key indicators of firms producing woven in Nicaragua, 2010

Firm	Yr. Est.	Ownership[a]	Prod. Type[d]	Fabric[c]	Prod/wk[d]	Emp.[e]
W1	2009	Nicaragua	90% CMT; 10% FP	50% Asia 50% U.S.	125,000	3,900
W2	-	U.S.A	CMT	U.S., Mexico, China, Nicaragua (Alpha)	130,000	2,500
W3	2000	U.S.A	FP	50% China, 50% U.S.	120,000	1,200
W4		U.S.A	FP	15% U.S., 85% Nicaragua (Alpha)	65-70,000	1,600
W5		Mex./U.S.	50% CMT, 50% FP	United States, Mexico Asia	100,000	1,600
W6	2008	U.S.A	FP	United States, Nicaragua (Alpha)	100,000	2,000
W7	2007	U.S.A	FP	50% China, 50% U.S.	105,600	800
W8		U.S.A	OBM	50% Pakistan & China, 50% U.S. Mexico (<1%)	170,000	1,000-1,100
W9	2009	Mexico	Contract launderer	NA	200,000	1,100
W10	1999	Taiwan	CMT	Depends on client, some Guatemalan	105,000	1,200

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

Source: Firm interviews by authors.

Table 9: Top Cotton Woven Fabric Exporters to Nicaragua, 2009

Year	Asian Suppliers				Regional Suppliers			World	
	China	Hong Kong	Pakistan	Asia % World	USA	Mexico	Regional % World	Value	Top 5 % World
1995	2	6	--	83%	1	--	11%	9	94%
1996	1	1	--	80%	0	--	5%	3	85%
1997	1	2	--	81%	0	--	5%	4	86%
1998	4	1	--	75%	0	--	0%	7	75%
1999	3	1	--	52%	0	--	0%	7	53%
2000	11	4	--	52%	0	10	34%	30	86%
2001	8	3	--	48%	2	7	39%	23	87%
2002	14	7	--	62%	2	7	28%	33	90%
2003	14	11	0	81%	4	0	14%	31	95%
2004	20	11	0	80%	6	--	14%	39	95%
2005	15	13	0	81%	2	3	15%	35	97%
2006	15	16	7	73%	8	2	19%	53	93%
2007	20	14	3	73%	7	2	17%	52	90%
2008	25	8	5	61%	15	0	25%	62	86%
2009	22	11	5	63%	20	2	37%	60	100%

Source: UN Comtrade: Exports HS5209 as reported to Nicaragua; download Oct. 15, 2010.

Note: **(--)** indicates country did not report export values for given year. Values are in US$ millions.

Table 10: CAFTA-DR and Mexico Textile Suppliers by Country and Product

Country	Yarn	Knit Fabric	Woven Fabric	Processors	Country Totals
Mexico	11	5	14		30
Guatemala	6	6	7	1	20
El Salvador	3	3	2		8
Honduras	1	3		1	5
DR		2			2
Nicaragua			1	1	2
Category Totals	**21**	**19**	**24**	**3**	**66**

Source: ADOZONA: Retrieved September 14, 2010.

Note: Processors include: dyers, printers, finishers. Honduras (yarn): Group Karim added.

Table 11: U.S. Exports of Cotton Denim Woven Fabric, 2000-09

Country/ Region	Value (Mil)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
World	**506**	**455**	**445**	**437**	**559**	**443**	**388**	**285**	**235**	**214**
Mexico	348	316	326	284	362	302	229	126	131	148
CAFTA-DR	11	12	17	67	128	78	89	118	75	39
Guatemala	--	1	3	44	115	69	34	38	27	18
Nicaragua	--	--	--	--	2	1	6	5	5	14
DR	7	9	10	16	9	1	2	10	6	5
Honduras	--	--	2	4	1.6	5	26	40	34	2
Costa Rica	--	--	--	1	--	2	22	26	4	--
Colombia	2	3	2	19	24	34	46	18	12	12
Canada	53	45	43	38	27	15	12	12	6	6
Philippines	4	3	6	6	7	8	4	4	4	1
Other Top 10	18	3	1	1	2	1	--	--	--	2
Hong Kong	--	2	1	--	3	--	2	2	1	--
Belgium	65	66	45	17	--	--	--	--	--	--

Source: UN Comtrade: U.S. Exports: HS-5209.42 as reported: CIF value.

Note: Top 10 countries by year; (--) indicates country not in top 10 in given year.

Table 12: U.S. Exports of Cotton Denim Woven Fabrics to CAFTA-DR, 2000-09

Country/ Region	Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CAFTA-DR World Share	2	3	4	15	23	18	23	42	32	18
Country Share of CAFTA-DR Total (%)										
Guatemala	7	9	18	66	90	88	37	32	35	45
Nicaragua	--	--	--	1	2	1	7	4	6	36
DR	60	77	62	23	7	2	2	8	8	11
Honduras	4	5	14	7	1	6	29	34	45	6
El Salvador	20	8	5	1	0	0	0	0	1	1
Costa Rica	8	1	2	2	0	2	25	22	5	0

Source: UN Comtrade: HS5209.42 as reported; CIF value.

Note: (--) indicates the U.S. did not report exports to Nicaragua 2000-2002.

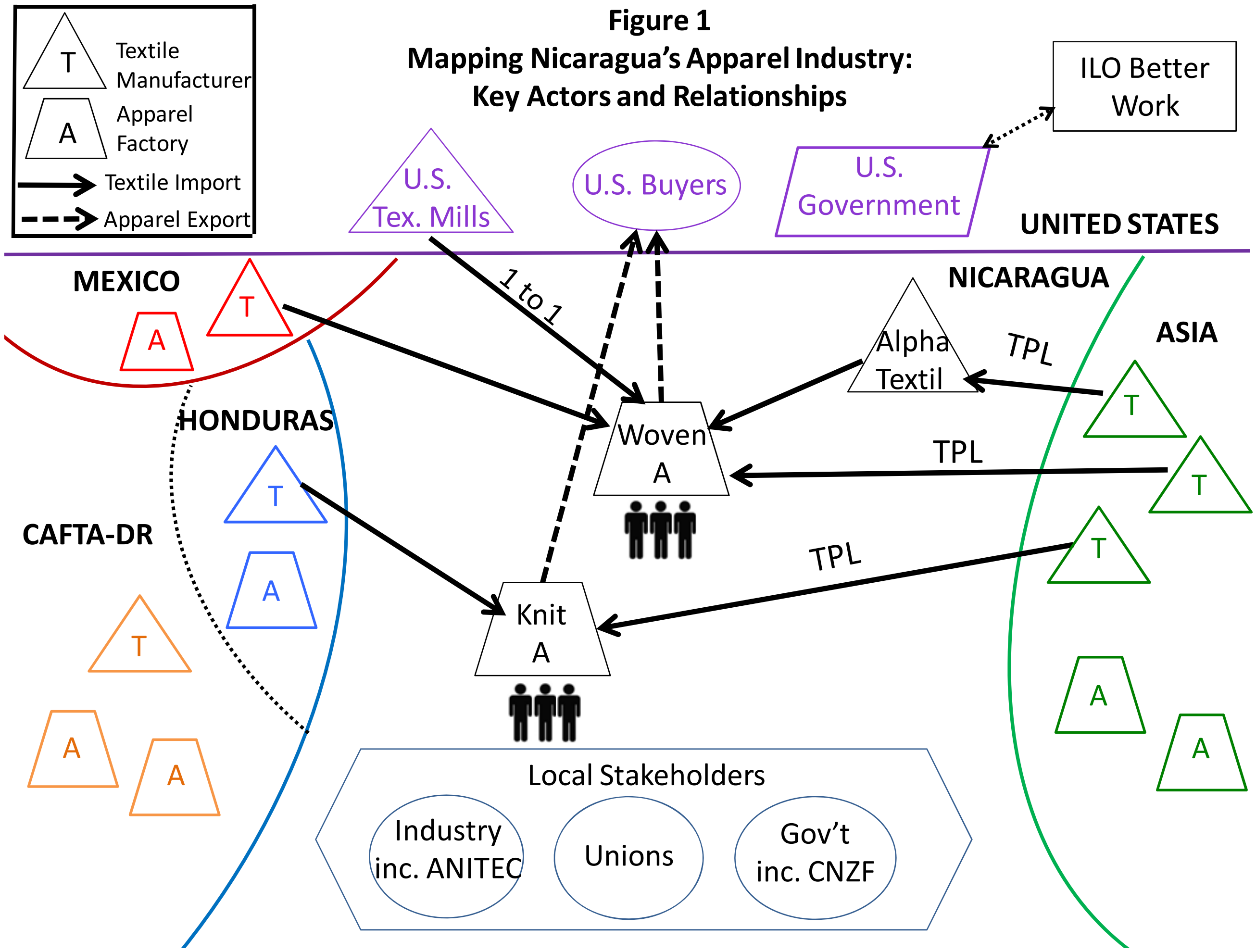
Table 13: U.S. Exports of Cotton Knitted Fabric 2000-2009

Country/ Region	Values (in Mil)									
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
World	**807**	**949**	**1,101**	**1,419**	**1,659**	**1,808**	**1,638**	**1,679**	**1,554**	**911**
Mexico	344	356	332	365	542	622	618	630	566	367
CAFTA-DR	93	252	517	787	839	867	728	771	749	365
El Salvador	18	81	153	266	272	281	231	235	253	138
Honduras	27	87	244	340	351	380	317	340	338	107
DR	31	45	71	124	152	134	108	118	87	55
Costa Rica	13	17	30	34	37	31	28	32	27	24
Guatemala	--	19	16	16	24	31	33	27	22	22
Nicaragua	--	--	--	--	--	11	--	20	23	20
Canada	196	182	141	146	146	130	111	86	75	63
Hong Kong	26	20	21	25	24	21	16	--	17	12
Dominica	--	--	--	--	--	--	--	21	15	10
Haiti	--	--	--	11	26	60	35	22	--	--
Japan	15	13	10	--	--	--	--	--	--	--
France	11	--	--	--	--	--	--	--	--	--
U.K.	11	11	8	12	8	--	--	--	--	--
Germany	--	--	--	--	--	--	17	--	--	--

Source: UN Comtrade: U.S. Exports: HS60 as reported: CIF value.

Note: Top 10 countries by year; (--) indicates country not in top 10 in given year.

Figure 1
Mapping Nicaragua's Apparel Industry:
Key Actors and Relationships



APPENDIX A: Schedule of Meetings in Nicaragua, Sept. 30, 2010- Oct. 12, 2010

FIRM / DATE	TIME OF VISIT
Thursday, September 30	
Corte y Confeccion de Nic.	9:00 AM
Rocedes Apparel	10:15 AM
Gatornica	3:00 PM
USLC	4:30 PM
Friday, October 1	
Comisión Nacional de Zonas Francas (CNZF)/PRONicaragua	8:30 AM
Presidential Delegate for Investment	10:30 AM
Cupid Nicaragua	2:00 PM
Textiles Unlimited	3:30 PM
Monday, October 4	
New Holland Apparel	9:00 AM
Kaltex Argus	11:00 AM
ALPHA TEXTIL	3.00 PM
Tuesday, October 5	
AALF UNO	9:00 AM
Sincotex	2:00 PM
sae-a-Tecnotex	3:30 PM
Confederación de Trabajadores de Zonas Francas	7:00 PM.
Wednesday, October 6	
GILDAN SAN MARCOS	9:00 AM
Annic	11:00 AM
VF Jeanswear	3:00 PM

FIRM / DATE	TIME OF VISIT
Thursday, October 7	
ISTMO TEXTIL (LAS MERCEDES) MOD. 47	9:00 AM
GD Maquilador de Nicaragua	10:00 AM
METRO GARMENTS EMBAJADA AMERICANA	2:00 PM 4:00 PM
Friday, October 8	
Roo Hsing Garment	8:15 AM
Ministerio del Trabajo	10:00 AM
CNZF	11:30 AM
Corporación de Zonas Francas (CZF) (reunión en oficinas de PRONicaragua)	2:00 PM
Monday, October 11	
CNZF	8:15 AM
COSEP	9:00 AM
MIFIC	11:00 AM
INCAE	2:00 PM
SITEL	3:30 PM
CARANA, Empresas y Empleo	5:20 PM
Tuesday, October 12	
PRONicaragua	9:00 AM
CZF	10:30 AM

APPENDIX B: National Commission of Free Trade Zones (CNZF)

In Nicaragua the Free Trade Zone System was born in 1976 by Decree No.22 "Establishment of Export Zones," of March 23, 1976 and its Regulation Decree No.47 "Regulations to the Law on Export Zone," adopted on October 8, 1976[2]. By 1979, clothing and apparel had become a driving sector in the development of the free trade zones (FTZ) in the country with eight out of the nine companies established being involved in clothing and the preparation of leather. It was not until the 1990s however that the Free Zone Regime was reactivated by Decree No.46-91 "Export Zones" of November 13, 1991. This decree also established the creation of the National Commission of Free Zones (CNZF), the governing body of the scheme of Export Zones.

Since its creation CNZF has served as a promoter and regulator of the Free Zones regime in Nicaragua.[3] The CNZF is responsible for granting permits and administering the expansion of the regime. It also takes part in the negotiation of international agreements or conventions relating to export processing zones. Revenues of the CNZF are strictly for its own use. Currently there are about 20 active parks with 130 firms operating in the Free Zone. These generate a steady income.

For the past three and a half years the CNZF has implied a newfound importance. The arrival of General Baltodano to the institution has signified a reorganization of several different aspects of the regime; in particular on internal organization issues, financial relations between CNZF and its users, and environmental issues. More particularly, CNZF has focused on:

1. ***Facilitating by creating the "ventanilla única"***

In order to facilitate the process of installation, operation and internal and external trade for companies operating in the free-zone, CNZF has created a one-stop-window where firms can do all government related paper work. The "ventanilla única", represents a significant improvement in efficiency and of business climate, strengthening the competitive position of Nicaragua to the rest of the world.

2. ***Improving relations with other government entities***

Relations with the Ministry of Environment, the Ministry of labor and the Institute of Social Security have been improved. This is particularly important given 25% of the revenues of the Social Security Institute come from CNZF. The influx of revenue to the Social Security Institute has become more constant as the CNZF has taken responsibility of payment even when its own users/firms get behind in their payments. The CNZF has also been a key player.

[2] http://www.cnzf.gob.ni/index.php?option=com_content&view=article&id=24&Itemid=12&lang=en
[3] http://www.cnzf.gob.ni/index.php?option=com_content&view=article&id=21&Itemid=2&lang=en

3. *Bringing together perceptions and beliefs of labor and entrepreneurs*

CNZF has helped breach the gap that existed between entrepreneurs and workers. CNZF proceeded by convincing each party separately and managed to bring them together. The distance between entrepreneurs and workers was partly due to the perceptions union leaders had of the Free Zone and to a bias against unions from entrepreneurs. This gap however has been decreased with negotiations. Problems have decreased in magnitude and in quantity. As a result there are now better work conditions and higher stability. Some minor problems remain but these are more firm specific.

4. Improving labor relations in the apparel and textile sector

The arrival of the new administration in 2007 implied a shift in the priorities of the Ministry of Labor and increased tensions between firms, workers and government institutions. Between 2007 and 2009 minimum wages were subsequently increased. Given the importance of labor in costs this signified a significant increase in overall cost for businesses. However since 2009, there has been a quest for a more balanced approach as manifested by the ratification of the Tripartite Agreements, first signed in 2009 and then in 2010. This more balanced relation between labor and investors was mediated by the CNZF, who has made relations more formal and has coordinated the interventions of the Ministry of Labor in the Free Zone

5. Raising wages without losing cost advantage

Since the beginning of the new administration, the government seeks to improve working wages in the free-zone. The policy of CNZF has been to raise the minimum wage in Nicaragua, without losing its cost advantage over the other countries in CAFTA-DR.

6. Increasing quality of jobs and quality of investments in the free-zone

From the beginning of the free-zone, the objective of the government has been to increase the number of jobs. The free-zone in Nicaragua has created about 76-80,000 direct employments and 100,000 indirect employments. This means that between 150-200,000 families are affected by the free-zone. Initially the focus was in the apparel and textiles industry. The current government's vision is to consolidate the industries that already exist. The focus is not to grow massively but rather to maintain the size of the free-zone and to grow in quality; that is, to focus in the application of rights, environmental protection, and the quality of the industry and ZF as a whole.

CNZF is not focusing on getting investments from a particular country or region. Their main interest is to attract serious business; that is businesses that are committed. CNZF is also looking for investments that go beyond the textile industry, even though textiles are like an engine for the economy. It works with ProNicargua, entity also managed by General Baltodano, looking for investments that are not as traditional. They have for instance already started contact with a small plane assembly enterprise and firms that produce female implants (such as silicone implants). They hope to bring about a new kind of investment in the region.

APPENDIX C: Ministry of Labor (MITRAB)

The Ministry of Labor of Nicaragua (MITRAB) is in charge of defending and protecting the labor rights of workers in Nicaragua. Although the free-zone does not receive special treatment *per se* by the Ministry, due to the high concentration of formal workers in the zone, the MITRAB has needed to give some special concessions. Since the beginning of the current administration in January 2007, the MITRAB has mainly focused on restoring labor relations and more recently it has focused on increasing tripartism across sectors. It is important to note however that the MITRAB does not directly intervene in the process of creation of an union and does not get involved in conflict among unions. The MITRAB only intervenes if workers make a claim at the MITRAB offices.

Labor relations and MITRAB organization has improved in several aspects:

1. ***Workers have regained importance***

The government has set as a priority improving worker conditions in Nicaragua. These have regained a new found importance in the eyes of the government.

2. ***Tripartism has been adopted***

Recognizing the need for involvement of all major stakeholders, MITRAB has encouraged communication between worker unions, corporations and the government across sectors. In the textile sector this resulted in the signing of the Tripartite Agreement in 2009 and in 2010 and has implied greater stability for firms and better conditions for workers.

3. ***As a result of concerted work with the private sector, CNZF, and unions, union representation and collective agreement problems have decreased.***

The conflicts that had been more frequent, those related to union formation and collective agreements, have significantly been reduced in number. Before 2007 it was typical that free-zone representatives would ask for a list of workers that were in the process of forming a union. Employers would use this list to fire workers before the union got to be created. Now, there is an effective level of protection of labor rights. The level of conflict has been significantly reduced.

Furthermore work relations have improved since the social dialogue was initiated. In August 2007 there were 7 collective bargaining agreements, while in August 2010 there were 22. This represents a larger level of trade union activity and a larger level of tolerance of labor union activity, which is a manifestation of 1) the right to organize and 2) enterprise management. Unionism has transitioned from what Fernando Malespin, the General Advisor to the Minister called referencing Marco de La Cueva “a period of heroism”, in which it was hard to survive, to a “period of tolerance”.

4. The number of labor inspectors and inspections has increased

There are about 90 inspectors/monitors in Nicaragua. This represents a large increase in number of inspectors. Although the MITRAB has a smaller budget that during the previous government (in particular due to the crisis), they used to do 300 inspections per year while they are presently doing 7,500 inspections.

5. MITRAB's logistics have improved

The MITRAB has invested in acquiring new technology in order to improve communication among its offices. There used to be 3 computers with internet and now all the regions are connected. Furthermore, the MITRAB now provides a "Labor Agenda" ("Agenda Laboral") where monthly and semiannual performance is evaluated.

6. The individual conciliation process has been improved

Currently 60% of labor problems are solved by agreement between the parties. This represents an increase from previous years and a decrease in costs for parties involved.

7. In some cases there has been complementary action between the government, brands, NGOs and international organizations

Solutions have in some cases been the result of "concerted pressure". Complementary action by brands has also helped achieve an improvement in union and labor conditions. Usually brands intervene after a claim has already been made to the MITRAB. The MITRAB guarantees the application of the law to the brands. Employers get a certification from the Ministry. NGOs can also intervene by giving publicity. The Ministry has also received financial help from the Inter-American Development Bank (IDB) and other international organizations, IDC

APPENDIX D: National Institute of Technology (INATEC)

The National Institute of Technology, INATEC, founded in 1991 as INATEC an autonomous body of the Ministry of Labor (MITRAB) with a tripartite board, has as its main mission to train and certify technical competence and quality of the Nicaraguan labor force as a means to achieve the objectives of economic growth and social development of the country. The programs offered by INATEC aim to increase efficiency and productivity of workers and to integrate new technicians to the labor market. In addition to providing training to the unemployed, underemployed and those living in poverty and extreme poverty because of low or no qualifications, INATEC also provides training and technical education to workers in companies and institutions that contribute 2% of their payroll in order to increase productivity and efficiency in carrying out their duties. INATEC has a network of 34 own Vocational Training Centers located throughout the country, which offers more than 25 specialties in various fields: Agriculture, Forestry and Construction Industry Trade and Services. In 2005, there were 6761 companies contributing to the system, making INATEC the largest provider of vocational training for the private sector[4]. In 2009, 52,527 workers of the contributing companies had access to training. This represents a 175% from the 30,000 annual objective.

INATEC covers 10% of the training offered to workers in the private sector financed by the contribution of 2%. Other private providers under the purview of the policies and regulations INATEC cover 90%.INATEC. The total budget for 2003 amounted to 216.9 million cordobas (about 13.95 million U.S. dollars).

INATEC is primarily funded by a contribution of 2% of the wage applied to companies that are legally established (including government institutions). The training tax is collected directly by the social security tax system and transferred to INATEC. While the 2% tax covers 75.6% of the budget of the Institute, only 29% of it goes to the private sector that pays this contribution. In fact, INATEC spends a large percentage of its resources to technical training (46%) and training of the unemployed (3%). Added to this, INATEC administrative costs are extremely high (22% of budget).[5]

In 2005, the allocation of resources to the private sector by sector in was as follows: the agricultural sector, which represented 5.7% of business and 21.1% of the funds generated by the tax, receives 0.35% of the funds are allocated. The industrial sector, which represented 42% of the companies and 34.4% of the funds, received 15.3% of the funds allocated. The biggest beneficiary was the trade and services sector, which accounts for 52% of the companies, 44.5% of the funds and gets 84.3% of the funds.[6]

[4] FIAS 2005
[5] FIAS 2005 pp.39-55
[6] FIAS 2005

APPENDIX E: ProNicaragua

ProNicaragua, is the Nicaraguan Investment Promotion Agency, established in 2002. It is a non-profit, public-private institution that seeks to generate economic growth and job creation in Nicaragua by attracting high-quality foreign direct investment. The Agency provides complimentary support services to qualified investors seeking investment opportunities in the country. The organization has three main functions:

1) Communication: on business opportunities in Nicaragua and key investment information
2) Promote investments
3) Facilitate FDI (foreign direct investment) and create a good investment climate.
4) PRONicaragua also proposes policies to the government in subjects related to these aspects (e.g., the foreign investment law).

It has six priority sectors – 3 related to services and 3 for goods:

1) Energy.
2) BPO/KPOs
3) Tourism.
4) Textiles and footwear.
5) Light manufacturing.
6) Agro-industries.

APPENDIX F: ILO's Better Work Program

The Better Work Program is a partnership between the International Labour Organization (ILO) and the International Finance Corporation (IFC) of the World Bank, officially launched in August 2006. The program aims to improve labor standards and competitiveness in global supply chains. To achieve this, the program assists enterprises to improve labor practices based on core ILO labor standards and national labor law. So far the program has been implemented in Cambodia, Haiti, Jordan, Lesotho and Vietnam.

Better Work Nicaragua

Nicaragua is the first Central American country to implement the Better Work program with the support of the United States Government, represented by the Secretary of Labor, Hilda Solis. The goal of the *Better Work Nicaragua* project is to expand decent work opportunities in the textile and apparel sector in Nicaragua. By improving worker-management cooperation, working conditions and social dialogue the project seeks to also increase the competitiveness of the industry.

Important dates:

- *2008: E*xploratory discussions with key partners and stakeholders in Nicaragua.
- End of 2009: *P*re-feasibility study in order to analyze the possibility to implement the program in a variety of countries in Central America and the Dominican Republic.
- January 2010: Consultative mission involving representatives from *Better Work* Global. During that mission, all local partners in Nicaragua confirmed their interest to participate in the *Better Work* program.
- February/March 2010: Project design mission was conducted
- March 2010: as a first step, *Better Work* managed to have eight (8) international brands (Columbia, Gap, Fishman & Tobin, Levi's, Target, Sears, VF Corp. and Wal-Mart) sign a letter in which they support the launching of *Better Work* program in Nicaragua and commit themselves to reduce their own audits of the factories if the program is implemented successfully.
- *27-28 July, 2010*: first Better Work international buyers' forum in the country.
- *6 Oct. 2010*: Panel discussion of Better Work Nicaragua in D.C. with Gen. Baltodano and U.S. Secretary of Labor Hilda Solis and announcement of the US$2 million grant to Nicaragua from DOL to implement Better Work
- *Early 2011:* Beginning of Better Work Nicaragua

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APPENDIX G: Tripartite Agreement in Nicaragua's Free Trade Zone System

1. English version

Social Labor Agreement of the Free Zone Tripartite Labor Commission

Based on the success of the Emergency Economic and Labor Agreement of 2009, signed by us, active and permanent members of the Free Zone Tripartite Labor Commission conformed by leaders of unions, ANITEC, the National Free Zone Commission and the Ministry of Labor, convinced that decent work summarizes the aspirations of people during their working lives, which means that all working women and men in the free zone system can have opportunities for productive employment that produces a dignified wage, security in the workplace and social protection for their families, better possibilities for personal development and social integration, freedom for workers to express their opinions, organization and participation in the decisions that affect their lives, and equality in opportunities and treatment for all women and men.

Conscious of the persistent economic crises which continues to impact our economy, the members of the Free Zone Tripartite Labor Commission in the primary interest of saving investment and jobs, and all the efforts necessary to grow by 15 thousand additional jobs during the period from 2010-2013, we have decided to make use of the social agreement through a dialogue, to agree on points of interest for the benefit of each of the productive actors, with the goal of contributing towards strengthening the economic and social stability which facilitates Nicaragua´s development. With this interest we the Free Zone Tripartite Labor Commission agree to:

1.- The parties commit themselves to uniting forces to promote social policies directed towards comprehensive development of working women and men in the free zones within the framework of decent work, characterized by the fundamental Agreements of the International Labour Organization.

2.- Consequent with the needs to save and attract more investment, save and create more jobs, strengthen job stability and improve wage conditions, we establish the minimum wage levels of the free zone sector for the period 2011 – 2013, which become effective on the first day of January of each year.

2011	8%
2012	9%
2013	10%

3.- The parties agree within the framework of improving living conditions for working women and men in the free zones to promote a low income housing program. Towards this end, the parties propose the construction of one thousand low income houses within the timeframe of 2010 to 2013. It is agreed that joint efforts will be made to authorize subsidies for the Government and organizations dedicated to this issue for securing the houses.

4.- To continue working towards the creation of commissaries in the businesses that do not have them and to guarantee at least forty thousand food packages this year, with the goal of assuring basic products of primary need for the working women and men at low prices which facilitate greater purchasing power for the workers to increase their real salaries.

5.- To promote the creation of Recreation Centers for the working women and men of the free zones and their families so they may have healthy leisure. Towards this end, the parties commit themselves initially to working on the development of a recreation center for the department of Managua, followed by other departments in the country to the extent that investment and jobs increase.

6.- The parties agree to foster the creation of Savings and Loan Cooperatives in each of the businesses within the free zone system, with the object of promoting savings and facilitating low interest loans to its members, towards this end the Tripartite Labor Commission will search for support and advising from the Nicaraguan Institute for Cooperative Promotion (INFOCOOP) and from other Government programs dedicated to this goal.

7.- Based on the DR-CAFTA "Development of capacities in labor and environmental issues in the countries of DR-CAFTA," it is agreed to propose to the International Labour Organization (ILO) to allow the Free Zone Tripartite Labor Commission to participate in future programs and projects that the ILO develops in the country related to free zones given the level of organization and experience achieved by this tripartite organ.

8.- The Free Zone Tripartite Labor Commission will meet on Tuesdays of the second week of May, September and December in 2010-2011-2012, with the objective to review compliance and evaluate performance on all the points of the present Agreement framed by the letter and spirit of the Maquila Table of the National Labor Council, as well as the Agreement on decent work signed by the Government of Nicaragua through the Ministry of Labor, the Supreme Court of Justice, the International Labour Organization (ILO), and COSEP (Superior Council of Private Enterprise) and the Nicaraguan union organizations represented by the liaison Committee of the ILO.

9.- To formulate in conjunction with INATEC (National Technological Institute) a strategy to train and find the most effective formulas for improving the productivity of the workers in the businesses of the free zones. At the same way demand a special program for the free zone sector which can provide the workers with new technological skills.

The present agreement was read, the parties found it in conformance to our wills, we each ratified it and we signed it all together in three original copies, committing ourselves to permanent participation in pursuit of all of the objectives declared.

Given in Managua, at four in the afternoon on the twentieth of January two thousand and ten.

FOR THE UNIONS

(signed)
ROBERTO GONZALEZ GAITAN
General Secretary
Sandinista Workers Center
CST –

(signed)
PEDRO ORTEGA MENDEZ
General Secretary
Confederation of Free Zone Workers
CST

(signed)
LUIS BARBOSA CHAVARRIA
President CST – JBE/FNT
“José Benito Escobar” Union Confederation

(signed)
MIGUEL A. RUIZ ESTRADA
General Secretary
“José Benito Escobar” Union Confederation

(signed)
JOSE FRANCISCO ESPINOZA NAVAS
General Secretary – CUS – CPT
Confederation of Labor Unification

LUIS COLLADO AGUIRRE
Deputy General Secretary – CUS – CPT
Confederation of Labor Unification

(signed)
ROBERTO ANTONIO MORENO CAJINA
General Secretary – CUT – CPT
Unitary Confederation of Workers

(signed)
PIO SANTOS MURRILLO GONZALEZ
Secretary General – CUT – CPT
Unitary Confederation of Workers

FOR THE PRIVATE BUSINESSES

(signed)
CARLOS VARGAS MANTICA
President
Federation of Nicaraguan Chambers
Of Private Export Zones (FCNZFP)

(signed)
JAMES SCOTT VAUGHN
President
Nicaraguan Association of the
Textile Manufacturing Industry
(ANITEC)

GOVERNMENT

(signed)
Ministry of Labor
DR. JEANETTE CHAVEZ
Minister

(signed)
National Free Zone Commission
GENERAL ALVARO BALTODANO
Technical Secretary

2. ***Spanish version***

Concertación Socio Laboral de la Comisión Tripartita Laboral de Zonas Francas

Basados en el éxito del Acuerdo de Emergencia Económica y Laboral del 2009, firmado por nosotros, miembros activos y permanentes de la Comisión Tripartita Laboral de Zonas Francas conformada por los dirigentes sindicales, Anitec, la Comisión Nacional de Zonas Francas y el Ministerio del Trabajo, convencidos de que el trabajo decente resume las aspiraciones de la gente durante su vida laboral, lo cual significa que cada uno de las y los trabajadores del régimen de zonas francas puedan contar con oportunidades de un trabajo que sea productivo y que produzca un ingreso digno, seguridad en el lugar de trabajo y protección social para sus familias, mejores perspectivas de desarrollo personal e integración a la sociedad, libertad para que los trabajadores expresen sus opiniones, organización y participación en las decisiones que afectan sus vidas, e igualdad de oportunidad y trato para todas las mujeres y hombres.

Conscientes de la persistencia de la crisis económica la cual sigue impactando nuestra economía, los miembros de la Comisión Tripartita Laboral de Zonas Francas en el interés supremo de preservar la inversión y los empleos, y todos los esfuerzos necesarios para crecer en quince mil empleos adicionales durante el periodo 2010-2013, hemos decidido haciendo uso de la concertación social a través del dialogo, acordar puntos de interés en beneficio de cada uno de los actores de la producción, a fin de contribuir al fortalecimiento de la estabilidad económica y social que permita el desarrollo de Nicaragua. En este interés la Comisión Tripartita Laboral de Zonas Francas concertamos:

1.- Las partes se comprometen a unir esfuerzos para promover políticas sociales encaminadas al desarrollo integral de las y los trabajadores de zonas francas en el marco del trabajo decente, caracterizado éste por los Convenios fundamentales de la Organización Internacional del Trabajo.

2.- Consecuentes con las necesidades de preservación y atracción de más inversión, preservación y generación de más empleos, fortalecimiento de la estabilidad laboral y mejoramiento de las condiciones salariales, establecemos los niveles de salarios mínimos para el sector de zonas francas para el periodo 2011-2013, los cuales entrarán en vigencia los días primero de enero de cada año.

2011	8%
2012	9%
2013	10%

3.

3.- Las partes acuerdan en el marco de mejorar las condiciones de vida de las y los trabajadores de zonas francas impulsar un programa de viviendas sociales. A tal fin las partes se proponen la construcción de un mil viviendas de interés social en un lapso de tiempo del 2010 al 2013. Se acuerda también hacer esfuerzos en conjunto para avalar subsidios de parte del Gobierno y de otras organizaciones dedicadas a este tema para la obtención de las viviendas.

4.- Seguir trabajando en la creación de comisariatos en las empresas que no cuenten con estos y garantizar al menos cuarenta mil paquetes alimenticios este año, a fin de garantizar la canasta básica de productos de primera necesidad a las y los trabajadores con precios bajos que permitan mayor capacidad de consumo a los trabajadores, aumentando así su salario real.

5.- Impulsar la creación de Centros Recreativos para las y los trabajadores de zonas francas y sus familias a fin de que éstos puedan esparcirse sanamente. A tal fin las partes se comprometen inicialmente a trabajar en el desarrollo de un centro recreativo para el departamento de Managua y seguidamente en otros departamentos del país en la medida que las inversiones y los empleos vayan creciendo.

6.- Las partes acuerdan fomentar la creación de Cooperativas de Ahorro y Préstamo en cada una de las empresas que se encuentran bajo régimen de zonas francas, con el objeto de promover el ahorro y facilitar préstamos a sus cooperados con bajas tasas de intereses, a tal fin la Comisión Tripartita Laboral buscará el apoyo y asesoramiento del Instituto Nicaragüense de Fomento Cooperativo (INFOCOOP) o de otros programas de Gobierno dedicados a este fin.

7.- En base al CAFTA-DR "Desarrollo de capacidades en temas laborales y ambientales en los países del CAFTA-DR", plantearle a la Organización Internacional del Trabajo (OIT) que permita en el futuro a la Comisión Tripartita Laboral de Zonas Francas la ejecución de programas y/o proyectos que la OIT desarrolla en el país, relacionados a zonas francas, considerando el nivel de organización y experiencia alcanzada por este órgano tripartito.

8.-La Comisión Tripartita Laboral de Zonas Francas se reunirá los martes de la segunda semana de mayo, septiembre y diciembre del 2010-2011-2012, con el objeto de revisar el cumplimiento y evaluar el desempeño de todos los puntos del presente Acuerdo enmarcado dentro de la letra y el espíritu de la Mesa de la Maquila del Consejo Nacional del Trabajo, así como en el Acuerdo sobre el trabajo decente suscrito por el Gobierno de Nicaragua, a través del Ministerio del Trabajo, La Corte Suprema de Justicia, la Organización Internacional del Trabajo(OIT), el COSEP y las organizaciones sindicales nicaragüenses representadas en el Comité de enlace de la OIT.

9.- Formular junto con INATEC una estrategia de capacitación para encontrar formulas más efectivas para mejorar la productividad de los trabajadores en las empresas de zonas francas. De igual manera demandar un programa especial para el sector de zona franca donde se pueda dotar a los trabajadores de nuevas capacidades tecnológicas.

Leída que fue el presente acuerdo, las partes lo encontramos conforme a nuestras voluntades, la ratificamos y lo firmamos todos juntos en tres tantos de un mismo tenor, comprometiéndonos a la permanente participación en la búsqueda de todos los objetivos planteados.

Dado en la ciudad de Managua, a las cuatro de la tarde del día veinte de enero del dos mil diez.

POR LOS SINDICATOS

ROBERTO GONZALEZ GAITAN
Secretario General
Central Sandinista de Trabajadores
CST

PEDRO ORTEGA MENDEZ
Secretario General
Confederación de Trabajadores
de las Zonas Francas - CST

LUIS BARBOSA CHAVARRIA
Presidente CST – JBE/FNT
Confederación Sindical de Trabajadores
Trabajadores
"José Benito Escobar"

MIGUEL A. RUIZ ESTRADA
Secretario General
Confederación Sindical de

"José Benito Escobar"

JOSE FRANCISCO ESPINOZA NAVAS
Secretario General - CUS – CPT
CPT
Confederación de Unificación Sindical
Sindical

LUIS COLLADO AGUIRRE
Secretario General Adjunto – CUS -

Confederación de Unificación