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Combining Global and Local Forces: The Case of Labor Rights in Cambodia

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Abstract

An innovative policy experiment in Cambodia links improvement of workers' rights with increased orders and market access for the products of the country's garment factories. The policy originated with the US-Cambodia Textile Agreement, which awarded Cambodia higher garment export quotas into the lucrative US market in return for improved working conditions and labor regulations. Private sector firms that buy Cambodia's garments also found value in the improved labor practices, as a form of reputation insurance. Policy makers opted to continue this approach even after the expiration of the global garment quota system at the end of 2004. The agreement's effectiveness has depended on the role of the International Labor Organization, a specialized agency of the United Nations, acting as compliance monitor, bringing unique credibility to this role and generating unprecedented transparency about conditions in factories. Government intervention has been crucial to prevent some apparel producers from free-riding on others' improvements.

Keywords

South East Asia, Cambodia, ILO, Labor standards, US trade policy

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Introduction

For the past six years a unique and largely successful international policy experiment has been underway in Cambodia. The project involves monitoring of labor conditions in the factories of Cambodia's export apparel sector. The International Labour Organization (ILO), an international public agency, conducts the monitoring.[i] The results are published in credible, highly transparent reports that detail compliance or non-compliance by the factories with national labor laws and internationally agreed basic labor rights.[ii] Until the end of 2004, these reports were used by the US government as a key input for decisions under an innovative scheme that allowed increased access to the US market in response to improved working conditions and labor practices. A further element of the experiment that was largely unanticipated but has proven critical to its ongoing success is the use of the ILO reports by private retail apparel firms that buy from Cambodian producers. These buyers, conscious of their brand reputations, use the reports to determine whether their supplier firms comply with labor standards, to encourage remediation of problems, and to shift orders in some cases.

The project combines roles for local and international actors in previously untried ways and relies on a combination of private self-regulation with limited but essential public interventions. The experiment warrants attention by policy makers elsewhere for two reasons. First, it introduces novel policy tools into the arena of global corporate regulation and self-regulation. These new elements have an established record of effectiveness that can be examined. Second, the project combines elements of voluntary corporate self-regulation with key public interventions. The public interventions – at both national and international levels – corrected deficiencies that typically arise in purely voluntary corporate self-regulation. The resulting system changed the incentives facing private actors, effectively aligning their interests more closely with public objectives. As policy makers search for effective ways to improve the public role in global regulation and to realize more of the potential of private self-regulatory efforts, the Cambodia experiment offers new and successful methods that can be replicated, as well as important analytical lessons.

This paper begins with a brief description of the Cambodia project and its economic and historical context. It then discusses the novel elements involved in the experiment and the key public interventions. Next, it analyzes their impact on the private sector, tracing the changes in incentives faced by firms and resulting changes in corporate behavior. It then looks at practical outcomes in Cambodian factories. A discussion of the costs and benefits of the project follows, including an assessment of its cost-efficiency and the distribution of burdens and benefits. A final section addresses the issue of replicability and improvements that might be made in future applications of these new policy tools.

Genesis of the Project

Cambodia is one of the least developed countries in the world. It entered the modern global economy late, partly because of civil strife from the 1960's through the 1980's. As the country stabilized in the 1990's, it sought to play catch up in its economic development. One important strategy was to transform a handful of state-owned textile and apparel factories into an export industry, to earn foreign exchange and create new jobs for the underemployed Cambodian workforce. The apparel industry requires relatively low levels of investment and limited skills on the part of workers. It is usually the first step in the process of industrialization and Cambodia was eager to take it.

The global apparel trading system has been governed for 40 years by a system of quotas that set limits on the textile and apparel products from any one country that can be sold in large, affluent markets like those of the US and the European Union.[iii] Because Cambodia was a latecomer to the apparel industry, it was not party to that system and therefore had no quotas. It was free to sell into the US and EU markets, but at the same time those countries were free to limit or cut off access at will in the absence of negotiated agreements. Notwithstanding that risk, willing investors from Taiwan, China, South Korea and other East Asian countries bought, leased or built apparel factories in Cambodia. Buyers from the US and Europe also arrived, in part to circumvent the export limits they faced in other countries under the global quota system.

The infant apparel industry grew rapidly. From virtually no apparel exports in 1994, exports had grown to almost half a billion dollars in value by 1998.[iv] The share going to the US increased rapidly, to the point that in 1998 the domestic US textile and apparel industries called for import restraints. The US government concurred and initiated negotiations with Cambodia to bring it under the quota system.

Meanwhile in Cambodia, the burgeoning workforce in the factories became increasingly discontent with conditions. The workers turned for help to labor unions, many affiliated with political parties. Demonstrations and strikes became increasingly common. In June of 1998, supportive labor groups in the US petitioned the US government to review claimed abuses of workers' rights in Cambodia's apparel factories.

These converging issues formed the backdrop for the quota negotiations. They came at a time when the US government was increasingly interested in linking trade privileges with support for labor rights.[v] US and Cambodian negotiators worked out a three-year textile trade agreement for the period 1999-2001 that established quota limits on the twelve largest categories of apparel exports. However, in a unique step, they agreed that if the Cambodian government were able to ensure substantial compliance by the apparel factories with national labor laws and internationally agreed labor rights, the new quotas would be increased on an annual basis.[vi] The parties agreed to consult twice each year during the three-year agreement to identify the key challenges involved in meeting that overall goal. These consultations established practical goals for each semiannual period, which were used as benchmarks to determine whether to grant the quota increase for the subsequent year.

Both parties recognized that a reliable source of information on the actual practices and conditions in the factories would be needed for the quota determination. The capacity of the Cambodian government to inspect private firms and enforce national labor laws was extremely weak. It was tacitly acknowledged that reporting by government inspectors was not credible as a basis for the quota decisions. Alternatively, private for-profit and not-for-profit monitoring groups existed, but none were deemed to have the credibility to provide the basis for a significant public decision that would have broad economic impacts. To fill the gap, the two countries turned to the ILO, which is the arm of the United Nations system assigned responsibility for setting international labor standards and supervising compliance. The ILO had an elaborate, if bureaucratic, supervisory system that was oriented toward reviewing the conduct of governments, both through periodic examinations of their compliance with ratified labor conventions and in response to complaints raised by labor unions and others.[vii] The organization had never monitored the private sector and had never engaged in on-the-ground inspection of workplaces. The request from the US and Cambodia to take up a new role evoked a cautious response from the Director General of the organization, Juan Somavia, and provoked debate within the ILO bureaucracy and governing body.[viii] After a deliberative process, Somavia decided that the ILO should support a project that was seen to have value by the member states involved, and that had the backing of both employers and labor unions in the target country.[ix]

Innovative Features of the Project

The two key innovations of this project have been identified above: the creation of a trade agreement that provides positive market access incentives as a reward for improved labor conditions; and the inauguration of a new role in international governance for an international agency. These innovations are highly significant new policy instruments that are now available as options for policy makers elsewhere.

The linkage between trade and labor rights had been discussed since the early twentieth century, but the first practical applications date from the mid-1980's.[x] The first such instruments to be created arose under the system of special trade preferences for developing countries. Wealthy nations were permitted to extend extra market access privileges to such countries without violating international trade agreements against discrimination between trading partners. In 1984, the US made such additional trade privileges conditional on respect for labor rights by the developing country recipient.[xi] In 1993, the US included labor provisions in a side agreement to the North American Free Trade Agreement (NAFTA).[xii] This pact included commitments by the trading partners to enforce their own labor laws, with the possibility of a fine or loss of trade benefits for a failure to carry out that commitment.

Both types of trade-labor instruments operated primarily as negative incentives, since trade privileges already granted could be withdrawn for a failure to comply with labor obligations.[xiii] The US-Cambodia Textile Agreement, by contrast, created a prospective positive incentive that would be granted annually for progress in the previous period. This had the potential to elicit ongoing improvements in performance in order to qualify for a greater quota bonus in the subsequent year. The effectiveness of the ongoing and potentially increasing reward was enhanced by the close temporal connection between the behavior of firms and government in one year and the rewards that would flow from good behavior during the following year. As it turned out, the US government decided to award a 9% increase in quotas during 2000 and again in 2001.[xiv] The parties were pleased with their experiment and agreed to extend the trade pact for three additional years, from 2002 through 2004. Quota bonuses of 9%, 12% and 18% were awarded for those years.

The second major innovation in the Cambodian experiment is the novel role for the ILO.
To make the quota decisions, the US needed credible and timely information on actual labor conditions in Cambodian apparel factories. The Cambodian government was not an effective source of such information. As noted above, Cambodia had been engaged in civil strife or outright war for much of the last 30 years, and is still struggling to establish full rule of law. The state is generally weak and faces severe resource constraints. Civil servants, including labor inspectors, are woefully underpaid. As a result, it is difficult to attract and hold competent inspectors. The average wage of a civil servant is the equivalent of US$28 a month.[xv] By contrast, the minimum wage in the apparel industry in Cambodia is $45 a month, and average

monthly wages in the sector are about $61.[xvi] By any account, the pay of government inspectors does not provide an acceptable minimum standard of living, and therefore second and third jobs that compete for inspectors' time are the norm, not the exception. Taking bribes from employers is also common. Under these circumstances, the role of the national public authorities in inspecting workplaces and ensuring compliance with labor laws was a goal to be pursued over the medium term. It was not a reliable source of information for the immediate purposes of the textile agreement. At the same time, a growing apparel sector that created jobs and profits was part of the solution to the problem of government capacity, as it would increase the tax base and resources for essential government functions. So while building public capacity to enforce laws was desirable, a short-term solution was needed to fill the information gap.

It was theoretically possible to engage private actors to monitor the worksites. Over the course of the 1990's, the creation of corporate codes of conduct and the need to monitor their implementation created a body of experience among an array of private actors. They ranged from for-profit accounting organizations such as KPMG and PricewaterhouseCoopers (PWC) and specialized for-profit auditing groups like Intertek Testing Service, to non-profit social auditing groups such as Verité and non-profit multi-stakeholder groups like the Ethical Trading Initiative. However none of these groups had established credibility at an international level and among the diverse groups affected by the textile agreement, including employers, investors, buyers, labor unions and governments. The entire field of social auditing is still at an early, experimental stage with no clear leader or widely accepted methodology.

In the absence of either national public capacity or satisfactory international private capacity, the two governments faced the necessity of finding an agent to supply a missing function: provision of internationally credible workplace inspection and information. Although the ILO lacked specific experience in factory monitoring, it possessed an established record of neutrality and expertise and was acceptable to all concerned parties. The ILO had been established by the Treaty of Versailles in 1919 and was the oldest agency in what would become the UN system. Over the years, it had gained extensive experience in evaluating labor rights in countries at al levels of development. As global economic integration accelerated in the 1990's, labor markets became increasingly integrated as well, causing greater competition between workers of different nations and greater scrutiny of labor conditions in distant workplaces. Rich country governments felt increasing pressure from constituents to maintain labor conditions and standards at home while improving them abroad. It was natural that government policy makers grappling for means to address the new challenges would turn to the ILO to play new roles. For most of the 1990's, however, the new roles envisioned were in the public sphere, and entailed functions such as technical assistance and capacity building for ministries of labor in the developing world. The unprecedented US-Cambodia agreement, with its requirement for reliable, timely and credible information about actual factory conditions was a breakthrough that pushed the ILO to move beyond its traditional public sphere. Arguably, this foray into the private domain may prove to be a critical element of continued relevance for the ILO, as global production chains increasingly elude the control of national labor ministries and labor inspectorates.

Key Public Interventions

The experiment was put in place through two formal agreements: the textile agreement that began January 1, 1999 and an agreement between the ILO, the Cambodian government and Cambodian garment manufacturers to launch the monitoring initiative, signed on May 4, 2000.[xvii] The two agreements operated independently, but in complementary ways. The potential quota bonus created an incentive for the Cambodian government and the factory owners to improve labor conditions in order to obtain economically valuable increases in access to the US market; and the ILO monitoring program provided critical information for the bonus decisions. However there were shortcomings in the basic arrangement launched by the two agreements that might have greatly limited its effectiveness. A key shortcoming was that the ILO monitoring program, as created, provided for voluntary participation by factories. But the quota bonus was awarded to the country as a whole, based on overall performance. The voluntary nature of participation meant that information would be incomplete, and perhaps unrepresentative, if some factories chose not to participate. Further, it created a perverse incentive for firms to stay out of the monitoring program, because those factories that did participate would bear the burden of improvement while non-participating firms could share the increased bonus without the increased costs of better labor practices (a "free-rider" problem, in economic terms). The government of Cambodia recognized these distortions quickly, as they began to emerge. It stepped in to remedy the shortcoming in the plan design by issuing a regulation ("prakas") that limited the availability of export quota to the US to those firms participating in the monitoring program.[xviii] This resulted in full participation and allowed the ILO monitors to generate information on the entire sector.

A second potential shortcoming was that the monitoring program required reports on conditions in factories, but left unclear whether the information would be provided in aggregate form or would identify conditions in individual factories by name. As the monitoring program began, this issue remained unsettled. After discussions with the multiple stakeholders, the ILO decided to issue reports in the first instance that aggregated results. These "synthesis reports" would give a profile of problems in the sector without naming individual firms. However, after a period of time was allowed for remediation of any problems found, the ILO monitors would re-inspect each factory for compliance. Factories that had not remedied violations of national labor laws or international labor rights found on the first visit would be identified by name in a subsequent report. This decision established a level of transparency regarding factory conditions that was significantly higher than information provided by any private monitoring programs that currently exist.

Private Sector Response

These two seemingly small public interventions, one by the Cambodian government to make participation in monitoring a requirement for receiving quota allotments, and the other by the ILO to provide full transparency of monitoring results, together created a situation that was unprecedented in the realm of global corporate self-regulation. Once the monitoring and reporting system became fully functional, the two interventions resulted in the provision of a high level of information to all actors regarding labor conditions and legal compliance in the entire Cambodian apparel sector. This transparency changed the incentives facing private actors, including both the factories producing garments and the international buyers. The latter now knew the full range of conditions in their existing supplier firms and all other garment firms in the country.[xix] Under conditions of transparency, the factory owners now had multiple incentives to come into compliance with laws and improve working conditions. They stood to gain increased market access to the US through the quota bonus system. They also faced peer pressure from other firms, whose own quota bonus would be at risk if other factories failed to comply. At the same time, international buyers who were concerned about working conditions and/or their reputations now were able to choose between supplier factories on the basis of good information about their practices.

Good information is a prerequisite for any well functioning market.[xx] The Cambodia experiment marks the first time that credible information about labor conditions in a developing country's workplaces has been widely accessible to actors at the local and international levels, in both the private and public sectors. The experiment provides an unprecedented opportunity to witness the effects on market participants' behavior. As noted above, the first effect was to align the incentives facing private firms with Cambodia's twin public objectives of achieving better labor conditions while winning more market access to the US. A second effect, operating purely between private actors, was the shifting of orders to compliant firms. While the public incentive of quota increases was the more readily apparent, the private incentive for firms to improve their labor standards to attract reputation conscious buyers was very significant as well, perhaps dominant in some cases.[xxi] This can be seen by examining the evolution of apparel exports over the period of the experiment. From 1999 through 2002, apparel exports from Cambodia to the US of items that were covered by quota limits increased by 44.8%, from a value of US$433 million in 1999 to US$627 million in 2002. Over the same period, exports of garments that were not covered by the quotas increased by 302%, albeit from a smaller base of US$83 million in 1999 to US$334 million in 2002.[xxii] This pattern indicates that buyers were attracted to place orders with factories that were seen as compliant with labor norms even when they were making decisions on items that were not restricted by quota and thus would not benefit from the labor based quota increases. Collectively, these buyer decisions shifted the composition of Cambodia's apparel exports over the course of the experiment. In 1999, only 19% of exports were of non-quota items, while by 2002, 53% of exports were not under quotas.

This experience led the Cambodian government and the country's apparel manufacturers to conclude that the value of good labor standards and transparency will survive the end of the quota system.[xxiii] In 2003, they asked the ILO to continue the monitoring program for another three years, beyond the end of the quota system. Both the government and the manufacturers contributed funds for the program, augmented by continuing financial support from the US government. Subsequently, as part of the World Bank Group's policy assistance to Cambodia, the group's Foreign Investment Advisory Service (FIAS) conducted surveys among apparel buyers. These surveys revealed that buyers rated Cambodia's labor standards higher than those of regional competitors, and that the buyers would continue to purchase garments from Cambodia if credible monitoring by the ILO were to continue.[xxiv]

The economic basis for this strategy can be understood as a risk mitigation or insurance function. The ILO monitoring and reporting system provides a form of reputation risk insurance to global apparel retailers who source their goods in Cambodia. While labor conditions are still far from perfect in the country's apparel factories, as discussed below, ILO inspections reveal any serious abuses, allowing buyers to insist on rapid remediation or shift orders to other factories with better practices. The detailed ILO factory monitoring reports that form the basis of the public reports discussed above are provided to the individual factories soon after the monitoring visit, to allow them to begin remediation. Many buyers now routinely require their suppliers to share those reports when they are received, rather than waiting for the periodic public reports issued by the ILO.[xxv]

Although most apparel buyers have their own internal codes of conduct and undertake factory compliance inspections themselves or contract with for-profit or not-for-profit monitoring agencies to do so, none of these efforts have the credibility of the ILO system. Purely self-regulatory schemes assure buyers that their suppliers are not violating laws or codes of conduct, but they have little credibility with the public and other interested actors. The skepticism of other actors is founded on the potential conflict of interest between the firm's incentive to cut costs and its desire to avoid reputation risk. This perceived conflict of interest is compounded by the lack of transparency of private sector self-monitoring efforts, creating a potentially large credibility gap. A respected third party such as the ILO, whose governance structure includes governments and worker representatives as well as employer organizations, has interests in the monitoring process that broadly correspond the combined interests of the workers, managers and governments covered by this monitoring scheme. The high level of transparency that the ILO adopted in its reporting further enhances the credibility of results, because the specificity of the reports allows for challenges by any actors that hold information to the contrary. This operates as a reality check and reinforcement of the credibility of the ILO. It is hard to imagine a self-regulatory scheme that could achieve this level of credibility.

Results in the Factories

The impact of the quota bonus and monitoring experiment has been positive for employment and working conditions in Cambodia's apparel sector by many measures.[xxvi] At the most basic level, the increase in quota and the sourcing decisions of reputation-conscious buyers have been key factors in the very large increase in output and employment in the sector. In 1998, before the textile agreement took effect, apparel factories employed about 80,000 workers. At the end of 2004, apparel employment stood at 220,000.[xxvii] These jobs make up an important share of scarce formal sector employment and are among the highest paid jobs in the country for low skilled workers. The overwhelming majority of employees in the sector are young women. To put the desirability of these jobs in context, the minimum monthly wage in the sector (US$45) is greater than the entire average monthly household income in rural areas (US$40).[xxviii] Average monthly apparel wages are about US$61.

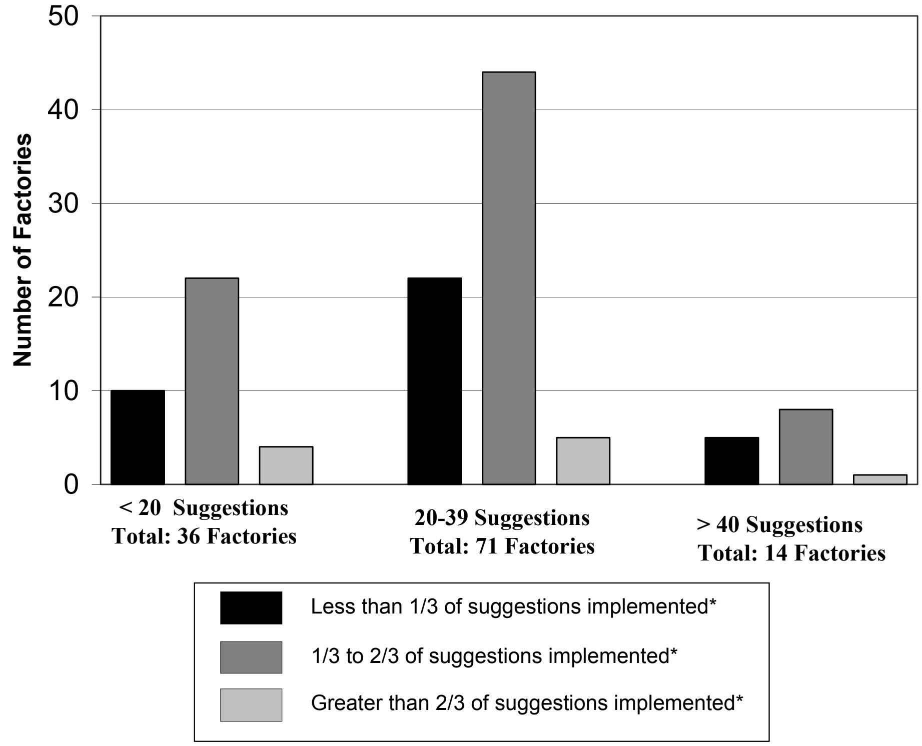
A second measure of the impact of the experiment can be found in the ILO monitoring reports. Eight reports had been issued by mid-2004.[xxix] Each report covers a group of factories that were visited by the ILO monitors. After the first visit, the details of compliance or non-compliance with each of 156 items on a checklist are reported for that group of factories, in an aggregated form. The ILO then allows those factories a period of several months for remediation of problems found, while it goes on to visit a different group of factories. Later, it revisits each group, noting which recommendations (called "suggestions" in the ILO reports) have been acted upon and which have not been remedied. In a subsequent report, the ILO publishes these findings, identifying by name each factory that has complied with each suggestion or not. By mid-2004, all factories in the sector had been visited at least once, and most been revisited additional one or more times.

The reports show that on their first visit, ILO monitors typically found a mixed pattern of compliance and non-compliance by factories.[xxx] Compliance was good in two key areas of basic labor rights: there was little or no child labor and little gender discrimination, although isolated instances of sexual harassment were found. However widespread problems were found in incorrect payment of wages and excessive hours or forced overtime. Violations of health and safety laws were common, including both minor and more serious infractions. Problems with freedom of association- the right to form unions and bargain collectively- were found in a relatively small number of factories, although the violations found were sometimes very serious.

The pattern of initial findings was in itself somewhat encouraging. The presence of child labor poses a particularly damaging threat to buyers' reputations. Before the advent of the ILO monitoring project, a British Broadcasting Corporation (BBC) program had interviewed two ostensibly underage workers in a factory that supplied apparel products to Nike. While many knowledgeable observers questioned the accuracy of the program, Nike ended its contracts with the factory and left Cambodia. After the ILO began its monitoring program and issued its first report, Nike returned to place orders in Cambodia once more. This demonstrated the value of the ILO's credibility to global firms. Although Nike had internal monitoring mechanisms in place before the BBC report, the company knew that its own internal findings would not be credible enough to counter the damaging report. The ILO's findings, by contrast, commanded global respect. Similarly, the finding that discrimination was not a widespread problem was welcome.

The ILO monitors made detailed suggestions to each factory to correct the deficiencies that were identified. The first three groups of factories were subsequently re-inspected. (The final group will be re-inspected this year.) Among the re-inspected factories, some progress was made by the great majority of factories in implementing the suggestions for improvement. Sixty-one per cent had implemented between one-third and two-thirds of the ILO's suggested corrections, while an additional 8.2% of factories had implemented more than two-thirds of the recommendations. A small group of factories came into full compliance with the ILO recommendations. Due to the sheer volume of practices reviewed by the monitors (156 items are on the checklist) and the number of suggestions for improvement, it can be difficult to see the patterns in the ILO reports. Figure 1 is an attempt to quantify the results, through a schematic that groups the responsiveness of factories to ILO recommendations. The factories are sorted into four categories: those with relative few deficiencies on the first inspection (fewer than 20 of the 156 items required improvement), those with 20-39 deficiencies, and those with 40 or more deficiencies. For each group, the figure presents the percentage of problems that were corrected between the first and second visits (less than one-third, one-third to two-thirds, or greater than two-thirds of suggestions implemented).

Figure 1: Reinspected Factories: Response to ILO Suggestions



* Includes suggestions partly implemented and in the process of being implemented.
Source: Tabulations of ILO Third, Fifth, and Eighth Synthesis Reports on the Working Conditions Situation in Cambodia's Garment Sector

A different way of quantifying the results is by types of workplace deficiencies found. The table below summarizes results for the issues of wage payments, hours of work, safety and health, and freedom of association for the same group of factories.

Table 1: Factory Remediation of Specific Labor Problems

	Factories with no suggestions (perfect)	Factories fully compliant (on 2nd inspection)	Factories with mixed compliancy	Factories with zero compliancy
Wages	8	27	79	7
Hours	21	31	26	43
Safety & Health	0	0	117	4
Freedom of Association	2	22	67	30
Total	**31**	**80**	**189**	**84**

Source: Tabulation of ILO Third, Fifth, and Eighth Synthesis Reports on the Working Conditions Situation in Cambodia's Garment Sector

It is clear from the table that the greatest progress was made in payment of wages, an area in which almost 95% of factories had adopted some or all of the ILO's recommendations. With regard to health and safety problems, some violations were remedied by 95% of firms, although none were in full compliance with the law and ILO suggestions. Forty-one percent of factories were in full compliance with legal hours of work or overtime requirements or had fully remedied problems found on the first inspection, while 33% of factories had not remedied any of the problems. About 76% of factories had remedied some or all problems with freedom of association identified by the ILO, while the other 24% had failed to correct any of the problems with freedom of association that the ILO identified.

The ILO project provides a source of useful and reliable information both about initial conditions in the factories and progress on remediation of problems. The progress seen in the reports and the figures above are noteworthy. While it is regrettable that some factories have been unresponsive in one or more areas, it is remarkable that so many factories have made rapid changes and corrections to practices that routinely confront apparel workers in many countries.

The Cambodia experiment also gave rise to progress in the factories through channels other than the ILO monitoring program. Significant benefits arose from collaboration between the Cambodian and US governments to fill gaps in Cambodia's regulatory regime that had hindered the implementation of labor laws. The Cambodian labor law, which was drafted with the assistance of the ILO and adopted in 1997, is a modern law incorporating all of the basic international norms. However the law left many institutional and procedural lacunae that were meant to be filled in through regulations, known in Khmer as *prakas*. Few of these regulations had been enacted and the resulting procedural gaps included such basic matters as the method for a union to establish its status as the legitimate representative of workers in a factory and thus gain the legal right to engage in collective bargaining with the employer. Another missing regulation involved the creation of an arbitration council, which was foreseen in the law as a venue to resolve workplace disputes without the need for strikes and lockouts by private sector actors or for intervention by government inspectors and courts. These gaps came to be a major focus of the semiannual meetings between the Cambodian and US governments. Progress on drafting and issuing the most critical *prakas* sometimes served as a benchmark to be used by the US in judging whether to award a quota bonus.[xxxi] In drafting the procedural regulations, the US assisted the Cambodian government when invited to do so, and further help was sought from the ILO. Draft *prakas* were reviewed with employers' organizations and trade unions for further modification before being enacted. Gradually, procedures were put in place that allowed for orderly determination of worker, union and employer rights and obligations.[xxxii] The arbitration council *prakas* was issued and the body was established with further assistance from the ILO. The arbitration council is now functioning and commands wide respect from employers, trade unions and workers in the private sector. Twenty-eight cases were arbitrated in the council's first ten months of existence, with 85% of the disputes resolved.[xxxiii] Thus, the labor consultations mandated by the textile agreement provided an impetus and contributed to the articulation of procedures and institutions that extended the rule of law and dispute settlement in Cambodia. These mechanisms are likely to have positive spillover effects on the broader political system. Lessons from other developing countries suggest that nations that create institutions to successfully resolve distributional conflicts enjoy stronger and steadier growth than those that do not.[xxxiv]

Benefits and Costs

Some of the benefits of the quota bonus and monitoring experiment are direct, quantifiable and substantial. For example, the quota bonus itself constituted a clear benefit to the Cambodian government, apparel firms and workers. In 2002, the value of the quota bonus was US$56.4 million (calculated by multiplying the 9% quota bonus for that year times the share of exports under quota, valued at US$627 million).[xxxv] By the same calculation, about 13,000 jobs were created by the increased exports that year, and workers earned total wages of US$9.5 million in those jobs. As the quota bonus grew to 12% in 2003 and 18% in 2004, the value to all parties increased dramatically. These earnings of apparel firms and workers also translated in increased tax revenue for the government. Overall, Cambodia was the first least-developed country in the world to achieve over $1 billion in yearly exports, with garments accounting for 80% of the total. Beyond the quantifiable contribution of the quota bonuses, the risk mitigation that the labor practice and monitoring offered to buyers was also significant.

The ILO monitoring program confers additional direct benefits to Cambodian apparel workers. They are now more likely to be paid the wages to which they are entitled under law, to receive appropriate overtime pay and bonuses, to work in safer and healthier workplaces that pose less risk to their well-being and to enjoy freedom of association, with the attendant possibility of increasing wages and benefits through their collective bargaining strength.[xxxvi]

The costs of the program have been surprisingly modest. The initial three-year monitoring project was funded at US$1.4 million. The US and Cambodia governments contributed US$1 million and US$200,000, respectively, and the Garment Manufacturers Association of Cambodia contributed US$200,000. Spread over three years, with an average of 200,000 workers in the sector, the annual cost per worker was US$2.33 and the annual cost per factory was US$2,333. These costs compare very favorably to private monitoring schemes in the region, where the cost of factory inspections and certification that the factory conforms to a buyer's code of conduct can range as high as $10,000.[xxxvii] The US Government subsequently provided an additional contribution of US$675,000 to the project, after judging that the project lacked sufficient personnel at senior levels to allow it to respond to demands from various Cambodian stakeholders and still maintain its ambitious monitoring schedule. Even with the additional funds, the cost per worker was only US$3.46 on an annual basis, or about US$3,500 per factory. The parties agreed in late 2003 to renew funding for two additional years, at comparable levels.

The program was cost effective primarily because of personnel costs. The project director, an ILO expert with substantial international experience, was hired at a competitive international salary. However the eight monitors were hired locally, at salaries that were attractive by Cambodian standards, but very economical by international standards. The director trained the local monitors and exercised oversight to ensure that the monitoring met international norms. The local monitors were carefully selected and generally have been praised by all parties.[xxxviii] Because the local monitors were paid at levels that were attractive in Cambodia, they were less vulnerable to the temptations to corruption faced by government labor inspectors – indeed, the incentive to stay employed by the ILO was strong and offset any blandishments they might have been offered. Even with the addition of an assistant project director, hired at international pay scales, the balance of salaries in the project made it possible to carry out activities at an internationally credible level of competence while paying salaries at the local level. One reason for the high costs of many private monitoring programs is that auditors are typically paid at international salary or consultant levels and are often flown in for inspections from distant locations with attendant travel, housing and per diem costs.

The cost-effectiveness of the local hires was further enhanced by equally important intangible contributions. The local hires spoke Khmer and thus were able to communicate with both workers and employers. As local residents, they were well positioned to meet with workers and unions away from the work place if necessary. By contrast, private auditors who are not locally based may have difficulty communicating with workers and may not inspire their confidence, particularly if the only contact is in the workplace where workers may feel intimidated by employers.

The distribution of costs of the Cambodia program was less than optimal in one respect. International buyers, who gained substantial economic benefit from the project, did not contribute directly to the costs of the project. In effect, the project provided reputation insurance for the buyers without requiring that they pay a premium. It is hypothetically possible that canny factory owners were able to negotiate better prices for goods produced under conditions that posed less risk to buyers' reputations. But given the competitiveness of the global apparel sector, that is doubtful.

The future of the strategy

As already noted, the Cambodian government and garment factory owners have decided that there is an international market for good labor standards that are verified through credible, transparent monitoring. They have decided to continue the strategy indefinitely, despite the end of the quota system.[xxxix] The ILO will continue to supervise the monitoring project during a transition period from 2006 through 2008, while building the capacity of a Cambodian monitoring agency to assume responsibility in 2009. The project has been renamed "Better Factories Cambodia" and expanded to include training for factories on how to achieve and maintain good standards. Monitoring will be reported through an improved web-based system that allows closer tracking of violations and improvements.[xl] Financial support will be provided by the Cambodian government and garment industry, the World Bank, the Agence Française de Developpement (AFD) and possibly by other developed country aid agencies. The largest purchaser of Cambodian garments, Gap Inc., has announced that it will continue to purchase garments from the country's factories.[xli]

Replicability

The Cambodian experiment comprised a multiplicity of elements that were combined in mutually reinforcing ways. The combination could not be recreated in the exact configuration elsewhere, due to the end of the quota system. However many elements of this successful project are separable and replicable. Policy makers in other countries should consider adopting some of the key components and applying them in new configurations in other situations. The purpose of this section is to identify the most important distinct components of this experiment and the key characteristics that made each component successful, as a contribution to efforts to replicate these innovations in other circumstances.

<u>1. Positive incentives</u>
An important innovation in Cambodia was the manner in which trade privileges were linked with improved labor rights. Labor provisions had been included in other trade agreements and trade preference programs by the US, but those provisions operated as a negative incentive.[xlii] In those arrangements, trade privileges were granted to the trading partner with the condition that they could later be revoked if labor conditions deteriorated, governments failed to improve severe

existing problems, or new violations were discovered. In negotiating terms, the privileges were "front-loaded".

By contrast, the textile agreement with Cambodia created a positive incentive that operated prospectively. The additional market access (quota) was not granted until the Cambodian employers and government met pre-established benchmarks of progress, for example in labor conditions, resolution of specific problems, or upgrading of legal instruments. The improvements had to be demonstrated first, and then the commercial reward followed. The difference in impact of positive and negative incentives can be substantial. Looked at from the perspective of the grantee, a positive incentive system requires real changes in behavior in order to access the desired market reward. Under a negative incentive system, continuing improvement in labor standards may be less likely once the desired market access has been granted. Unless the parties establish clear benchmarks and timetables for the withdrawal of benefits in case progress stalls, the deterrent effect of a general and vague conditionality may be discounted by the recipient. From the perspective of the grantor, it may be politically unappealing to employ a negative incentive, because revoking privileges already granted can disrupt ongoing economic activities. Partly as a consequence of these considerations, negative incentives are typically employed only in cases of egregious abuse of labor rights. This can limit the efficacy of such systems to achieve sustained progress on labor rights and conditions.

In this case innovation went beyond the substitution of positive for negative incentives. The positive incentives were structured in a way that required progress in each annual period to gain a quota increase for the following year. The repetitive nature of the exercise elicited more progress than a one-time qualifying period could achieve. It allowed modest, feasible steps to be taken and rewarded rapidly, as part of the repeated annual exercise. This aspect of the program design is particularly important, because many of the labor problems encountered in developing countries are difficult to solve in one stroke.

Policy makers would be wise to look for opportunities to link prospective trade, investment and other benefits to progress on labor rights, given the marked and rapid progress achieved in Cambodia.

<u>2. Goal setting</u>

The semiannual consultations between the two governments proved to be an important mechanism for harnessing the positive incentives to practical goals. Benchmarks were set that could be achieved in a six to twelve month period. The goals included both structural elements, such as the issuance of necessary regulations and creation of institutions, and the remediation of specific, egregious problems in particular factories. Once the ILO monitoring reports became available, an overall goal in each period was the demonstration of progress by factories in remedying identified problems.

The specificity of goals meant that all actors understood what was expected. The fact that the short-term goals were agreed in the consultations between governments provided ownership by both sides of the benchmarks for the period. The challenge faced by the parties was to identify goals that were sufficiently ambitious to contribute to significant and sustained progress in labor rights while recognizing the constraints on Cambodian actors and not setting unrealistically ambitious goals.

Policy makers seeking to replicate this approach should include a frequent consultative process and give thought to including all affected actors in the consultations.

3. ILO monitoring

As noted above, the Cambodia monitoring program marked the first time the ILO had inspected factories or directly monitored private sector behavior. The organization proceeded in a careful, deliberative manner, which slowed the development of the program somewhat but allowed it to build consensus among relevant actors at each step. It gained experience through an iterative process of inspections and a problem solving approach to issues that arose. This careful process was an important factor in the success the monitoring program has enjoyed.

The experience has built a strong new capacity within the ILO that is highly relevant to the needs of its constituencies elsewhere. As countries struggle to balance economic and social policies, and to advance trade while promoting acceptable levels of labor standards, the ILO could be called upon to use its newly developed skills to monitor and provide credible information in a wide range of situations. Such an invitation could come from governments, and it is likely that the ILO would act only if the governments involved explicitly requested its participation. However the private sector could also initiate ideas and projects involving the ILO, and then solicit their governments to endorse or join the project.

4. Transparency

If there is one aspect of the Cambodia monitoring program that can be singled out as indispensable to its success, it is the high level of transparency that the ILO provided through its reports. As discussed above, this transparency allowed governments, firms, trade unions and other interested parties to use the information generated. The reports served a multiplicity of purposes in the hands of different actors and reinforced the common interests they shared. Any future role for the ILO should replicate at least this level of transparency.

The question arises whether private auditing groups could substitute for the ILO and provide a similar degree of transparency and credibility. Currently, no private sector group has attempted this level of transparency. Those groups that do publish the results of monitoring have been unwilling to identify the specific factories inspected and the findings, both positive and negative, in those factories. Some multistakeholder monitoring groups, such as the Fair Labor Association, have improved their transparency in recent years. Even such groups still aggregate information for large groups of factories, countries or regions. Without specific information about a particular factory and its performance, outside actors are not in a position to act on the information. In addition, the credibility of reporting is undermined and a useful check on the accuracy is lost if workers or others who might possess conflicting information about a particular firm's behavior are not able to identify firms in the reports. The reputation risk to factories and buyers is not effectively mitigated by reports that lack adequate transparency and credibility. Particularly in countries where there are widespread derelictions from national and international labor standards, an aggregated approach to reporting has little value. Unless private monitoring groups begin to report more detailed information, by factory, to all relevant actors, it is unlikely that they could improve the functioning of markets and generate the progress on overall performance that was achieved by the ILO in Cambodia.

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[i] The ILO is a specialized agency of the United Nations system.
[ii] The member states of the ILO, currently 187 nations, have agreed that all workers have certain fundamental rights, regardless of the level of development of their country. These include the right to freedom of association and collective bargaining, freedom from forced labor, restrictions on employment of children and elimination of the worst forms of child labor, and freedom from discrimination in employment. *ILO Declaration on Fundamental Principles and Rights at Work,* Geneva, June 1998. Available at www.ilo.org.
[iii] The quota system dates back to the 1960's and reflected the fact that these industries were important sources of exports, income and jobs in many countries, both rich and poor. To address concerns of domestic industries and workers in rich countries, while allowing poor countries to grow out of poverty, successive international agreements were negotiated over several decades that allocated shares of guaranteed access to rich country markets. As developing countries' capacity grew, they began to push for a phase-out of the system, and this was finally agreed in the negotiations that created the World Trade Organization in 1995. The quota system was to be phased out over ten years and will be completely eliminated on January 1, 2005.
[iv] "Cambodia: Selected Issues and Statistical Appendix", IMF Country Report No. 03/59, International Monetary Fund, Washington, DC, March 2003, p. 9.
[v] Polaski, Sandra, "Protecting Labor Rights through Trade Agreements: An Analytical Guide", Journal of International Law and Policy, Vol. 10, No. 1 (Fall 2003), p. 14.

[vi] US-Cambodia Bilateral Textile Agreement, available at: http://199.88.185.106/tcc/data/commerce_html/TCC_2/Cambodiatextilebilat.html.
[vii] See ILO website, www.ilo.org.
[viii] The ILO is governed by a unique structure that includes the governments of the 184 member countries (controlling half of the votes in decisions), employers' organizations (one quarter of votes) and labor unions (one quarter of votes).
[ix] Conversation with the author, Geneva, Switzerland, January 19, 2000. See also Elliott, Kimberly Ann and Richard B. Freeman, Can Labor Standards Improve under Globalization? Washington, DC: Institute for International Economics, June 2003, p. 117.
[x] Polaski, op. cit., pp.13-15.
[xi] Such programs are permitted under the Generalized System of Preferences (GSP) of the World Trade Organization. The European Union also created a similar link between respect for labor rights and market access under its GSP.

[xii] The North American Agreement on Labor Cooperation (NAALC), agreed between Canada, Mexico and the US in August 1993. Available at www.naalc.org .
[xiii] Verma, Anil, "Global Labour Standards: Can we get from here to there?", Centre for Industrial Relations and Rotman School of Management University of Toronto, December 2002 Available at: http://www.fu-berlin.de/iira2003/papers/track_3/Workshop_3_4_Verma.pdf
[xiv] Elliott and Freeman, op. cit., pp. 117-118.
[xv] IMF Country Report No. 03/59, op. cit., p. 27.
[xvi] Ibid., p.48.
[xvii] Because of delays in launching the monitoring project, decisions on the quota increases for 2000 and 2001 were made without the benefit of information from the ILO monitoring project.
[xviii] *Prakas* No. 108 MOC/M2001, Cambodian Ministry of Commerce, March 28, 2001.
[xix] Interviews with factory managers and buyers, reported in Kolben, Kevin," Trade, Monitoring, and the ILO: Working to Improve Conditions in Cambodia's Garment Factories", *Yale Human Rights & Development Law Journal,* Vol.7 (2004), p. 105-106.
[xx] The problem of imperfect information is a widely recognized impediment to well-functioning markets. See for example Joseph Stiglitz, "Information and the Change in the Paradigm in Economics", in *The Nobel Prizes 2001*, ed. Tore Frangsmyr (Stockholm: The Nobel Foundation, 2002), pp. 472-540.
[xxi] Kolben, op. cit., p. 106.
[xxii] IMF Country Report No. 03/59, op. cit., p. 9.
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[xxvi] For example, an extensive list of positive results is included in a speech by Lorne W. Craner, US Assistant Secretary of State, "Corporate Social Responsibility at the State Department", March 11, 2004. Available at: http://www.state.gov/g/drl/rls/rm/30962.htm
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[xxx] Ibid.
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[xxxiii] See Arbitration Council web site at http://www.arbitrationcouncil.org/eng_index.htm
[xxxiv] See for example Dani Rodrik, "Institutions for High-Quality Growth: What They Are and How to Acquire Them", *Studies in Comparative International Development,* Vol. 35, No. 3 (Fall 2000).
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[xxxix] Financial Times, "Cambodia favoured in Asian labour survey", 3 December 2004.
[xl] Agence France Presse, "Cambodia: UN labour body expands monitoring of Cambodia's garment factories", 11 February 2005.
[xli] Ibid.
[xlii] Polaski, op. cit., pp. 21-22.