# Addressing the Impact of Garment Quota Phase-out on Nepal

Research Brief

## Overview of Garment Trade

One of the unintended consequences of libralisation in the Textile and Clothing (T&C) trade has been the toll it took on the burgeoning Ready Made Garments (RMG) sector in many developing and least developed countries. Quota restrictions from the US and other developed countries made it possible for manufacturers from small economies like Nepal to export to the US market. As the RMG sector is labour intensive and requires low levels of investment, manufacturing plants were set up and expanded rapidly to capitalise on the "rents" from the quota system. Starting from the mid 1980s, the RMG sector in Nepal, too, experienced fast growth. Within 10 years, the sector went from being non-existent to being the biggest export-oriented manufacturing sector. In 1994/95, although it comprised of less than one percent share of the global RMG trade, Nepal's RMG exports made up 29 percent of the country's total exports and employed more than 50,000 workers (NRB and GAN, Various Years).

However, as per the World Trade Orgranisation (WTO) agreement to liberalise the T&C industry, the Agreement on Textile and Clothing (ATC) came into force in 1995. It required all members to lift quotas on RMG imports within the next 10 years. As the elimination proceeded, it brought about changes in the worldwide RMG trade. Some countries witnessed rise in exports (China, Vietman etc.) while others, usually smaller and less competitive countries (Nepal, Maldives etc.), saw their RMG sectors drastically shrink (Adhikari & Yamamoto, 2006).

The Human Development impact of those affected by the implementation of the ATC are immense. Hundreds of thousands of workers who depended on the RMG industry for their livelihood have lost their jobs. Entrepreneurs have seen their investments turn into scrap and governments have had to cope with sudden drop in export earnings. This Research Brief is a summary of a study undertaken by South Asia Watch on Trade, Economics and Environment (SAWTEE) and ActionAid Nepal (AAN) to assess and address those impacts on Nepal. It includes the findings of a survey carried out to determine the extent of losses to entrepreneurs and workers as well as policy recommendations to promote the RMG sector for the benefit of concerned stakeholders.

## Impact on Manufacturers

Although the quota phase out began in 1995, its full impact on Nepali manufacturers took some time to occur. This was because Nepali RMG exports were concentrated on a few products (mainly cotton casual wear) that still had restrictions on place until the last phase of the treaty. In fact, Nepali RMG sector continued to grow during the first five years of the phase

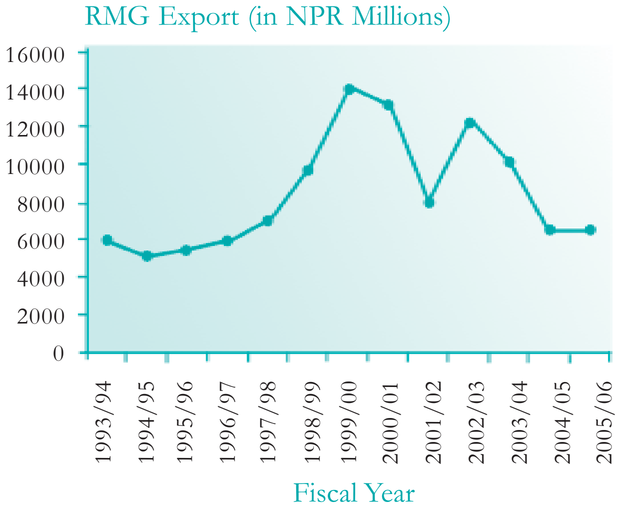
out. The share of the RMG industry in the manufacturing sector rose from 26 percent in 1994/95 to 37 percent in 2000/01. The decline in exports began only after 2001 due to two reasons. The terrorist attacks in the US in 2001 created unanticipated problems for the RMG exporters, as did the increase in the number of RMG items on which quotas were lifted. All quotas on all RMG products were completely eliminated in December 31, 2004. The full implementation of the ATC treaty, however, does not imply that the RMG trade operates in a distortion-free market. Major consumers like the US, provides preferential market access to some trading blocks, at the expense of others.

Out of the 115 garment manufacturing factories in 2000/01, only 26 were operational during the time of the survey in 2006. According to the survey, total value

NO.I, YEAR 2007

of exports stood at NPR 3130 million in 2004. By 2005, exports decreased by about 10 percent to NPR 2790 million. During the survey, only 4 companies reported an increase in demand after January 2005, 5 companies reported no change, while the remaining 17 reported a decrease. Similarly, 6 firms surveyed claimed their business to be better than during the ATC period, while a majority (17) found their business in a situation worse than in the year before.

**Graph: Trend in RMG export**




*Source: Nepal Rashtra Bank data*

Nepali RMG exporters also appear to be pessimistic about the survival and growth of Nepal's RMG sector in the quota free regime. Only 27 percent of the entrepreneurs think that their company can survive in the post-quota environment.

Although the gradual phasing out of the quota system was common knowledge, many firms worldwide have been unable to cope with the changed trading environment. In the post-quota period, price, along with other variables such as tariffs and non-tariff barriers, trade policies of the trading nations, and a firm's capacity to respond to the changing trade environment determine the competitiveness of a firm. In this context, the problems faced by Nepali garment entrepreneurs have worsened. Notwithstanding the elimination of quotas, unstable political climate tops the list of garment entrepreneurs' concerns. By-products of such an environment; general strikes, complete shut downs of roads and institutions, and accommodations made to placate opposing political forces have, as expected, affected the industry. During the survey, RMG entrepreneurs also stressed that the government has been unable to stabilise the sector with the establishment of a Garment Processing Zone and lobby for duty free access in the USA market.

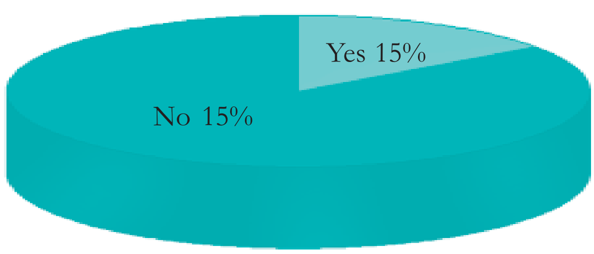
## Impact on Workers

As the RMG sector does not require sophisticated training, the sector employs low-skilled workers, the part of the population that faces the biggest challenges in securing employment. Thirty-nine percent of the surveyed employees were either illiterate or had not completed primary education. Only 24 percent of them had more than 10 years of schooling. The RMG industry also contributed towards Human Development by providing employment to women. The share of women employees in Nepal's RMG sector is high (45 percent) compared to other sectors.

Out of the 274 current factory workers interviewed, eight percent reported their monthly income to be less than NPR 2250 per month while six percent of the employees earned less than NPR 2000 per month. The statistics show that nearly ten percent of the RMG employees earn less than US$ 1 per day. Although a majority (56 percent) of workers reported their income as insufficient to meet basic needs, 92 percent said that they are satisfied with their job. The survey also showed the effect of quota elimination on earning levels. Twenty three percent of the workers reported a decrease in their earnings after 2004 while 41 percent of the workers saw no increase in wages. A consistently high annual inflation in Nepal means a falling real income for them. Besides wages, most of the workers also claimed worse conditions in other factors that determine their well being, namely, availability of over time work and pay rate, work environment and job security, among others.

Beside monthly wages, factory workers augment their income by working over time. Only a small portion of the employees get allowances for transportation, medical treatment, house rent, and other facilities. Less than fifty percent of the employees get extra payment for festivals (annual *Dashain Bonus*). Regarding job security, only 11 percent of the RMG employees have signed a job contract. Incidentally, lack of contracts has been one of the causes of labour disputes in Nepali industries.

**Can Nepali garment industry survive in the post-quota marketplace?**



Although the garment sector is to be commended for providing employment to women, the study shows a distinct gender disparity in wages. The average wages for women is 60 percent of men's monthly wages. While the difference is insignificant in some job categories (helpers, packers and quality controllers), the survey found significant wage disparities in several other job categories (finishers, sewers and supervisors).

The survey of present workers shows that 19 percent of the employees are entitled to company housing facilities, while the rest make their own housing arrangements. Generally, workers living in company provided houses share a room with co-workers. The survey shows that 23 percent of the workers share their room with 5 or more people. In two extreme case, they claimed to share a single room with 40 other people.

Despite an abundance of trade unions in Nepal, the present study shows that nearly 90 percent of the surveyed workers claimed no affiliation with trade unions.

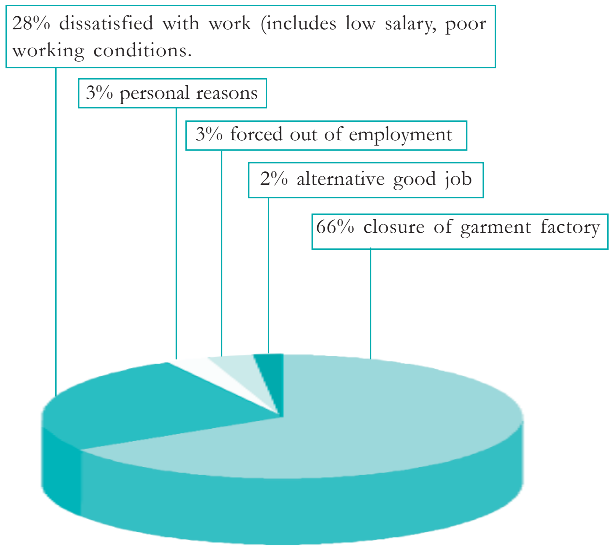
None of the workers reported that either they themselves or their fellow workers have experienced any type of physical and sexual harassment at work. A small number of workers claimed to have been subjected to verbal abuse.

The survey revealed that 60 percent of the employees are not able to save any amount of money from their incomes. Among those able to save, 12 percent save less than NPR 500 per month, 10 percent save between NPR 500-1000, 13 percent save in the range of NPR 1000-2000, 4 percent save between NPR 2000-5000, and only 3 percent save more than NPR 5000 per month.

RMG workers spend the largest portion of their income on food (39 percent), which is typical among low income households. House rent occupies the second largest portion (12 percent) of expenditure. Sizable number of workers are economic migrants. This is corroborated by the fact that 54 percent of workers send some remittance home. On average, they send about 12 percent of their wages to their families living in different parts of the country, and in some cases, to families in India. Most of the remittance money is used by the receiving families on basic necessities. Remittances were also used for education of family members and debt payments. From the remaining income, 9 percent of their earnings go towards their children's education and 7 percent is spent on clothing.

The survey of recently unemployed RMG workers shows a direct relation between unemployment in the RMG sector and the removal of quota system. Out of the 133 past employees surveyed, 66 percent cited closure of garment factory as the reason for unemployment. The sample data indicates that about 60 percent of workers left their job within the last 2 years.

**Reasons for leaving garment factory**




The loss of employment due to the decline in Nepali garment sector is most keenly felt by those who are unable to find another job. About 60 percent of the workers found employment in less than a year, while for 11 percent of the workers it took 3 or more years. Of those who have managed to find a job, 30 percent reported an increase in income while a majority (64 percent) claimed a fall in income. Workers with little or no education were among the hardest hit by the shutting down of garment factories, as they were more likely to remain unemployed.

## Challenges and Recommendations

A continuous decline in RMG exports poses challenges for the government, entrepreneurs as well as to the workers employed by the garment factories. The concerns range from human development to macroeconomic imbalance.

While the number of firms during the quota regime may have been artificially high due to the existence of "quota rents", firms that exist to date do so because of their capacity to compete in the liberalized trading environment. The challenge ahead for Nepali RMG sector is to find means to help these firms be competitive. In a quota free marketplace, price is not the only factor that determines exports, it is also important to assess the demand and supply side constraints. It is in the latter category that the Nepali government can play a positive role and has the responsibility to do so in order to sustain the sector in the long run.

Examples from other countries show that government intervention is important for the survival of the industry(Adhikari, 2006). Post quota preparations done by various Asian countries include investments to reduce lead time (China and India), funds to help upgrade technology ( India, China, Bangladesh, Pakistan), incenticves that encourage backward linkages (Bangladesh, China, India, Vietman) and tax incentives to RMG manufacturers (Vietman, Sri Lanka and others).

If the Nepali government is unable to support the RMG sector because of financial contstraints, there are other ways to help the sector in the short run. One such way is to lobby for preferential access in developed country markets to mitigate the impacts and provide a "cushion" to the infant industry. Nepali exporters already enjoy preferential access in the EU market. However, because the share of RMG exports to the EU is small compared to that in the US, Nepali government must concentrate its efforts in bargaining with the US for similar access. As it is, worldwide RMG trade is not free of market distortions. Various trading blocks around the world enjoy privileges in the US market. Members of NAFTA (North American Free Trade Association) and Caribbean as well as Sub Saharan countries have duty free access. For the last few years, Nepali RMG entrepreneurs too have repeatedly requested the government to become more proactive in lobbying for similiar preferences. Other demands from the RMG sector include development of backward linkages (for example, by establishing a processing zone), simplification of the tax and custom procedures, and investment in technology and infrastructure.

As the RMG industry is going through a difficult time, activities of trade union are equally important to develop a congenial industrial relation that is necessary for a labour-intensive industry to flourish. Unfortunately the Nepali garment factories are repeatedly shut down because of hostile relationship between labour unions and entrepreneurs. In order to establish a more amicable relationship, a labour policy acceptable to both employers and employees is necessary. A mutually accepted code of conduct may also provide a solution as demonstrated by the recent agreements between the Hotel Association of Nepal and labour unions.

From a human development perspective, it is equally important to consider the welfare of employees. Welfare related issues include a minimum wage, job security and removal of wage disparities among the sexes. Similarly, for workers who have lost their jobs in the RMG sector, training and credit programmes could lessen the burden of unemployment and help them find alternatives.

The loss of welfare due to the elimination of the quota system need not be borne by the entrepreneur or the worker alone. A coordinated effort from various actors that includes the government, the private sector and the NGOs and INGOs could help revive and strengthen an RMG sector with a human face in Nepal. ■

## References

Adhikari, Ratnakar and Yumiko Yamamoto, 2006. *Sewing Thoughts: How to Realize Human Development Gains in the Post-Quota World.* UNDP Regional Center, Colombo.

Adhikari, Ratnakar, 2006. *Governments' Support to Textile and Clothing Sector in Select Asian Countries.* UNDP Regional Centre, Colombo.

NRB, various years. *Quarterly Economic Bulletin.* Nepal Rastra Bank, Kathmandu, Nepal.

Launched in December 1994 at Nagarkot, Nepal by a consortium of South Asian NGOs, South Asia Watch on Trade, Economics & Environment (SAWTEE) is a regional network that operates through its secretariat in Kathmandu and 11 member institutions from five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. Registered in Kathmandu in 1999, the overall objective of SAWTEE is to build the capacity of concerned stakeholders in South Asia in the context of liberalisation and globalisation.

SAWTEE
SOUTH ASIA WATCH ON TRADE, ECONOMICS & ENVIRONMENT

P.O. Box: 19366, 254 Lamtangeen Marg, Baluwatar, Kathmandu, Nepal
Tel: 977-1-4415824/4444438, Fax: 977-1-4444570, Email: sawtee@sawtee.org, Web: www.sawtee.org

Published with the support from UNDP Regional Center, Colombo, this Research Brief is a part of a project "Human Develpment Impacts of Quota Phase-out on the Ready Made Garment Industry in Nepal" implemented by SAWTEE and ActionAid Nepal.