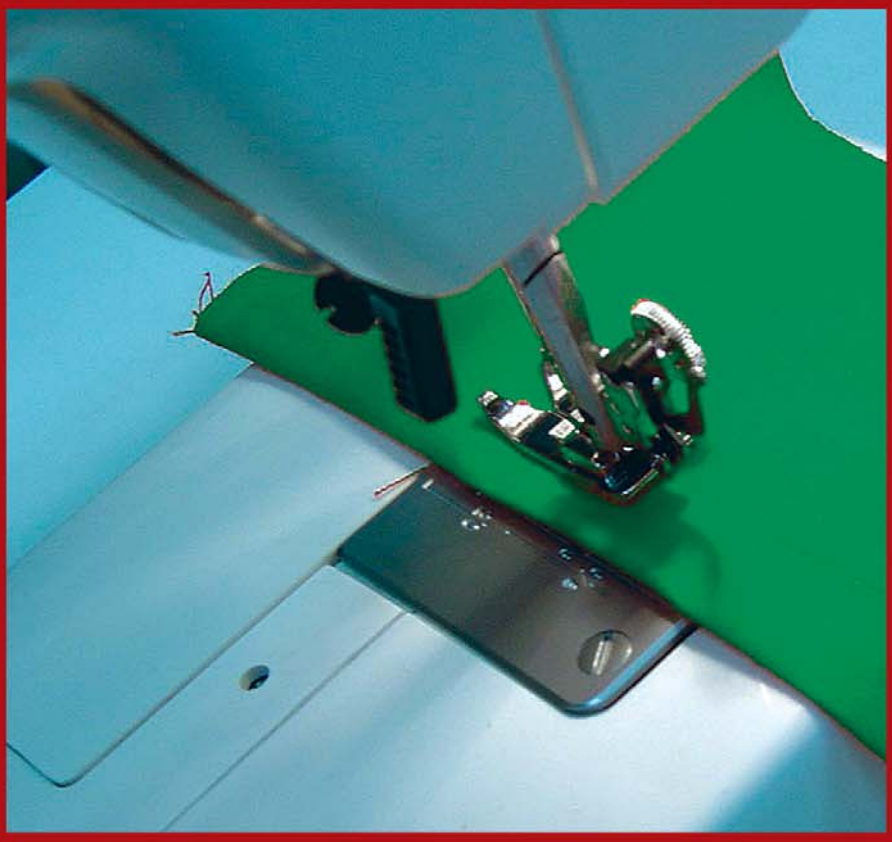
Impact of

Textiles and Clothing Quota Phase Out on Nepal



A STUDY FROM HUMAN DEVELOPMENT PERSPECTIVE

actionaid nepal

SAWTEE
SOUTH ASIA WATCH ON TRADE, ECONOMICS & ENVIRONMENT

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SAWTEE

Published by : South Asia Watch on Trade, Economics & Environment (SAWTEE) and ActionAid Nepal (AAN)

Supported by : United Nations Development Programme (UNDP) Asia Pacific Regional Centre, Colombo, Sri Lanka

Citation : SAWTEE and AAN. 2006. *Impact of Textiles and Clothing Quota Phase Out on Nepal: A Study from Human Development Perspective.* viii+88. Kathmandu: South Asia Watch on Trade, Economics & Environment (SAWTEE) and ActionAid Nepal (AAN)

Design : Indra Shrestha, Effect, 9851046272

ISBN :

Printed at : Modern Printing Press, Jamal, Kathmandu

Available from :

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Acknowledgements

Full implementation of the Agreement on Textiles and Clothing (ATC) of the World Trade Organization (WTO) on 1 January 2005 ended 40 years of quota-based trade of textiles and clothing. Even though the quota system restricted trade for competitive manufacturers, it resulted in an unintended but beneficial outcome for the least developed countries (LDCs) like Nepal by allowing them to export to rich countries' markets. However, the expiry of the quota system has not only resulted in a drastic decline in Nepal's readymade garment (RMG) exports but has also led to the closure of manufacturing units and loss of jobs.

Considering the effects of the phasing out of the quota system on Nepal, South Asia Watch for Trade, Economics & Environment (SAWTEE) and ActionAid Nepal (AAN) with support from United Nations Development Programme (UNDP) Asia Pacific Regional Centre in Colombo undertook a project titled *Addressing the Impact of the Phasing Out of Textiles and Clothing Quotas on Nepal*. The project encompassed four research studies namely, 'Impact of Textiles and Clothing Quota Phase Out on Nepal: A Study from Human Development Perspective', 'Export Diversification Strategy for Nepal', 'Trade and Industrial Policy Environment in Nepal' and 'Trade Negotiation Strategy for Nepal'.

This book is the outcome of the first study under the project. I would like to thank Lead Researcher Mr. Shivraj Bhatta and Researchers Mr. Gyanu Sharma, Ms. Manisha Pradhananga, Mr Milan Udas and Mr. Shivendra Thapa for their untiring efforts in conducting the study. I would also like to thank Mr. Bijendra Shakya for contributing the fifth chapter of the book and Mr. Kamalesh Adhikari for his comments and suggestions.

I would like to express gratitude to Mr. Ratnakar Adhikari, Programme Specialist and Ms. Yumiko Yamamoto, Gender and Trade Programme Advisor at UNDP Asia Pacific Regional Centre in Colombo for their valuable comments and advice.

I would like to thank Dr. Posh Raj Pandey, former president of SAWTEE and Member, National Planning Commission, Government of Nepal; Mr. Prachanda Man Shrestha, Joint-Secretary, Ministry of Industry, Commerce and Supplies; Dr. Dilli Raj Khanal; and Dr. Yubraj Khatiwada for their contributions during various stages of the study. Finally, I would like to thank the members of National Reference Group (Annex 1) for their guidance and all the people consulted from various government institutions, international and local organisations, and the private sector for their support and cooperation during the study.

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Abbreviations

AAN	ActionAid Nepal
ACP	African, Carribean and Pacific
AGOA	African Growth and Opportunity Act
ARS	Average Ranking Score
ASEAN	Association of South East Asian Nations
ATC	Agreement on Textiles and Clothing
BoP	Balance of Payment
CAD	Computer Aided Design
CAFTA	Central American Free Trade Agreement
CAM	Computer Aided Manufacturing
CBTPA	Carribean Basin Trade Partnership Act
CMT	Cut, Manufacture, Trade
EBA	Everything But Arms
EPZ	Export Processing Zone
EU	European Union
GAN	Garment Association of Nepal
GDP	Gross Domestic Product
GPT	General Preferential Tariff
GPZ	Garment Processing Zone
GSP	Generalised System of Preferences
HDI	Human Development Index
ICD	Inland Container Deport
MFA	Multi-Fibre Arrangement
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NAMA	Non-Agricultural Market Access

NCTO	National Council of Textile Organization
NGOs	Non-Govermental Organisations Anti-dumping and Safeguard Measures
NRB	Nepal Rastra Bank
NRs	Nepalese Rupees
NTBs	Non-Tariff Barriers
OECD	Organisation for Economic Cooperation and Development
OPT	Outward Processing Trade
QRs	Quantitative Restrictions
R&D	Research and Development
RGEPC	Readymade Garment Export Promotion Committee
RMG	Readymade Garment
RoO	Rules of Origin
ROW	Rest of World
SAARC	South Asian Association for Regional Cooperation
SAP	Structural Adjustment Programme
SAWTEE	South Asia Watch on Trade, Economics & Environment
SEZ	Special Economic Zone
SITC	Standard International Trade Classification
T&C	Textiles and Clothing
UK	United Kingdom
US	United States
VAT	Value Added Tax
WTO	World Trade Organization

Note: The Nepalese Fiscal Year (FY) extends from 15 July to 14 July.
US$ 1 = NRs. 65.49 (Exchange Rate as of 7 August 2007)

CHAPTER 1

Introduction

Context

Starting from the mid 1980s, the readymade garment (RMG) industry in Nepal experienced rapid growth, mainly due to the quota facility provided by the industrialised countries such as the United States (US). Capitalising on the quota 'rents', within 10 years, the industry also became the biggest export-oriented manufacturing industry of the country. In 1994/95, though the industry comprised less than 1 percent share in the global RMG trade, its exports made up 29 percent of the country's total exports and employed more than 50,000 workers.

In recent years, the industry is, however, facing stiff competition in the global market and struggling to survive. The World Trade Organization (WTO)'s rule to phase out all textiles and clothing (T&C) quotas by 31 December 2004 under the Agreement on Textiles and Clothing (ATC) has not only led to the drastic reduction in T&C exports and closure of T&C manufacturing units but has also created other serious human development challenges, including unemployment.

In order to assess the impact of the removal of T&C quotas on Nepal, South Asia Watch on Trade, Economics & Environment (SAWTEE) and ActionAid Nepal (AAN) conducted a research on the *Impact of Textiles*

and Clothing Quota Phase Out on Nepal from the human development perspective. This book is the outcome of research that SAWTEE and AAN conducted in 2006 in Nepal.

The book is divided into six chapters. Chapter 2 presents an overview of the macroeconomic reforms, growth and foreign trade of Nepal. Chapter 3 highlights the role of the RMG industry in the Nepalese economy. Assessment of the impact of T&C quota phase out at the level of workers and manufacturers is presented in Chapter 4. Views of manufacturers on the problems faced by them and external factors affecting their business, prospects for the Nepalese RMG industry in the post ATC period and an empirical analysis of duty free access to the US market are presented in Chapter 5. The final chapter concludes the study and presents recommendations for various stakeholders, including the government and the private sector.

Objectives

The broad objective of the study was to identify the major challenges that the government of Nepal, RMG manufacturers and workers are facing in the post ATC period and the ways to address those challenges. The specific objectives were to:

- Assess the impact of the T&C quota phase out at the level of workers and manufacturers;
- Identify and analyse the demand and supply side factors affecting RMG exports and prospects and challenges of the RMG sector in the post ATC period; and
- Provide recommendations to the concerned stakeholders, including the government, private sector and the international community about the role that they need to play to help the Nepalese RMG industry survive and compete in the international market in the post ATC period.

Methodology

The study is based on literature review and empirical study. For the

purpose of literature review, macroeconomic data on the Nepalese economy and various other literature and data relating to the RMG industry were reviewed and analysed. For the empirical study, a questionnaire survey, based on random sampling, was conducted with the past and present workers as well as manufacturers of the RMG manufacturing units. The survey was carried out in Kathmandu and Biratnagar as more than 99 percent of RMG manufacturing units are located in these two districts. A National Reference Group (NRG) was also formed (Annex 1) to create a platform for stakeholders such as the government, private sector, civil society, media and experts/academia to share their experiences and provide inputs to the study.

Limitations

- The study is based on the secondary information and data from the literature review and primary information and data from the empirical study. The findings of the study, thus, have to be gauged realising the limitations of the information and data gathered from the secondary and primary sources.
- The study has drawn a conclusion that the impact of the T&C quota phase out has a significant bearing on the status of human development in Nepal since it has, particularly at the level of workers, affected several aspects of human development such as income, health and education. However, the study has not compared the pre and post scenario of human development at the level of workers.
- Most of the RMG manufacturing units are located in the Kathmandu valley whereas more than 80 percent of the workers are from outside the valley. Tracing the past RMG workers was, thus, difficult. Based on the information provided by the current workers, attempts were made to interview the past workers in their home towns/villages. However, most of them were not found in their homes and some others were even found to have migrated to India. Therefore, many of the past workers surveyed are the ones who are currently working or are looking for a job in Kathmandu. The study, thus, might not provide a complete picture of the impact at the level of past RMG workers.

Major Findings

The quota phase out under ATC began in 1995 but its impact on the Nepalese economy was not immediate. This was due to the fact that the RMG exports from Nepal were concentrated on a few products (mainly cotton casual wear) and these products were not under quota restrictions until the last phase of the Agreement.

The RMG sector, in fact, continued to grow during the first five years of the quota phase out and 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, mainly 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.

The impact has been severe after quotas on all RMG products were completely eliminated on 31 December 2004. The impact ranges from negative consequences in the macroeconomic situation of the country to employment and other human development aspects of the workers. In the post ATC period, while RMG manufacturers are facing problems in finding ways to adjust to the changed situation and enhance the competitiveness of their products to survive in the international market, a majority of workers have lost their jobs and those who have found new jobs have seen a decrease in their earnings.

Impact on Manufacturers

Out of 212 RMG manufacturing units in 2000/01, around 30 manufacturing units were operational in 2006. During the survey conducted with 26 manufacturing units, only four manufacturing units reported an increase in demand after January 2005, five reported no change and the remaining 17 reported a decrease. While six manufacturing units stated that there had been improvement in their business in the post ATC period, 17 manufacturing units mentioned that their business was in a worsening situation. Similarly, only 27 percent of the manufacturing units reported that they would survive without T&C quotas.

In the post ATC period, price, along with other factors such as tariff and non-tariff barriers, trade policies of the trading nations and the capacity of the RMG sector to respond to the changing trade environment determine the competitiveness of RMG products. In this context, the problems faced by the Nepalese RMG manufacturing units have worsened. Besides the elimination of quotas, deteriorating political climate in Nepal has been perceived to be a major impeding factor for the growth and survival of the RMG manufacturing units. General strikes, blockade of roads and shut downs of trading institutions have negatively affected the RMG industry. Moreover, the surveyed manufacturers cited that the government has not been able to promote the RMG industry with incentives and establish Garment Processing Zones (GPZs). In addition, they indicated that the government has not made any concerted effort to obtain duty free access to the US market.

Impact on Workers

Out of 274 current workers interviewed, 23 percent reported a decrease in their earnings after 2004. They also reported that it has limited their ability to spend on basic needs such as food and accommodation as they spend the largest portion of their income on food (39 percent), followed by house rent (12 percent). In addition, 54 percent of the workers were found to have been sending remittance (12 percent of their income) to their families. The decrease in their earnings has not only restricted their ability to financially support their families but has also limited the scope of their families to spend on basic needs, including education of family members and debt payments.

In the case of 133 past RMG workers, 66 percent cited that the closure of the RMG manufacturing units has led them to joblessness. About 60 percent of the workers were able to get another job in less than a year but for 11 percent, it took three or more years. Among the workers who managed to get a job, 30 percent reported an increase in income while 64 percent stated that there has been a decrease in income. Workers with little or no education were among the hardest hit by the closure of the RMG manufacturing units.

CHAPTER 2

Macroeconomic Reforms, Growth and Foreign Trade

Macroeconomic Reforms and GDP Growth

Nepal is a landlocked Himalayan country, nestled between China in the North and India in all other sides. Its 25 million inhabitants are among the poorest in the world with gross domestic product (GDP) per capita US$ 297 (PPP US$ 1490) in 2004. The country is also characterised by low level of human development. Nepal's human development index (HDI) in 2004 was 0.527, compared to the world average of 0.741 and the average of 0.679 for the developing countries (MoF 2005/2006 and UNDP 2006).

Agriculture is the main source of livelihood for nearly 80 percent of the population. According to the estimates of Ministry of Finance and Nepal Rastra Bank (NRB), its contribution to GDP has, however, declined in the past three years (61.3 percent in 1975 to 39.2 percent in 2005). With such decline, the industrial and services sectors have witnessed a rise in their contribution to GDP. Over the same period, the contribution of the industrial sector in GDP increased from 10.3 percent to 22.2 percent and that of the services sector to 38.6 percent from 18.4 percent.

Until the mid 1980s, industry, trade, finance, and foreign exchange regimes were highly regulated with license requirements, quantitative restrictions (QRs), quotas, price administration and high tariff on imports. The economic policy domain was dominated by state led industrialisation, import substitution and protection for domestic enterprises.

Following severe balance of payment (BoP) crisis, the country initiated economic stabilisation programme in 1984/85. This was followed by the Structural Adjustment Programme (SAP) in 1986/87. The overall aim of the liberalisation programme was to stabilise the economy, reorient production structures towards the market, create the 'correct' incentives for increased private sector participation in economic activities, limit the involvement of the state in the economy and increase openness (Khatiwada 2005). The major elements of the programme were: devaluation of the Nepalese currency, restraining public expenditure, removal of restriction on commercial bank credits, liberalisation in industrial licensing, export promotion and control on imports (Khanal et. al 2005).

The liberalisation process received further push after the restoration of multiparty democracy in 1990. These reforms led to wide ranging changes in the fiscal, financial, external and manufacturing sectors. In the fiscal sector, reforms resulted in streamlined tax rates and slabs and withdrawal of subsidies on food, fertiliser, irrigation and operations of public enterprises. In the financial sector, the reform resulted in greater private sector participation in the banking sector, interest rates deregulation, removal of portfolio restrictions, market orientation of government debt instruments and reform in the capital market. Similarly, reform in the external sector resulted in the elimination of import license and quotas, rationalisation of tariff structure, reduction in average level of tariffs, introduction of full convertibility of the rupee in current account and deregulation of trade. In the manufacturing sector, reforms led to delicensing, reduction in the level of protection, opening of foreign investment and privatisation.

These reform measures raised some hopes of improvement in the performance of the economy, particularly during the mid 1990s. Mainly

Table 2.1 GDP growth at constant 1985 prices (in %)

Sectors	1976-85	1986-95	1996-2005
Agriculture	1.9	2.8	3.4
Non-agriculture	12.2	5.6	4.0
GDP at factor cost	3.7	4.9	3.7

Source: MoF, Economic Survey (various issues).

because of political uncertainties and intensification of armed conflict, the economy, however, could not achieve planned objectives and its overall growth rate averaged merely at 3.7 percent during 1996-2005, compared to 4.9 percent during 1986-95.

Foreign Trade

Through the 1990s, the external sector remained robust in general, except for a few years towards the middle of the decade. Exports grew at an average of 28 percent per annum whereas imports grew by 20 percent. After 2000, imports witnessed compression mainly due to low economic growth, depreciation of the rupee, decline in demand for third country goods for re-export purposes, and decline in demand of raw materials related to exports. During 2001-05, imports grew by 4.4 percent whereas exports grew at a slower rate of 3.7 percent (Table 2.2).

Both goods and services sector recorded robust growth during the early 1990s, but the growth rate could not be maintained thereafter. Expansion of both exports and imports increased the trade-GDP ratio

Table 2.2 External sector indicators (growth rates in %)

Items	1981-90	1991-2000	2001-05	1986-95	1996-05
Exports	19.0	28.0	3.7	23.0	14.1
Imports	18.0	20.0	4.4	23.7	8.0
Trade deficit	19.4	17.2	5.3	25.3	5.9
Services exports	3.2	12.8	-1.4	17.4	-2.3
Services imports	7.0	2.7	6.7	10.7	-0.7

Source: MoF, Economic Survey and NRB, Quarterly Economic Bulletin (various issues).

Table 2.3 External sector indicators (as % of GDP)

As % of GDP	1986	1990	1995	2000	2004	2005
Total trade	22.2	22.7	37.1	41.7	38.8	36.0
Export	5.5	5.0	8.0	13.1	10.7	11.0
Import	16.7	17.7	29.1	28.6	28.1	25.0
Trade balance	-11.2	-12.0	-21.0	-15.5	-17.5	-14.0
Current account balance	-4.4	-7.4	-5.4	4.5	2.9	5.6
Service income	6.2	6.1	17.1	8.1	6.9	5.2
Export/import ratio	33.0	28.1	27.7	45.9	37.9	44.1

Source: MoF, Economic Survey and NRB, Quarterly Economic Bulletin (various issues).

from little over 20 percent in the mid 1980s to more than 40 percent in the year 2000 (Table 2.3). However, after 2000 trade grew at a slower rate than GDP, and thus the share of external trade in GDP declined.

It has been argued that macroeconomic reform, particularly trade liberalisation, decreases the trade deficit by enhancing exports through the correction of anti-export bias (Khatiwada 2005). However, for Nepal, liberalisation further increased the trade deficit from 11 percent of GDP in 1985 to 21 percent of GDP in 1995. The reduction in imports due to slow economic growth finally led to a reduction in the trade deficit to 16 percent in 2000 and further down to 14 percent in 2005. Despite a widening trade deficit, the current account balance improved over the years due to service and transfer incomes, particularly from remittances. The BoP position remained stable throughout the decade, and led to expanding foreign exchange reserves, with a capacity to cover more than 10 months of imports of goods and services.

There was a notable change in the structure of exports during the reform period. The share of primary goods in total exports declined from nearly 70 percent in 1980 to 22.5 percent in 2005 and the share of manufacturing goods in the total exports, increased from 30 percent in 1980 to 71 percent in 2005 (Table 2.4).

The structure of imports, however, observed little change. The import of primary goods hovered around 20 percent of total imports, and the

Table 2.4 Composition of trade (share in %)

	1980	1985	1990	1995	2000	2004	2005
Export items							
Primary goods	69.5	56.2	17.0	12.9	16.4	19.9	22.5
Manufactured goods	30.1	42.4	82.7	85.2	75.0	71.8	70.7
Others	0.5	1.4	0.2	1.9	8.7	8.3	6.8
Import items							
Primary goods	16.3	18.2	21.2	16.3	21.4	21.1	18.1
Fuel and lubricants	11.8	11.9	8.3	7.4	8.4	16.1	21.5
Capital goods	29.2	30.4	32.2	28.9	28.9	28.0	26.4
Manufactured goods	42.7	39.5	38.3	47.4	41.3	34.9	34.0

Source: NRB, Quarterly Economic Bulletin (various issues).

share of capital goods stood at around 30 percent. The share of manufactured goods ranged between 38 percent and 47 percent throughout 1980s and 1990s, and declined to less than 35 percent in recent years due to a significant decline in gold imports.

An analysis of exports by regrouping the Standard International Trade Classification (SITC) shows a deceleration of exports in all the groups. The growth rate of primary goods in total exports decreased to 12 percent during 2001-05 compared 30 percent during 1996-00 (Table 2.5). Exports of manufactured goods also decelerated to 3.4 percent during 2001-05 compared to a growth of 33 percent during 1991-95 and 21 percent during 1996-00. The manufacturing sector contributes to more than 70 percent of the total exports, generating a majority of employment in the exports sector. The dismal performance of the sec-

Table 2.5 Periodic average growth rates of exports

Export items	1986-90	1991-95	1996-2000	2001-05
Primary goods	-8.8	28.0	30.3	11.7
Manufacturing goods	31.4	32.8	21.0	3.4
Chemical and drugs	133.3	160.2	70.3	-0.2
Others	-15.8	331.8	86.0	9.4
Total	14.4	31.6	23.5	3.7

Source: NRB, Trade Statistics (various issues).

tor in the recent years reveals the short lived effect of trade liberalisation on exports, and the need for product and market diversification.

Amongst Nepal's manufactured exports, woollen carpets and RMG products are the dominant ones. Exports of woollen carpets witnessed marked growth of 27.2 percent during 1991-95 (Table 2.6).[1] However, the growth slowed down to 5 percent during 1996-00 and the carpet industry saw a decline by 10 percent in absolute amount during 2001-05.[2] As the carpet industry is highly labour intensive, its bleak performance has led to job losses. The case of the RMG sector is similar. On an average, exports from this sector declined by 5 percent during 2001-05. Since it is a labour intensive industry, the decline in RMG exports has not only affected the trade performance of the country but has also led to further job losses, forcing many marginalised workers to live a more vulnerable life.

Table 2.6 Growth rates of major export items (periodic averages)

Items	1991-95	1996-2000	2001-05
Woollen carpets	27.2	5.0	-9.9
RMG	29.7	22.1	-15.4
Pashmina	*NA*	*NA*	-25.9
Vegetable ghee	*NA*	*NA*	11.1
Pulses	16.7	18.3	-6.3
Thread	*NA*	*NA*	13.6
Tooth paste	*NA*	62.8	-10.7
Jute and jute goods	20.2	28.3	19.5
Textiles	*NA*	*NA*	85.1
Polyester yarn	*NA*	20.2	24.7
Zinc sheet	*NA*	*NA*	95.7
Copper wire rod	*NA*	*NA*	-3.4
Hides and skin	7.9	-15.2	4.1
Total exports	27.9	25.8	0.9

Source: NRB, Trade Statistics (various issues).
Note: g = compound growth rates.

1 In volume terms, the growth was slower. During 1991-95, carpet exports grew by 20 percent in volume terms
2 During 1996-00 and 2001-05, carpet exports shrunk in volume by an average of 2 percent and 11 percent respectively.

Table 2.7 Shares of major export items in total exports

Items	1980	1985	1990	1995	2000	2002	2004	2005
Woollen carpets	4.8	9.1	45.0	43.8	17.7	13.2	10.5	10.0
RMG	0.7	17.2	27.1	29.1	25.1	16.7	17.7	10.4
Pashmina	0.0	0.0	0.0	0.0	11.2	4.0	2.8	2.4
Vegetable ghee	0.0	0.0	0.0	0.0	4.9	15.1	5.5	8.0
Pulses	7.1	4.0	4.1	2.6	1.9	2.6	1.6	1.3
Thread	0.0	0.0	0.0	0.0	2.1	1.8	3.0	3.8
Toothpaste	0.0	0.0	0.0	1.1	4.1	3.4	2.7	2.2
Jute and jute goods	23.6	11.1	2.5	1.8	2.0	3.5	3.5	4.6
Textiles	0.0	0.0	0.0	0.0	0.2	1.2	3.3	5.1
Polyester yarn	0.0	0.0	0.0	1.4	1.1	2.3	2.1	3.3
Zinc sheet	0.0	0.0	0.0	0.0	0.1	0.0	5.2	2.9
Copper wire rod	0.0	0.0	0.0	0.0	1.1	5.6	0.4	0.9
Rice	3.7	9.1	0.0	0.0	0.0	0.0	0.0	0.0
Hides and skin	18.4	8.9	5.5	2.4	0.3	1.0	0.6	0.4
Timber	11.8	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Total exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MoF, Economic Survey and NRB, Quarterly Economic Bulletin (various issues).

Besides carpets and RMG, pashmina is also an important labour intensive export item of Nepal. Conventional products like rice, timber and hides and skin are not exported anymore. In fact, rice is being imported in large quantities. In recent years, manufactured products such as vegetable ghee, toothpaste, zinc sheets and plastic goods have seen growth in exports (Table 2.7).

With deteriorating exports to overseas markets and limited items for export, Nepal faces a continued high risk of trade concentration with India. Despite being subject to several non-tariff barriers (NTBs), a few items such as jute goods, juice, textiles, thread, polyester yarn, plastic goods, chemicals and metallic products like corrugated sheets, copper wire rod and aluminium are emerging as major exports to India. However, these items have very little value addition in Nepal and enjoy comparative advantages through tariff differences on raw materials in Nepal and India.

CHAPTER 3

RMG Industry in the Nepalese Economy

Growth of RMG Industry

During the multi-fibre arrangement (MFA)[3] era, many Asian countries, including India and Pakistan, were benefiting from the exports of T&C products. However, T&C exports from most of these countries started to decline after developed countries imposed quotas on them. This, however, provided a spillover business to relatively less efficient countries, including Nepal.

Having gained experience from Indian businesses in Nepal, the Nepalese entrepreneurs soon came in the forefront by enhancing their capacity to respond to the global demand of T&C products. They even became capable to supply clothing to the renowned US retailers on 'cut, manufacture, trade (CMT)' basis.

Since the RMG industry is highly labour intensive and requires relatively low investment, many manufacturing units came into existence for RMG

[3] MFA, which came into force in 1974, provisioned for T&C quotas, mainly by the industrialised countries over imports from developing countries.

exports. The number of export oriented RMG manufacturing units continued to grow until the beginning of the quota phase out under ATC.[4] With the phasing out of the quota system and the changes in internal quota distribution policy,[5] the number of establishments declined. In 2001, 212 manufacturing units were operational but after the expiry of ATC, the number has gradually declined. According to the Garment Association of Nepal (GAN), in July 2006, around 30 manufacturing units were in operation.[6]

Employment, Production and Cost

Although data and trend on employment (direct and indirect) in the RMG sector is not readily available, GAN puts the figure at 50000 (direct only) during the boom period (1999-00), which accounted for 12 percent of employment in the manufacturing sector.[7]

After peaking in 1991/92, the number of manufacturing units in the RMG sector continued to decline while output continued to rise. In

Table 3.1 Key indicators of RMG industry

Fiscal year	No. of establish-ments	No. of employees	Average No. of employees per establishment	Output (in 1000 NRs.)	Wages and salaries (in 1000 Rs.)	Average wage(in 1000 Rs.)
1986/87	86	8518	99	391303	79291	9.30
1991/92	234	17260	74	2528233	409160	23.70
1996/97	136	14848	109	3801673	374818	25.24
2001/02	115	18134	158	5771802	795932	43.89

Source: CBS, Census of Manufacturing Establishments (various issues).

[4] In 1995, a total of 1067 RMG units were registered at the GAN. The government issues registration number for export-oriented garment units at GAN's recommendation.

[5] Since 1996, quotas were distributed on the basis of past performance rather than simply based on equal distribution to all registered units, discouraging the registration of new manufacturing units.

[6] According to Census of Manufacturing Establishments of CBS (2001/02), the number of establishments were 115 in apparel sector, 59 in knitted crocheted articles, 15 in made-up textiles, 68 in finishing of textiles and 60 in spinning and weaving of textiles, as based on the NSIC.

[7] According to CBS, there were 18134 employees in the RMG industry in 2000/2001 but if the number in spinning and weaving of textiles, finishing of textiles, made-up textiles, manufacture of knitted crocheted articles and wearing apparel are combined, the total employment was 30212.

addition, the number of people engaged in the RMG industry increased by around 3000 between 1996/97 and 2001/02. The reduction in the number of establishments along with an increase in employment and output suggests that the average size of establishments was growing, perhaps to reap the benefits of economies of scale. This argument is reinforced by the fact that the average number of employees per establishment increased from 109 to 158 between 1996/97 and 2001/02, along with a rise in average wage by 73 percent during the same period.

Table 3.2 Number of employees by nationality and sex

Fiscal year	No. of employees			
	Nepalese		Non-Nepalese	
	Male	Female	Male	Female
1991/92	9913 (58%)	1968 (11%)	5338 (31%)	23 (>1%)
1996/97	10362 (70%)	2657 (18%)	1827 (12%)	2 (>1%)
2001/02	11807 (65%)	4853 (27%)	1472 (8%)	2 (>1%)

Source: CBS, Census of Manufacturing Establishments (various issues).

A popular misconception regarding the RMG sector in Nepal is that it employs mostly foreign nationals, mainly Indians. In 1991/92, a third of the RMG industry employees were not citizens of Nepal but 10 years later in 2001/02, less than one out of every 12 employees of the industry was non-Nepalese. Also notable in the employment figure of the industry is the percentage of women involved in this sector. Nearly 45 percent of the employees are women.[8]

Table 3.3 Annual apparel manufacturing production and producers' price index (1996/97=100)

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Annual production index	100	96.01	103.69	123.45	122.07	88.74	118.91	115.34
Annual producers' price index	100	91.23	106.70	125.30	131.68	161.64	157.20	160.23

Source: CBS, 2005.

[8] The Census of Manufacturing Survey conducted by CBS, however, reports the figure as 27 percent in 2001.

Although the RMG industry is labour intensive, the capital-labour ratio in the Nepalese RMG industry is relatively high compared to some other RMG exporting countries (Table 3.4). The labour content in the RMG industry is less than 15 percent of gross output. It is paradoxical that the industry's capital is relatively higher than labour in total value added. The technology requirements of a modern garment factory imply that the Nepalese manufacturers are unable to exploit cheap labour and become price competitive in the world market. Another reason for the low labour content in the total value added is that the garment products of Nepal are low-end clothing items. Nevertheless, the RMG industry provides employment to a large number of unskilled workers through factory floor jobs.

Table 3.4 Cost and value addition in the apparel industry in select countries (% of gross output)

	Labour	Capital	Value added	Intermediate inputs	Of which imported
Nepal*	13.79	27.69	41.48	58.51	-
Vietnam	10.20	3.8	14.0	86.0	40.0
India	24.0	7.8	31.8	68.0	40.4
China	20.7	12.2	32.9	67.1	5.7
Italy	17.4	16.4	33.8	66.2	13.5
France	26.3	8.4	35.0	65.0	24.3
US	26.8	5.8	32.6	58.8	19.8

Source: Nordas, 2004.

** Calculation based on the principal indicators of the apparel industry given in the Census of Manufacturing Establishment of CBS.*

Contribution to Manufacturing Industry

The RMG industry in Nepal occupied a significant position in the overall manufacturing sector. The share of this sector in manufacturing grew from 26 percent in 1994/95 to 37 percent in 2000/01. However, with the phase out of the quota system the share of RMG in manufacturing sector declined to 26 percent in 2003/04 and further to 16 percent in 2004/05 (Table 3.5).

Table 3.5 Share of RMG exports in manufacturing							
	1994/95	1996/97	1998/99	2000/01	2002/03	2003/04	2004/05
Garment exports as % of manufac -turing exports	26	24	32	37	35	26	16

Source: MoF, Economic Survey (various issues).

Trend, Composition and Direction of RMG Exports

RMG products have occupied a prominent position in Nepal's exports. Its average annual share exceeded 40 percent of Nepal's overseas exports and about 20 percent of the total exports. Table 3.6 shows the share of RMG in total exports.

Until the complete elimination of T&C quotas, RMG exports from Nepal were not affected due to 'back-loading' or delay in eliminating quotas on product categories that interested the Nepalese manufacturers. However, the downward trend in RMG exports was apparent after the last phase of quota elimination in 2004 (Table 3.7).

The overseas market dominates the Nepalese RMG exports, accounting for more than 95 percent of the total RMG exports. The exports to India remained modest, despite market proximity and bilateral preferential trading arrangement between the two countries.[9] In recent years, the share of India in total RMG exports has, however, been encouraging.

The US, the EU, Canada and Japan are the major destinations for the Nepalese apparel and will remain crucial in the future. Among them, the US has been a prime market for apparel exports, with a share of almost 85 percent until the first half of the ATC period.[10] This has, however, decreased to 75 percent immediately after the quota phase out, reflecting the impact of liberalisation in the international RMG trade (Table 3.9).

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[9] The bilateral trade is based on preferential treatment but there is a provision of sensitive list for export of Nepalese products to India.

[10] Whereas the US share in Bangladesh's export was 54 percent, 31.2 percent for India and 54.3 percent for China.

Table 3.6 Contribution of T&C in export (NRs. in million)

Year	Total Export	Export TC*	Export RMG	Share TC	Share RMG
1993/94	19293.4	5943.2	5943.2	30.8	30.8
1994/95	17639.2	5390.8	5139.3	30.6	29.1
1995/96	19881.1	5612.8	5374.8	28.2	27.0
1996/97	22636.5	6281.3	5955	27.7	26.3
1997/98	27513.5	7582	7032.5	27.6	25.6
1998/99	35676.3	10231.4	9744.7	28.7	27.3
1999/00	49822.7	22134.4	13987.7	44.4	28.1
2000/01	55654.1	23046.3	13316.8	41.4	23.9
2001/02	46944.8	12408.6	8046.5	26.4	17.1
2002/03	49930.6	16692.8	12289.3	33.4	24.6
2003/04	53910.7	16201	10176.7	30.1	18.9
2004/05	58705.7	14988.41	6490.5	25.5	11.1
2005/06**	55812.5	14922	6505.7	26.7	11.7

Source: MoF, Economic Survey (various issues)

*Notes: * Internationally, products from HS codes 50 to 63 are considered as T&C and include carpet (HS 57). In this table, "T&C" means Pashmina, Polyester Yarn, Textile, Thread and RMG.*

*** For the first 11 months only.*

The trend was reversed in the case of the three other export markets, the EU, Canada and Japan, where export shares have grown moderately. This is probably due to preferential market access granted by these countries to Nepal, under the Generalised System of Preferences (GSP). The share of the EU has particularly been encouraging in recent years, mostly due to the relaxation of the standard EU preferential rules of

Table 3.7 Nepal's apparel export to overseas countries and India (value in 1000 NRs.)

Fiscal year	Overseas	%	India	%	Total	%	% change in total
2000-01	11,431, 246	98.34	192,100	1.65	11,623,346	100	-
2001-02	7,752,296	97.31	213,500	2.68	7,965,796	100	- 31.4
2002-03	11,613,749	96.67	399,200	3.32	12,012,949	100	+ 50.8
2003-04	9,552,544	93.84	626,700	6.15	10,179,244	100	- 15.2
2004-05	6,307,211	94.51	365,700	5.48	6,672,911	100	- 34.4

Source: Calculation based on the data available at TPC.

Table 3.8 Share of apparel in overseas export and total export

Fiscal year	Total export (NRs.)	Overseas export (NRs.)	Apparel export (NRs.)	Share of apparel in overseas export (%)	Share of apparel in total export (%)
2000/01	55,245,900	28,690,299	11,623,346	39.84	21.03
2001/02	47,386,788	18,409,236	7,965,796	42.00	16.81
2002/03	50,011,122	21,981,475	12,012,949	52.83	24.02
2003/04	53,949,414	20,941,661	10,179,244	45.47	18.86
2004/05	58,975,321	17,691,885	6,672,911	35.65	11.31

Source: Calculation based on the data available at TPC.

origin (RoO). In particular, EU countries, such as the United Kingdom (UK) and France, appear more promising than Canada and Japan.

Some other EU countries with scope for expansion are Germany, Italy and Spain. However, export values in these markets have been small, despite the preferential market access and relaxation of the standard RoO. These facts show that Nepalese RMG exports after quota abolitions have two distinct market choices: the preferential market in the EU, Canada and Japan; and the non-preferential market in the US.

Regarding the export items, in general, cotton items have dominated Nepal's RMG exports. Product categories such as trousers, shorts, t-shirts, vests, blouses, pullovers and cardigans managed to retain their position in the US market. Although these products had the highest quota utilisation rates (above 90 percent), Nepal lost the market share

Table 3.9 Share of major markets in RMG exports (in %)

Fiscal year	US	EU	Canada	Japan
2000/01	90.96	7.32	0.91	0.42
2001/02	85.28	12.28	0.85	0.60
2002/03	87.87	9.80	1.00	0.65
2003/04	75.58	20.48	2.18	1.00
2004/05	75.18	17.84	3.25	1.45
2005/06*	62.07	27.31	3.58	2.00

** First 10 months.*

Source: Calculation based on the data available at TPC.

Table 3.10 Major apparel items exported to the US and the EU

US			EU		
Products	**Export value in NRs.**		**Products**	**Export value in NRs.**	
	2003-04	**2004-05**		**2003-04**	**2004-05**
Cotton trousers and shorts for men/boys	862,952,292	752,731,557 (-12.77)	Woollen or fine animal hair shawls, scarves and veils	555,072,861	564,607,861 (+1.71)
Cotton T-shirts, singlets and other vests	798,928,706	29,362,547 (-96.32)	Cotton trousers and shorts for women/girls	320,025,802	102,088,423 (-68.09)
Cotton blouses and shirts for women/girls	574,362,841	212,955,259 (-62.92)	Cotton blouses and shirts for women/girls	198,771,131	65,345,078 (-67.12)
Cotton trousers and shorts for women's/girls	561,197,763	334,793,309 (-40.34)	Cotton pullovers, cardigans and similar articles	26,721,598	62,043,884 (+132.18)
Cotton pullover, cardigans and similar articles	336,590,606	324,827,056 (-3.49)	Silk shawls, scarves and veils	906,794	33,532,562 (+3601)

Source: Calculation based on data available at GAN and TPC.
- Figures in parenthesis are percentage change in comparison to the previous year.

of these products in the US despite the growth in US imports in the first quarter of 2005.

An important reason for Nepal's loss could be increased market share of the previously quota-constrained suppliers such as China, India, Bangladesh, Pakistan, Sri Lanka, and Vietnam. For instance, China increased its share in US imports from 21 percent to 65 percent in April 2006 in items freed from quotas (NCTO 2006). Similarly, India's share

in the US market increased from 2.9 percent to 3.8 percent, and Vietnam's rose from 0 percent to 2.9 percent.

It is also worth mentioning that there is a marked difference in the product composition of the two major markets. Products concentrated in the US market are lower-end cotton items while the EU market has attracted relatively high value wool and silk based items along with a few cotton products. Compared to previous years, export values for cotton items in both the markets sharply declined in 2004-05, indicating stiff competition in the cotton category in the post ATC period. The reduction in exports in the five major cotton items to the US is alarming. If the trend continues, Nepal's position in the US will deteriorate further (Table 3.10).

RMG exporters have, however, held their position in the EU market. This is probably due to an established brand image in Europe in woollen and silk shawls, scarves and veils. In recent years, the market for woollen or fine animal hair shawls has been deteriorating due to over supply and lack of quality control but the EU market for silk items has expanded due to market diversification within EU countries. The government's decision to provide bonded warehouse for silk material imports has provided extra impetus for exporters.

CHAPTER 4

Empirical Evidence of the Impact of T&C Quota Phase Out

Impact of the Quota Phase Out

The end of the quota system after the expiry of ATC has increased international competition in the RMG sector in terms of lower prices, increased demand for shorter lead times and higher quality clothing. Due to their inability to compete against more efficient industries of China, India, Thailand, and Mexico (Pasha 2004), countries like Nepal are now finding it hard to survive and compete in the global T&C market. The quota phase out has not only led to the closure of T&C manufacturing units and drastic reduction in T&C exports but has also created other serious human development challenges.

The impact has been severe among the workers due to major cuts in employment and deteriorating working conditions, decrease in wages and increase in working hours, for those who are able to keep their jobs. Decline in RMG exports has also increased women unemployment as when labour cuts are required, women are the first to be let go (UNCTAD 2004). This, in turn, has generated other socio-economic problems at the household level as women workers in the T&C sector are often the main household income earner and the chances of getting an alternate job are relatively low for women (Bhatt and Bhattarai 2006).

The impact of the loss of employment is most keenly felt by those who are unable to find another job after being laid off. The RMG manufacturing units are relatively specialised with most of the workers concentrating in only one stage of the production process. With the closure of RMG manufacturing units, the laid-off workers have difficulty in finding employment in other industries due to a lack of transferable skills.

In order to assess the impact of T&C quota phase out on Nepal, particularly at the level of manufacturers and workers, SAWTEE and AAN conducted an empirical study between June and July 2006. While dealing with impact at the level of workers, the study analysed the situation and condition of the workers from the perspective of human development. It has been observed that the removal of quotas has a significant bearing on human development, particularly because it has not only affected the income of the workers but has also limited the choices of their families to live a decent life and support their family members to get a better education and health facilities. The study has not, however, done a comparative analysis of pre and post scenario of human development at the level of workers.

Empirical Study

In order to grasp the depth and severity of the impact of the removal of T&C quotas at different levels, the empirical study was done at two levels – at the level of the manufacturers and workers. In order to gather data and information, three different questionnaires for operating manufacturing units, current workers and past workers were prepared.

At the enterprise level, 26 manufacturing units were surveyed for data and information on the internal and external problems faced by the RMG industry in the post ATC period and the domestic and international factors that determine the future of the Nepalese RMG industry. Similarly, at the level of workers, 274 present workers from 26 manufacturing units and 133 past workers were surveyed.

Findings

Employment, Income and Working Conditions of Workers

Employment

When the Nepalese RMG industry was at its peak, it used to provide direct employment to more than 50000 people (Shakya 2005) but during the survey, it was found that there has been a drastic reduction in employment. Only 4450 people were found to be currently employed in the industry. Out of these, 274 workers were surveyed for the empirical study.

Table 4.1 Full time employee data for 26 manufacturing units

	Sewers	Helpers	Supervisors	Managers	Others	Total
Male	1450	351	131	125	397	2454 (55%)
Female	1015	634	77	19	251	1996 (45%)
Total	2465	985	208	144	648	4450

Among the current workers surveyed, 175 were male (77 percent married and 23 percent unmarried) and 99 were female (61 percent married and 39 percent unmarried). Most of the workers (91 percent) were less than 40 years of age while 65 percent of the female workers were less than 30 years of age (Table 4.2).

Table 4.2 Number of people surveyed (by age group)

Age group	Male		Female		Total	
	Number	Percent	Number	Percent	Number	Percent
Less than 20	8	4.6	16	16.2	24	8.8
21-30	82	46.9	48	48.5	130	47.4
31-40	67	38.3	29	29.3	96	35.0
41-50	14	8.0	4	4.0	18	6.6
51 and above	4	2.3	2	2.0	6	2.2
Total	175	100	99	100	274	100

Out of 274 current workers interviewed, 6 percent earn less than NRs. 2000 per month and 8 percent earn less than NRs. 2250. Only 15 percent of the workers earn more than NRs 7500 per month (Table 4.3).

Table 4.3 Monthly income of workers

Basic monthly salary (NRs.)	No. of workers	%
Less than 2000	16	5.84
2000-3000	84	30.66
3000-4000	45	16.42
4000-5000	48	17.52
5000-7500	41	14.96
7500-10000	31	11.31
10000 and above	9	3.28
Total		100

The highest paid RMG jobs are those of mechanics and cutting masters with incomes above NRs.10000 per month. All other categories, including managers and accountants (in which most of the workers are graduates) earn less than NRs.10000. The average income of all the workers is NRs. 5676.87. Among them, helpers and sweepers earn the least (Table 4.4).

Table 4.4 Average monthly income (by type of work)

Type of work/worker	Average monthly income (NRs.)
Mechanic	13125.00
Cutting Master	11034.24
Manager/Accountant/Storekeeper	7736.84
Supervisor	7097.75
Pressman	6600.00
Stitching	5652.17
Secretary/Receptionist	5501.67
Kaj-Button machine operator	5195.14
Quality control/Checker	4909.79
Finishing/Packing	4497.27
Thread cutter	4185.67
Layer-man	4151.42
Guard	3740.52
Helper	3337.29
Sweeper	2691.67
Others	5232.00
All workers	5676.87

Educational attainment does not, however, correlate to earnings. The highest average income earner is the group of workers with secondary level education and not the workers with graduate degree (Table 4.5).

Table 4.5 Average monthly income (by educational status)

Education level	Average income (NRs.)
Cannot read and write	5671.27
Just read and write	5167.73
Primary	5493.45
Secondary	6030.60
Higher secondary	5548.83
Graduate and above	5820.75
All workers	5676.87

Other Monetary Benefits

Besides monthly wages, workers make extra income through overtime work. Out of the workers who work overtime, 45 workers, on an average, earn more than NRs. 1000 per month. In terms of other benefits such as payments for transportation, medicine, house rent, and other facilities, the number is insignificant. Only 7 percent, 4 percent, 3 percent and 11 percent of the total workers get extra payment for those facilities. However, the share of workers who get payment for festivals (annual *Dashain Bonus*) is remarkable. A total of 111 workers reported to have been receiving extra payments as annual *Dahain Bonus*. Earnings from overtime and annual *Dahain Bonus* are quite significant with the highest overtime earning of NRs. 4000 per month and highest *Dahain Bonus* of NRs. 20000 (Table 4.6).

Table 4.6 Other monthly payments to workers

Other payments (NRs.)	No. of workers					
	Overtime	Transportation	Houserent	Health	Festival	Others
0	146	254	263	266	147	245
1-500	41	11	5	8	6	2
501-1000	42	8	1	0	10	15
1000 and above	45	1	5	0	111	12
Highest payments	4000	3000	2680	100	20000	6000

Expenditures

Around 39 percent of their income is spent on food. House rent occupies the second largest portion (12.2 percent) as most manufacturing units are located in Kathmandu and most of the workers are migrants from different parts of the country. As economic migrants, the workers send about 12 percent of their income to their families. It has been found that an average worker spends more than 9 percent of his/her earnings on children's education and around 7 percent in clothing (Table 4.7).

Table 4.7 Expenditure pattern

Particular	Expenditure (% of total expenditure)
Food	38.69
Transportation	4.59
House rent	12.18
Clothing	6.70
Medicine	3.05
Children's education	9.07
Entertainment	3.06
Remittances	12.02
Others	1.00
Savings	9.63
Total	100

Use of Remittance

The survey shows that 149 workers remit some amount of money to their homes. The average monthly remittance is NRs. 1925, with a minimum remittance of NRs. 50 per month and a maximum remittance of NRs. 10000 per month (Table 4.8).

Table 4.8 Remittances by RMG workers

Send remittances (No. of workers)	149
Do not send remittances (No of workers)	125
Minimum remittances (NRs. per month)	50
Maximum remittances (NRs. per month)	10000
Average remittances (NRs. per month)	1925.2

Note: Average of remitting workers.

Most workers reported that the income they remit is used for basic necessities by their families. This suggests that the number of people dependent on the RMG industry for basic necessities is much higher than the number of people employed by the industry. The second largest use of remittances is on education of family members. Out of the total workers, 43 workers informed that their remittance is used for the education purposes. Debt repayment is the third largest category in the use of remittances (Table 4.9).

Table 4.9 Use of remittances

Use of remittances	Number	Percent
House construction/renovation	9	7.26
To buy necessities	114	91.94
Repaying Debt	20	16.13
To run small enterprise	2	1.61
Education of family member	43	34.68
Others	11	8.87

Note: Due to multiple answers, total exceeds the number of sample size.

Access to Education

The survey shows that 39 percent of total workers surveyed are either illiterate or have not completed primary level education and only 24 percent have more than 10 years of schooling. Therefore, the low skilled nature of the RMG industry was an asset for creating significant job opportunities for the less educated and uneducated (Table 4.10).

Table 4.10 Education status of current workers

Education level	No. of workers	Percent
Cannot read and write	18	6.57
Just read and write	44	16.06
Primary	46	16.79
Secondary	101	36.86
Higher Secondary	52	18.98
Graduate and Above	13	4.74
Total	274	100

Access to Health, Nutrition, Sanitation and Other Benefits

Working conditions in the RMG manufacturing units are to an extent determined by the code of conduct devised by the buyer. Major importers of T&C products in the US have minimum standard requirements, which they compel the manufacturing units to follow. These include basic amenities like drinking water and toilet and in some cases, childcare centres (Table 4.11).

Table 4.11 Facilities at work in 26 manufacturing units

Water	Toilet	Women's toilet	First Aid	Café	Childcare centres
26	26	25	25	10	2

Job Contract

Only about 11 percent of the workers have signed a job contract. It has been observed that the lack of job contract is a significant cause for labour disputes and thus friction between the employers and the employees (Table 4.12).

Table 4.12 Contract signed

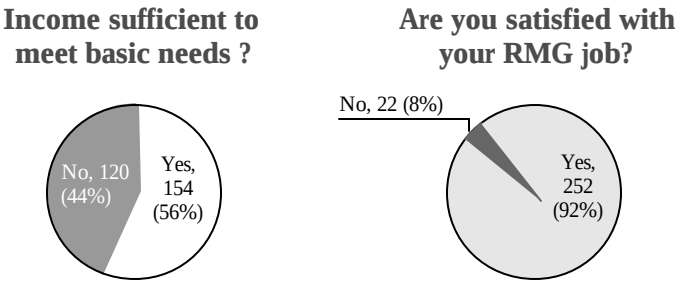
Contract signed	No. of employees	Percent
Yes	29	10.58
No	245	89.42

The survey of the manufacturers also reveals that the disputes regarding labour management have largely affected the working environment and growth of the manufacturing units.

Job Satisfaction

Out of the total workers surveyed, 92 percent reported that they are satisfied with their current jobs but 56 percent of the workers also reported that their income is not sufficient to meet their basic needs.

Figure 4.1: Job satisfaction



Savings

The survey shows that 60 percent of the workers are unable to make savings from their earnings. Among the savers, 12 percent of the workers save less than NRs. 500 per month, 10 percent save between NRs. 500 and NRs. 1000, around 13 percent save at the range of NRs. 1000-2000, 4 percent save at the range of NRs 2000-5000, and only 3 percent save more than NRs. 5000 per month (Table 4.13).

Table 4.13 Savings of workers

Monthly savings (NRs.)	No. of workers	Percent
No savings	162	59.12
1- 500	32	11.68
500-1000	26	9.49
1000-2000	35	12.77
2000-5000	11	4.01
More than 5000	8	2.92
Total	274	100.00

Gender Empowerment

Although the RMG industry can be commended for providing employment to women, the study shows distinct gender disparity in wages. The survey shows the incomes of male and female workers to be statistically different, with women workers, on an average, earning only 60 percent of men's monthly wages.

Table 4.14 Average monthly income (by gender)

	Average income (NRs.)
Male	6724.29
Female	4066.27
Income ratio (Female/Male)	60.47

Gender disparities in wage might be due to difference in the types of work done by men and women. However, the findings from the study suggest that even for similar categories of work, disparities exist. In some job categories such as finishing and stitching, these differences are larger than in average wages.

Table 4.15 Male/female wage differential (by type of work)

	Average monthly income (NRs.)		Female income as % of male income
Work type	Male	Female	
Helper	4396.94	4359.89	99.16
Packing	5038.33	4400.80	87.35
Quality control	6595.83	5118.31	77.60
Checker	6196.68	4363.28	70.41
Supervisor	7664.73	4883.33	63.71
Sewing	6713.96	4209.85	62.70
Finishing	8025.00	3663.24	45.65
All workers	6724.29	4066.27	60.47

To some extent, these wage differences exist due to differences in working hours (assuming women works fewer hours than men because of their household duties). However, working hour disparities cannot fully explain the extent of differences between male and female earnings. For example, out of 99 women workers, 20 women work seven days a week while the rest 79 women work six days a week. Whereas, out of 175 men, only 34 work seven days a week while the rest 141 work six days a week. If we look at a checker's (quality controller) wages, on an average, men work 11.6 hours a day while women work 10.5 hours a day. A possible reason for the discrepancy could be the different level of experience between the workers.

Table 4.16 Male/female work differentials (by type of work)

Work type	Average working hours/per day	
	Male	Female
Helper	10.8	9.8
Packing	10.3	9.6
Quality control	9.0	10.6
Checker	11.6	10.5
Supervisor	9.7	9.5
Sewing	11.1	10.4
Finishing	10.0	9.0
All workers	10.3	9.8

Trade Union Membership

Despite an abundance of trade unions in Nepal (all the major political parties have affiliated trade unions), the present study reveals that a majority of the workers are not a member of any trade union. Only 10 percent of the workers reported to have been associated with trade unions (Table 4.17). These figures, however, need to be examined with caution as disagreements with trade unions are common in Nepal and negotiations were ongoing in some manufacturing units visited during the survey.

Table 4.17 Trade union membership

	No. of workers	Percent
Yes	28	10.22
No	246	89.78
Total	274	100.00

Due to the volatile nature of trade union activities, especially with revolutionary tactics being employed by unions affiliated with the Maoists, workers were hesitant to discuss union activities. In addition, the workers frequently displayed sympathy towards union activities although they claimed not to be affiliated with any.union.

Harassment at Work

None of the workers reported any kind of physical or sexual harassment at work. However, some stated that they experienced verbal abuse. Among the surveyed workers, 37 reported verbal abuse by their fellow workers (11 cases), senior managers (14 cases), owners (8 cases) and others (4 cases) (Table 4.18).

Table 4.18 Harassment at work

From	Number of cases recorded		
	Verbal	Physical	Sexual
Other fellow workers	11	0	0
Senior managers	14	0	0
Owners	8	0	0
Others	4	0	0
Total	37	0	0

Housing Arrangements

Only 19 percent of the workers are receiving housing facilities and rest arrange and bear the cost of housing arrangements by themselves. Mostly, workers engaged in stitching are provided with shared housing facilities. The survey found that 67 percent of the workers share their room with 2 or more persons, 23 percent with 5 or more persons, and in two extreme cases, with 40 persons (Table 4.19).

Table 4.19 Room sharing

Room shared with	No. of employees	Percent
Single occupancy	36	13.14
2 persons	54	19.71
3-5 persons	68	55.84
6-10 persons	22	8.03
11-20 persons	3	1.09
Above 30 persons	4	2.19
Total	274	100.00

Impact on Manufacturers

Exports

In 2004, the total value of exports of the surveyed manufacturing units was NRs. 3130 million. In 2005, exports dropped by more than 10 percent to about NRs. 2790 million. Since, these figures only cover manufacturing units that were still operating and exporting in 2005, it does not portray an accurate picture of the overall decline in RMG exports. Many manufacturing units that were exporting in 2004 have ceased production altogether after the abolition of the quota system on 1 January 2005.

Table 4.20 Change in exports (NRs. in million)

Year	2004	2005
US	2957	2700
EU	134	48
Canada	21	16
Others	23	26
Total	3135	2790

Similarly, only four manufacturing units reported an increase in supply orders after January 2005, five reported no change, while most of the units reported a significant decrease in supply orders after the phasing out of ATC (Table 4.20).

Buying and Selling of New Assets

Buying and selling of new assets reveals the future expectations of the entrepreneurs. Buying of new assets is usually associated with optimism in the industry while selling with pessimism. The survey found that only six manufacturing units purchased capital assets after January 2005 while a majority, i.e., 22 manufacturing units did not. In addition, four reported selling some capital assets after January 2005.

Other Aspects of Business

When asked for their opinion on the impact of quota phase out on other aspects of the business, the response was mixed. As expected, an overwhelming majority thought the impact on the business as a whole was negative. The impact on production capacity seemed minimal while the condition of overtime and outsourced work had deteriorated (Table 4.21).

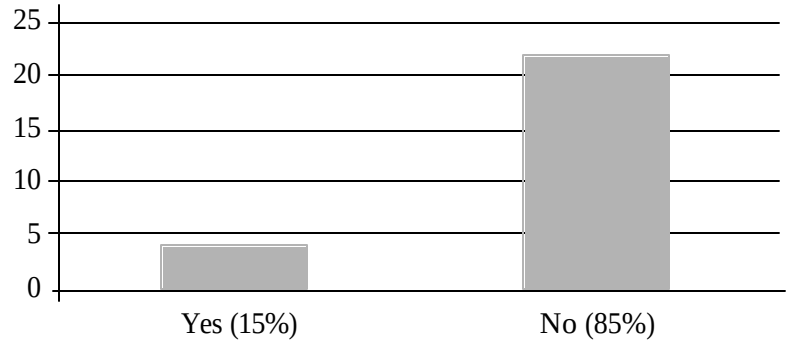
Table 4.21 Comparision of pre and post ATC period

	Better	Worse	Same	Total
Your business	6	17	3	26
Production capacity	7	8	12	26
Overtime work	3	11	9	23
Outsourced work	3	11	5	19
Benefits to workers	10	5	11	26

Survival in the Post ATC Period

A majority of manufacturers (85 percent), as depicted graphically below, were overwhelmingly pessimistic regarding their survival in the international market in the post ATC period (Figure 4.2).

Figure 4.2: Can the Nepalese RMG industry survive in the post ATC period?



Impact on Present Workers

Around 36 percent of the workers, who are still working in the RMG industry, saw an increase in their earnings since 2004. The major cause for the increase was promotion and an increase in efficiency. However, 23 percent of the workers also said that their wages had been decreased while 40 percent of the workers reported that there had been no change in their income.

In terms of work environment, 26 percent of the workers claimed it to be better than in 2004. Similarly, 21 percent, 24 percent and 23 percent of the workers informed improvements in management, children's education and social and economic participation respectively. In terms of health and living conditions, the majority said there has been no change. However, a majority of the workers reported worsening conditions in the most influential determinants of their well-being such as: salary, over time work, over time work rates and job contracts. Deteriorating income levels, attributed to the quota phase out, is the prime reason for the registered negative developments.

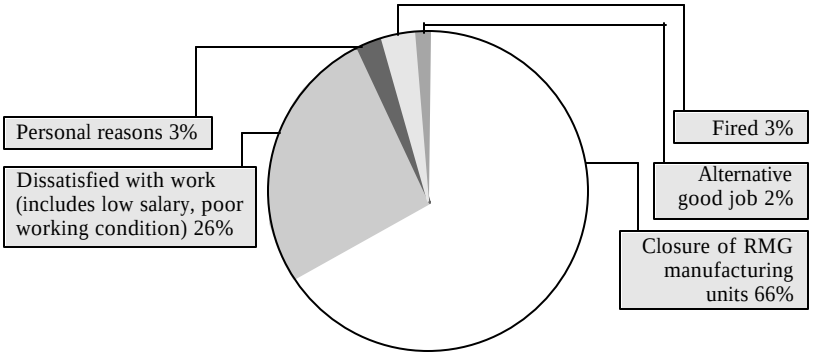
Table 4.22 Comparison of working conditions in the pre and post ATC period (in %)

	Better	Worse	Unchanged
Salary	36.14	23.29	40.56
Working environment	26.91	9.64	63.45
Factory Management	21.69	6.02	72.29
Health condition	12.85	11.24	75.90
Living condition	18.15	7.66	74.19
Children's education	24.55	6.70	68.75
Social and economic participation	23.79	4.84	71.37
Overtime work (no. of hours)	13.08	21.96	64.95
Overtime rate	15.69	15.69	68.63
Employment contract (long Vs. short)	9.52	23.02	67.46

Impact on Past Workers

Among the past workers surveyed, almost 80 percent lost their job within the last 4 years, and the other 10 percent lost their job in the last 5-7 years. The biggest proportion of workers surveyed (60 percent) reported that they lost their job after the complete elimination of the quota system under ATC.

Figure 4.3: Reasons for leaving RMG industry



Among the total respondents, 73 percent were forced out of employment from the RMG industry, while the remaining 27 percent left their job willingly. A majority of the workers (66 percent) cited closure of RMG manufacturing units as the reason for unemployment while 26 percent expressed dissatisfaction with work (due to low and late distribution of salary, poor working condition, and irregular and sometimes lack of work) as the reason for leaving the industry. It is, however, also possible that low salary, poor working conditions and irregular or lack of work are also the results of the ATC phase out. As salaries in the RMG industry are usually on a piece-rate basis, decrease in supply order may affect income and lead to irregular and lack of work.

The loss of employment due to decline in RMG exports and closure of RMG manufacturing units is most acutely felt by those who are unable to find another job. As most RMG workers concentrate in only

Table 4.23 No. of years after leaving the garment industry

Years	No. of people	Percent
Less than a year	33	24.8
1-2 years	47	35.3
3-4 years	25	18.9
5-7 years	14	10.5
8-10 years	10	7.5
More than 10 years	4	3

one stage of the production process, with the closure of the manufacturing units, the laid-off workers have been facing difficulty in finding employment in other sectors. This hypothesis is supported by the survey data as about 82 percent of the workers did not find employment immediately after leaving the RMG industry, 42 percent were unemployed for less than a year, while 29 percent remained unemployed for a period of 1-2 years (Table 4.24).

Table 4.24 No. of years without employment

Years	No. of people	Percent
0	24	18
Less than a year	56	42.1
1-2 years	38	28.6
3-4 years	11	8.3
More than 4 years	4	3

Similarly, out of the total male workers, who have left the job, 21 percent are employed, 49 percent are self-employed and 29 percent are unemployed. On the other hand, only 15 percent of the total female workers is employed, 37 percent are self-employed and 47 percent are unemployed.

Also according to the survey, illiterate workers are more likely to be unemployed (67 percent) than employed (17 percent) or self-employed (16 percent). Workers with at least primary education tend to create self-employment (62 percent), perhaps because of the confidence they gain through education. Interestingly, workers with higher secondary

Table 4.25 Employment status on the basis of education

	Employed		Self-employed		Unemployed	
	Number	%	Number	%	Number	%
Illiterate (cannot read/write)	1	16.7	1	16.7	4	66.6
Primary	5	10.6	29	61.7	13	27.7
Secondary	9	21.4	17	40.5	16	38.1
Higher Secondary	4	20	7	35	9	45
Graduate and above	7	38.9	7	38.9	4	22.2

education prefer to stay unemployed (45 percent), perhaps in search of better employment options rather than creating employment options for themselves (Table 4.25).

Of the self-employed workers, while 45 percent started their own shops ranging from RMG store to hardware, canteen and *kirana* shops (corner stores), 20 percent of such workers are involved in readymade stitching or colouring jobs. In the absence of employment opportunities, 20 percent of the workers have been forced to sell vegetables, RMG products and lighters on the sidewalks. This form of self-employment is often illegal and leads to deterioration in living standards and work environment.

Figure 4.3: Composition of self-employed jobs

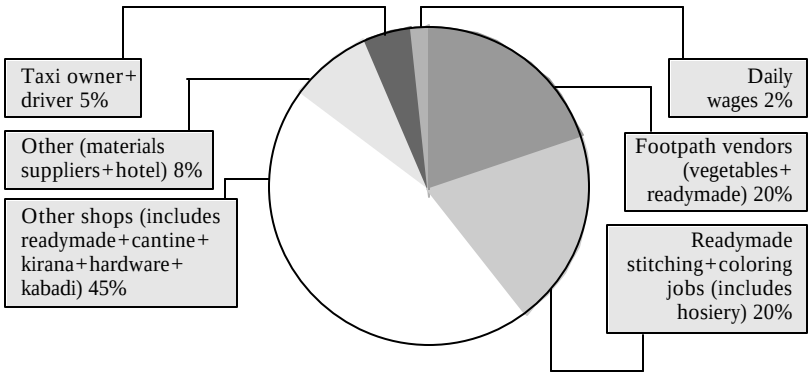


Table 4.26 Comparison of wage in RMG industry and present

Monthly wage (NRs.)	Garment		Current	
	No.	%	No.	%
0-2000	10	7.5	56	42.1
2000-3000	22	16.5	9	6.8
3000-4000	22	16.5	14	10.5
4000-5000	20	15.1	15	11.3
5000-7500	22	16.5	13	9.8
7500-10000	22	16.5	18	13.5
10000+	15	11.4	8	6

In order to assess the change in incomes, 133 workers, previously employed in the RMG industry, were asked to compare their past and present income levels. Of them, 30 percent reported an increase in their basic income while 64 percent claimed a fall in income.

The survey also shows changes in expenditure pattern of workers previously employed in the RMG industry. About 68 percent of the workers reported an increase in expenditure for food while for 17.3 percent food expenditure decreased. Inflation is the main reason cited for the rise in the food expenditure. As wage levels of previously employed workers have generally fallen, the rise in expenditures on food implies

Table 4.27 Comparison of expenditure in RMG industry and present

	Expenditure (%)		
	Increase	Decrease	Same
Food	68.4	17.3	11.3
Housing	60.9	17.3	11.3
Clothing	47.4	20.3	24
Medicine	32.3	5.3	43.6
Child education	36.8	3.8	30.8
Entertainment	18.8	33.1	27.1
Remittance	8.3	30.1	10.5
Saving	10.5	48.1	4.5

Note: Since many workers did not answer, the percentage does not add up to 100.

lesser resources for education and health. Similarly, 61 and 47 percent of the workers reported a rise in housing and clothing expenditure respectively. Likewise, 33, 30 and 48 percent of the workers reported a fall in entertainment expenditure, remittance and savings respectively (Table 4.27). These reductions are a result of lower income.

CHAPTER 5

Nepalese RMG Industry in the Post ATC Period

Competition in the International RMG Trade

The nature of competition in the international RMG trade has changed after the quota phase out under ATC. In order to enhance the competitiveness of their products in the international market, the government and the private sector now need to concentrate on different factors that affect the demand and supply side of RMG trade. It is due to the fact that in the post ATC period, in addition to price, many other factors such as infrastructure, technology, tariffs and non-tariff barriers and trade policies of the trading nations determine the capacity of the manufacturing units to respond to the changing trade environment.

Factors affecting Demand Side

Strong Buyers' Market

The international clothing market is fast changing from a 'seller's market' to a 'buyer's market'. With the elimination of quota restrictions, international buyers are free to import from wherever they choose. Consequently, they are now concentrating their imports from a few countries with consolidated production capacity. The US Department

of Commerce in its report in 2004 estimated that the number of countries from which US imports garments will be reduced to half by the end of 2006, and by a third by 2010. The surviving exporters to the US market will exclude countries that have enjoyed an "artificial comparative advantage" due to the "quota rents." Some landlocked least developed countries (LDCs) such as Laos and Mongolia that lack consolidated production capacity have already lost their market share. Hence, it is likely that if the major buyers, including the US, exclude from their list the countries that have low production capacities and few manufacturing firms, Nepal will also suffer.

The China Factor

China is a leading player in the world's T&C market. With the expiry of ATC, its export of apparels has grown rapidly. China's comparative advantage and supply capacity in the apparel industry has added more

Table 5.1 Leading apparel exporters

	Value (billion US$)	Share in world clothing exports (in %)			
	2004	1980	1990	2000	2004
EU (25)	74.9	-	-	27.0	29.0
Extra EU exports	19.1	-	-	6.9	7.4
China*	61.9	4.0	8.9	18.3	24.0
Hong Kong (China)	25.1	-	-	-	-
Domestic	8.1	11.5	8.6	5.0	3.2
Re-exports	17.0	-	-	-	-
Turkey	11.2	0.3	3.1	3.3	4.3
Mexico**	7.2	00.	0.5	4.4	2.8
India***	6.6	1.7	2.3	3.1	2.8
US	5.1	3.1	2.4	4.4	2.0
Romania	4.7	-	0.3	1.2	1.8
Indonesia	4.5	0.2	1.5	2.4	1.7
Bangladesh	4.4	0.0	0.6	2.0	1.7
Thailand**	4.1	0.7	2.6	1.9	1.6
Vietnam**	4.0	-	-	0.9	1.5

** Or nearest year ** Includes significant exports from processing zones *** Includes Secretariat estimates*

Source: WTO, 2005.

to its competitiveness. The catalogue of China's strengths is long, some of them are: low labour costs, strong business networks, and excellent shipping connections that allow for shorter transit times to the world's major markets – the US and the EU (UNDP 2006).

China's share of total apparel exports has substantially increased with the quota phase out. Total exports from China went up by 6 percent and constituted 24 percent of the total world exports in 2004. Similarly, its share in the US and the EU increased by 46 percent in value and 44 percent in volume terms between 2004 and 2005 (UNDP 2006). Moreover, the phenomenal growth in exports has occurred in categories of clothing important to the Nepalese exporters. China's export growth rates for some of Nepal's key export items increased by more than 1000 percent immediately after the quota phase out (Table 5.2). For example, China claims 40 percent share of world exports for cotton and manmade fibre trousers, men's woven shirts, cotton and manmade fibre knit shirts and underwear (GAFTT 2005).

Table 5.2 Growth rate of selected Chinese clothing imports to US

Key individual category / description	Quantity (January-March 2005 against January-March 2004)	Percentage change
Cotton knit shirt	+ 6,521,795 doz.	+ 1257.87%
Non-knit shirts	+1,422,603 doz.	+284.12%
Cotton and manmade fibre trousers	+6,176,504 doz.	+1521.04%

Source: Shakya, 2005a and ADB, 2005.

In 2005, the US and the EU imposed restrictions through safeguard quotas on some of the major categories of RMG that were removed from quota restriction.[13] With safeguard quotas in place, the growth of Chinese exports to the US is limited to 7.5 percent. Chinese companies

[13] In May 2005, the US imposed restrictions on cotton knit shirts and blouses, cotton trousers, slacks and shorts, and cotton and manmade fibre underwear. And the restriction was further extended to cotton yarn, men's and boys' cotton and manmade fibre shirts, manmade fibre knit shirts and blouses and manmade fibre trousers. Similarly, the EU also investigated Chinese imports of t-shirts, pullovers, men's trousers, blouses, stockings and socks, women's overcoats, brassiers, flax yarns and woven fabrics.

utilised the US quotas within the first few months (particularly in those items restricted during the quota regime and also important for the Nepalese exporters) and they had to stop exporting for the rest of the year. The quota exhaustion in China gave some scope to other countries' exports. However, Nepal failed to benefit from the US' action on China and larger suppliers like India and Bangladesh benefited the most. It appears unlikely that Nepal will benefit from the safeguard measures of the US and the EU on China's exports without strengthening its capacity to meet the buyers' requirement for extra services.

Declining Apparel Prices

The price of apparel seems to be declining in a quota free RMG trade for several reasons. The average international price of apparel will continue to decline, mainly due to increased world production, reduced distribution and administrative costs for quotas and relocation of production bases to cheaper locations. The decreasing trend in the world apparel price is also reflected by the value growth rates, which are much lower than volume growth, implying declining unit values and product prices following the quota abolition. All these factors have contributed in lower prices, primarily in China.

According to National Council of Textile Organization (NCTO) of the US, in 2005, the prices for Chinese apparel products have declined by an average of 48 percent between 2001 and 2004 and the prices for items removed from quotas will continue to decline further. The sharp fall in average prices of Chinese apparels is more threatening to other

Table 5.3 Reduction in unit value of select Chinese apparel (in first half of 2005)

Cotton trouser		T-shirt	
US	30% approx	US	45%
France	> 25%	France	30%
UK	> 25%	UK	> 40%
Germany	>20%	Germany	40% approx
Canada	> 20%	Canada	-

Source: Knappe, 2005.

countries than any other single factor. Prices of some items important for the Nepalese exporters such as cotton trousers, shorts and t-shirts have reduced by almost half. The trend of price reduction in Chinese apparels is intense not only in the US market but also in the European and Canadian markets (Table 5.3). If the present trend continues, price competitiveness of small suppliers like Nepal is likely to further erode.

The fact that price is a sensitive variable in the demand function is demonstrated by the inverse relationship between prices and values of some exported items (Table 5.4 and 5.5).

However, it is difficult to generalise these observations to the Nepalese exports as demand for select Nepalese items has gone down despite lower prices. This suggests that the price difference is not the only or the

Table 5.4 Price for cotton knit shirt for men/boys in the US

Exporter	Price per piece in US$		Import value in million US$	
	Jan-Sept 2004	Jan-Sept 2005	Jan-Sept 2004	Jan-Sept 2005
Bangladesh	3.39	2.52	18.8	38.8
China	8.86	2.93	37.9	91.0
India	4.88	3.78	78.9	102.2
Pakistan	3.65	3.23	157.0	137.2
Sri Lanka	6.02	4.94	21.0	31.4
Nepal*	2.96	2.71	12.39	7.31

Table 5.5 Price for cotton trousers/shorts for women/girls in the US

Exporter	Price per piece in US$		Import value in million US$	
	Jan-Sept 2004	Jan-Sept 2005	Jan-Sept 2004	Jan-Sept 2005
Bangladesh	5.90	4.42	37.1	63.7
China	12.36	5.47	73.9	334.7
India	9.34	7.54	46.7	76.2
Pakistan	5.56	6.25	8.2	18.0
Sri Lanka	6.94	6.77	62.2	90.1
Nepal*	3.86	4.02	43.55	22.33

Source: otexa.ita.doc.gov/

** Garment Association of Nepal (GAN).*

most decisive factor to the buyers. Other factors, including quality and delivery efficiency, could equally affect demand. Therefore, the Nepalese exporters have two options to respond to declining demands. They can either improve the price competitiveness by squeezing the output cost or add more values to quality and delivery, without reducing the prices.

Preferential Market Access and Duty Advantage

The demand for clothing in the international market is not solely determined by the product price and quality. Countries that have access to preferential market access have extra leverage to raise their exports at the expense of non-privileged ones. Preferential market access (regional, bilateral, etc.) to select countries is not uncommon in international trade. Countries with preferential access gain a competitive advantage at the cost of countries that do not have such privilege. The proliferation of preferential market access has, in reality, complicated the new trading system in apparel trade.[14]

One of the major drawbacks of the preferential trading arrangements is that it discriminates among developing countries, and the practice is intense in the T&C sector. The tariff advantages are valuable as tariffs are relatively high on T&C in industrialised countries, compared to other industrial products. The average applied tariffs on these products in the US, the EU and Japan, for instance, are three to five times higher than those applied to other products.

About half of the products in this sector are subject to tariffs between 15 percent and 35 percent in the US, about 9 percent in the EU and 7.6 percent in Japan (Shakya 2005a). Tariff peaks of duties exceeding 12 percent *ad valorem* on apparels are also high; the frequency of post Uruguay Round tariff peaks in T&C is 21 and 44 in the US respectively, and 45 and 93 in Canada.[15] The Uruguay Round effort to reduce tariff on

[14] The total number of preferential agreements notified to the WTO has reached 170. Between January 2004 and February 2005 alone, 43 regional trade agreements – RTA - have been notified to the WTO, making this the most prolific RTA period in recorded history.

[15] As reported in the UNCTAD Trade and Development Report, 1999.

T&C became seemingly ineffective as the tariff cutting formulae had shifted the focus to less sensitive areas, and, as a consequence, there was a persistence of tariff peaks on sensitive products – which is evident in the cases of T&C, which was a major exports of the developing countries.

The advantage of duty free treatment for Nepal cannot be underestimated as a major chunk of the country's exports depends on this privilege under the GSP.[16] However, the value of preferential trade in Nepal's apparel exports is mixed. Nepal's apparel exports are facilitated by the preferential treatment under the GSP schemes in quad countries (except the US). The exports also benefit from the Everything but Arms (EBA) scheme of the EU, the Market Access Initiative for LDCs of Canada, and the revised GSP scheme of Japan (See Table 5.9). The facilities provided by these GSP giving countries are unilateral and non-reciprocal. However, there is no special bilateral or regional preferential facility for the Nepalese clothing.[17]

Table 5.6 Major preferential schemes available for Nepalese apparel

Country	Preferential scheme	Effective	Basic features
Canada	Market Access Initiatives for LDCs	2003	Duty and quota free. Improved rules of origin.
EU	EBA	2001	Duty and quota free. No time limitation. Derogation from the GSP rules of origin.
Japan	GSP (Revised scheme)	2003–2014	Duty free entry Exemption from ceiling restriction and change in tariff heading for RoO.

[16] Apart from the quad countries, Nepalese exports have access to about 15 GSP schemes in different countries including Switzerland, Australia, Norway, New Zealand, Russian Federation and some East European countries. In addition to these, the Nepalese exports, except for a few items under the sensitive list, get preferential treatment in India under the bilateral trade agreement.

[17] Nepal has, however, a bilateral agreement with the EU for the GSP and ceiling on exports of select T&C items for derogation from the GSP/RoO. Also, it has memorandum of understanding for the GSP with Canada.

The US offers tariff concessions to countries in the Caribbean and South America under the North American Free Trade Agreement (NAFTA) and Carribean Basin Trade Partnership Act (CBTPA), and very recently the Central American Free Trade Agreement (CAFTA). It also favours select economically vulnerable African countries under the African Growth and Opportunity Act (AGOA). Countries with preferential access have "unfair advantage" over non-beneficiaries like Nepal. For example, under NAFTA, Mexico has the margin of preference equivalent to 50 percent, which means that clothing items from Mexico can compete effectively with those from Asia even if they cost twice as much to produce, taking into account the costs of transportation and time to ship goods to the US retail markets (James 2005).

Similarly, in terms of market access to the US, the Nepalese apparel is subject to most favoured nation (MFN) rates in the US, which increases its relative cost. It would be relevant to observe the US bound and applied MFN rates to assess their incidence on the Nepalese exports. The US bound tariffs for articles of apparel accessories, knitted or crocheted (HS Chapter 61) range from an average of 11.22 percent (for those products that face an *ad valorem* tariff to 13.31 percent) plus a specific tariff of US$ 494.73 per ton (for five products that face both an *ad valorem* and a specific tariff component). For HS Chapter 62, or the articles, not knitted or crocheted, the tariff rates range from the average of 8.76 percent to (for those products facing only an *ad valorem* tariff) 16.84 percent plus specific tariff for US$ 384 per ton (for 9 products that face both an *ad valorem* and a specific tariff component). The bound tariffs on Nepal's top exported items to the US ranges from the lowest 6 percent on shawls, scarves and veils of wool or fine animal hair (HS 621420) to as high as 27 percent on men's/boys' trousers and shorts (HS 620343). The next highest maximum bound rate is 26 percent for women's/girls blouses and shirts, of manmade fibres, not knitted (HS 620640). Out of the select top apparel items exported to the US, the highest applied rate is 19.7 percent on men's/boys' cotton shirts. For the five top categories (which includes items like cotton trousers, shorts, shirts and t-shirts), the applied rates range from 0 percent to 19.7 percent with a simple average across all products of 11.3 percent.

Table 5.7 US applied tariffs on selected apparel items of Nepal

Product Code	Product Description	Tariffs Applied by US to Nepal (2005)	No. of tariff line products
620520	Men's/boys' shirts, of cotton, not knitted	19.7% and 8.7%	2
620342	Men's/boys' trousers and shorts, of cotton, not knitted	16.6%, 10.3% and 0%	3
620462	Women's/girls' trousers and shorts, of cotton, not knitted	16.6%, 8.9%, 7.1% and 0%	4
610910	T-shirts, singlets and other vests, of cotton, knitted	16.50%	1
610510	Men's/boys' shirts, of cotton, knitted	19.70%	1
620630	Women's/girls' blouses and shirts, of cotton, not knitted	15.4%, 9% and 3.5%	3
611020	Pullovers, cardigans and similar articles of cotton, knitted	16.5% and 5%	2
620411	Women's/girls' suits, of wool or fine animal hair, not knitted	14%	1
620412	Women's/girls' suits, of cotton, not knitted	14.90%	1
620442	Women's/girls' dresses, of cotton, not knitted	11.8%, 8.4% and 5.5%	3

Source: Analysis of Export Structure and Market Access Barriers to Nepal's Apparel Trade, Bijendra Man Shakya, Garment Association – Nepal (GAN) under the grant assistance of the International Trade Centre (ITC), September 2005.

However, there are a number of items at the tariff line level that face lower rates of tariffs (sub-categories of Nepal's top 10 exports at HS-6 level). Roughly, the average applied rate for all Nepalese apparel is estimated at 14.6 percent and most of Nepal's exported items fall under these two HS chapters.

Thus, it can be inferred that the discriminatory nature of the US preferential scheme makes it difficult for the Nepalese RMG industry to survive and compete in the post ATC period. Since the Nepalese apparel exporters have to operate in an uneven playing field, the general concern of the Nepalese exporters is that Nepal needs preferential market access in the US to offset the relatively higher output and

transaction cost due to geographical disadvantages (Shakya 2005b).

The EU, similarly, provides duty free treatment to select east European and North African countries under the outward processing trade (OPT). Unlike the US, the EU grants preferences to all LDCs under the GSP under EBA. Canada also provides GSP to all LDC products, including textiles and apparel. Both have made their preferential RoO relatively flexible in recent years. Such policies have supported the LDCs to export their products in these markets as they help to offset higher production costs.

The impact of EBA on Nepalese apparel shows promising signs. Exports have increased steadily in recent years, particularly due to the relaxation of GSP/RoO for the Nepalese apparel. The Canadian and Japanese schemes are also crucial as both provide duty free and quota free facility with relatively flexible RoO. However, the preference utilisation in all the three countries is not significant despite changes in the preferential RoO.

Although Nepalese apparels enjoy full preferential margin in absolute term in all schemes, the margins are smaller compared to other preference receiving developing countries. For example, the EU provides reduced MFN rates for all developing countries, narrowing the relative margin of preference for countries like Nepal. Moreover, the erosion of preferential margin will largely be affected by the outcome of non-agricultural market access (NAMA) negotiations under the Doha Development Round. During the NAMA negotiations, WTO Members have been stressing for reducing high tariffs, tariff peaks and tariff escalations. Since the tariffs on apparel are relatively high, negotiations to reduce MFN rates will surely also affect the apparel industry. If the talks succeed, it is likely that the margin of preference will further erode, making all the preferential schemes irrelevant.

Market Proximity

Geographical closeness to major markets is an important factor that determines competitiveness in the international apparel trade. Firstly, prox-

imity helps secure preferential market access. As mentioned earlier, the US and the EU have given preferences to imports from countries geographically close to them. The Caribbean and Latin American regions have benefited from the US preferential schemes under the NAFTA, CBTPA and CAFTA. The strong export performance of Mexico, Costa Rica, Honduras and Dominican Republic is substantially due to their proximity to major importing markets. Likewise, the EU's sourcing pattern has favoured Eastern European countries, such as Hungary, Poland, Romania, Bulgaria and Czech Republic, as well as the Mediterranean countries, like Morocco, Tunisia and Turkey. These countries had considerably increased their export values to the EU, replacing traditionally important Asian suppliers. This shift in the EU imports was aided by the OPT trade and other bilateral arrangements (Joshi 2002). However, countries that were under the preferential treatments in both the US and the EU had experienced deteriorating export trend in 2005, if compared to their exports to the respective countries in 2004 (Adhikari and Yamamoto 2006).

Secondly, even without preferential market access, market proximity offers other advantages. Quicker response and delivery times as well as ease of quality control and monitoring by buyers help secure export ties. In addition, proximity also helps transfer low value activities from high cost to low cost countries. Such practice have helped retain capital-intensive fabric production in the US, France, Germany, Italy and the UK, and their exports were largely concentrated to countries close to them that have preferential market access provisions.[18] Since Nepal does not enjoy the advantage of market proximity with major world markets, its competitiveness largely depends on how efficiently it can manage the value chain. However, with unprecedented growth of the Indian economy and Nepal's preferential trading arrangement, India can also become a major market in the future.

[18] About 28 percent of EU fabric exports were concentrated in Romania, Tunisia, Morocco and Bulgaria alone in 2004. The figure increased to 37 percent if EU exports to Turkey are also included. Likewise, almost 80 percent of all US yarns and fabric exports went to NAFTA and CAFTA partners, during the same period.

Value Chain Management

The nature of clothing trade has started to change from purely CMT business to a more service-oriented one. International buyers have been imposing more requirements on manufacturers and increasing the number of services up the sourcing and supply chain. Unlike in the past, manufacturers have to be responsible for an integrated production network, consisting of sourcing of raw materials to production, as well as distribution and marketing. Manufacturers have to manage the value chain and consider the costs, quality, reliability, transport and transaction cost as important variables in order to be competitive. In a changing marketplace, the manufacturers can either absorb the costs and thus lower profit margins or reduce the costs by improving productivity, or pass the cost further up the supply chain to the textile sector (Nordas 2004).

In this context, the competitiveness of the Nepalese manufacturers depends on whether they can manage sourcing and supply chains efficiently. Concurrently, they should be able to meet the standard lead-time of international markets. The average time, from design to US distribution center, for orders for one major buyer has shortened from 21 weeks in 2000 to 12 weeks in 2003 (Lezama, Webber and Dagher 2004). If that is any indication of a continuous trend, the lead-time would further shorten in the future.

Rules of Origin

RoO is part of the preferential market access scheme that is used to determine products eligible for duty concession. Such rules are put in place to control trans-shipment of the goods from non-beneficiary to beneficiary countries. RoO is stringent in the apparel industry because manufacturing of a product undergoes processing in several countries, from spinning of the yarn to weaving, dying, cutting, sewing, and assembling of apparel. Normally, the preferential RoO requires the preference receiving countries to make apparel from yarn or fabric of the beneficiary country, or add some percentage of value. Some preference giving countries allow the product to be eligible if there is a substantial transformation or change in the tariff heading (HS code) of the product

in the beneficiary country. Going by these requirements, what really matters is not just preferential tariffs, but also the capacity to meet the RoO.

It is important to examine the RoO under different preferential schemes to assess the potential gains from such privileges. Although the general rules seem difficult to be met by Nepalese apparel manufacturers, some flexibility have been introduced by Canada and the EU recently. The Canadian rule, which is based on percentage value addition, has been liberalised by increasing domestic value added rate up to 60 percent of cumulated value of imported inputs either from Canada or from other countries eligible for the country's General Preferential Tariff (GPT).[19] With specific reference to apparel, a product can qualify under a wholly produced rule or one of the new specific RoO governing the country of origin of inputs. The application of either one of the exiting rules or the new rules is dependent on the nature of the good being exported and whether it is provided according to the RoO regulations outlined by the General Preferential Tariff and the Least Developed Country Tariff (Canadian Customs and Revenue Agency 2002).

The EU, in general, applies three systems: change in tariff heading, percent of value added requirement and the undertaking of a specified production process. It allows the third country fabric inputs (with a cumulative limit) when they are imported from other LDCs. The most noteworthy provision of the EU preferential rule with special application to Nepal is that it allows derogation from the standard EU GSP/RoO.[20] Under this special provision, Nepalese apparels made after only one processing are eligible for the GSP facilities. Under 'cumulation rules', inputs originating from other South Asian Association for Regional Cooperation (SAARC), Association of South East Asian Nations (ASEAN) and African, Carribean and Pacific (ACP) countries can be used without affecting eligibility and the specific value added criteria is not applicable. However, quantitative limits apply to imports of the apparel products under derogation from standard EU GSP rules.

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[19] GPT countries are the countries or territories entitled to the GPT tariff or general preferential tariffs.

[20] The Commission Regulation (EC) No. 2187/2004 of 20 December 2004, amending Regulation (EC) No. 1615/2000 derogation from Regulation (EEC) No. 2454/93 in respect of the definition of the concept of originating products used for the purposes of the scheme of generalised preferences to take account of the special situation of Nepal regarding certain exports of textiles to the Community.

The Nepalese exporters have benefited from this system since 1997. The EU expanded the facilities in 2002, 2004 and 2006 upon Nepal's request for the derogation.[21] The provision of derogation for certain time period and application of quantitative limit on items under the facility have, however, created uncertainty for the Nepalese apparel exporters. It may be worth mentioning that preference utilisation of the Nepalese exporters under EBA is only 81.6 percent. The utilisation rate is even lower in apparel items. For example, in 2003, the utilisation rate was 68.7 percent for women's/girls' cotton blouses and shirts and 69.4 percent for women's/girls trousers and breeches. Relatively higher utilisation rate was achieved in shawls and scarves of silk (92.9 percent) and women's/girls' cotton denim trousers and breeches (88.5 percent). These low utilisation rates suggest that Nepal has ample opportunity to expand exports to the EU, provided it overcomes the supply-side constraints and exploits the EBA schemes.

Standard Related Issues

Due to mounting domestic pressures, the buyers' requirements for standards and code of conduct in manufacturing are becmoing increasingly important in international trade. Fear of exploitation and disregard for environment compel the buyers to make sure that certain basic standards are met by all manufacturers. Domestic industries in importing countries are quick to point out the unfair (and unjust) advantages enjoyed by manufacturers in less developed countries due to the absence of strict labour and environmental regulations. There is a growing concern that access to markets in developed countries will be significantly reduced due to consumer boycotts of non-labelled goods (because it may be exploitative) and aggressive advertising by protectionist domestic industries (ITC 2004).

Although the Nepalese exporters have not been confronted with such measures, except for work place codes as required by US buyers, the importance of standards should not be underestimated. Non-govermental organisations (NGOs) in the industrialised countries are

[21] The request for the prolongation was made by Nepal to the EU in 2006 and is now valid upto 2008.

pushing buyers and retailers to import from "ethically correct" manufacturers. Similarly, eco-labelling in clothing, so far voluntary, is likely to be mandatory in the future, especially in the EU. As EU enterprises face additional responsibilities with respect to the environmental impact of their activities, they will be required to enforce stricter standards on imports of clothing in the future. When that happens, Nepalese apparel manufacturers and exporters will be required to bear extra costs. In order to minimise the impact of standard related measures in the future, the Nepalese exporters should, therefore, work towards building their capacity to face these requirements.

Anti-dumping and Safeguard Measures

The use of trade remedy measures, such as anti-dumping and safeguards, is gradually escalating after the phasing out of quotas on T&C. The most prominent case is the US safeguard imposed by the US against select Chinese T&C products in 2003 and 2004. Since trade remedy actions are more likely to be taken against developing countries with high export volumes, the Nepalese apparel exporters are certain to be unaffected by these measures in the short run.

At the moment, the Nepalese exporters should try to exploit the opportunities borne out of the actions taken by the US and the EU against the big players in textiles and apparel trade. Because safeguard measures are likely to target large countries with integrated T&C industries, such as China, India, Pakistan and Indonesia, smaller countries could benefit from protectionist measures from the buyers (ITC 2004). The China safeguards put in place by the US and the EU, for example, have diverted trade from China to smaller players. It was earlier thought that with safeguard provisions against Chinese apparel in place under China's WTO Accession Protocol, there is a possibility of spillover trade to the Nepalese apparel industry too, at least until the expiry of the provision.[22] However, the Nepalese exporters have not been able to take advantages of trade remedy actions against China.

[22] The China's WTO Accession Protocol allows two safeguard mechanisms: One is the T&C specific safeguards valid until December 2008, and another is, the product specific safeguards, valid until 10 December 2013.

Factors influencing the Supply Side

Physical Infrastructure

Supply efficiency in the apparel industry is more vital than ever before because international clothing business is characterised by full involvement in the production process (designing, fabric development, market research, marketing etc.) instead of being confined to CMT. Competitiveness in such environment depends on the availability of adequate physical infrastructure such as improved transportation network, physical distribution system and trade facilitation, including simplified customs procedure at the national level. At the enterprise level, supply efficiency largely depends on management and availability of ancillary industries specialised in production of clothing accessories, banking services and cargo services.

Supply efficiency of the Nepalese apparel industry is impeded by the unavailability of these physical facilities and services. While the lack of direct access to sea has added to the costs of doing business, the absence of backward and forward linkages has obstructed industry consolidation and technology development. Moreover, these factors have restrained the industry from the possibility of vertical integration, an important supply side factor in the post ATC period. Hence, the possibility of overcoming the supply side constraints and a reduction of industry output costs would largely depend on government policy and the commitment of the enterprises to develop these facilities.

An appropriate means of overcoming infrastructure problems could be through industrial clustering within a GPZ, as proposed by GAN.[23] Similar to an Export Processing Zone (EPZ), the GPZ is a product specific export oriented zone, aimed at special functional areas to match international standards (Shakya 2005a). The GPZ could be instrumental for the vertical integration of the Nepalese RMG industry and economies of scale. Nepalese EMG entrepreneurs are insisting on establishing the

[23] The idea of GPZ was first proposed by GAN in 2001 to mitigate internal bottlenecks and to adjust with the changing global trade environment for clothing. This idea was, in principle, also agreed by the Government of Nepal but the government policy has not embraced the issue so far.

GPZ closer to the Inland Container Deports (ICD) at Birjung to facilitate delivery efficiency. Although a Special Economic Zone (SEZ) has been proposed in the budget speech for the FY 2006/07, RMG entrepreneurs are sceptical of its usefulness to help revive RMG exports.

Transportation and Lead Time

Transportation has remained a stumbling block in Nepal's export trade in general. Transportation issues are more troubling in the case of the apparel industry as it increases transaction costs. Transaction costs of Nepal's RMG products is up to 20 percent higher than in other RMG exporters in the South Asia region. A common complain of apparel exporters is that they have to bear the full cost of a container and clearance charges in Kolkotta regardless of the volume of the goods, which has resulted in higher transaction cost. Secondly, due to transportation problems, the delivery time required for the Nepalese suppliers is 50 percent longer than for other suppliers within the region (Shakya 2005a). Hence, Nepalese apparel exporters are affected by both cost inefficiency and a longer lead time (Shakya 2005a). This poses a serious threat to apparel exports because lead time in international clothing trade has substantially decreased. Apparel is increasingly becoming a perishable good, particularly in the case of the fashion-segment, with shorter selling periods and frequent changes in style.

The Nepalese exporters could reduce much of the problem in transportation and delivery by enhancing facilities and management of the ICD[24] in Nepal. It is estimated that transportation costs in the RMG sector could be reduced by 40 percent if the ICD facilities are fully utilised (Shakya 2005a). This explains the widespread demand for efficient use of the ICDs and it is important that priority be given to the Birjung ICD to expedite transportation and delivery efficiency.

[24] With the financial assistance of the World Bank, the Government of Nepal has established ICDs in the three major transit points of the country: Biratnagar, Bhairahwa and Birgunj. The first two are road-based ICDs and the last one is rail-based and linked directly with Kolkota in India.

Human Resources and Technology

A focus on human resources and improved technology is required in the RMG industry to address the supply side challenges. As mentioned earlier, the nature of RMG business has changed from being totally dependent on the buyers to being responsible for product development, marketing etc. It is impossible to respond to these challenges, especially in the fashion-oriented industry, without enhancing inputs for quality, skill development, and research and development (R&D).

One of the reasons for the Nepalese apparel industry to remain confined to lower end products is due to its inability to upgrade quality and technology. In this context, the Nepalese entrepreneurs should realise that the advantage of low cost inputs is not the only requisite to be competitive in the industry. The use of sophisticated technology such as Computer Aided Design (CAD)/Computer Aided Manufacturing (CAM) system should be adopted to increase efficiency in designing and quality. At the same time, development of human resources is required to match technology advancement. At the enterprise level, it is important to enforce in-house training and combine R&D with training. This will help the enterprises to improve the ratio of direct labour to indirect labour and downsize and re-engineer production lines. Importantly, to overcome the supply constraints and reduce costs, RMG manufacturing units can also cooperate at different levels of production chain.

Financial Issues

Easy access to trade financing is vital for a successful export transaction. The need for trade financing in the RMG sector is imperative at both pre-shipment and post-shipment stages. Since Nepal's RMG industry is based on imported raw materials and involves long processing time, pre-shipment financing is crucial. Similarly, post-financing is important to maintain cash flow once the consignments have been dispatched. It is also important for the exporters to back their offers to foreign buyers with attractive credit terms to compete effectively and win contracts. This can be a valuable competitive tool for the exporters in the post ATC period.

However, most commercial banks show little interest in financing the RMG industry, due to their deteriorating situation in the post quota regime. The lack of mutual trust between the industry and commercial banks is the major reason for the problem of financing in the clothing industry. Once trust is reestablished, financing can be extended with provisions of term loans and project loans, including the facility of export financing based on confirmed export letter of credits. This will also help in sorting out problems related to other issues such as bank rates and collateral.

Political Stability and Policy Issues

The first year of the post ATC period has been disappointing for the RMG industry in terms of political instability and escalated insurgency. Problems related to political instability seemed to be more responsible than the quota adjustment problem in affecting the supply side. Apart from quota elimination, labour agitation and strikes have also affected RMG business. However, no concrete government policy is in sight to deal with the problems that the RMG industry is facing. The persistent supply constraints, related to income tax rebate, refund of value added tax (VAT), industrial relations, and duty drawback schemes including the provision of bank guarantee, seem to aggravate the problem. Interestingly, the Readymade Garment Export Promotion Committee (RGEPC), which consists of representatives from government agencies and the private sector, is also almost dysfunctional due to lack of effective coordination and authority.

Factors affecting the RMG Industry: Views of Manufacturers

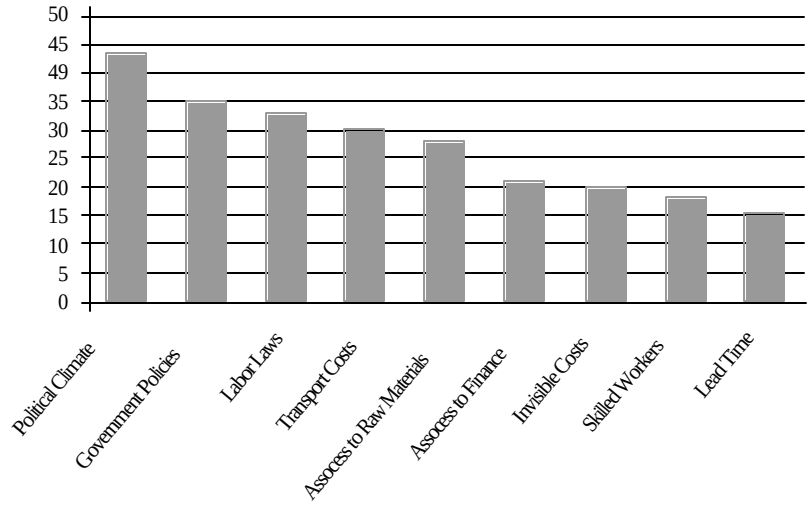
Problems faced by the RMG Industry

The RMG manufacturers were asked to identify the problems faced by them. They were first asked to rank the problems faced by industries in Nepal from 1 to 10 (with one being the most sever and 10 being the least severe) from the following list – physical infrastructure, political climate, skilled workers, capital and financial facilities, government's rules

regulations and facilities, lead time, transport costs, invisible costs (bribe, red-tape, etc.), labour laws and access to raw materials.

The results were used to calculate the Average Ranking Score (ARS) and summarise the problems ranked according to severity. As expected, political climate tops the list as the most severe concern among the manufacturers. Despite dramatic changes in the Nepalese politics in the last few months, it is apparent that the business community feels it to be the greatest threat to their success. The by-products of an unstable political environment – general strikes, blockade of roads, complete shut downs of institutions and accommodations made to placate opposing political forces – seem to have affected the industries the most. The manufacturers also stressed that weak and often illegitimate governments have been unable to help the business community through bilateral or multilateral trade agreements, lobbying for privileges in the international market, and planning and implementation of long term plans to promote industries, especially export-oriented sectors.

Figure 5.1: Average ranking scores of problems faced by manufacturers

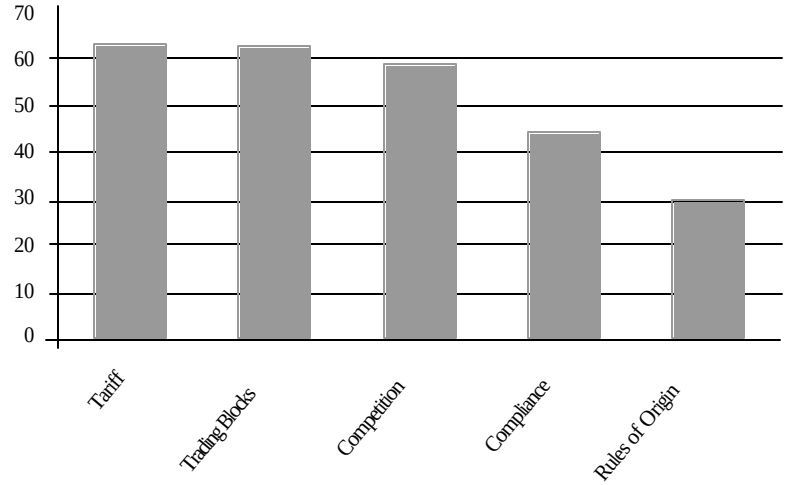


The top three issues relate directly or indirectly to the first, i.e., political climate. The respondents ranked inadequacies of government policies related to trade, investment and industry as the second most severe issue. Labour related problems were ranked the third most severe issue by the manufacturers. Labour laws of the country are considered "too progressive" by many in the business community. The argument for pro-business labour laws are many but a common one is echoed through the questions – In a country where the majority of the population is deprived of employment, how wise it is for the government to insist on maximum benefit (especially when it comes to hiring and firing) for those who are working? Many respondents insisted that labour regulations actually discourage entrepreneurs from adding extra workers and are anti-employment in nature.

External Factors affecting the RMG Industry

The manufacturers were asked to rank the external factors that hinder their export potential. The results are summarised in Figure 5.2. On an

Figure 5.2: Average ranking score of external factors affecting the RMG industry



average, tariff imposed by the importing countries was ranked the most important factor limiting exports, followed by increased competition in the absence of quotas, and the emergence of trading blocks that have managed to gain preferential access in the US market. The respondents claimed that similar preferential access was necessary for the LDCs like Nepal.

Prospects for the RMG Industry in the Post ATC Period

Nepal was identified as one of the countries to be affected overwhelmingly by the liberalisation in apparel trade. The impact of the quota phase out was most pronounced in Nepal while some LDCs, such as Bangladesh and Cambodia, managed to withstand competition and even increased their exports despite the dire predictions. The combined T&C export of Nepal to the US, the largest market for the product, decreased by more than 25 percent in value and over 40 percent in volume during the first nine months of 2005 compared to the same period in the previous year. The decline is even more catastrophic in clothing, which declined by 38 percent in value and 45 percent in volume. Observing the trend, it can be inferred that landlocked and economically vulnerable countries are likely to lose their share in apparel trade. It is interesting that while some countries such as Bangladesh and Cambo-

Table 5.8 US' T&C imports from select countries

Countries	Value in million US$ January – September		
	2004	2005	% change
Bangladesh	1,986.3	2,380.4	19.8
China	14,948.5	22,445.5	50.2
India	3,946.3	4,973.7	26.0
Pakistan	2,550.6	2,887.9	13.2
Sri Lanka	1,600.6	1,694.5	5.9
Cambodia	1,430.8	1,716.2	19.9
Mongolia	229.0	134.8	-41.2
Nepal	**132.6**	**98.4**	**-25.8**

Source: USITC Interactive Tariff and Trade Data Web (http://dataweb.usitc.gov/)

Figures for the entire year are available in Adhikari and Yamamoto, 2006.

dia have survived despite predictions made that they would lose, some confirmed winners such as China and India are yet to benefit as anticipated. This reflects how unpredictable international trade in T&C has become after the elimination of quotas.

With the elimination of quotas, other restrictive measures, vis-à-vis, the standard and certification requirements as well as the trade remedy measures have emerged as new means of trade barriers. For instance, the new trade policy measures by the US and the EU as in the form of new safeguard restrictions on China and anti-dumping on bed linen from Pakistan would appear to have caused fresh market distortions, which shows that trade policies of affluent countries continue to be the major underlying cause afflicting the export prospects of several developing countries (Ahmad 2005). Therefore, it is not enough to consider only the product price but also market imperfections in place to successfully revive Nepal's RMG industry in the post ATC period.

Empirical Analysis of Duty Free Access to the US Market

In this study, two methods – survey based opinion and econometric forecasting – have been used to assess the possible changes in exports under two different scenarios.

Survey Based Opinion

Assuming that the RMG manufacturers can best predict likely impacts of duty free access and flexible RoO in Organisation for Economic Cooperation and Development (OECD) countries, three questions were asked to the manufacturers for identifying the effect in their exports if there is:

- duty free market access to the US market; and
- flexible RoO in the EU.

In both cases, most of the manufacturers responded that their exports will increase significantly if the two conditions were fulfilled. It is interesting that representatives of five manufacturing units said that the export will increase while 21 claimed that the export will highly increase.

To further assess the impact of zero tariff and relaxed RoO, we asked them to quantify the benefits in above two conditions. They were asked to estimate the percentage rise in their exports compared to exports in 2005. With zero tariff, the exporters estimated an increase in exports ranging from 5 percent to 200 percent, while with relaxed RoO, their estimates ranged from 0 percent to 100 percent. The estimated rise in exports was calculated by aggregating the individual firm's estimate using the following formula.

$$\sum_{i=1}^{n=26} X_{Predicted} = \sum_{i=1}^{n=26} X_{2005} + \sum_{i=1}^{n=26} \Delta X_{Predicted}$$

Where,

$X_{Predicted}$ = Predicted export, if above two conditions fulfilled
X_{2005} = Export in the base year 2005
$\Delta X_{Predicted}$ = change in export, if above two conditions fulfilled.

Results

In 2005, the total export of the 26 manufacturing units was NRs. 2310 million. The model above predicts an increase in export of NRs. 1520 million compared to the base year's export, which is 66 percent higher than the total export in 2005. The result shows that Nepalese exporters estimate their exports will rise by 66 percent if they get zero tariff access to the US market. Similarly, with relaxed RoO in the EU and Canadian markets, the manufacturers estimated an export rise of 38 percent compared to the exports in the year 2005. Export of all operating manufacturing units totalled NRs. 64.2 million in 2005. The exporters predict an increase of NRs. 24.5 million if they get market access with more flexible RoO.

Econometric Forecasting

A single-equation regression model was used to estimate the change in exports with zero tariff access to the US market. Since the US market absorbs the biggest portion of Nepal's RMG export, the model was used to estimate changes in the US market only.

To build an econometric forecasting model, determinants of Nepal's RMG exports were considered. As discussed earlier, various external and internal factors affect Nepal's RMG export. The factors range from demand side to supply side. We may, however, identify three types of factors that possibly affect Nepal's RMG export in the US market. They are: demand conditions; supply conditions; and relative prices. Thus, Nepal's export function to the US market can be expressed as:

$$X_{RMG}^{US} = f(X_{RMG}^{Total}, GDP_{US}, P_{RMG}^{ROW} / P_{RMG}^{NEP}) \quad \text{---(1)}$$

Where,

X_{RMG}^{US} = Nepal's RMG export to the US

X_{RMG}^{Total} = Nepal's total RMG export

GDP_{US} = US GDP

P_{RMG}^{NEP} = Unit price of Nepalese RMG products in the US

P_{RMG}^{ROW} = Rest of World's (ROW) unit price for RMG products in the US

In the equation above, US GDP captures the demand conditions for Nepal's RMG exports in the US market. The total RMG export of Nepal was included as a variable to represent Nepal's supply capacities and the ratios of ROW prices to Nepalese unit prices stand for the relative prices of Nepalese RMG products in the US market.

The econometric specification of the equation (1) may be written as:

$$\ln X_{RMG}^{US} = a + b \ln X_{RMG}^{Total} + f \ln GDP_{US} + d \ln(P_{RMG}^{ROW} / P_{RMG}^{NEP}) + h \quad \text{--- (2)}$$

Where,

a = constant term

b = elasticity of RMG export of Nepal to the US with respect to Nepal's total RMG export

f = elasticity of RMG export of Nepal to the US with respect to US GDP

d = elasticity of RMG export of Nepal to the US with respect to relative RMG prices

h = stochastic component

The coefficient of relative prices (d) in equation (2) gives an estimate of overall effect of changes in relative prices of Nepal's RMG products in the US market. It was assumed that any changes in the tariff rates applied by the US would be fully reflected by the changes in the relative prices. The model was estimated using time series data for the period 1990-2005. The estimating equation involves the use of growth rates of the dependant and explanatory variables. The method applied was the use of natural logarithms of the variables in equation.

The Results

The regression of explanatory variables on dependent variables shows positive and significant coefficient for all explanatory variables. Adjusted R^2 = 0.87 and the computed Durbin-Watson statistics for *first order autocorrelation* is 1.83.

Table 5.9 Estimates of specification

Dependent Variable: LOG()
Method: Least Squares
Included observations: 16

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant (a)	-37.07491	9.068625	-4.088261	0.0015
LOG (X_{RMG}^{Total})	0.446455	0.179628	2.485445	0.0287
LOG (GDP_{US})	1.594518	0.375295	4.248708	0.0011
LOG ($P_{RMG}^{ROW} / P_{RMG}^{NEP}$)	0.772183	0.336517	2.294632	0.0406
R-squared			0.8719	
Adjusted R-squared			0.8398	
F-statistic			27.2158	
Durbin-Watson stat			1.8305	

The results indicate that the relative prices are positively related with Nepal's RMG export. The estimated coefficient for relative prices (d) shows that for any increase in ROW RMG prices in the US market, it will lead to an increase in Nepal's RMG export. The positive coefficient for the ratio of prices also implies that Nepal's RMG export is negatively related with Nepal's RMG prices, i.e., if prices of Nepal's RMG export decline, other things remaining constant, Nepal's RMG exports will rise.

Quantitatively, the coefficient on variable indicates that one percent increase in relative prices will increase Nepal's RMG exports to the US by 0.77 percent. Assuming that Nepal's RMG products face an average tariff rate of 15 percent in the US market, duty free market access will lead to an increase in Nepal's RMG export by 11.55 percent (15 x 0.77 = 11.55). The results show that if ROW prices remain constant and Nepal gets preferential market access (duty free market access) in the US market, Nepal's RMG export will rise significantly.

CHAPTER 6

Conclusions and Recommendations

Conclusions

The RMG industry has been playing a significant role in the Nepalese economy. The industry contributed nearly 30 percent in the total export of Nepal during 1990s and during its peak, it provided direct employment to 50000 people, including a significant number of women. While the share of this sector in manufacturing was 26 percent in 1994/95, it reached 37 percent in 2000/01.

The phasing out of the quota system has, however, led to a drastic decline in RMG exports, closure of many manufacturing units and loss of employment, including those of women. While in value terms, RMG exports declined from NRs. 11890 million in 2002/03 to NRs. 6039 million in 2004/05, out of 115 RMG manufacturing units in 2000/01, around 30 were operational in July 2006. As a result, the employment has decreased from 50000 in 1999/00 to less than 5000 in July 2006.

These consequences in the RMG industry have now raised several concerns for the Nepalese government, private sector, workers and other concerned stakeholders. The impact of the quota phase out has been severe to the extent that they are now facing serious socio-economic

challenges, ranging from macroeconomic imbalances to human development concerns.

The survey conducted to assess the depth and severity of impact at the level of workers and manufacturers shows a direct relation between unemployment and the gradual removal of the quota system. The loss of employment due to the decline in RMG exports and closure of manufacturing units is most acutely felt by those who are unable to find another job after being laid off.

While 82 percent of the workers did not find employment immediately after being laid-off, among the workers who managed to find a new job, 64 percent reported to have witnessed a decrease in their earnings. It was also found that workers with little or no education are more likely to remain unemployed as they lack skills to work in other industries.

Living conditions and job security of those who are currently engaged in the RMG industry is also not very satisfactory. Around 56 percent of the workers reported that their income is not sufficient to fulfill basic needs. Although a few of the current workers reported an increase in income since 2004, around 24 percent reported a decrease while 41 percent saw no change in their income in the last two years. Similarly, most workers reported worsening working conditions such as in relation to salary, over time work, over time work rates and job contracts.

At the level of the manufacturers, out of 26 manufacturing units surveyed, only four manufacturing units reported an increase in demand after January 2005, five reported no change and the remaining 17 reported a decrease. While six manufacturing units stated that there has been improvement in their business in the post ATC period, 17 manufacturing units mentioned that their business is in a worsening situation. Similarly, only 27 percent of the manufacturing units expressed that they would survive without T&C quotas and a majority of the entrepreneurs were found to be pessimistic about the survival of the RMG industry in the post ATC period.

Besides the elimination of quotas, deteriorating political climate in Nepal has also been perceived to be a major impeding factor for the growth of the RMG industry. General strikes, blockade of roads and shut downs of enterprises have negatively affected the RMG industry. Moreover, the surveyed manufacturers cited that the government has not been able to promote the RMG industry with incentives and establish GPZs. In addition, they indicated that the government has to take a lead role in undertaking some initiatives to help them address their supply side and demand side concerns.

While analysing the constraints of the RMG industry in the post ATC period, it was realised that various supply and demand side factors have affected the competitiveness of the Nepalese RMG exports. Therefore, in the future, the supply capacity will largely depend on the availability of trade infrastructure, transportation facilities, skilled human resources, technology and policy stability. Similarly, the demand side will be determined by market access conditions, including tariff rates, RoO and quality requirements.

Given such constraints and challenges, it is imperative for the government and the private sector to work together and address the problems in the post ATC period. However, in this process, other actors and agencies such as civil society, media and the international community also have a major role to play. In particular, the developed countries such as the US and the EU should create favourable conditions of market access for the LDCs like Nepal and provide support to strengthen their supply side capacity through 'technical and financial assistance' and 'aid for trade'.

Recommendations

Government

In order to help the RMG industry survive in the quota free environment, the government should assist the private sector in technology upgradation and productivity enhancement. The government should not also delay the establishment of GPZs.

Intervention is also required to resolve persistent complications relating to taxation, bank financing, trade procedure, labour and trade facilitation. The government must understand that the enterprise level efforts are not sufficient to overcome all the supply side constraints that the RMG industry is currently facing and is likely to face in the future.

In addition, there is also a need to help the private sector to address the demand side constraints such as in relation to market access. The government, along with the private sector and governments of other like-minded LDCs, should continue to lobby for duty free access to the US market.[25] Such an alliance is important to build pressure on the US to implement the US Tariff Reduction Assistance for Developing Economies Act or the TRADE Act 2005, which is intended to grant duty free treatment (similar to AGOA) to apparel imports from 14 LDCs of Asia and the Pacific region.[26]

Private Sector

At the enterprises level, manufacturers will have to improve lead-time and decrease output costs, by taking more responsibility in the value chain. They should strengthen their competitiveness by responding to specific buyer requirements and handle smaller and more difficult orders as this can help divert their business from the traditional US market to the EU market. However, as international retailers are placing smaller and more frequent orders closer to the selling season, this will require development of merchandising capabilities and efficient sales networking. Moreover, collaboration with buyers is essential for the development of patterns and designs and exchange of data (Knappe 2003). In addition, the private sector will be required to make investment in training for product development and quality improvement as well as identify niche products and markets. Equally important is to respond to

25 An initiative was taken by GAN and the government to lobby for the duty-free treatment of Nepalese apparel in the US. Accordingly, the Nepal Bill was proposed at the US Senate and House of Representatives in 2003 for granting the AGOA status treatment to Nepalese apparel. But unfortunately, the Bill could not proceed further.

26 The TRADE Act has been supported by more Senators and Congressmen recently. The total number of supporters of the bill at the Senate is 12 and 22 at the House of Representative as of August 2006.

international regulations, especially labour standards and other non-tariff barriers.

Other Important Actors

Besides the government and the private sector, other actors such as NGOs, trade unions and consumer groups should play an influential role in helping the industry compete in the post ATC period. They should help the government and the private sector in their efforts to increase productivity and consolidate the industry through research, networking and advocacy. International influence over these elements should not be underestimated, as international NGOs and consumer forums in other countries as well as in buyers' countries are more suited to fulfil their interests, particularly in the area of social compliance and environmental issues.

GAN, as an apex body of RMG entrepreneurs, is responsible to promote and protect the industry. The association should focus on activities that are not possible at the enterpirse level such as advocacy for market access. For this purpose, GAN should strengthen its institutional capacity to assess and monitor international agreements related to T&C trade. GAN also has an important role of networking between the private sector, government agencies and NGOs.

The activities of trade unions are equally important to develop congenial industrial relations. As the RMG industry is labour-intensive, it cannot flourish and sustain without good industrial relations. Unfortunately, the RMG industry is time and again obstructed by labour agitations. This problem cannot be solved without a labour policy, which is acceptable to both employers and employees and embraces issues of international labour standards related to job security, working conditions, and health and safety regulations. The labour policy also needs to take into account the changing international environment and the sensitivity of delivery deadlines in the RMG industry.

Suggested Action Matrix

Objectives	Action Recommended / Instrument	Timeframe	Major Stakeholders
Improve human development status of employees	• Effective implementation of minimum wage law • Prepare and implement code of conduct	Immediate	Government / GAN / Trade Unions
Promote gender equity in RMG industry	• Remove gender based wage disparities and ensure equal wage for similar work through effective implementation of minimum wage law and implementation of code of conduct	Immediate	Government / GAN / Trade Unions
Support job losers	• Conduct training programmes • Credit for self-employment	Immediate	Government / financial institutions / NGOs / INGOs / Trade Unions
Develop infrastructure	• Human resources development (conduct specific training programme for enhancing productive capacities of RMG workers) • Technology upgradation for productivity enhancement (attract domestic and foreign investment in RMG industry) • Development of vertical production for industrial consolidation • Establishment of GPZ	Short to medium term	Government / Donor agencies / entrepreneurs / GAN and other private sector organisations
Simplify tax, customs and financial system	• Resolve persistent complications related to taxation, bank financing, trade procedures, and trade facilitation. • Upgradation of ICD.	Short to medium term	Government / financial institutions / Donors
Increase market access	• Lobbying for duty-free access and flexible rules of origin system (lobby for enactment of US TRADE Act).	Short term	Government
Diversify market and Product Portfolio	• Research on new products / technology required for production. • Improve design capabilities. • Market new products.	Immediate to short term	Entrepreneurs

Immediate = less than one year, Short term = one to two year, Medium term = two to five year, Long term = more than five year

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ANNEX 1

National Reference Group

Organisations

1. Mr. Chandi Raj Dhakal, President, Federation of Nepalese Chambers of Commerce and Industry (FNCCI)
2. Mr. Binod K. Chaudhari, President, Confederation of Nepalese Industry (CNI)
3. Mr. Surendra Bir Malakar, President, Nepal Chamber of Commerce
4. Mr. Kiran Prakash Sakha, President, Garment Association- Nepal (GAN)
5. Mr. Laxman Basnet, President, Nepal Trade Union Congress
6. Mr. Mukund Neupane, President, G-FONT
7. Mr. Tana Gautam, Director General, Department of Industry

Individuals

1. Mr. Naindra Prasad Upadhyay, Joint Secretary, Ministry Of Industry Commerce and Supplies
2. Mr. Prachanda Man Shrestha, Joint Secretary, Ministry Of Industry Commerce and Supplies
3. Mr. Sriram Pande, Assistant Resident Representative, UNDP
4. Dr. Shibesh Chandra Regmi, Country Director, Action Aid International Nepal
5. Dr. Dilli Khanal, Chairman, IPRAD
6. Mr. Badri Bahadur Karki, Executive Director, Export Promotion Council
7. Mr. Narayan Prasad Shrestha, Executive Director, Trade Promotion Centre
8. Mr. Bijay Ghimire, President, Society of Economic Journalists in Nepal
9. Prof. Dr Bishwambher Pyakuryal, President, Nepal Economic Association
10. Mr. Puspa Shakya, Under Secretary, National Planning Commission
11. Mr. Shyam Sundar Sharma, Joint Secretary, National Planning Commission
12. Mr. Hari Datta Pandey, Joint Secretary, National Planning Commission

ANNEX 2

An Indicative Chart of Governments' Support to the T&C Sector in seven Asian countries

Support measures	BD	CN	IN	IS	PK	SL	VN
Support for technological upgradation	■	■	■	■	■	■	■
Subsidized/preferential credit	■	■	■	□	□	■	■
Creation/designation of textile/ garment cities/villages	■	■	□	□	■	□	□
Special economic/export processing zones	▒	▒	▒	▒	▒	▒	▒
Duty reduction for the import of inputs/machinery	■	□	■	□	■	■	■
Excise, sales tax, VAT refund/ reduction	▒	▒	▒	▒	▒	▒	▒
Income tax holiday/rebate/ reduction	▓	▓	□	□	▓	▓	▓
T&C specific infrastructure support	□	■	■	□	□	■	□
Incentives for use of local inputs/ outputs	■	□	□	□	□	■	□
Reduction in price of infrastructure	■	□	□	□	□	□	□

Support measures	BD	CN	IN	IS	PK	SL	VN
Export credit insurance	■	▒	□	□	□	□	□
Subsidies to loss making state owned enterprises	□	▒	□	□	□	□	□
Writing off of upaid debt / debt forgiveness	□	■	□	□	□	■	□
Other support							
Human resource/skills development	■	■	■	□	■	■	□
Image building/quality improvement/market promotion	■	□	■	□	■	■	□
R&D support	□	■	□	□	■	□	□
Strengthening domestic capacity to supply inputs	□	■	■	□	■	■	■

Source: Adhikari, R. 2006. *Government Support to Textiles and Clothing Sector in Select Asian Countries*, Mimeo, Colombo: UNDP Asia Pacific Regional Center.

Notes:

Shade signs

■ T&C specific

▒ all exports

□ N/A

(The white boxes do not necessarily mean that the government support is not available but that the information regarding the existence or otherwise of such measures is not available.)

Country abbreivations BD: Bangladesh; CN = China; IN = India; IS = Indonesia; PK = Pakistan; SL: Sri Lanka; VN = Vietnam

SAWTEE

Launched in December 1994 at Nagarkot, Nepal by a consortium of South Asian non-governmental organisations, South Asia Watch on Trade, Economics & Environment (SAWTEE) is a regional network that operates through its secreatariat 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.

ActionAid Nepal

ActionAid is an international anti-poverty agency working in over 40 countries. It has been working in Nepal since 1982. Its mission here is to empower poor and excluded people to eradicate poverty and injustice through rights-based approach. AAN's rights holders are the poorest and the most excluded people particularly women, children, victims of conflict and disasters, poor landless and tenants, people living with HIV and AIDS, Dalits, indigenous peoples, former Kamaiya, people with disabilities, and urban poor. Women's Rights, Education, Food Security, HIV and AIDS and Peace Building are its priority themes.