Nepalese Garments Industry and Poverty Reduction

Prepared by South Asia Watch on Trade, Economics & Environment
(SAWTEE)
Kathmandu, Nepal

2006

Draft Report not for citation

Paper prepared for the project Linkages between Trade Development and Poverty Reduction, implemented by CUTS International

1. Nepalese Garments Industry

The application of the quota system under the Multi Fibre Agreement (MFA) in 1974 was the main reason for the growth of garments industry in Nepal. In the early eighties, Indian exporters constrained by the lack of quotas turned to Nepal and there was a sharp increase in the export-orientated garment manufacturers. As a consequence, the number of establishments rose sharply between 1986/87 and 1991/92 from 86 to 234 (Table 1)[1]. The number of persons employed in garments industry also doubled during this period and reached 17260 in 1991/92. However, the number of establishments and number of people employed both declined between 1991/92 and 1996/97. The decline in number of establishments was around 42% and in 1996/97 garment industry employed about 2000 fewer individuals as compared to 1991/92. However, the output during this period increased, which was perhaps due to increase in productivity during this period. The increase in productivity (output per worker) is also reflected by the growth in average wages from Rs. 25,243 to Rs. 43,892 (per annum) during this period.

The number of establishments further decreased between 1996/97 and 2001/02 and reached 115. Currently 90 enterprises are registered with Garment Association Nepal (GAN) of which only around 25 are in operation.

Table 1: Key Indicators of Garments Industry

Year	No. of Establishments	No. of Employees	Avg. No. of Employees per establishment	Output (in thousand Rupees)	Wages and Salaries (in thousand Rupees)	Avg. Wage (in thousand Rupees)
1986/87	86	8518	99	391303	79291	9.3086
1991/92	234	17260	74	2528233	409160	23.70568
1996/97	136	14848	109	3801673	374818	25.2436692
2001/02	115	18134	158	5771802	795932	43.8916952

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

After peaking in 1991/92, the number of establishments in the garment sector continued to decline while, at the same time, the output continued to rise. The number of people engaged in the garment industry increased by around 3000 between 1996/97 and 2001/02. The reduction in the number of establishments but an increase in employment and output suggests that the average size of establishments was growing. This is also reinforced by the fact that the average number of

[1] The analysis in this report is done on the basis of information available from Census of Manufacturing Establishments conducted by Central Bureau of Statistics in 1986/87, 1991/92,1996/97 and 2001/02. The census included those establishments having more than ten employees. It has been assumed that most garment industries in general have more than ten employees and have been included in the census.

employees per establishment increased from 109 to 158 between 1996/97 and 2001/02. The average wages rose by 73% during the same period.

The Nepalese garment industries are concentrated in three clusters viz, Kathmandu valley, Morang and Sunsari districts in Eastern Terai and Parsa and Bara districts cluster in central Terai. (Table 2)

Table 2: Number of Garment Industries by Districts

Districts	1996/97	2001/02
Jhapa	-	7
Morang	9	9
Sunsari	1	4
Lalitpur	11	13
Bhaktapur	5	1
Kathmandu	100	68
Bara	-	2
Parsa	2	7

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

The hypothesis that the garment industry was consolidating and/or expanding is also supported by the trend in the total fixed assets owned by the establishments engaged in this sector. The number of establishments with fixed assets between 1 and 5 Crores has risen in every census period, from 2% of the total establishments in 1991/92 to 24% in 2001/2 (Table 3).

Table 3: Distribution by Fixed Assets

	Fixed Assets		
Year	< 1 Crore	1 Crore - 5 Crore	5 Crore and Above
1991/92	228 (97%)	5 (2%)	1 (<1%)
1996/97	117 (86%)	18 (13.3%)	1 (0.7%)
2001/02	84 (73%)	28 (24.3%)	3 (2.7%)

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

During the period between 1991 and 2002, at least 119 establishments left the garment sector (the reduction could be due to mergers too). The decline mostly occurred in establishments having less than 1 crore worth of fixed assets. In this category, the number of establishments fell from 228 in 1991/92 to 84 in 2001/2 (Table 4).

Table 4: Number of Employees by Nationality and sex

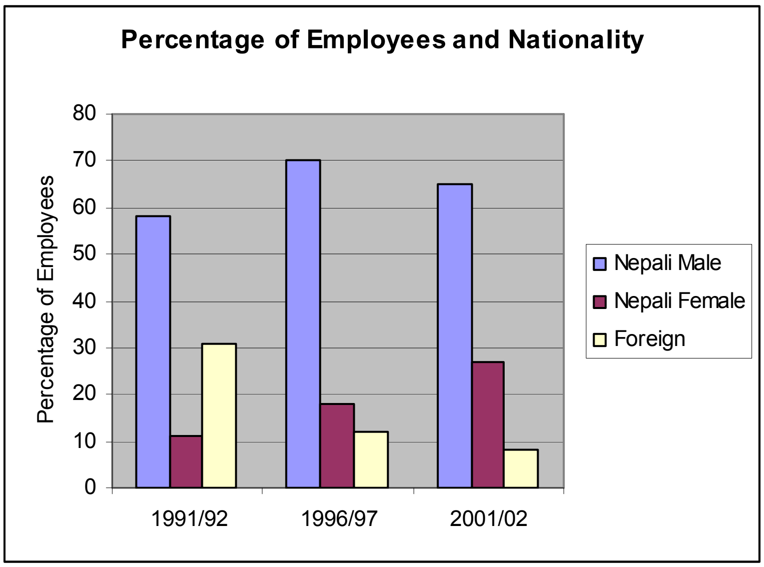
Year	Number of Employees			
	Nepali		Non-Nepali	
	Male	Female	Male	Female
1991/92	9913 (58%)	1968 (11%)	5338 (31%)	23 (>1%)

1996/97	10362 (70%)	2657 (18%)	1827 (12%)	2 (>1%)
2001/02	11807 (65%)	4853 (27%)	1472 (8%)	2 (>1%)

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

One popular misconception regarding the garment sector in Nepal is that it employs mostly foreign nationals, mainly Indians. However, when we look at the numbers, it says that it is untrue in all census periods. In 1991/92, a third of the people employed by this industry were not citizens of Nepal. Ten years later, less than one out of every twelve people employed by the industry was a not a Nepali citizen (Table 4).

Chart 1: Employees by Nationality



Notable in the employment figures is the percentage of women employed in this sector. More than a quarter of the total employees in the garment industry are women, an exceptionally high figure for a society rife with gender discrimination. In 2001/02, 27% of the employees in the garment industry were Nepali women.

Table 5: Capacity Utilization

Year	Less than 20%	20%-40%	40%-60%	60%-80%	>80%	Total
1991/92	N/A	N/A	N/A	N/A	N/A	N/A
1996/97	6 (4.4%)	27 (19.8%)	53 (39%)	39 (28.7%)	11 (8%)	136
2001/02	18 (15.5%)	27 (23.5%)	40 (34.8%)	27 (23.5%)	3 (2.6%)	115

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

If we compare the 1991/92 period with the 2001/02 period, we see that an increasing percentage of the establishments are operating *under* their capacity. The percentage of establishments operating at less than fourty percent of installed capacity rose from around 25 percent to 40 percent between 1996/97 and 2001/02 (Table 5).

Table 8: Distribution by Number of Employees

	No. of Employees				
Year	**10 -19**	**20-49**	**50-99**	**100-199**	**>200**
1991/92	40	61	74	43	16
1996/97	32	20	28	38	18
2001/02	26	20	15	26	28

Source: Census of Manufacturing Establishments, Central Bureau of Statistics

There was an increase in the number of establishments that hire more than 200 employees between 1991/92 and 2001/02 (Table 8). However, there were drops in the number of companies that hire lesser employees in the same period. The number of small establishments that hire between 10 and 19 people went down by 14. The biggest drop appeared in the establishments that hire between 50 and 99 people. There were 59 fewer establishments in this category in 2001/02 compared to 1991/92. Similarly, the number of establishments that hire between 20-49 people declined by 41 during the same period. Again, this supports our hypothesis that the establishments operating in the garment sector are getting bigger.

2. Contribution of Garments in Manufacturing and Exports

The export-oriented garment industry occupies 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 (Table 9). At 26 percent, the share of this sector in manufacturing was still significant in 2003/04.

Table 9: Contribution of garment exports in overall manufacturing (Rs. in Million)

	94/95	96/97	98/99	2000/01	02/03	03/04
Garments Exports	5139	5955	9702	13125	11890	9550
Manufacturing	19555	24816	30337	35495	34337	36634
Percent	26	24	32	37	35	26

Source: Economic Survey 2004/05

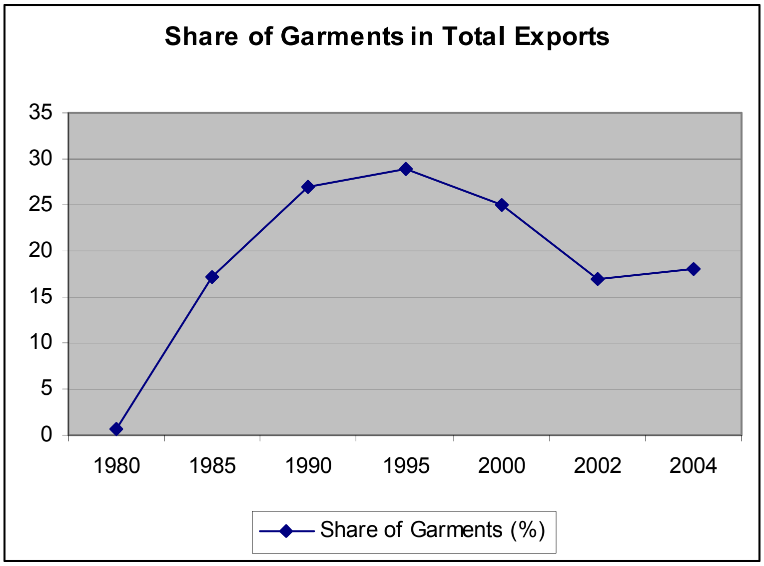
Ready made garments have also occupied an important position in the exports of Nepal. Table 10 and the graph below shows the share of this sector in the total exports. The share of garments in total exports was 17.7% in the year 2003/2004. If we exclude exports to India, this figure stands at 41.3% of total exports.[2]

Table 10: Share of garments in total exports

	1980	1985	1990	1995	2000	2002	2004
Share of Garments (%)	0.7	17.2	27	29	25	17	18

[2] *Economic Survey*,p.135, *HMG- Ministry of Finance, 2005*

Chart 2: Share of Garments in Total Exports



Source: Economic Survey and Various Nepal Rastra Bank Publications

3. Export Performance

Nepalese garment exports grew dramatically from Rs 8 million in 1980 to Rs. 13,942 million in 2000 (Table 11). However, the exports have declined after 2000

Table 11: Nepalese Readymade Garments Export

Year	Readymade Garments Exports (in Million Rs.)	Total Exports excluding India (in Million Rs.)	Share of Readymade Garments
1980	8	1150	0.7
1985	471	2741	17.2
1990	1423	5156	27.1
1995	5139	17639	29.1
2000	13942	55654	25.1
2004	9550	53911	17.7

Source: Various Economic Survey and Nepal Rastra Bank Publications

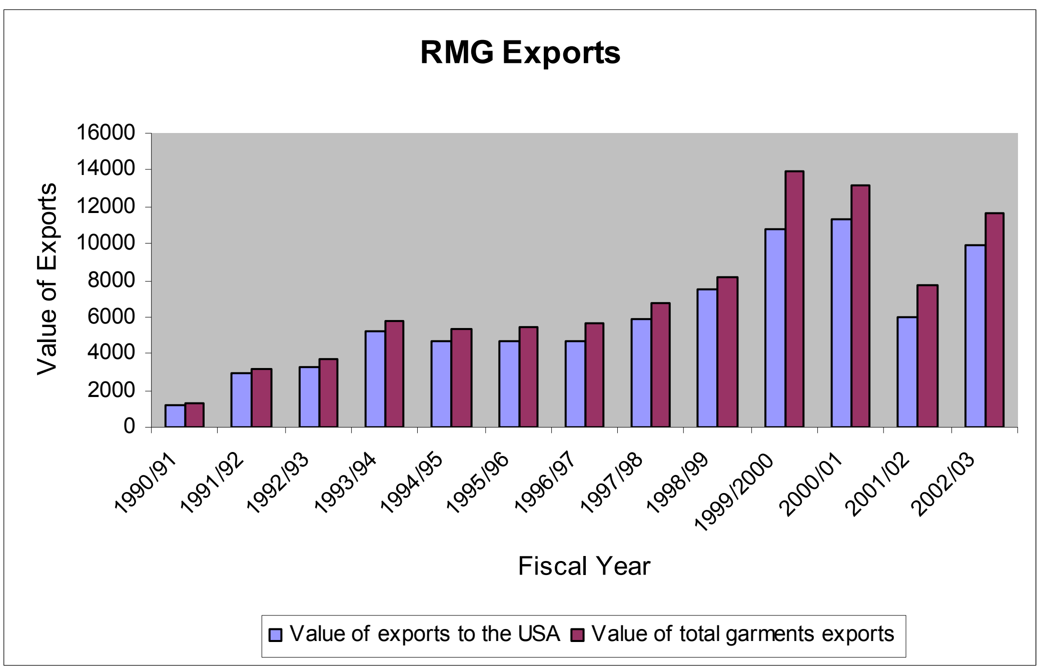
USA has been the main destination market for Nepalese readymade garments. In 1990/91 93 percent of Nepalese readymade garments were exported to the US (Table 12). Ten years later, the export to the US still was very high at 86 percent of the total garment exports.

Table 12: Share of US in Nepal's Readymade garments exports

Year	Value of exports US	Total value of garments exports	Share of the US in total export
1990/91	1245	1344	92.6
1991/92	2898	3112	93.1
1992/93	3258	3723	83.5
1993/94	5216	5757	90.6
1994/95	4637	5357	86.5
1995/96	4671	5418	86.2
1996/97	4693	5618	83.5
1997/98	5926	6783	82.9
1998/99	7532	8155	92.3
1999/2000	10769	13942	77.24
2000/01	11350	13122	86.49
2001/02	6023	7752	77.70
2002/03	9921	11613	85.43

Source: Shakya 2001 and Shakya 2005

Chart 3: Garment exports to the USA compared to total export



After a period of steady growth, Nepalese garments exports started to decline after 2000 (Table 13). Export in 2004 was only 57 percent of export in 2000. Export to the US has also declined and in 2004,it was only 52 percent of the export in 2000. One main reason for this is said to be the preferential market access granted to sub-Saharan countries by the US under AGOA (African Growth and Opportunity Act) in 2000. The uncertainties and apprehensions regarding the possible post-ATC scenario also seems to have contributed to the gradual decline in Nepalese garment exports between 2000 and 2004. There has been a further decline in the total exports and exports to the US after the abolition of the quota system beginning January 2005. The total export and the export to the US in 2005 were 30 and 40 percent less than those in 2004.

Table 13: Value of Exports (Value in thousand US$)

Year	US	Canada	EU	Total	US % of total
2000	164,223	1,328	22,449	188,000	87
2001	136,527	1,448	12,459	150,434	90
2002	105,910	498	14,017	120,425	88
2003	123,121	784	16,559	140,464	88
2004	85,716	1,552	19,374	106,642	80
2005	50,722	1,400	NA	75,532#	67

Source: Garment Association of Nepal (GAN) and # Trade Promotion Center (export of first 11 months of 2005)

The decline in US share in total exports continued in 2005 and it has been estimated to be 67 percent of total exports (Table 13). It was, however, not due to rise in exports to other destinations but due to the decrease in overall exports.

Nepal's trade relation with the US and EU for textiles and garments was governed by separate bilateral agreements signed with the respective countries. The agreement relating to trade in cotton textiles and garments products with the US was done in 1986. Since then Nepal was also subjected to quota limitations.

The agreement with the EU for trade in textiles was initiated in 1999 and in 2002 for quantitative limitations and for access to the generalized system of preferences (GSP) for Nepalese textile products. Since 1997 Nepal has been facilitated by the derogation from the EU GSP rules of origin, and the provision has been renewed by the EU twice at Nepal's request. The latest provision was revised in 2004 and is effective until 31 December 2006. Nepal is also a beneficiary of the EU's ‘Everything but Arms’ scheme, which provided duty and quota free market access to all LDC products since 2001. This allows Nepalese exporters to enter into the EU market with only one-step processing. The general rule of RoO under the EU GSP scheme requires two-step processing i.e., a country has to use fabric made in its own country to qualify for GSP scheme. Despite this incentive scheme, Nepalese exporters were not able to increase exports to the EU . As a result, garment export to EU in 2004 was less than that in 2000. Canada also announced GSP treatment to all LDC garments exports under the new scheme in 2003. Nepal has already signed a Memorandum of Understanding with the Canadian government for duty free privileges for export of Nepalese garments to Canada.

As mentioned above, Nepalese export to the US was based on quota and was subject to an average 14.6 percent duty (Shakya 2004, 13). It is however noteworthy that looking at the quota utilisation rates, lack of quota was never a restrictive factor for Nepalese exports to the US (Table 14). Nepalese readymade garments export to the US has been limited to a few product lines. Ladies dresses (category 336/363), men’s shirt (category 340), and cotton trousers and shorts (category 347/348) dominated Nepal’s garments exports to the US accounting for 60 percent of the total garments exports (Bajaj 2004, 4). However, the quota utilisation in all the products categories except for cotton trousers and shorts has been very low.

Table 14: Quota Utilisation of selected items

Year	336/636	340	341	342/642	347/348	640	641
1994	-	77.77	97.96	47.02	62.93	33.06	60.90
1995	-	97.96	34.59	46.29	78.01	22.15	14.49
1996	99.78	100.00	20.38	31.86	84.65	23.64	3.18
1997	80.56	90.35	10.03	13.99	77.35	46.41	4.74
1998	74.78	98.92	14.75	5.08	96.99	53.52	1.03
1999	75.86	100.00	41.35	12.54	100.00	74.16	0.78
2000	82.70	94.84	45.42	58.37	95.57	92.19	5.56
2001	46.11	51.57	23.27	34.67	91.29	40.47	0.77
2002	10.58	20.48	15.73	27.38	92.24	15.16	16.55
2003	9.59	17.67	22.12	18.51	86.94	3.38	3.12

Source: Bajaj 2004 and Garment Association Nepal

The lack of diversification in product lines in Nepal's garment export was basically due to a 'spillover' effect. Whenever there was shortage of quota in India and Bangladesh or other supplying countries, buyers turned to Nepalese exporters. As the shortage was more severe in category 347/348 and not so critical in other categories, utilisation of quota of most categories except 347/348 was low. The inability of Nepalese exporters to utilise quota other than by 'spillover effect' was due to the higher cost of production compared to neighbouring India and other low cost producers such as Bangladesh. Most of the Nepalese manufacturers focused on these lower end product categories. However, unlike the US market, export items to the EU contained relatively higher price tags (Table 15). The high value Pashmina, shawls and stoles, with a good Nepalese brand image, emerged as promising export product during the late 1990s. But the export of Pashmina declined with oversupply, poor quality control and change in international fashion trend in a very short period.

Table 15: Major garments categories exported to USA and EU

USA	EU
• Women's/girls' cotton trousers and shorts • Men's/boys' cotton trousers and shorts • Pullover and cardigans • T-shirts, singlets and other vests	• Shawls and scarves of wool or fine animal hair • Pullovers, cardigans and similar articles of cotton • Women's/girls' cotton trousers and shorts • Pullovers and cardigans

Source: Garment Association Nepal (GAN) quoted in Shakya 2005

5. Post ATC Export Performance

The expiry of the quota system beginning 1 January 2005 brought to an end decades of managed international trade in the textile and garments sector. International trade in textile and clothing has been distorted for the last 40 years. Some developed countries including the EU, US and Canada had limited the imports of textile and clothing from 'low cost' developing countries through various agreements starting with the 1961 Short Term Arrangement and 1962 Long Term Arrangement Regarding Trade in Cotton and Textile (LTA) and later the Multi Fiber Agreement (MFA) which was renewed several times between 1974 and 1994 (Wagle 2004, 8). Canada, EU and the US are very important markets for garments as they accounted for 67 percent of world imports in 2002 (Nordas 2004, 16).

During the Uruguay Round negotiations to establish the World Trade Organisation (WTO), it was agreed to eliminate the quota on garments and bring this sector within the ambit of General Agreement on Tariffs and Trade (GATT) rules. This was done through the Agreement on Textiles and Clothing (ATC), which came into force on 1 January 1995 with a ten-year plan to phase out the quota. The phasing out of quota was end-loaded and 49 percent of the items became quota free from 1 January 2005.

The quota system in the textile and clothing industry was introduced to protect the textile and clothing industries in the developed countries from competition form 'low cost producers' developing countries. This however, also helped many small countries including Nepal to enter this industry. However, the elimination of the quota system has altogether altered the competitive environment in which Nepalese garment manufacturers operated. With no quota restriction on efficient producers in China and India, among others, Nepalese garment exports faced tough competition in the post-ATC period.

As expected, the decline in Nepalese garment exports continued after the expiry of the Agreement in Textile and Clothing (ATC) in December 2004. At US $ 75,532,543, the total exports of garments in the first eleven months of 2005 was 30 percent less than that in the same period in 2004 (Table 16). However, the change in volume during the same period was only 24 percent.

Table 16: Garments export 2004 vs. 2005

Month	**Year (2004)**		**Year (2005)**	
	Quantity (Pieces)	Value (US$)	Quantity (Pieces)	Value (US$)
Dec – Jan	3,943,311	13,102,540	1,410,354	4,880,876
Jan - Feb	4,583,622	14,114,017	2,249,356	7,628,354
Feb – Mar	3,821,282	11,591,190	2,398,308	8,103,904
Mar – Apr	3,849,342	13,314,522	2,625,327	9,216,462
Apr - May	3,535,796	11,584,261	2,406,699	6,848,970
May – Jun	2,643,701	9,315,398	2,296,722	6,604,501
Jun - Jul	2,143,857	6,802,700	1,883,708	6,182,307
Jul - Aug	2,552,015	8,287,637	2,014,760	6,129,554
Aug - Sep	2,327,456	7,140,460	2,060,483	5,699,310
Sep - Oct	2,354,734	7,599,544	3,326,888	9,603,356
Oct - Nov	1,733,401	5,614,693	2,776,992	4,634,949
TOTAL	**33,488,517**	**108,466,962**	**25,449,597**	**75,532,543**

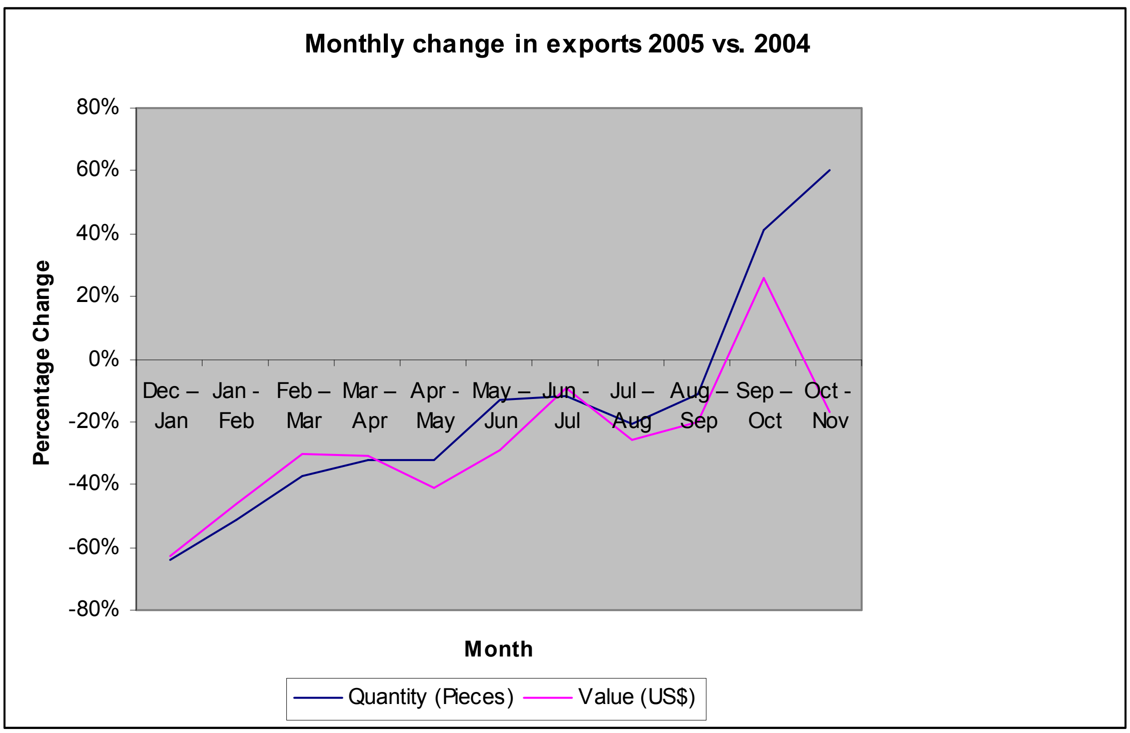
Source: Trade Promotion Center

The volume of exports in Sep/Oct and Oct/Nov of 2005 was significantly higher compared to the same periods in 2004. The change in value during the same period was much less and even negative in Oct-Nov (Table 17). This is an indication that the per-unit price of exported garment was decreasing. Between 2004 and 2005 the average per-unit export price of garments decreased from US $ 3.24 to US $ 2.97, a decrease of 8.4 percent. This was probably in response to the decrease in garment prices in main destination markets due to cheaper exports from China. It is however not clear as to whether this came from increased efficiencies of Nepalese manufacturers, a cut in the profit of Nepalese exporters or a change in products exported.

Table 17: Monthly change in exports 2005 vs. 2004

Month	Year (2005 vs 2004)	
	Quantity (Pieces)	Value (US$)
Dec – Jan	- 64%	- 63%
Jan - Feb	- 51%	- 46%
Feb – Mar	- 37%	- 30%
Mar – Apr	- 32%	- 31%
Apr - May	- 32%	- 41%
May – Jun	- 13%	- 29%
Jun - Jul	- 12%	- 9%
Jul – Aug	- 21%	-26%
Aug – Sep	-11%	-20%
Sep – Oct	41%	26%
Oct - Nov	60%	-17%
TOTAL	- 24%	- 30%

Chart 4: Monthly change in exports in 2005 compared with the same months in 2004



6. Constraints facing Nepalese Garment Industry

Other than stiff global competition in the garments industry, Nepali manufacturers engaged in the garment industry have to face several internal constraints of different magnitudes. These constraints range from supply inefficiency to administrative complications. We will look at each set of constraints separately.

6.1 Supply Side Inefficiencies

Supply side of the Nepalese garments industry is impeded particularly by low productivity and higher transaction costs. It would be useful to compare the average costs of Nepali exports with that of the biggest player in the garments industry, China, and the rest of the world.

Table 18: Average Prices of Various Chinese, World and Nepali exports (2004)

Category	Average Chinese export price	Average rest of world price	Average Nepalese export price
Cotton trousers (347/8)	$ 2.87	$ 7.73	$ 3.86
MMF Trousers (647/8)	$ 2.16	$ 4.90	$ 2.50
Men's woven shirts (340/640)	$2.83	$ 4.16	$ 3.12
Cotton knit shirts (338/9)	$ 1.29	$ 4.29	$ 2.71
MMF knit shirts (638/9)	$ 1.50	$ 4.37	$ 3.0

Source: Shakya 2005

Although average Nepalese export prices are higher than the average Chinese export prices, they are significantly lower than the average rest of the world prices (Table 18). This factor, coupled with other factors such as full utilization of capacity and rise in costs in major manufacturing countries like India and China could be the reason for importers' preference to source from Nepal which is reflected in the increase in sales in the last two moths of 2005 compared to the same period in 2004 (Table 17).

One reason for higher costs of Nepalese exports is the use of outdated and non-competitive technology, including the lack of methods to rationalize production. Neither the government nor an individual establishment has taken any initiative regarding the adaptation of new technologies, unlike the governments in the neighboring countries who have already initiated various kinds of measures, including funds to upgrade technology, to cope with the situation. [38] An example of this is the absence of sophisticated computerized system for pattern making, designing or for cutting like the CAD/CAM system, which is used worldwide for these purposes.

Relatively low labor cost is the only distinct advantage that Nepal has, but low labor productivity remains obstacle to competitiveness. Studies have shown that, except for Bangladesh, the per hour labor cost in garment industry in China and India is higher than in Nepal, but the productivity of Nepalese worker is lower by more than half of the Chinese or Indian workers. Labour productivity in the garment industry in Nepal is about 60 to 70 percent of that of Chinese workers (Shakya 2004, 4). Therefore, it is important to note that the low labor cost, alone, has little significance to reduce output cost among Nepalese manufacturers. Furthermore, compared to the cost of imported materials, the labor costs constitute a relatively small portion of the total cost to the manufacturers. For instance, the component of labor in the total cost for making a

[38] India has already instituted a textile upgradation fund to modernize its textile industry, whereas Pakistan and Sri Lanka have also taken similar measures to strengthen supply side.

garment in Nepal is only about 29% as against more than 60% of the cost required for imported materials. Labour cost, which ranged from 18 to 30 percent of total production cost, is also relatively higher compared with similar costs in India and Bangladesh (Joshi ed. 2002, 88).

Apart from low labor productivity, the competitiveness of Nepalese products is also hampered by high transaction cost, owing to inadequate transportation and logistic facility, high cost customs procedures, and cumbersome administrative process at the ports. The general lack of inadequate infrastructure puts the manufacturers in a difficult position. More specifically, the access to Kolkata port as the only transit point for Nepal's trade with third countries has resulted in a cumbersome and costly transit procedures which require both time and money. For an example, the cost for logistics and transit is approximately 20% of the ex-work price for garments, mainly due to higher cost for air and sea cargo rates. Transportation cost of both raw material and finished products is very high, as transportation of goods from Nepal to Calcutta constitutes 70-80 percent of transportation cost from Calcutta to the US port. This is a major disadvantage for Nepalese exporters as compared to those in India and Bangladesh. The cost of fabric and other accessories that are mainly imported from India are also higher to those in India. Due to all these factors, Nepal's production and delivery cost is estimated to be about 25 percent higher than that in the neighbouring countries (Shakya 2004, 9). Being a landlocked country, Nepal is also at a disadvantageous position in terms of lead time for exports. Nepal's lead time of 120 days is much higher compared to 35-60 days for China. This is a very important factor influencing the purchase decision of importers in the garment industry.

In this regard, the facilitated transit point, such as the efficient implementation of ICD in Birgunj, cannot be overlooked to reduce land transit times through reduced handling and less cumbersome procedures. However, it is estimated that the transportation cost would come down by 40% after full implementation of the ICD facilities in Birgunj.

To summarize, the ability of Nepali manufacturers to compete in the post-MFA world depends not just on cheap labor cost alone. Other than reductions in transport costs through improved infrastructure, trained manpower would also be essential in the fields of merchandising, production management, and marketing to increase the efficiency in overall production. The problem of low labor productivity and a dearth of skill manpower can be overcome by activating the existing textile-training center under the Department of Cottage & Small Industry.

6.2 Inadequate Institutionalisation

The problems with regard to institutional and trade support services in the garment sector primarily relate to poor information on international markets and prices, delivery efficiency and a complicated export financing mechanism.

The lack of direct marketing network by Nepalese garment companies has held up their capacity to directly access for international product, market and price information. There are no responsible institutions to provide these facilities in order to make the industry more flexible with the competitive environment in a quota free trade. There are a number of solutions to this. From the private sector, the GAN can be strengthened as an institution to assist the garment industries on the issues such as compliance with buying policies, market access opportunities and barriers, training policies etc. Parallel to that the Trade Promotion Centre (TPC) can also be made a responsible organization for handling those issues on behalf of the government to serve the private sector.

The other problem, related to financial instruments available for entrepreneurs also requires scrutiny. Instead of giving a privilege to the sector, which is actually facing with the difficult adjustment problems, the commercial banks are increasingly becoming reluctant to make new investment in this sector and initiating stricter actions against debtors, thereby impending further growth in the industry. The garment sector, among other export-oriented industries, has to pay relatively higher bank rates and subject to higher collateral requirements than in other countries in the region.

Raw materials used for exports are exempted from custom duties. The government has implemented a bonded warehouse provision for this purpose. Under this current arrangement exporters can import raw material against a bank guarantee without paying custom duties. Once the products are exported the bank guarantee is released. However, exporters who have not exported for a year have faced administrative hassles to benefit from this facility. If the exports of garments increase, exporters who have not exported for a year might also start to export again. There is thus a need to streamline the process for providing bonded warehouse facility to these exporters.

6.3 Complicated Bureaucracy

A typical exporter faces several bureaucratic hassles ranging from acquisition of bonded warehouse facility, bank guarantee and rebates on VAT. For instance, in order to release the bank guarantee, the new provision requires garment exporters to get two separate recommendations (from the Department of Customs and the Department of Internal Revenue) instead of a single recommendation from the Customs Department.

Another contentious issue is the process of refunding VAT. The administrative process for recognizing an industry as export-oriented (for some privileges awarded to that industry) is inconsistent. For example, while the Customs Department grants tariff rebate to an industry which exports 80% of the total production, the Department of Internal Revenue seeks 90% for the same case in order to be eligible for VAT refund. Likewise, the tariff is rebated for the cancelled export orders, whereas the refund of VAT is not given. On top of that, the refunds are not delivered in time and take more than 30 days to process from the date of claim made by the exporters

6.4 Stringent Labour Law

The labor law has prevented many garment firms from employing permanent workforce due to extreme difficulty in firing employees. The lack of flexibility in the labor law has discouraged employers from hiring permanent workers and investing in workers' training, affecting labor turnover, long-term labor productivity and competitiveness. Though the practice is said to be in decline, the rigidity in labor law is also reckoned to be the factor responsible for encouraging employers to hire workers from neighboring country. The law has, paradoxically, encouraged employers to hire workforce under contract system. This issue has considerably strained industrial relations in Nepal between the government and the industrialists.

6.5 Lack of Backward Linkages

The portion of imported inputs for manufacturing garments in Nepal is relatively very large. The industry depends on almost all imported materials such as zipper, button, neck boards, threads, printed labels, hang tags, plastic collar inserts and clips. One estimate shows that the use of locally made fabrics by the export-oriented garment industry is hardly 2%, as they do not meet international buyers' requirement, vis-à-vis, the standardized size and consistency in quality and color. One of the basic problems in domestic sourcing is the lack of dependency for a large quantity in a very short period. The absence of these basic ancillary industries had created difficulty of operation, and sometimes mismatching or creating shortages between imports of the materials and their requirements.

Establishment of the basic types of ancillary industries are important to add more value to the industry's output, on the one hand, and to expedite sourcing of the industry, on the other. However, there is a problem of making these industries viable in terms of the economies of scale with regard to domestic demand.

In this context, the government may find it difficult to make a decision on protecting ancillary industries. That is why the tendency to import through bonded warehouse has become preferable to depending on the local ancillary industries. But the garment industry cannot sustain without giving priority to efficient domestic ancillary suppliers in the long run if it wants to maximize the gain from preferential market access, which seeks the preferential rules of origin.

For enhancing these types of ancillary industries, the industrial policy should treat the supply made by domestic ancillary industries to garment industry as export, based on authenticity. Such policy is expected to encourage low cost ancillary industries needed for garment manufacturing.

7. Impact of Quota Phase out on Nepalese Garment Industry

Protected by a quasi-guaranteed market access, due to 'spill over' businesses from countries constrained by the quota, mainly India, the export-oriented Nepalese garment industry now faces arduous adjustment problems. The abolition of quotas has basically affected the feature of Nepal's 'artificial' comparative advantage and the benefits from managed trade in the past regime. As anticipated Nepalese garment exports have declined after January 2005. Listed below are some of the major trends in the Nepalese garment industry in the post-ATC period.

- The decline in Nepalese garment export continued in 2005 and the decrease in terms of quantity and value of exports in the first eleven months of 2005 compared to the same period in 2004 were 24 and 30 percent respectively.
- Between 2004 and 2005 the average per-unit export price of garments decreased from US $ 3.24 to 2.97, a decrease of 8.4 percent.
- There has been a significant decline in the number of operating garment manufacturers with only 90 industries registered with GAN and around 25 in operation at the end of 2005. The number of industries registered with GAN in December 2004 was 138 and around 40 of them in operation.
- After a decreasing trend in the first eight months of 2005, the export volume have increased in Sep- Oct and Oct – Nov, compared to same periods in 2004. The increase in total export value has been lower than the increase in volume and has actually been negative in Oct- Nov compared to that during the same period 2004.
- Nepalese garment exports to the US in the first eleven months of 2005 was 40 percent lower than that in the same period in 2004.
- Nepalese exporters were not able to significantly increase exports to non-US markets in the first eleven months of 2005.

8. Impact of Quota Phase Out on Poverty

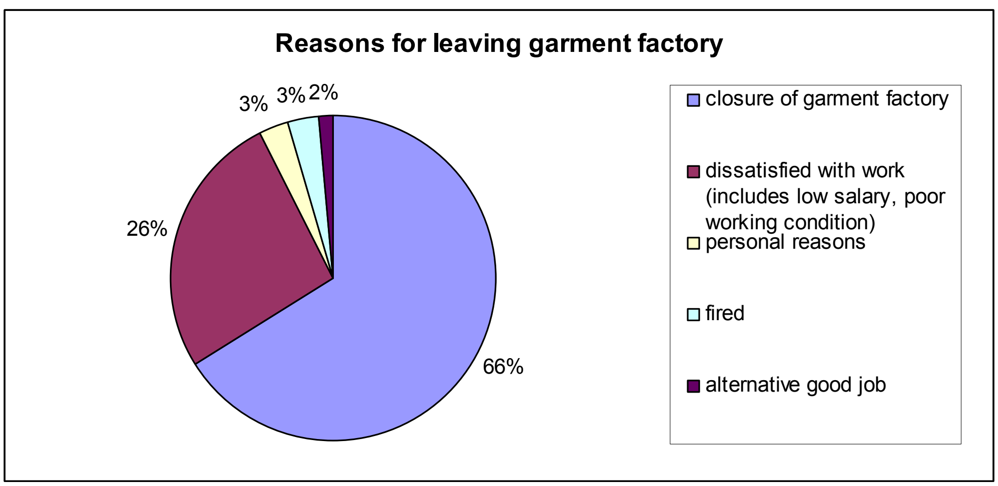
The decline in exports since the expiration of the ATC treaty has had a direct effect on thousands of families who have lost employment. Almost all of the workers dependent on this industry come from low income families and tend to possess low skill levels. A large portion of them come from low-caste families and about half the workers were women.

In order to empirically assess the conditions of workers, SAWTEE conducted a survey of past and present workers employed by the garment factories.

Findings from Survey of Past Employees

A total of 133 random past employees were questioned, of which 93 were male and 40 were female. Most of the respondent were in the age-group 20-30 (46 percent) and 30-40 (34 percent). About 40 percent of the interviewee have attained just primary level education or below, with almost 5 percent not being able to read and write. This shows that textile and clothing sector is an important exporting sector in Nepal providing opportunities and income to less educated people who otherwise would have few other alternatives. In order to avoid any bias with regard to high skilled and low skilled workers, the survey incorporated past employees whose position in the garment factory ranged from thread cutter and helper to accountant and supervisor.

The survey covers the duration that spans over 10 years over which the employee left their work in the garment factory. However, almost 80 percent of the unemployment occurred within the last 4 years and other 10.5 percent of the total past employees left during the last 5-7 years. Among the total respondents, 73 percent were forced out of employment in the garment factory, while the remaining 27 percent left the job willingly. More detailed reasons for leaving the garment factory is presented below.



Of the total employees surveyed, 66 percent cite closure of garment factory as the major reason for leaving garment factory, while 26 percent express dissatisfaction with their work in the garment factory due to low and late distribution of salary, poor working condition, irregular and sometime lack of work.

Relation between unemployment in the garment sector and removal of quota

The sample data indicates that about 60 percent of interviewee left their work at the garment factory during the last 2 years. This drastic rise in unemployment in the garment sector during the last 2 years coincides with the forth stage of the ten year long transition period introduced by the ATC during which quotas imposed by the developed countries on textile and clothing product was removed. This is evident from the sharp fall in employment (of 60 percent) following the end of ATC in January 1, 2005.

The loss of employment in the garment factory as a result of quota phase out is supported by the fact that 80 percent of the employees were forced to leave their work due to the shutdown of the garment factory during the last two years. While the closing of the garment factory is a direct result of ATC phase-out, low salary might be its indirect effect. Salary in garment factory is based on piece-rate. With the increase in the production, the salary of the workers increases. Low salary, thus, might be a result of reduced production due to the removal of quota system and hence the inability of garment factories in Nepal to compete in the international market.

Comparison of monthly wage

The respondents were also asked to compare the present wage with that of the garment factory. 30 percent of the population reports an increase in their basic wage, while 64 percent of the sample population is of the opinion that there is a fall in their wage. On average, 42 percent of the interviewees are under the poverty line of US $ 1 per day.

This shows that not only there is a lack of employment opportunities in the post ATC period; there is a decrease in overall income across the employed citizen as well.

Comparison of expenditure

About 68 percent of the workers previously employed in the garment sector felt that there was an increase in the expenditure allotted to food, while 17.3 percent said that their food expenditure decreased. The main reason cited for rise in the food expenditure was growing inflation. Similarly, 60.9 and 47.4 percent were of the opinion that there is a rise in housing and clothing expenditure respectively. However, 33, 30 and 48 percent have reported a fall in entertainment expenditure, remittance and savings respectively. These reductions are a result of lower income and the rise in the expenditure of basic necessities.

Findings from the Survey of Present Employees

A similar survey of 274 present employees of garment factories was conducted. Among The employees 175 were males and 99 were females. Most of the employees (91.2%) are less than 40 years of age. Among the female employees 64.6% are less than 30 years in age.

Income Status of Present Employees

Total 23 employees (8.39% of the total) reported their monthly income less than 2250 Nepali Rupees, which is less than US$ 1 a day. 16 out of 274 employees, which are 5.84% of the total, earn even less than NPR 2000 per month. If measured by US$ 2 a day criteria of poverty line, the percentage of poor becomes 59.12% (162 out of 274 employees). Only 14.59% of the RMG employees earn more than 7500 Nepali rupees (US$ 100) per month. The findings are summarized in the table below.

Table: Monthly income of the employees