VII. Nepal*

Introduction

The T&C sector has remained a prime contributor to Nepal's export trade development. The imposition and elimination of the quota system in international apparel trading has been responsible for both the rise and the fall of the T&C sector in Nepal. With the introduction of MFA quotas, the industry boomed rapidly because of spillover business from neighbouring countries; however, it was also damaged unexpectedly by the elimination of the quota regime more than two years ago.

When compared to other LDC apparel-exporting countries, Nepal is probably the only country to have experienced an immediate impact resulting from the ending of the quota system in the form of a severe drop in its exports to the United States. There are two basic reasons for this adverse situation. First, Nepal is not only an LDC economy, but also a land-locked nation with a relatively low competitive edge in both production and delivery for international markets. Second, it acted late in adopting an environment conducive to international textiles and clothing trade in the post-MFA period. Despite that, the industry has managed to survive, although the situation is still far from sound.

A. Production and employment situation

The apparel subsector in Nepal involves two types of industries – businesses that are totally focused on domestic demand and those that are totally export-oriented. Domestic market-based firms have remained traditional and fragmented with a sluggish growth trend, whereas the export-oriented businesses continued to surge until the mid-1990s, reaching a peak of 1,067 according to Garment Association of Nepal (GAN) records. However, the number of exporting firms then declined rapidly with the phasing out of the quota system as well as changes in the internal quota distribution policy.

The declining trend in the number of garment businesses has been ominous, particularly since 2003. The number of operational firms, which totalled 158 in 2003, had declined to 126 by 2004. Currently, only 99 firms are registered with GAN, of which only 20 per cent are operational. Regarding ownership, almost all of the firms are owned by domestic entrepreneurs, except for one that is joint venture with India.

Employment in this subsector was more than 50,000 (direct only) during the boom period of 1999-2000, accounting for 12 per cent of total employment in the manufacturing sector. About 25 per cent of the total employees in the garment industry are women, which is an exceptionally high figure for a society with widespread gender discrimination.

After reaching a peak level in the mid-1990s, the number of firms continued to decline, while total output continued to rise, indicating growth in the average size of the firms. That can be attributed to modernized production plants and increased experience

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of Nepalese manufacturers in apparel export marketing. However, Nepal did not really benefit from the its factor endowment, despite the industry being labour-intensive. This may be because of high employment of unskilled labour and overemphasis placed on low-value commodity items by Nepalese exporters.

B. Export composition and direction

From an initially minuscule export value until the mid-1980s, exports of Nepalese apparel increased steadily to achieve a share of more than 90 per cent of the country's total exports. Among overseas markets, the United States, Canada and the European Union, were the major destinations for Nepalese apparel during the quota regime, and remain so.

Although exports of Nepalese garments to the Indian market previously appeared trivial, that destination has shown promising indications as the share has gradually increased in recent years. Exports to India surged rapidly in 2005/06, passing the NRs 1 billion level with a share of more than 17 per cent of total clothing exports to that country. However, a downward trend in total Nepalese garment exports has become apparent since the last phase of quota elimination in 2004, as the value of exports shrank by more than 34 per cent in 2004/05, compared with a year earlier. However, that trend improved slightly in 2005/06, as the loss of exports to overseas markets has been replaced by exports to India (table 1).

Table 1. Apparel exports from Nepal to international markets and India

(Value in NRs '000)

Year	International markets	%	India	%	Total	%	Percentage 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
2005/06	5 420 975	82.65	1 137 300	17.37	6 558 275	100	–0.017

Sources: TPC and GAN.

The share of garments in Nepal's total national exports ranged from 11 per cent to 24 per cent between 2000/01 and 2004/05, whereas its share in the total overseas exports ranged from 35 per cent to 50 per cent, indicating a dominant role in Nepal's overseas exports only (table 2).

Regarding market access opportunities, it is relevant to consider Nepalese garment exports to the Quad countries (the United States, European Union, Canada and Japan) (table 3). Among them, the United States has been a prime market for Nepalese apparel exports, with an annual share of exports to Quad countries ranging from 85 per cent to 90 per cent until the first half of the MFA period. However, the United States share has contracted from as high as 90 per cent in 2000/01 to 75 per

Table 2. Share of apparel in overseas export and total national export of Nepal

Year	Total overseas exports (NRs)	Apparel exports to overseas (NRs)	Share of apparel in overseas exports (%)	Total national export (NRs)	Total apparel exports (NRs)	Share of apparel in total national exports (%)
2000/01	28 690 299	11 431 246	39.84	55 245 900	11 623 346	21.03
2001/02	18 409 236	7 752 296	42.00	47 386 788	7 965 796	16.81
2002/03	21 981 475	11 613 749	52.83	50 011 122	12 012 949	24.02
2003/04	20 941 661	9 552 544	45.47	53 949 414	10 179 244	18.86
2004/05	17 691 885	6 307 211	35.65	58 975 321	6 672 911	11.31

Sources: TPC and GAN

Table 3. Share of Nepalese garment exports to the Quad countries

(Unit: Percentage)

Year	United States	European Union	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

Source: Calculation based on TPC data.
* First 10 months.

cent immediately after the quota phase-out, reflecting the impact of liberalization on the international RMG trade. In addition, the United States' share in the post-MFA period is declining at a faster rate.

However, the situation has reversed in the case of the other Quad countries, where exports have increased modestly. The increase in exports to Quad countries other than the United States is probably due to preferential market access granted by those countries to Nepal under GSP. Exports to the European Union, in particular, have been encouraging, with a relatively faster growth rate and larger shares in recent years. One of the reasons for this could be that the standard European Union preferential rules of origin have been relaxed for Nepalese garment imports since 1997. Since then, Nepal's exports to European Union countries, such as the United Kingdom and France, have individually appeared more promising than exports to Canada and Japan. Other European Union markets such as Germany, Italy and Spain have shown good potential.

However, Nepal has not been able to utilize fully the European Union market access opportunities, despite preferential market access and relaxation of the standard preferential rules of origin. On the other hand, one of the reasons for the decline in Nepal's share in the United States market has been attributed to the absence of equal opportunity in the American market, as Nepal does not enjoy United States preferential market access. Thus, the export market for Nepal can be distinctly classified into preferential and non-preferential markets, thus perhaps making it desirable to develop two different marketing strategies in order to increase overall garment exports.

With regard to export products, cotton apparel has dominated Nepal's apparel export composition. Nepalese exporters had managed to retain their position in cotton-based consumer items in the United States market, despite stronger competition in this product category, the most popular of which were cotton-based trousers and shorts, T-shirts and vests, blouses and tops (including pullover and cardigans). However, Nepal has lost its market share of these products in the United States, despite the growth in imports by the United States in the first quarter of 2005. These products actually had the highest quota utilization rates (above 90 per cent) during the quota regime.

There is a marked difference in the composition of products exported to the United States and the European Union. The American market has mainly concentrated on lower-end cotton consumer items, while the European market has attracted relatively high-value wool and silk-based items. Exports of cotton items to both destinations have declined sharply in recent years, probably due to the higher degree of competition in the cotton category since the removal of quotas. In contrast, the European Union market has been concentrating on relatively high-value woollen and silk items.

C. Challenges in the post-MFA period

1. Internal bottlenecks

Internal bottlenecks to development of the Nepalese garment subsector remain persistent. The ability of apparel manufacturers and exporters to provide a full package business system has been constrained by the lack of physical infrastructure and logistics in Nepal, mainly due to geographical disadvantages. Similarly, Nepalese firms have yet to improve supply efficiency by changing the pattern of sourcing management. In addition, they are affected by the unavailability of ancillary industries and services.

Delivery efficiency is largely affected by the lack of direct access to seaport facilities, increasing the transaction costs for Nepalese garment exports. The difficulties faced in the transportation of goods are inherent in Nepal's export trade. This is even more problematic in the case of garment exports, as Nepalese exporters require payment of up to 20 per cent more in transportation costs and 50 per cent longer times for the delivery of goods compared to other suppliers within the region. Hence, in addition to infrastructure problems, Nepalese garment exporters are affected by cost inefficiency and longer lead-times. Another related constraint is that the possibility of consolidating Nepal's garment industry through vertical integration is still being hindered by the absence of backward and forward linkages. Resolving these constraints remains critical to the success of efforts by the Nepalese garment subsector to overcome existing supply constraints and become competitive in trading without quotas.

Other major internal bottlenecks affecting the Nepalese garment sector are the scarcity of human resources and skilled labour and difficulty in gaining access to trade financing (both pre-shipment and post-shipment).

At present, however, the Nepalese garment sector is concerned more about the political environment than about market access and competition affecting the international marketing.

2. External factors

Price competition was, and remains, a major external factor affecting competitiveness of the Nepalese garment sector. However, demand for some selected items has not improved despite their competitive prices. This somehow suggests that the price difference is not a decisive factor in sourcing decisions of buyers. Thus, Nepalese exporters should consider other factors when responding to the growing international competition.

It is also important to assess the market access issue, as the MFN system applies in the United States (a prime market), and preferential treatment must be faced in the European Union (the second-most important export destination). While Nepal no longer has an equal opportunity market in the United States, it not only enjoys preferential treatment under GSP in the European Union but also the facility of derogation from the standard European Union GSP rules of origin. However, although European Union preferential treatment supports improved competitiveness of Nepalese garments due to the duty advantage, the preferential utilization rate among Nepalese exporters still appears to be quite low. There remains ample scope for Nepalese exporters to expand in the European Union market, as the European Union GSP scheme is applicable for an unlimited period and not subject to periodic reviews, thus providing greater certainty of market access.

The Canadian and Japanese preferential schemes are no less valuable to Nepalese apparel exporters, as both initiatives have granted duty-free and quota-free status to clothing, with relatively flexible rules of origin requirements. However, Nepalese garment exporters should not depend totally on preferential market access, as the margin of preference is eroding due to reductions in average tariff rates for manufacturing goods internationally. In addition, the significance of preferential treatment to Nepalese garment exports would largely depend on the result of the ongoing non-agricultural market access negotiations under WTO. Similarly, the relevance of the WTO Hong Kong, China, commitment to duty-free and quota-free treatment for all LDC products would be meaningless if the scheme were to exclude most of the garment items under the provision of a sensitive list.

In a post-quota trade regime, Nepalese exporters are expected to face difficulties in meeting buyers' requirements for standards as well as the workplace code of conduct that the manufacturers have to follow. These measures have, however, not been a major issue of concern for market access, but they must not be underestimated.. Nepalese traders have to be able to meet such requirements by expanding their capacity, so that they will be able to minimize the incidence of such measures in the future.

D. Post-MFA adjustment programmes

With regard to the post-MFA situation, the Nepalese garment subsector needs to concentrate on supply capacity as well as on strengthening their competitive edge through economies of scale in production and delivery efficiency. The current trend indicates that buyers' decisions on sourcing depend not only on pricing, but also on exporters being assured of supply quantity and delivery. However, this cannot be achieved without developing an infrastructure for vertical production together with consolidation of the Nepalese clothing industry that includes delivery efficiency. The Nepalese garment subsector, under a GAN initiative, has been advocating industrial clustering through the Garment Processing Zone (GPZ) concept.

The proposed GPZ will be a specialized product-processing zone, with every type of facility required by the clothing industry available closer to the production site. It will support the clustering of industries and services. The major objectives of this processing zone would, among others, be consolidation of output capacity, simplification of trade procedures, and enhancement of delivery efficiency by reducing transportation and transaction costs. However, the idea of establishing a GPZ is at a very early stage, as the Government has not yet officially endorsed it.

E. Conclusion

Among major LDC garment exporters, the end of the quota system has hit Nepal the hardest. Two major factors are responsible. One is higher transaction costs that have eroded Nepal's competitive edge in liberal trade, which does not allow protection from quotas. Two, Nepal has been slow to adjust to an international clothing trade that is without a quota regime.

The end of quota system has reduced the number of garment industries and their export value substantially, thus having a significant impact on employment opportunities at large. From direct employment of more than 50,000 workers during the boom period, that number has fallen to approximately 10,000.

Exports to other regions, with a major portion going to the United States market, have gained a significant share of Nepal's total garment export trade. Although apparel has secured a prominent share of the country's total overseas garment exports (approximately 50 per cent), its share of total national exports has not exceeded more than 24 per cent. In 2004/05, apparel shared 11 per cent of total national exports. Interestingly, exports to India have shown an increasing trend, growing from a share of just 5 per cent of total in 2004/05 to more than 17 per cent in 2005/06.

The Quad country markets still important with regard to market access opportunities for Nepal. The United States remains a prime market even in the post-quota regime, but its share in total exports to Quad countries is declining at an accelerating rate, revealing a decline in the scope for marketing. Nepal no longer enjoys equal opportunity benefits in the United States, as its garment exports do not enjoy preferential market access in that country. However, the European Union, Canada and Japan continue to grant this privilege. However, compared with the European Union, Nepalese apparel exports to Canada and Japan appear insignificant.

Exports to the European Union have shown promising signs of a smooth growth trend in recent years. The European Union's GSP system and the facility for derogation from the European Union GSP rules of origin for Nepal have supported the country's market diversification drive. However, preferential utilization rate by Nepalese garment exporters to the European Union is still low. Therefore, efforts should be made to increase the preferential utilization rate not only in the European Union market, but also in Canada and Japan as well as in other markets where Nepal is eligible for GSP.

Another problem is that of internal bottlenecks (a lack of both trade infrastructure and trade support services), which continue to be a major barrier to development. In addition, the difficulties created by supply-side constraints and delivery inefficiency will remain unresolved unless an initiative is taken to consolidate output and vertical production. This will not be possible without the Government's assurance of capacity-building together with the ability of individual businesses to manage sourcing and the supply chain. By giving priority to these issues, the private sector – under the auspices of GAN – has proposed the establishment of a GPZ to the Government in order to overcome the various internal bottlenecks and raise the efficiency of the Nepalese garment sector.