Trade-Development-Poverty Linkages

Reflections from Selected Asian and Sub-Saharan African Countries

Volume II - Sector Case Studies

Edited by
Selim Raihan
Mohammad A. Razzaque

25 years 1983 2008 CUTS International

#0805

Trade-Development-Poverty Linkages

Reflections from Selected Asian and Sub-Saharan African Countries

Volume II - Sector Case Studies

CUTS International

Trade-Development-Poverty Linkages

Reflections from Selected Asian and Sub-Saharan African Countries

Volume II - Sector Case Studies

Published by

CUTS International

D-217, Bhaskar Marg, Bani Park
Jaipur 302 016, India
Tel: +91.141.228 2821, Fax: +91.141.228 2485
Email: cuts@cuts.org
Website: www.cuts-international.org

Edited by
Selim Raihan and Mohammad A. Razzaque

With the support of

MINBUZA
Ministry of Foreign Affairs,
The Netherlands

&

DFID Department for International Development

Printed by
Jaipur Printers P. Ltd.
Jaipur 302 001

ISBN: 978-81-8257-119-8

This volume has been produced with the financial assistance of MINBUZA, The Netherlands and DFID, UK. The views expressed herein are those of the editors and the contributors and can therefore in no way be taken to reflect the positions of CUTS International, MINBUZA, The Netherlands and DFID, UK and the institutions with which the editors and contributors are affiliated.

#0805, Suggested Contribution: Rs.500/US$50

Table of Contents

List of Tables

List of Figures

List of Charts and Box

Foreword

A decade ago, few would have believed that trade and development would become so inextricably linked, at both economic and political levels. It is now generally recognised that trade can be a powerful engine for economic growth and development, and that it is a tool that developing countries can and should use to attain their development objectives. Trade helps in the global allocation of resources, enhances output and productivity and increases overall welfare gains. It allows countries to concentrate on what they can do best. The successful experiences of a number of developing countries that have achieved rapid economic development through trade expansion are testimony to the benefits from increased participation in international trade.

The linkages between trade and development and the idea that export earnings from trade can help achieve development were acknowledged very soon after the General Agreement on Tariffs and Trade (GATT) came into being. Following some early initiatives to incorporate concerns of developing countries in the multilateral trade rules, members of GATT attempted to address the broad array of development principles and objectives by including an entire section of trade law under the chapeau of "Trade and Development". To a great extent, this new section reflected the needs and economic development of the GATT's newest Members, or newly independent states in Africa, Asia, and Central and South America.

The establishment of the World Trade Organisation (WTO) at the conclusion of the Uruguay Round was in many ways a great success for multilateral cooperation, as well as for trade and development, and boded well for the global economy. It was a signal that the majority of the countries in the world wanted a wide a far reaching global trade body to promote equitable and transparent rules for trade in goods, services and intellectual property. In fact today, when we look back at the Uruguay Round agreements, these seem to mark the inception of a new era for the multilateral trading system.

That being said, the Uruguay Round concluded with what some have termed "unfinished business". For example, while agriculture was for the first time brought explicitly into the multilateral trading system under the Uruguay Round, significant cuts in trade distorting subsidies and agricultural tariffs were not really achieved. For developing countries, the amount of protection offered by some developed countries to their agricultural sectors remains a major concern today, especially as certain developing countries do have a comparative advantage in some agricultural products. Developing countries also remain concerned with the high tariffs still facing them from developed countries on industrial products of export interest to them. Moreover, on concessions on service trade agreed to at the end of the Uruguay Round were very limited, and further liberalisation is needed to optimise benefits flowing to the world economy

especially to developing countries. As many developing countries said the 'development dimension of trade was missing'.

This was the reason that at the Doha Ministerial Conference which launched the Doha Round, the Ministers put development and the interests of developing countries at the heart of the negotiations. Today, openness to trade and an equitable multilateral trading system are seen as necessary ingredients of any country's efforts for addressing the problems of underdevelopment and poverty alleviation.

However, economic growth is complex and multifaceted. Since there are potentially so many factors influencing the growth process, it is typically difficult to establish the precise contribution of any particular one. In that sense, a direct causal link between trade and growth often cannot be properly identified. The fact that each country has its own particular set of circumstances, and that a "one size fits all" approach will therefore not work, makes it all the more challenging to identify prescriptions that will allow trade and trade policy to work for economic growth.

A further layer of complexity arises when the challenge is to find causal linkages among trade, development and poverty alleviation. Even if it could be identified how, and to what extent trade contributes to economic growth, how this growth translates it relatively to poverty alleviation is an even more difficult one to analyse. Economic growth is certainly not a necessary condition for the reduction of poverty. National policies, including redistributive policies, may typically be called for to ensure equitable and poverty reducing economic growth, trade driven or otherwise.

Such difficulties in identifying appropriate transmission mechanisms from trade to poverty alleviation and development only accentuate the importance of the present volume. Indeed, while the challenges inherent in identifying the linkages are clear, this does not in any way diminish the need to try and understand how these can work. For trade to lead to development, and then for development to result in poverty alleviation, there is a need for policy coherence not only at the national level where various Ministries must begin to interact more to tackle common problems, but also at the international level where trade institutions must engage their counterparts in the area of finance and development. Countries must work together to promote regional and global integration and realise the development potential of greater trade so that benefits of negotiated market opening translate into tangible benefits for the people of all developing countries.

Clearly therefore the relationships among trade, development and poverty alleviation are complex and it is perhaps only through specific case studies that a flavour of what may be required to make the trade-development-poverty alleviation linkage work can be obtained.

The present volume is, therefore, very timely. I am sure these case studies will also show that trade cannot be a panacea for all developmental challenges.. It is a very important part of the cure but cannot suffice on its own. Trade openness and the willingness to engage in trade reforms require understanding of its potential benefits and an acceptance of its net beneficial impact on development. Such policies need to be couched in a supportive economic, social and political context and need to be

placed in a coherent policy framework. These can only be initiated and sustained if they are complemented by practices and regulations which address human, bureaucratic or structural bottlenecks. These must result in benefits for the population at large such as improved standards of living, the alleviation of poverty, better working conditions and greater social welfare.

The World needs more trade, not less. But it also needs a system of fair global rules to support trade which also strengthen the different global partnerships for development and advance resulting benefits. I am sure that these case studies will point us in the right direction.

Shishir Priyadarshi
Director, Development Division
World Trade Organization
Geneva, Switzerland

Preface

The linkages between international trade, development and poverty reduction and their implications for the development prospects of the countries of the South are being debated actively in international policy forums. While theoretical exposition of the relationships between trade and economic growth, as well as economic growth and poverty reduction are present in the economic literature, such theorising is often not backed up by adequate or even appropriate empirical evidence. The absence of such empirical evidence often leads to critics doubting the significance of these relationships. In many cases, motivated interests often use this lack of evidence to paint 'international trade' as the cause of modern economic failures, as and when they occur.

In a world that is more globalised today than it ever has been in the past, this volume serves an important purpose – of intelligently presenting and analysing empirical evidence from different points of view at varying levels of generalisation so that our understanding of the mentioned linkages assumes a more concrete form.

International trade policies affect poverty in manifold ways through their effects on economic growth and income distribution. Rather than striving for growth *per se*, a pro-development and pro-poor growth policy might be a more convenient and useful way to facilitate poverty reduction. The benefits of economic growth resulting from international trade can positively impact the poor through increased spending on health, education and social welfare, an increase in employment opportunities because of the potential expansion of labour intensive sectors and the acquisition of new skills and technologies.

If trade policies do not consider the needs of the poor, the potential negative impacts of trade and related economic activity include displacement of labour due to contraction of import substituting industries and a limited scope for political decision making due to the increased influence of transnational corporations on domestic economies. Such influence can lead to a loss of employment opportunities, the exploitation of vulnerable and marginalised groups, increased environmental degradation and threats to food security.

With the support of the Department for International Development (DFID), UK and the Ministry of Foreign Affairs (MINBUZA), The Netherlands, CUTS International has implemented a project, Linkages between Trade, Development and Poverty Reduction (TDP) over a period of four years (from January 2005 to December 2008). The project includes several countries in Eastern and Southern Africa, South and Southeast Asia, and Europe, covering developing land-locked states, island states and big emerging economies as well as developed countries. The TDP project manifests the relevance of international trade policy for poverty reduction and helps in articulating ways and means of achieving policy coherence between the international trading system and national development strategies for facilitating human development and poverty reduction.

The research findings aim at contributing to the policy debate for achieving the Millennium Development Goals (MDGs), and examine the partnership among different stakeholders to achieve the MDGs. The project also aims at facilitating enhanced dialogues between civil society and policy makers in both the North and the South, cross-fertilisation of ideas, informed decision-making and further research. This comprehensive volume ultimately aims at sharing the research results with relevant stakeholders to influence a policy shift by decision makers towards a more development-oriented international trade policy.

Following up on the country case studies published in the first volume, the sectoral case studies of this volume provide an insight into the effects produced by trade liberalisation in select sectors in project countries. The individual assessments show that the same set of policies has resulted in drastically different outcomes in different countries, thus establishing that outcomes of trade policy also depend critically on characteristics of individual economies.

Thus, policies pertaining to international trade at the country or regional level need to be buttressed by complementary measures: flanking social policies at the national level including social safety nets as well as coherence between multilateral/regional trading arrangements and the unilateral trade policies of nations. It is only then that countries can use trade to target goals of sustainable development and poverty reduction with some certainty.

The sectoral studies conducted in the 13 TDP countries identify the factors that need to accompany trade openness for it to become an engine of economic development and poverty alleviation. Along with economic growth rates, productive supply-side capacities, skill development, technology transfer, infrastructure improvements and investments have to be secured on a national level. To achieve this, good governance and transparent institutions are essential. The findings reflect the need for fair and balanced rules in the multilateral trading system for ensuring sustainable and inclusive development in the countries of the South.

In introducing this second volume of the TDP project studies, let me thank all those who have been associated with this project in various capacities, in particular the development partners such as the DFID, UK and the MINBUZA, The Netherlands, whose support made the project possible; the partner organisations in the project countries; the editors of this volume: Selim Raihan and Mohammed A. Razzaque; the contributors of the sectoral case study papers and the project staff at CUTS Centre for International Trade, Economics & Environment (CUTS CITEE).

Jaipur
December 2008

Siddhartha Mitra
Director (Research)
CUTS International

Note on the Contributors

Kenya

Cotton

Gloria Otieno is currently associated with the Institute of Social Studies in The Hague, Netherlands. She earlier worked for the Kenya Institute for Public Policy Research & Analysis (KIPPRA) in Nairobi. Otieno's research interests include poverty reduction and rural development.

Telecom

***Gloria Otieno* (see above)**

Eric M. Aligula is a Senior Analyst and Head of the Economic Services Division at the KIPPRA in Nairobi. His policy research focuses on infrastructure sector performance, information and communication technology, the role of urban and regional planning, construction industry and housing as well as development funding for decentralised entities.

Uganda

Dairy & Maize

Geoffey Bakunda is a senior lecturer at the Faculty of Management at Makerere University Business School in Kampala. He holds a PhD in International Trade and has undertaken extensive research on trade policy, trade development and poverty reduction, focusing on Africa. His areas of interest include globalisation challenges, development strategies, economics of international trade, international trade relations and trade logistics.

Tanzania

Textiles

George Kabelwa is a Principal Economist at the Energy and Water Utilities Regulatory Authority in Dar es Salaam. He previously worked for a number of non-governmental institutions including the Economic and Social Research Foundation (ESRF), the World Bank Country Office for Tanzania, the Research for Poverty Alleviation (REPOA) and the RAND Corporation. His research interest is on international trade, foreign direct investment, taxation and transport. Kabelwa has authored several reports on trade in services, trade and poverty linkage, tax revenue performance and transport competitiveness.

Josaphat Kweka is a Senior Economist at the World Bank's Tanzania Country office. He also worked for the ESRF where he served as Senior Research Fellow. Dr Kweka has vast experience in conducting policy research, consulting and publishing on a wide range of economic development issues including trade, regional integration and industrialisation.

Fisheries

***George Kabelwa and Josaphat Kweka* (see above)**

Justin Musa is an Assistant Lecturer of Quantitative Methods at the Tanzania Revenue Authority Institute of Tax Administration (ITA) in Dar es Salaam. He earlier worked for the National Social Security Fund (NSSF) and the ESRF. His research interests include trade liberalisation, the impact of economic aid and poverty reduction.

Sri Lanka

Dushni Weerakoon is Deputy Director of the Institute of Policy Studies (IPS), Sri Lanka. She holds a Ph.D in Economics from the University of Manchester, UK. Her research and publications cover areas related to regional trade integration, macroeconomic policy and international economics.

Jayanthi Thennakoon is a Research Officer at the IPS, Sri Lanka. She holds a Masters Degree in Economics from the National University of Singapore (NUS). Her specialisation and research interests are in the fields of macroeconomics and international trade.

Zambia

Agro-processing and Textile Sectors

Venkatesh Seshamani is Professor of Economics at the University of Zambia. He previously taught at the Universities of Mumbai and Dar es Salaam. He has been a Visiting Research Fellow at the Institute of Developing Economies, Tokyo, the Institute of Development Studies, Sussex and the Swedish Institute of Health Economics, Lund. Sheshamani has authored and edited several books and written extensively on poverty, trade and human development issues. He has served as a consultant to several UN and other international organisations.

Cambodia

Garments

Neak Samsen is a researcher at the Economic Institute of Cambodia (EIC) in Phnom Penh, Cambodia. Earlier, he was associated with the Cambodian Agricultural Research and Development Institute. His research interests include international trade, foreign direct investment, globalisation, regionalisation and poverty reduction.

Yem Sokha is a Research Assistant at the EIC in Phnomh Penh. He earlier worked for the World Bank's Cambodia Poverty Assessment and the Cambodian Child Development Organisation. His research interests include trade liberalisation, competition policy and poverty reduction.

Fisheries

***Neak Samsen* (see above)**

Ek Chanboreth is a Research Assistant at the Economic Institute of Cambodia (EIC) in Phnomh Penh. His research interests include Cambodia's economic integration in ASEAN and the WTO, poverty reduction and competition policy.

China

Agriculture

Jing Chen is Account Manager at OgilvyOne Worldwide Beijing. He got his Bachelor of Arts degree in Economics at China Centre for Economic Research (CCER) in Peking University in 2006 and has been assistant analyst at CCER. His specialisation is in research on International Trade and Digital Marketing.

Yin He is a research fellow at the National Economic Research Institute of the China Reform Foundation and visiting scholar at the University of Colorado. She has been Assistant Professor at the CCER at Peking University and a consultant for the World Bank. Her research interests are International Trade, Development Economics and Empirical Econometrics.

Dan Liu is a Ph.D. student at the Department of Economics, University of California at Davis. She got her Master's degree in Economics at the CCER, Peking University, in 2007.

Bin Wang is a Ph.D. student in Economics at Texas A&M University. He received his Master's degree in Economics at the China Center for Economics Research in Peking University in 2006. His research interests lie in Time Series Econometrics, Financial Economics and Macroeconomics.

Home appliances

Chunzan Wu is a researcher at the CCER and has obtained a Master degree in Economics at the CCER and a Bachelor degree in applied chemistry and economics from Peking University. He has specialised in International Economics.

Guodong Zhang is a master student in Finance at the CCER, Peking University. He got his Bachelor's degree at Beijing University of Posts and Telecommunications. His specialisation is in research on International Trade.

Da Zhao is currently obtaining his PhD at the CCER at Peking University and Visiting Fellow in the Global Economy and Development Program at Brookings Institution. His research focuses on internationl trade and China's financial architecture.

India

Oilseeds

NC Pahariya is currently Professor in the Department of Economics, University of Rajasthan, Jaipur, India and a Fellow at CUTS International. He undertakes research on different aspects of trade and development and intermittently works as a consultant to World Bank funded projects on road development and highway transportation for various state governments in India.

Carpet

Purnima Purohit is an Assistant Policy Analyst at CUTS Centre for International, Trade, Economics & Environment (CUTS CITEE), Jaipur, India. She holds a Masters Degree in Economics and Development Studies with specialisation in Economics of Development, with minor in Quantitative Economic Policy Analysis from the Institute of Social Studies (ISS), The Hague. She has been working extensively on economic development issues including international trade and regional trade integration.

Prashmita Ghosh is currently an independent consultant for a Mumbai-based market research agency. She holds a Masters Degree in Economics from Jadavpur University, Kolkata. Earlier work experience includes posts with IndusInd Bank and CUTS CITEE. Her areas of interest cover international trade, environment and sustainable development.

Bangladesh

Cell Phone

M Abu Eusuf is an Assistant Professor at the Department of Development Studies at the University of Dhaka. He is an active member of the Bangladesh Economic Association. His fields of interest include trade, poverty, budget and micro-finance. He has published a number of research articles in reputed journals. M. Abu Eusuf is an active researcher and has worked for UNDP, WHO and the London School of Economics and Political Science.

Mohammad Mokammel Karim Toufique is a lecturer at the Department of Economics at the University of Dhaka. He holds a Master's and a Bachelor degree, both in economics, from the University of Dhaka. He is currently doing his Ph.D. at the University of Maryland at College Park, US. His main area of interest is empirical analysis on microeconomics and international trade.

RMG

M Abu Eusuf is an Assistant Professor at the Department of Economics and Development Studies at the University of Dhaka. He is an active member of the Bangladesh Economic Association. His fields of interest include trade, poverty, budget and micro-finance. He has published a number of research articles in reputed journals. M. Abu Eusuf is an active researcher and has worked for UNDP, WHO and the London School of Economics and Political Science.

Mohammad A Razzaque

Mohammad A Razzaque is an Economic Adviser at the Economics Affairs Division of the Commonwealth Secretariat, London. He is a faculty member at the Department of Economics at the University of Dhaka and has written extensively on trade issues. His research interests include trade liberalisation, poverty reduction and labour issues. Mohammad A Razzaque has contributed to research projects initiated by the ADB, CUTS, IDRC, ILO, UNCTAD, UNDP and the World Bank.

Pakistan

Telecommunications

Farkhanda Sohail is an economist working for Azam Chaudhry Law Associates in Islamabad. Earlier professional experience includes the Monopoly Control Authority and the Corporate Law Authority, Islamabad. She has extensive experience of working on a variety of projects relating to WTO, Competition Laws, Environment and Poverty.

Mohammad Qasim Qureshi is a Barrister and Chief Executive & Legal Director Research at the Asian Institute of Trade & Development (AITD), Islamabad. He has worked with Malik & Malik Solicitors, London, UK and Jerome Godinich, Houston, Texas, US.

Cutlery

Mohammad Qasim Qureshi (see above)

South Africa

Tourism

Brendan Vickers is a senior researcher with the multilateral programme at the Institute for Global Dialogue (IGD), Johannesburg. His work focuses on South Africa's multilateral, regional and bilateral trade negotiations, regional integration and the relationship between trade, development and poverty. He earlier worked for an advisory unit on International Relations and Trade attached to the Office of President Thabo Mbeki. He has published extensively on South Africa's international relations, including a study on investment climate reform for the World Bank's 2005 World Development Report.

Clothing

Christi van der Westhuizen is an independent analyst and researcher, and has received various journalism awards for political and social commentary and environmental reporting in South Africa. She was previously employed by the IGD as a senior researcher in the multilateral programme. She holds a Master's degree in Political Economy and South African Politics and is a PhD candidate at the University of Cape Town.

Nepal

Tea Study

Gyanu Sharma was earlier affiliated as a programme officer with South Asia Watch on Trade, Economics & Environment (SAWTEE), Kathmandu, Nepal.

Footwear

Manisha Pradhananga is a researcher and was earlier affiliated as a programme associate with SAWTEE, Kathmandu, Nepal.

Vietnam

Fisheries

Le Anh Vu is a consultant working for the Vietnam Economic Institute in Hanoi.

Ngo Huong is a co-founder of the Centre for Development and Integration (CDI) in Hanoi. She holds a Master's in Development Management from the Asian Institute of Management, Philippines and has a decade-long experience of innovative development work and social activism.

Footwear

Ngo Van Hoai is a consultant for the CDI in Hanoi. She has 20 years of experience as a researcher for the Ministry of Labour, Invalids and Social Affairs, conducting surveys and undertaking monitoring of the working environment in enterprises of the public and private sector. Her interests include labour issues, occupational health and safety, corporate social responsibility and migrant labour.

Nguyen Thi Tong is a co-founder and the director of the CDI in Hanoi. She has more than 30 years of experience in the industry sector, specialising in leather and footwear industry and is currently Vice-Chairperson of the Leather and Footwear Association Vietnam.

Abbreviations and Acronyms

A

ACP	African, Caribbean and Pacific
ACTIF	African Cotton and Textile Industry
ADB	Asian Development Bank
AFD	Agence Francaise de Developpement
AGOA	African Growth and Opportunity Act
AoA	Agreement on Agriculture
ASDS	Agricultural Sector Development Strategy
ASEAN	Association of Southeast Asian Nations
ASGISA	Accelerated Shared Growth Initiative for South Africa
ATC	Agreement on Textiles & Clothing
ATE	Association of Tanzanian Employers

B

BEE	Black Economic Empowerment
BMUs	Beach Management Units
BoP	Balance of Payment
BPL	Below Poverty Line
BRTA	Bangladesh Rural Telecom Authority
BTRC	Bangladesh Telecommunication Regulatory Commission
BTTB	Bangladesh Telegraph and Telephone Board

C

CAD	Computer-aided Design
CAM	Computer-aided Manufacturing
CBOs	Community Based Organisations
CDMA	Code Division Multiple Access
CEPC	Carpet Export Promotion Council
CIF	Cost, Insurance and Freight
CL&SMB	Cotton Lint and Seed Marketing Board
CMTs	Cut, Make and Trims
COMESA	Common Market for Eastern and Southern Africa
CPO	Crude Palm Oil
CPP	Calling Party Pays
CSOs	Civil Society Organisations
CSR	Corporate Social Responsibility
CU	Customs Union
CUPUE	Cash Per Unit Effort
CUTS CITEE	CUTS Centre for International Trade, Economics & Environment

D

DCCS	Duty Credit Certificate Scheme
DCL	Dairy Corporation Limited
DDA	Doha Development Agenda
DFID	Department for International Development
DFQF	Duty-free Quota-free
DGFT	Director General of Foreign Trade
DoF	Department of Fisheries

E

EAC	East African Community
EAP&TC	East Africa Posts and Telecommunications Corporation
EBA	Everything But Arms Initiative
EDB	Engineering Development Board
EDGE	Enhanced Data Rates for GSM Evolution
EIC	Economic Institute of Cambodia
EIP	Etisalat International Pakistan
EPAs	Economic Partnership Agreements
EPB	Export Promotion Bureau
EPF	Employees' Provident Fund
EPZ	Export Processing Zone
ETACS	Extended Total Access Communication System
ETF	Employees' Trust Fund
EU	European Union

F

FAB	Frequency Allocation Board
FDI	Foreign Direct Investment
FIFA	Federation Internationale de Football Association
FMP	Fisheries Master Plan
FTAs	Free Trade Areas
FTZs	Free Trade Zones

G

GAN	Garment Association of Nepal
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GMAC	Garment Manufacturers Association in Cambodia
GNP	Gross National Product
GSP	Generalised System of Preferences
GTZ	Deutsche Gesellschaft fur Techniche Zussammenardeit

H

HFC	Hybrid Fiber-coaxial

I

IBSA	India, Brazil and South Africa
ICD	Inland Container Depot
ICT	Information and Communication Technology
IFReDI	Inland Fisheries Research and Development Institute
IICT	Indian Institute of Technology
ILO	International Labour Organisation
IMF	International Monetary Fund
IMPA	Ibanda Milk Producers Association
ISPs	Internet Service Providers
ITU	International Telecommunication Union

J

JSE	Johannesburg Securities Exchange

K

KP&TC	Kenya Posts and Telecommunications Corporation
KPO	Kenyan Paraplegic Organisation

L

LDCs	Least Developed Countries
LDI	Long Distance International
LL	Local Loop
LVEMP	Lake Victoria Environment Management Programme

M

MCC	Milk Collecting Centres
MDGs	Millennium Development Goals
MFA	Multi-Fibre Arrangement
MFN	Most Favoured Nation
MICE	Meetings, Incentives, Conferences and Exhibitions
MINBUZA	Ministry of Foreign Affairs
MNCs	Multinational Corporations
MoU	Memorandum of Understanding
MSMEs	Micro, Small and Medium-sized Enterprises
MWRM	Ministry of Water Resource and Meteorology

N

NAMA	Non Agricultural Market Access
NBR	National Board of Revenue
NDAFCO	Ntungamo Dairy Farmers' Cooperative Society
NEPAD	New Partnership for Africa's Development
NGOs	Non-governmental Organisations
NIEs	Newly Industrialising Economies
NIP	National Investment Policy
NIS	National Institute of Statistics
NME	Non-Market Economy

NSGRP	National Strategy for Growth and Poverty Reduction
NTAEs	Non-traditional Agricultural Exports
NTBs	Non-Tariff Barriers
NTC	National Telecommunication Corporation
NTDC	Nepal Tea Development Corporation
NTE	Non-Tradition Export
NTP	National Trade Policy

O

OBC	Other Backward Caste
ODI	Overseas Development Institute
OGL	Open General License

P

PBTL	Pacific Bangladesh Telecom Ltd
PCs	Personal Computers
PCSSUMEA	Pakistan Cutlery & Stainless Steel Utensils Manufacturers & Exporters Association
PMA	Plan for Modernisation of Agriculture
PMB	Produce Marketing Board
POPs	Post Office Protocols
PPP	Public Private Partnership
PRSP	Poverty Reduction Strategy Papers
PSIC	Punjab Small Industries Corporation
PSTN	Public Switched Telephone Network
PTA	Pakistan Telecommunication Authority
PTCL	Pakistan Telecommunication Company Limited

Q

QRs	Quantative Restrictions

R

R&D	Research and Development
RBD	Refined Bleached Deodorised
RMG	Ready-made Garment
RoO	Rules of Origin

S

SAA	South African Airways
SAARC	South Asian Association for Regional Cooperation
SACCOS	Savings and Credit Cooperative Societies
SACTWU	Southern African Clothing and Textile Workers Union
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAM	Social Accounting Matrix
SAP	Structural Adjustment Programme
SAWTEE	South Asia Watch on Trade, Economics & Environment
SETA	Sector Education and Training Authorities

SLAEA	Sri Lanka Apparel Exporters Association
SMEDA	Small and Medium Enterprise Development Authority
SMEs	Small and Medium-sized Enterprises
SMMEs	Small, Medium and Micro Enterprises
SMP	Significant Market Power
SNO	Second National Operator
SOEs	State-owned Enterprises
SSA	Sub Saharan Africa
SSG	Special Safeguard Measures
SSI	Small Scale Industry
STC	State Trading Corporation
ST-EP	Sustainable Tourism-Eliminating Poverty

T

T&C	Textiles & Clothing
T&G	Textile and Garment
T&T	Telegraph and Telephone
TBS	Tanzania Bureau of Standards
TCB	Tanzania Cotton Board
TCLSB	Tanzania Cotton Lint and Seed Board
TCMB	Tanzania Cotton Marketing Board
TDP	Trade, Development and Poverty Reduction
TE	Triennium Ending
TEP	Tourism Enterprise Programme
THETA	Tourism and hospitality Education and Training Authority
TMIB	TM International Bangladesh
TPC	Trade Promotion Centre
TRV	Tariff Rate Value

U

UDC	Uganda Diary Corporation
UGT	Uganda Grain Traders
UHT	Ultra Heat Treated
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organisation
UNWTO	United Nations World Tourism Organisation
USAID	United States Agency for International Development
USF	Universal Service Fund

V

VAT	Value Added Tax
VLSS	Vietnam Living Standards Survey
VoIP	Voice over Internet Protocol
VSAT	Very Small Aperture Terminal

W

WFP	World Food Programme
WLL	Wireless Local Loop
WSSD	World Summit on Sustainable Development
WTO	World Trade Organisation

1 CHAPTER Sector Case Studies on Trade-Development-Poverty Linkages: An Overview

– Selim Raihan and Mohammad A. Razzaque

1.1 Introduction

The linkages involving trade, development and poverty (TDP) are far from straightforward. Volume I of this book reviewed TDP linkages in 13 developing countries from Asia and sub-Saharan Africa (SSA) from a macro perspective. The country experiences appeared to vary widely with regard to the relationships concerning international trade, economic growth and poverty alleviation. That is, there may not be any unique pattern of TDP linkages across countries.

This volume explores the same linkages in the same set of countries, but at the sectoral level. For each country, two sectors have been chosen where the linkages are thought to be prominent. Analyses at the sectoral level were expected to provide new insight. It is important to note that trade policy can primarily be considered as interventions geared towards specific sectors, and thus its impacts are essentially realised at individual activity levels. Policy reforms and/or trade liberalisation aim to improve inter-sectoral resource allocations to increase overall efficiency and competitiveness in the economy to stimulate growth. The effect of such intervention varies across sectors. In general, sectors with static comparative advantage are likely to benefit while others may face adverse implications. Therefore, the issue of distribution of gains is important in assessing overall economic consequences of policy reforms.

Depending on their structure, characteristics, mode of operation, and level of efficiency sectors are impacted differently due to changes in policy regimes. Sectors differ in many different aspects – factor intensity, market orientation, size, nature of ownership, dependence on fiscal and financial incentives from the government, etc. These dissimilarities lead to varying TDP linkages. A free trade regime facilitates specialisation in the export of commodities more intensive in the country's relatively abundant factors. That is, in a labour abundant developing country, free trade will tend to contribute to enhanced production of relatively labour intensive export products. On the other hand, moving from a protectionist regime to a liberal one is likely to affect domestic import substituting sectors.

Given the characteristics of sectors, some might be able to accommodate the reform measures, while others find it difficult to continue operation. When the latter sectors are directly linked to more vulnerable segments of the population, the poverty implications of a change in the trade regime can be far reaching. There are, however, other indirect effects of policy reforms. For example, liberalisation may result in cheaper products, which can have positive effects on people's well-being. In fact, it is quite an

involved task to assess the overall effects of trade policy reforms, particularly when one wants to incorporate the resultant dynamic effects, such as the development of new sectors and exports, investment opportunities, effects on productivity, etc.

Nevertheless, sectoral analyses on TDP linkages are important to understand the adjustment processes at the micro level and their immediate effects on poverty and welfare situations. Irrespective of the net benefits accruing in the medium to longer terms, there is a consensus that the most vulnerable groups need to be supported in the transitional phases through an alleviation of adverse impacts. Sectoral analysis is therefore also important to assess the importance of any safety-net measures that are required to sustain the poverty-reduction efforts of governments and make sure that trade policy reforms do not disrupt efforts to attain various social development goals.

While the sectoral case studies undertaken by the CUTS TDP project do not aim to cover all aspects of adjustment processes and the related trade-development linkages, they provide a description of overall sectoral performance during the post-liberalisation period. This chapter introduces the sectors studied in different countries. It summarises the broad characteristics of the sectors and provides a snapshot of the mechanisms through which trade openness can give rise to development and poverty implications. A number of interesting developments associated with these sectors have also been highlighted. After this introductory note, the individual cases studies follow as separate chapters.

1.2 Trade-Development-Poverty Linkages at the Sector Level

Broad Characteristics of the Sectors Selected

As mentioned above, the impacts of trade at the sector level depend on the characteristics of the sectors and their linkages with the rest of the economy. Here, we classify the sectors into two broad categories: export-oriented and import-substituting sectors. Impacts arising from trade policy reforms for an import-substituting industry can be different from those for an export-oriented industry. Moreover, depending on whether the sector is in the manufacturing, agricultural or services sectors, the consequences may vary.

Table 1.1 summaries some of the salient characteristics of the sectors selected. In the CUTS TDP project, each sector out of apparels, textile, fisheries and telecom has been studied in more than one country. Therefore, the apparels sector has been studied in five countries, viz. Bangladesh, Cambodia, Nepal, Sri Lanka and Vietnam. In an identical number of countries (Sri Lanka, Tanzania, Kenya, South Africa and Zambia) the textile sector has been studied. Case studies of fisheries and telecom have been conducted in three countries viz. Cambodia, Vietnam and Tanzania. On the whole, therefore, 26 country-specific case studies have come from 13 sectors of which eight are export-oriented (apparels, carpet, home appliances, cutlery, footwear, fisheries, tea, and tourism) while the rest five can be considered as import-substituting (textile, oil seeds, dairy, maize, and telecommunication). Out of the 13 sectors, six are manufacturing (apparels, textile, carpet, home appliances, cutlery, and footwear), four are primary commodity-based (fisheries, oil seeds, dairy, and maize), two are in the services sector (tourism and

telecommunication) and one can be categorised as agro-processing activity (tea). Apart from two (textile and telecommunication), all other sectors can be regarded as labour intensive sectors, given the nature of their production processes.

Table 1.1: Broad Characteristics of the Sectors Selected

Sectors	Manufacturing	Primary Commodity	Agro-processing	Services	Labour Intensive	Capital Intensive	Export-oriented	Import-substituting
Apparels (Bangladesh, Cambodia, Nepal, Sri Lanka, Vietnam)	✓				✓		✓	
Textiles (Sri Lanka, Tanzania, Zambia, Kenya, South Africa)	✓					✓		✓
Carpet (India)	✓				✓		✓	
Home Appliances (China)	✓				✓		✓	
Cutlery (Pakistan)	✓				✓		✓	
Footwear (Vietnam)	✓				✓		✓	
Fisheries (Cambodia, Vietnam, Tanzania)		✓			✓		✓	
Oil Seeds (India)		✓			✓			✓
Dairy (Uganda)		✓			✓			✓
Maize (Uganda)		✓			✓		✓	
Tea (Nepal)			✓		✓		✓	
Tourism (South Africa)				✓	✓			✓
Telecom (Bangladesh, Pakistan, Kenya)				✓		✓		✓

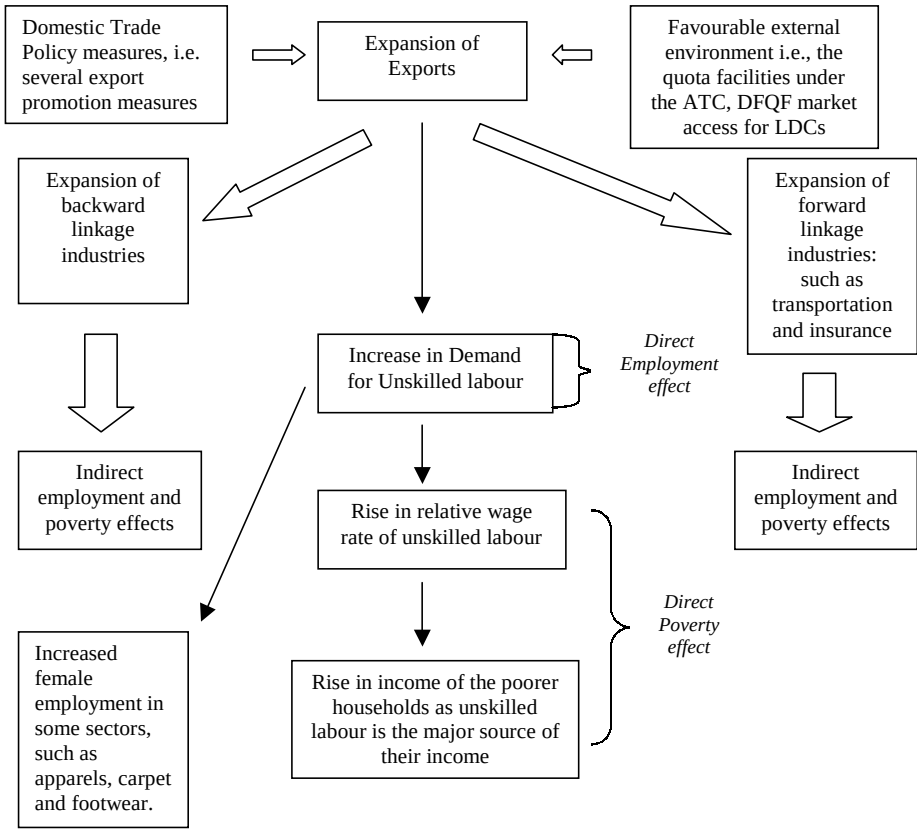
Schematic Presentation of TDP Linkages in Export-oriented Sectors

The TDP linkages in a typical export-oriented industry are summarised in Chart 1.1. In the absence of a static comparative advantage, expansion of any export-oriented sector depends on two major factors: domestic export-promoting support measures, such as, subsidies, access to duty-free (or reduced duty) imported inputs, and favourable external environment for exports including duty-free quota-free market (DFQF) access and any other favourable tariff and non-tariff preferences. The managed trade regime for apparels – known as the Multi-fibre Arrangement (MFA), which expired at the end of 2004 – provided many low-income countries with opportunities for increased apparel exports as the traditional developing country exporters with large supply capacity were constrained under the MFA. Consequently, production and supply chains shifted to other developing countries with cheap labour force, as the production process in the apparel industry is highly labour-intensive. This constitutes a classic case of countries developing their non-traditional export sectors by taking advantage of

imperfections in the global trading environment and making domestic support available to firms.

Expansion of labour intensive export-oriented sectors in developing countries leads to increased demand for unskilled labour which results in an increase in relative wages earned by such labour. Since poorer households are the major source of unskilled labour, such increases in the demand for unskilled workforce boost the incomes of these households. Therefore, expansion of labour intensive export-oriented sectors has direct employment generating and poverty reducing effects. Accompanying these direct effects are indirect employment and income generation opportunities associated with various backward and forward linkages.

Chart 1.1: TDP Linkages in the Export-oriented Industry



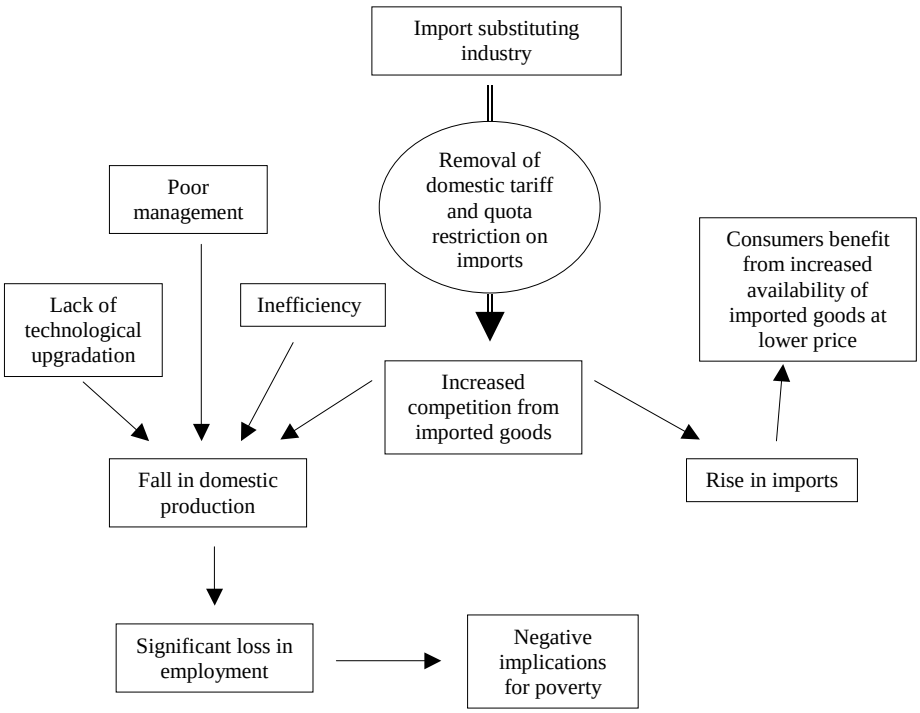
Schematic Presentation of TDP Linkages in Import-substituting Sectors

The TDP linkages in a typical import substituting industry are summarised in Chart 1.2. Traditionally, expansion of import substituting industries in the economies under consideration has been facilitated by the imposition of import tariffs and different forms of non-tariff protective measures. One of the principal arguments for such a protectionist strategy is the need to support the growth and development of domestic

infant industries by protecting them from foreign competition in the home market. In most countries, however, import substituting industrialisation, in general, has been associated with inefficiencies largely due to the lightening of competitive pressures. Import substituting sectors have resulted in huge unsustainable fiscal burdens for governments.

Against this backdrop, many TDP project countries were compelled to undertake structural adjustment policies that were translated into reduced protection and/or support for many of the traditional sectors. The liberalisation measures undertaken contributed to falling domestic production in many sectors along with rising imports. The consequent employment losses therefore have had adverse poverty and welfare implications. On the other hand, liberalisation was, however, potentially beneficial to consumers as they could access goods at lower prices.

Chart 1.2: TDP Linkages in the Import-substituting Industry



1.3 TDP Linkages in the Export-oriented Industries

The apparel industry is an important sector in Bangladesh, Cambodia, Nepal, Sri Lanka and Vietnam. In 2006, apparel exports were nearly US$8bn for Bangladesh and US$6bn for Vietnam. In Bangladesh and Cambodia, the share of apparel in total export receipts is in excess of 75 percent, suggesting very concentrated export baskets for them. On the other hand, this share is rather low in Nepal and Vietnam. It is worth mentioning that Vietnam has a well-diversified export basket, which makes it less dependent on apparels. For Sri Lanka, apparels accounts for around 43 percent of its total exports. The

development of apparel exports in all these countries have been facilitated by MFA quotas in the European Union (EU) and US as mentioned earlier. Bangladesh, Cambodia, Nepal have benefited from the DFQF market access offered by the EU under its Generalised System of Preferences (GSP) regime for LDCs.

The apparel sectors in the case studies are highly labour-intensive with important implications for poverty alleviation efforts. Employment of relatively unskilled women workers has particularly characterised export-oriented apparel making activities. In Bangladesh, the sector currently employs about 2.5 million workers, i.e. close to one-fourth of the country's total industrial work force. Approximately 80 percent of these workers are female.

On the whole, this sector is known to have important poverty alleviation effects in Bangladesh, Cambodia, Nepal, Sri Lanka and Vietnam.[1] However, there is emerging evidence that the end of MFA quotas has led to a decline in Nepal's apparel exports, increasing unemployment of women and pushing their households back into poverty. Therefore, the international trading environment that once facilitated the growth of the sector is now contributing to the shrinking of business opportunities with painful adjustment by workers employed in the sector. Countries such as Bangladesh, Sri Lanka, and Cambodia have so far managed to maintain their export performance.

The country case studies reveal that the apparel sectors in Bangladesh, Cambodia and Nepal are faced with both demand and supply-side problems. The demand-side problems include problems in market access to developed countries, stringent rules of origin (RoO) in the markets where preferences are provided (i.e. the EU), and those related to compliance with various labour and environmental standards. Weak physical infrastructure, low labour skills and productivity, long delivery time for orders, lack of sufficient backward linkages etc. are major supply-side problems. Trade-poverty linkages involving apparels in these countries will be affected greatly by attention to supply-side problems and the extent of favourable treatment received on the demand-side.

The carpet industry in India directly employs 2.5 million artisans, especially rural women. The sector also provides indirect employment opportunities to several thousands of people working in raw material and other sectors connected with the carpet industry. Carpet making is a sector where India has a long tradition. Until the early 1970s, India was one of the major players in the world export market of carpets. Since then it has faced stiff competition from China, Iran and Pakistan. The sector is almost 100 percent export-oriented and is highly labour intensive. The expansion of the carpet industry in India in recent years has been facilitated by several governmental support programmes, such as the establishment of Carpet Export Promotion Council. The industry, however, faces several challenges such as involvement of child labour, change in foreign consumer preferences in favour of cheap synthetic carpets, and lack of effective functioning of the Carpet Export Promotion Council.

China's home appliances industry depicts a situation where the expansion of the industry has generated significant employment opportunities for the rural surplus labour. In recent years, the industry has expanded rapidly to become the leading exporter of home appliances in the world. The reasons behind the rapid growth of the home

appliance industry in China are large potential market demand, abundance of cheap and experienced labour and a system which supplies all necessary spare parts. China's export of home appliances rose substantially over the last decade. In addition to employment generation, the rapid growth of the home appliance industry has also contributed to increased income for local governments in terms of tax revenues resulting in expansion of the local government's capacity to provide more public goods for poorer households.

The cutlery industry in Pakistan exemplifies cases where lack of trade liberalisation in the sectors supplying raw materials to industry has been instrumental in generating unsatisfactory outcomes for industry. The sector is purely comprised of small and medium-sized enterprises (SMEs). Around 8,000-10,000 people are directly employed in this sector. There is also a large number of people employed in linked industries. Pakistan exports both kitchen and table cutlery and non-kitchen and non-table cutlery items for industrial, commercial and domestic purposes including knives, spoons forks swords, scissors, manicure and pedicure sets and instruments, and non-electric razors etc. It is among the top 25 cutlery exporting countries in the world. The major export markets are the US and EU.

The case study included in this volume indicates that the exports of cutlery witnessed an annual average growth of 11 percent in the period 1998-2002. The value in export of cutlery increased from US$18.3mn in 1998 to US$30.8mn in 2004. The case study also suggests that the sector did not benefit much from the trade liberalisation process in the country. Insignificant reduction in custom duties on raw materials and machinery used in this industry coupled with increase in their world prices implies that cost of investment in the sector has actually gone up. Moreover, there has not been any significant technological advancement in this sector. Therefore, high cost and poor quality of raw materials, and lack of technological progress are among the main reasons behind this sector's inability to realise full potentials. This is in stark contrast to the experiences of 'apparels' and other export-oriented sectors in other developing countries where expansion has been facilitated by the availability of cheap imported inputs.

Since 2005 footwear has been reported as one of the top seven exporting sectors in Vietnam. In 2006, the country exported US$3.59bn worth of footwear. The growth of the footwear industry in Vietnam has also been associated with large employment opportunities for the unskilled labour, especially for women. In 2003, the total employment in this sector was 0.45 million workers, which increased to 0.58 million in 2005. It has been claimed that the recent high growth rate of this sector has contributed significantly to poverty alleviation. The growth of the footwear industry in Vietnam has been facilitated by the GSP facilities in EU. However, the phasing out of the GSP facility as well as the threat of imposition of anti-dumping duty on footwear exports from Vietnam to EU have had serious negative implications for the welfare of the people employed in this sector.

The case studies on fisheries in Vietnam, Tanzania and Cambodia suggest that, in general, the expansion of this sector has been associated with reduction in poverty in rural areas through increased employment opportunities. Vietnam has been very successful, in recent years, in increasing exports of fisheries. The sector contributes to four percent of the country's gross domestic product (GDP). The case study included

in this volume indicates that the fishery export in 2005 was over US$2.65bn and is expected to reach US$4.5 to US$5bn by 2010. In 2005, around four million people were directly employed in this industry.

The case study on fishers in Tanzania suggests that the fisheries sector contributes to about 10 percent of the country's GDP. In 2004, the export earnings from this sector were close to US$100mn accounting for around 14 percent of total export earnings. Around 1.5 million rural people are engaged in this sector.

In the case of Cambodia, however, though fisheries exports have increased significantly, there is a serious concern with respect to the distribution of gains from such an increase. It has been pointed out in the country case studies that because of unequal distribution of gains the livelihoods of people attached to this industry have not improved much. The fisheries exports from all these countries face stiff SPS regulations in developed country markets which significantly constrain their export expansion.

In Nepal, the expansion of the export-oriented tea sector has been facilitated by the trade liberalisation policies adopted in the early 1990s, bringing an end to the state monopoly in tea production. This has resulted in the establishment of numerous tea estates by the industrialists and businessmen. A large number of small farmers have switched to tea cultivation as the returns from the production of orthodox tea have been much higher than those from traditional crops. The Nepalese tea sector directly employs more than 1 million people and also facilitates significant indirect employment generation in supporting industries. In 2002-03, tea exports from Nepal were US$761000, which increased to US$167000 by 2006-07[2].

Tourism in South Africa is a fast growing industry and currently accounts for more than seven percent of GDP. The sector absorbs around four percent of the country's labour force. The case study highlights that by 2010, when South Africa is to host the Federation Internationale de Football Association (FIFA) Soccer World Cup, the sector is projected to employ about 1.2 million people either directly or indirectly.

1.4 TDP Linkages in Import-substituting Sectors

The case studies on import substituting textiles & clothing (T&C) industries in Sri Lanka, Tanzania, Zambia, South Africa and Kenya despict almost identical stories. In all these countries, T&C sectors had previously enjoyed significant protection which helped the sector grow and generate large employment opportunities for the relatively skilled labour force without attaining the efficiency level of their global competitors. Consequently, trade liberalisation together with reduced government support and subsidies caused a sudden fall in textile output and employment. This has led to a significant and sustained decline in household incomes, severely constraining their ability to maintain expenditure on healthcare, education and food.

Like the textile sector, the import-substitution strategy with respect to the edible oil sector in India, until 1994-95, delivered significant benefits in terms of achieving almost self-sufficiency in the production of oilseeds. This strategy also encouraged the production of new crops such as soybean, sunflower etc. even in those rain fed areas where poor farmers typically face more limited growth opportunities. India also started

exporting edible oils and became a major exporter by early 1990s. However, the liberalised regime, together with faster economic growth, resulted in acceleration of demand for edible oils which was increasingly being satisfied through cheap imports. Continued inefficiencies in marketing and processing of oilseeds and other supply-side problems deprived both the farmers and manufacturers of the gains offered by trade liberalisation.

The case studies of the dairy and maize sectors in Uganda suggest that liberalisation has contributed to the deepening of rural poverty. The welfare and real incomes of most rural farming households fell after liberalisation. Although liberalisation opened new opportunities, the incompetence of the private sector resulted in the expansion of trade at the informal level only, and limited the expansion of the formal marketing of agricultural output. Market efficiency subsided and increasing portions of agricultural output have remained unsold. The liberalised market regime has failed to effectively link the producers to local and export markets. Liberalisation has also not been accompanied by the requisite regulatory and promotional capabilities of institutions created for that purpose. Consequently, gaps in regulation, promotion and supporting infrastructure have remained which have not enabled liberalised markets to function properly. The cases of dairy and maize sectors in Uganda reiterate the fact that liberalisation alone is not sufficient to bring about efficiency and promote a positive supply response. Important and critical institutional reforms are needed to reap the benefits of liberalisation.

Liberalisation and deregulation in the telecommunication sectors of Bangladesh, Pakistan and Kenya has resulted in the development of the cellular phone industry, triggering the growth of mobile phone users at an exponential rate. Expanded telecommunication facilities have provided direct and indirect employment opportunities. Improved access to information for individuals has increased overall market efficiency by reducing uncertainty. The sector has also attracted large inflows of foreign direct investment (FDI). The emergence of new players in the telecom sector has had a positive impact on business transactions as well as the daily lives of common people. The increased competition among service providers has benefited the consumer as they have a wide array of telecom service choices.

However, in all these three countries there are concerns with respect to the effective functioning of the regulatory authority in ensuring a competitive environment and good quality of services at affordable prices. Despite some strong perceptions of anti-poverty effects, the actual impact of the improved telecommunication system has not been estimated yet.

1.5 Conclusion

The sectoral case studies, in general, suggest that, effective governmental policies and promotional measures are very important for the development and expansion of export sectors. A number of policies and programmes have been put in place in the studied countries for the promotion of the sectors discussed above. For example, trade regimes in all these countries have been made liberal with a view to reducing the policy-induced discrimination against export or trade sector investments. Several export promotion measures have also been made available to provide further incentives to such activities. However, these measures have not enhanced exports in many such activities. Country

experiences seem to suggest that only a few sectors have been beneficiaries of such reform policies.

Most cases of expansion by an export-oriented sector can be attributed largely to a favourable external environment, such as restricted competition in foreign markets, and favourable market access. The external environment, in many cases, also acted as an impediment to the successful expansion of export sectors in studied economies. For example, many of the sectors studied face high tariffs in the US market, stringent RoO and threat of anti-dumping duty in the EU market (while enjoying the preferences) and stringent standard-related requirements in developed country markets in general.

Along with the issue of market access, supply-side constraints that are common to many of these countries include high export delivery time, poor management, weak physical infrastructure and lack of technological upgradation. These constraints seriously hamper export prospects. Therefore, easing supply-side bottlenecks should be an important priority for governments and concerned institutions in these countries.

Liberalisation in import substituting sectors might generate important direct adjustment costs in terms of loss of employment and consequently incomes for many households. Therefore, mitigation of adjustment costs, through different compensating measures, should accompany the trade liberalisation process.

Finally, it should be mentioned that this CUTS project only signifies the importance of undertaking sectoral case studies. Future studies should be based on comprehensive analytical framework so that all routes/mechanism associated with positive and negative effects of policy changes can be captured. Despite their importance, estimates of poverty and welfare effects are rarely available. Therefore, more research is needed to inform the policy making process and evaluate policy changes.

Endnotes

1 Raihan and Khondker (2007), using a quantitative model, estimated that 1.02 points out of the 9-percentage point fall in the headcount poverty incidence in Bangladesh in 2000-2005 could be due to the growth of apparel exports alone

2 *http://www.tepc.gov.np/tradestatistics*

2 CHAPTER The Ready-made Garment Industry in Bangladesh

– Abdur Razzaue and Abu Eusuf

2.1 Introduction

The empirical evidence, as available in the academic literature concerning the relationship between trade and economic growth, is mixed. Nevertheless, when it comes to the question of poverty alleviation, the role of trade for the readymade garment (RMG) export sector of Bangladesh cannot be overemphasised. This is mainly because of the nature of operation of the export-oriented RMG firms. Although a significant portion of RMG exports is critically dependent on imported inputs, making its domestic value addition relatively low, its extremely labour-intensive mode of production process has an enormous role in poverty alleviation.

This chapter provides a case study of the RMG sector of Bangladesh by highlighting the effective role international trade can play in effective poverty alleviation. While doing so, the case study takes the structural and labour issues influencing various dynamics associated with exports, growth and poverty relationships into consideration. It also makes use of important stakeholders' perception on how to enhance the role of the sector in promoting the trade-growth-poverty relationship in Bangladesh.

2.2 RMG and the Bangladesh Economy

In the decade of the 1980s, Bangladesh's exports doubled from US$0.9bn to US$1.8bn, which in the next decade increased to just over US$5bn on its way to reach US$10bn by the end of the fiscal year 2005-06 (see Figure 2.1). Since the beginning of the 1990s, exports in US$ have increased at a rate of 14 percent per annum as against a comparable GDP growth rate of about five percent. This apparently impressive performance of export trade has been single-handedly driven by the RMG sector, which has witnessed its share in total exports rising from virtually nothing in 1980 to 75 percent in 2006.

RMG exports comprise woven and knitwear products. Although woven items have traditionally dominated RMG exports, knitwear items, as shown in Figure 2.2, have demonstrated a very robust growth performance in recent times, increasing the share in total RMG exports from as low as 10 percent in 1992 to 48 percent in 2006.

Highly labour-intensive nature of production process characterises the garment industry. Even as late as in 1985, just about 0.1 million people were employed in the RMG industry, but within the next 20 years it grew rapidly to reach about 1.9 million, accounting for 35 percent of all manufacturing employment in the country – 80 percent of whom were women (Rahman, 2004). The trend growth rate of employment for the period 1980-2004

Figure 2.1: Bangladesh's Merchandise Exports: Aggregate and RMG

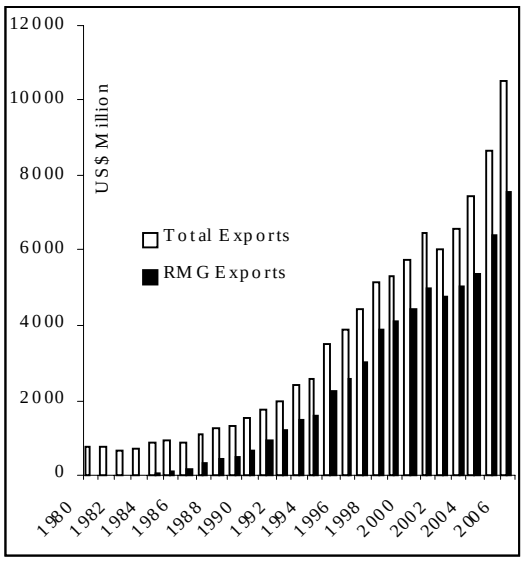
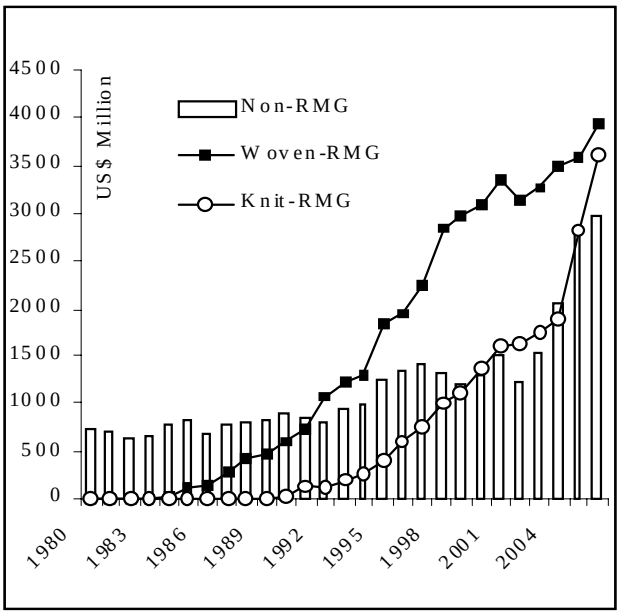


Figure 2.2: Woven-RMG, Knit-RMG and Non-RMG Exports from Bangladesh



has been estimated to be 24 percent per annum (Razzaque, 2005). It has been suggested that if one considered the jobs created in the complimentary enterprises as a result of the growth in this sector, the number of people either directly or indirectly depending for their employment on the existence and expansion of the RMG sector would rise to three million (Ahmed and Sattar, 2004). Currently, for every US$3,600 worth of RMG export there is one worker in the industry, and over the past two decades the employment elasticity of RMG export has decreased considerably. This is mainly attributable to rising labour productivity and partly due to the changing composition of clothing exports as reflected in the growing share of knit-RMG, which is relatively less labour-intensive. The woven sector with an export volume of US$3.5bn in 2004 employed 1.4 million workers, while there were 0.5 million people in the US$1.9bn knitwear industry.

The growth of RMG exports has certainly had favourable effects on macroeconomic balances. It has helped maintain a sustainable trade deficit, which has declined from around 10 percent of the GDP in the early 1980s to around 5.5 percent. On the other hand, the current account balance, on average, was close to three percent of the GDP during the 1980s, but for the 1990s the comparable figure was only 0.3 percent. In fact, the reduced dependence on foreign aid has been a remarkable development for Bangladesh's economy, which is mainly attributable to the RMG-led robust export growth and a surge in the inflow of remittances. The rising trend in foreign exchange flows in the economy brightly contrasts with the declining significance of foreign aid, which now constitutes only about three percent of the GDP as against 19 percent of exports and remittances taken together. It is in this context that the RMG-led export growth is argued to have transformed Bangladesh from a predominantly aid-dependent country to a largely trade-dependent nation (Rahman, 2002).

It is often argued that the RMG sector has a weak backward integration into the national economy, particularly the woven-RMG sector is critically dependent on imported raw materials. Currently, the domestic value added in the woven-RMG is 25-30 percent. However, over the time quite a strong backward linkage industry has grown up for the knit-RMG sector, which at present accounts for 70-80 percent of the total raw material requirements for exports. According to one estimate, the domestic content (in terms of local fabric use, wages and salaries, payments to government, linkages, etc.) exports in the aggregate RMG constitute about 46 percent of the total export receipts, i.e. about five percent of the GDP. Despite the much talked about low integration, out of a total of 85 sectors in the National Input-Output Table, the sector ranks 17th in terms of backward linkage effects. The total backward linkage multiplier for the RMG industry is estimated to be 2.1, indicating that a one unit increase in its final demand would lead to an economy-wide output increase of 2.1 units (Razzaque, 2005). When this multiplier effect is decomposed to find out the marginal effects on the outputs of different industries, sectors such as clothing, yarn, professional services, housing services, bank and real estate, storage, and machinery are found to have strong links with the RMG activity.

The RMG sector has a profound positive impact on poverty reduction and incomes of the poor, which is reflected in the growth of employment in the industry. From a constructed Social Accounting Matrix (SAM) for Bangladesh that allows for different

types of households with labourers of various skill types, it is found that the basic needs multiplier of the RMG output shows an increase in expenditure on nutrition by 0.76 Bangladeshi Taka (US$0.01) for every Taka extra demand for RMG.[1] Amongst all other sectors, the RMG multiplier as derived from the SAM, for the female low-skilled workers is found to be the highest. The SAM framework also allows capturing the changes in income (and thus poverty) by various household types as a result of shocks in different sectors. Amongst the rural households, the income effect of RMG activity appears to be the highest for non-agriculture households. In the urban areas, it is the low education households that benefit most from the increase in RMG expansion.

In the context of Bangladesh, the validity of the 'export-led growth' hypothesis has been called into question. The basic argument is that when the share of exports in GDP is very low, export may not act as an engine of growth.[2] In terms of domestic value added, the share of exports in Bangladesh GDP is very low – just about seven percent – making it unconvincing that such a small sector in the economy can boost overall economic growth. Nevertheless, the Bangladesh case seems to suggest that even without becoming the "engine" of growth the export sector can have substantial poverty alleviation effects because of the high employment intensity of the export activity.

2.3 Structural Factors and the Growth of the RMG Sector

International Trade Environment: The Demand Side

The international trade in T&C was long restricted in developed countries and the resulting quota system for controlling imports caused global dispersion of production in the sector by limiting imports from countries that would have a larger volume of exports had they not been constrained by their quota allocations. While the intention was to provide protection to domestic manufacturing units in the importing countries from the relatively efficient producers in developing countries, the operation of the 'managed trade' regime in the process led to exporting opportunities in countries where T&C was not a traditional export item.

Many international business firms, in particular those from Asia's newly industrialising economies (NIEs), faced binding quota restrictions in their own countries, and subsequently relocated part of their production and trade to other relatively poor developing countries including Bangladesh. As the process of production was labour-intensive in nature, especially in the production of apparels, the availability of cheap and easily trainable labour in these countries facilitated the growth and development of the sector. The quota system ensured a reserved market status for the new suppliers and gave them some time to develop and learn the skills required for production and marketing.

Domestic Trade Policy and Producers' Response: The Supply Side

Apart from the international trade environment, the growth of the RMG sector in the country coincided with Bangladesh's changing trade policy regime, providing the much needed policy support to the export sector. Up till the early 1980s, Bangladesh followed a very rigid import-substituting trade regime. This generated a highly distorted incentive structure resulting in widespread allocative and productive inefficiency, which

not only inhibited the prospect for growth, but also led to a policy induced anti-export bias, thereby undermining the potential for export growth. In the face of serious macroeconomic imbalances and stagnating export performance, the policy of reforms for stabilisation and structural adjustment was undertaken. This policy reversal introduced generous promotional measures for exports so that the erstwhile bias against the export-oriented investment could be reduced significantly.

Important export-promotion schemes include, *inter alia*, allowing exporters to open letter of credits (L/Cs) for the required imports of raw materials against their export L/Cs (popularly known as the back-to-back L/Cs), bank credit at a subsidised rate of interest, duty free import of machinery, providing intermediate inputs at world price either by bonded warehouse or by duty draw back facilities, cash subsidies, and exemption from value-added and other taxes. Along with these promotional schemes, DFQF market access to the EU market greatly contributed to the growth of the RMG sector. These incentives available to exporters to a large extent mitigated the problem of policy induced anti-export bias especially against the RMG sector.

2.4 Labour Market Effects

The Demand and Supply Sides and their Effects on Wages and Workers' Welfare

Employment in the RMG sector is characterised by low wages and there is hardly any controversy over the fact that the decent work record of Bangladesh's RMG industry is far from satisfactory. In fact, Bangladesh is a country with one of the lowest wage rates in the world (Abernathy *et al*., 2004). While the low wage rate reflects large supplies of workers relative to demand, it is striking is that the legal minimum wage for this sector has not been increased since 1994. Employers often argued that despite the unchanged legal rate, the actual minimum wage in the sector had increased in response to the adjustment with the increased standard of living and inflation. However, such a claim is grossly overstated as full inflation adjustment was never undertaken.

In spite of many significant contributions, the RMG industry is known for a wide variety of deprivations of women workers, which include, *inter alia*, the lack of proper infrastructure facilities and safety at workplace, non-compliance with the minimum wages, very low wages, wage discrimination, lack of provision of essential service benefits to workers, housing facilities, and lack of skill development and training opportunities (CPD, 2003). Many point out that if these issues can be addressed, the poverty alleviation effects of trade can be strengthened further. On the other hand, employers have long argued that such measures would undermine their competitiveness. Although the workforce of the industry is overwhelmingly dominated by women, provisions available in the sector are not gender sensitive at all[3].

The issue of enhanced poverty alleviation effect through higher wages and better working conditions has a very striking and interesting context in Bangladesh. The end of the MFA regime has exerted a worldwide business environment marked by serious price competition in which the sustainability of Bangladesh's exports is under some question. Nevertheless, Bangladeshi exporters have been under continuous pressures for complying fully with international labour standards, putting them into a dilemma: on one hand, in the face of price competition with rivals they need to be more competitive

and the strict compliance with standards would increase the costs of production thus weakening their competitive position further on the other hand. These apparently conflicting matters can be resolved by productivity gains. However, many business enterprises are of the view that neither the improvement in standards necessarily leads to better returns from investments nor that they secure the export market share. In this regard, a number of factors that need to be taken into consideration in order to better understand the issues related to competitiveness and better pay and poverty alleviation, are discussed in the following sub-sections.

Wage, Productivity and Competitiveness of the Industry

Although low in an absolute sense, the existing wages in the RMG industry of Bangladesh are above the market clearing ones, as there is the problem of excessive supplies of labour (relative to demand), and in this sense one could characterise the sector as the one which is already providing efficiency wages. However, the issue becomes far more complicated over the discussion on which efficiency wage is a fair wage and which is not. Many entrepreneurs try to rationalise the existing low wages with the low productivity of workers. This reasoning is, however, absolutely wrong. The wage-productivity relationship holds only when there is full employment. In the presence of an excess supply of labour, wages will be low irrespective of the productivity level.

In the context of Bangladesh, the share of labour in the RMG value chain is very low and hence a rise in workers' productivity might not result in substantial competitiveness gains for firms. For example, the integrated value chain analysis, undertaken by the World Bank (2005), shows that for a US$1.28 T-shirt produced in Bangladesh, the labour cost associated with sewing and assembly accounts for only 4.7 percent of the entire value chain (i.e. US$0.06). It can be calculated then, assuming that all other factors remain constant that a doubling of labour productivity (i.e., a 100 percent improvement in labour productivity) would result in the reduction of cost by just US$0.03, which is likely to have not much effect on the competitive position of Bangladesh in the world market.

Whenever the issue of low labour productivity is discussed, the reason behind it is implicitly attributed to workers. Given their low level of education and skills, most Bangladeshi workers are likely to be less productive than their counterparts in other developed and relatively advanced developing countries. Nevertheless, when Chinese workers for example, are considered to be three times as productive as those from Bangladesh, this does not imply that only the differences between the characteristics inherent in the workforce of these two countries explain the productivity difference. It could be that investment on capital is much higher in the countries with high productivity. In terms of annual average capital intensity, Bangladeshi garment factories spend less than US$1,500 per worker in comparison with more than US$4,000 spent by Chinese firms (World Bank and BEI, 2003).

Another important related point is the managerial efficiency or management productivity. Some firms are not in a position to move to high value added items, or expand their current capacity of production because of their management inefficiency. This may have some implications for overall low productivity. Yet another factor that needs to be

recognised is the extremely limited scope of training and skill development for factory workers. Investment on workers' skill development is something that has not become a part of firms' production and market expansion strategies.

The Demand for Higher Wages

Despite the pressure from the buyers, most of Bangladesh's garment manufacturers managed not to improve their labour standards substantially. However, given the very recent labour unrest, serious thoughts are now being given to the problem. The manufacturers' association has now agreed to a pay rise in line with the recommendations made by a Commission that was formed to address the issues of low wages and other work place related standards. The manufacturers association emphasised that it would take necessary measures to improve the situation on other non-wage fronts.

2.5 Factors for Promoting Trade-Poverty Linkages

Given the highly labour-intensive nature of the production process, the development of the RMG sector is to be considered as a route to achieve a desirable development process. Most stakeholders in Bangladesh recognise a number of important issues that need to be taken into consideration for strengthening the trade-poverty linkage in the RMG sector. During the perception interviews, labour representatives argued that if trade was to promote development and poverty alleviation, their concerns have to be addressed. On the other hand, exporters emphasised on protecting the competitiveness of the sector. According to them, if the sector cannot survive in the global market, the consequences would be far worse than the existing situation. By analysing the views and perception of various stakeholders, the following key points can be highlighted.

Critical Role of the Government

Most stakeholders seem to agree on the critical role that the government can play in promoting the trade-poverty linkages associated with the RMG industry. When the scope of productivity gain is relatively low, at least in the short-run, and the demand for better work place cannot guarantee increased exports and market success, appropriate wages and better work environment may be ensured by a more pro-active role of the government. There is no denying that standards related to work conditions will differ across countries. Nevertheless, many of the interviewed stakeholders emphasised the need for setting standards with regard to minimum wages and other working conditions. Even when people are willing to accept lower wages, there should be some minimum standards for working environment. The specification of these conditions has been argued to be considered as the provision of what is known as 'merit' goods (Khondker and Razzaque, 2005).

As in the case of all other merit goods, the government plays an important role either in establishing or facilitating the process of setting suitable codes of conduct by striking a delicate balance between the realistic country scenario and the need for protecting its workers. Enforcement of these conducts will be most important in ensuring the credibility of the official machinery and wining the confidence of buyers and consumers. An effective initiative by the government in this regard can also provide a basis for negotiating with buyers for a unique set of code of conduct that is based on national laws and core standards. Considering the increasing pressures of the buyers' side the

steps already taken by employers' associations in collaboration with various donors and agencies will only be sustainable over the long run if the government supports their enforcement. During our perception survey, workers' representatives pointed out that on most issues good laws were already in place, but their implementation had always been overlooked.

Setting-up Realistic Standards

The stakeholders interviewed were of the view that there was a need for improving the working conditions. However, some of them were concerned about setting up unusually high compliance standards, pointing out that the prevailing socio-economic conditions in Bangladesh would have to be assessed realistically. Besides, standards used in evaluating the working environment and conditions differ considerably amongst buyers. Complying with different standards set up by different buyers is extremely difficult for the entrepreneurs. To overcome this problem, a number of initiatives have been launched to develop a common set of codes of conduct for the sector, on which individual firms' work environment record can be assessed.[4]

It is yet not clear if and when these standards are specified, and whether they will be acceptable to all parties involved. Employers usually point out that setting unusually high compliance standards for the RMG industry would be unwarranted given the prevailing situation in other industry and non-tradable sector. They argue that the garment sector has a much better working environment than many of the state-run industries and other export-oriented sectors, which is partly attributable to T&C buyers' compliance requirement. Employers were also concerned that the investment on better codes of conduct can have immediate cost-raising effects, while the gains associated with improved competitiveness via enhanced productivity can only be achieved with a time-lag. Therefore, how firms are going to adjust the implication of rising costs at a time of increased competitive pressure is an important issue.

Trade Preferences and Labour Standards

During the perception survey, an issue of disagreement could be noticed on the potential role of trade preferences in promoting labour standards. Bangladesh currently does not have duty-free access to the US market while such access has been granted by the EU for a long time now under the GSP and the Everything-But-Arms (EBA) initiative. The EU preferences have been subject to the fulfilment of some stringent RoO, which most of Bangladeshi exporters are unable to comply with.[5] Therefore, despite the provision of zero-tariff access, the non-tariff barriers (NTBs) remain. Garment exporters from Bangladesh argue that if duty-free access to the US market is obtained and if the EU relaxes the RoO requirements, complying with standards will be easier, as the preferences will help the country protect its competitive advantage in the quota-free world.

Views expressed by workers' representatives and other stakeholders differed in this respect. They point out that the mere availability of preferences will not ensure that workers get some benefits out of this favourable treatment. According to workers' representatives, the fast expansion of the sector over the past two decades or so shows the profitability of the business, although workers' interests have been

completely ignored. Most stakeholders, however, agree that favourable treatment in the export markets will help maintain Bangladesh's competitiveness, but benefits accruing to workers may not be guaranteed.

Higher Wages and Poverty Alleviation

Will higher wages paid to workers contribute to further poverty alleviation? This important question resulted in some serious controversy during the perception survey. Business representatives argued that increased wages would not have any direct effect on the extent of absolute poverty, as workers with their existing wages were already above the poverty line. Under such a circumstance, only when business expands, more fresh jobs will be created, ameliorating the poverty situation through employment generation. Workers on the other hand argued that better pays will increase their productivity and improve their standards of living, which is in line with the arguments of trade-led development strategy.

While agreeing with the fact that a rise in wages itself may not have any direct impact on poverty alleviation, economists and trade analysts were prompt to point out the possible secondary effects of better pays in terms of increased spending on basic goods and services which would contribute to other economic activities if the workers and their households were already above the poverty line considering the way absolute poverty line is constructed in Bangladesh. However, they also mentioned that jobs to fresh workers were likely to have greater poverty alleviating effects. The best possible poverty alleviation action combines both the rise in the wage rate and the expansion of employment. Trade analysts were of the view that the RMG industry of Bangladesh was capable of achieving both of them.

Improving Workers' Skills to Enhance Competitiveness

Although the rise in labour productivity might not result in significant competitive gains, many stakeholders pointed out that an improvement in labour and management productivity should be considered as a strategy for improving competitiveness, particularly in the medium and long term. Skill development will also allow vertical mobility for some workers, resulting in positive effects regarding their poverty and welfare status. Trade experts argued that diversifying into high value added items will require improved skills of the workers: the fact that Bangladesh has not been able to specialise in such items is due to the shortage of skilled workers and managers.

Costs of Doing Business

Some stakeholders were of the view that if the costs of doing businesses could be reduced, its effect on competitiveness would have been positive, which in turn could help provide higher pays and better working environment. But, again should not be considered as a necessary association given the reasons mentioned above. However, most of the stakeholders suggested that reduced costs of doing business would have contributed to further growth of the sector resulting in more employment.

Mechanisms for Supporting Workers in the Face of Export Shocks

Most stakeholders were of the view that any shock in RMG exports will have disastrous consequences on poverty. Although there has not been any adverse impact during

the first two years of MFA phase-out, the situation from 2008 onwards could be different when all safeguard measures against China in the EU and US markets will be discontinued.

Role of Stakeholders in Promoting Trade-Poverty Linkages

Representatives participating in the perception survey broadly agreed on a number of issues related to roles of various stakeholders in promoting the trade-poverty linkages in the RMG sector. These are summarised below:

- The Government has to play a crucial role in assessing the working environment and their improvement from a perspective realistic to a poor developing country situation. It should establish its credibility in terms of setting up standards and effective enforcement. Without the implementation of the standards related rules and regulations, the workers in this excessive supply side labour market are unlikely to get fair wages and decent work environment. There was also an agreement amongst the representatives that in many cases the non-wage working environment was much more appalling than the problem of low wages.
- Employers/entrepreneurs are central to improved living standards and working environment in their firms. Ideally, the employers themselves should first identify their problems and find out means to address them effectively. In that sense, they need to play an active role rather than passively implementing the codes of conduct.
- Buyers can also have an important role in promoting trade-poverty alleviation nexus in Bangladesh. While operating purely on a profit-maximising motive, demanding high standards without taking into consideration the realities and cost structures of the firms into consideration is deemed to as unfair. One frequently hears the threat of 'boycott' from buyers, but such an action will do more harm than good to workers. On the other hand, the buyers may offer some incentives to help improve the factory working conditions in factories.
- The role of multilateral agencies in promoting the trade-poverty nexus in Bangladesh cannot be overemphasised. Disseminating knowledge about labour standards, campaigning the need for a good working environment, facilitating dialogues and exchange of ideas amongst stakeholders, etc. are important areas where their involvement can be instrumental. They can also extend technical assistance with regard to the improvement of standards. Many small and medium scale RMG factories find it difficult to comply with the codes of conduct. Helping these enterprises can be crucial in lifting the decent work record of Bangladesh. Multilateral agencies can also work with the employers in motivating the buyers to offer generous incentive packages to the firms and comply with labour laws and standards.

2.6 Conclusion

It is rather unfortunate that despite the striking growth record more than 20 years, supply-side bottlenecks and poor working conditions continue to feature the RMG industry prominently. Because of the lack of improvements in this sector, exporters have now come under sudden pressures, especially following the abolition of MFA quotas. As the workers have been subject to gross deprivation of their basic rights along with low wages, the issue of better working environment cannot be considered as a minor priority. On the other hand, if the implementation of better environment has to compromise with the country's international competitiveness, trade-led poverty alleviation may come under serious threat.

For Bangladesh, therefore, it is imperative to exploit every possible means to promote the competitiveness of the sector. Reducing the costs of doing business is the principal route through which some immediate gains can be materialised. With regard to setting up labour standards and their implementation, the Bangladesh case illustrates the important role that the government can play in promoting trade-poverty linkages. However, growth and expansion of the industry further by creating more employment opportunities is the likely key to achieve faster poverty reduction through trade. How much of the scope can be exploited in the future will to some extent be dependent on the country's export prospect in the post-MFA period.

It is expected that safeguard measures will remain on China until the end of 2008 giving Bangladesh less than a couple of years before entering into an unabated competition regime. In this regard, duty-free access to the US market can be instrumental in promoting the trade-poverty alleviation link in Bangladesh. According to one estimate, such access to the US market could increase annual jobs of up to about 0.2 million (Razzaque, 2005). If withdrawal of restrictions from China adversely affects Bangladesh's RMG exports, then the positive trade-poverty linkage could be reversed, with millions of women workers losing their jobs and being compelled to accept undesirable works in the informal sectors under deplorable conditions.

Better export prospects in the future could make the task of addressing the constraints to further poverty alleviation effects in the RMG industry easier to achieve. However, this should not be taken as a guaranteed outcome since even with a somewhat reserved market status for more than 20 years now, not much has been achieved with regard to various infrastructural and labour problems. This is where the government will have to play its role.

Finally, all stakeholders including the donors also have important roles to strengthen the trade-poverty nexus in Bangladesh. Collaboration amongst stakeholders is needed in almost every aspect of the RMG industry, from addressing the problem of supply side bottlenecks to raising awareness amongst the workers and employers about their roles and responsibilities.

References

Abernathy, F H, Volpe, A and Weil, D (2004), "The Apparel and Textile Industries after 2005: Prospects and Choices", Harvard Centre for Textile and Apparel Research

Ahmed, S, and Satter, Z,(2004), "Impact of Trade Liberalisation Looking at the Evidence", Economic and Political Weekly, September 04, 2004

Rahman, M (2002), "Bangladesh's External Sector in FY2001: Review of Performance and Emerging Concerns", in Sobhan, R (ed) *Bangladesh Facing the Challenges of Globalisation*: *A Review of Bangladesh's Development 2001*, Centre for Policy Dialogue, Dhaka

Rahman, M (2004), "Surviving In a Quota-free World: Will Bangladesh Make It?", Paper presented at a dialogue on March 18, 2004

Razzaque, M A (2005), "Sustaining RMG Exports after MFA Phase-Out: An Analysis of Relevant Issues with Special Reference to Human Development", Report Prepared for UNDP, Dhaka

UNCTAD (2004), "Linking Trade with Poverty Reduction", The Least Developed Countries Report 2004, UNCTAD, Geneva

World Bank and Bangladesh Enterprise Institute (2003), "Improving the Investment Climate in Bangladesh", Washington, D.C.

Endnotes

1 The SAM is constructed by extending the national Input-Output (I-O) framework, which then shows the circular flow in an economy in general, and inter-dependence and feedback mechanisms involving various activities, factors and institutions in the process of income generation, consumption, savings and investment

2 UNCTAD (2004) study shows that in the context of LDCs, neither the growth of exports been always associated with positive economic growth, nor export growth been a guarantee for poverty reduction

3 Rare availability of baby-crèches at the factory premises, irregularities associated with granting of maternity leave and benefits to the eligible workers, insufficient number of toilets, congested workplace in unsafe buildings, non-issuance of any formal contract of employment, non-compliance with overtime works and allowances are some of the serious regular allegations. During the entire lifetime of the industry in Bangladesh, there has been very little improvement with regard to minimum basic provisions

4 For example, BGMEA has drafted and proposed a single code of conduct to replace multiple codes of conduct, which has received support from one trade union centre or federation. BGMEA has also set up a compliance cell to monitor and improve compliance by members. It was learnt that GTZ has also taken initiative to develop a common set of compliance indicators particularly for the European buyers

5 Briefly, the EU RoO requires a two-stage domestic value addition in order to qualify for duty free access. Bangladesh has the necessary backward integration in the case of knitwear products for fulfilling the EU requirements, but bulk of woven products fail to do so

3 CHAPTER The Cellular Phone Sector in Bangladesh

– SM. Abu Eusuf and Mokammel Karim Toufique

3.1 Introduction

An undisrupted and transparent flow of information has become an integral part of a modern democratic society. Such a flow of information is thought to be pro-poor as the poor usually have difficulties in accessing information and the cost of the information gap is large enough to affect their living standards. Information, in its various forms and the ways it is received, always has a distinct and important role to play for economic development as well as overall social progress. Information dissemination and sharing are important for development. Better access to information changes the way people think and do their businesses. For an agricultural and rural-based country like Bangladesh, a better flow of information has the potential to play a vital role in improving the level of economic security and the rate of progress.

In recent years, information related to economic activities has increased substantially and also 'Information and Communication Technology' (ICT) has become an important element of development policy-making. According to Balit *et al.* (1996), *The least expensive input for rural development is knowledge*. The role of ICT for development is being increasingly recognised by policymakers across countries. Importantly, ICT helps rural development and food security as it affects agro-meteorology, production technologies, commodities, credit, land and labour markets, laws and regulations, management and training (Calvelo-Rios, 2000). In this paper, we explore the 'trade, development and poverty linkage' in the light of the highly expanding cellular phone sector in Bangladesh.

3.2 Changes in Telecommunication Policy and Evolution of the Cellular Phone Sector

In 1979, the Bangladesh Telegraph and Telephone Board (BTTB), effectively a monopoly service provider, was created. In 1989, for the first time, a private company named Bangladesh Telecom Ltd (BTL) was allowed to provide cellular phone service in Bangladesh (later the Pacific Bangladesh Telecom Ltd. (PBTL) carried out the responsibility). In the same year, the Bangladesh Rural Telecom Authority (BRTA) was issued a public switched telephone network (PSTN) license by the government to provide telecommunication services in rural areas with an exclusivity of 30 years.

In 1993, the BRTA license was modified to cover 199 northern *Upazilas* (sub-districts) and the exclusivity was reduced to 25 years and also the government issued PSTN license to a private operator, Sheba Telecom (Pvt.) Ltd, to cover rural areas in 191 southern *Upazilas* with an exclusivity right of 25 years. However, the BRTA became extinct in 2004 as the owners took different licenses. In 2001, the WorldTel got the

permission to install and operate three lakhs fixed lines in the Dhaka Metropolitan Exchange Area with an exclusivity of four years (A 2005 Supreme Court decision has made the exclusivity right illegal and invalid).

Table 3.1 provides the basic information about the cellular phone operators in Bangladesh. The first privately-run cellular service, Citycell, began its operation finally in 1994 (PBTL got the license in 1989) and under the protective regulatory environment created by the government, it operated like a monopoly charging sky-high prices and making supernormal profit. Later, in 1996, *Grameen phone* (GP), TM International Bangladesh (TMIB) and Sheba Telecom (Pvt.) Ltd – three private companies – were given licenses (all for 15 years) to provide cellular phone services. GP and TMIB began their services in 1997 while Sheba Telecom (Pvt.) Ltd entered the market in 1998. In 2004, BTTB was given a license by the government to provide cellular phone services. In 2005, a license was issued to the Warid Telecom Ltd to provide cellular phone services for 15 years, which commenced the service in 2007.

Amid the immense need for an effective regulatory body, the Bangladesh Telecommunication Act, 2001 established the Bangladesh Telecommunication Regulatory Commission (BTRC) which started functioning in the following year with the basic objective of liberalising and creating competitive environment to attract local/foreign investors, which would ultimately help a desired growth of the sector. The BTRC relaxed the PSTN licensing system by adopting an open licensing regime with no restriction on the number of operators with a view to promote private sector participation.

In recent years, the BTRC has permitted a shift in the 900 MHz frequency by allowing the 1800 MHz frequency, too. This will, for sure, help the cell phone operators to expand their networks and to improve the quality of services provided. The *Grameen Phone* received a very small aperture terminal (VSAT) license for her own IT use. In 2004, the government approved the use of Voice over Internet Protocol (VoIP). However, the

Table 3.1: Basic Information about the Cellular Phone Operators

Operator	Type of Service	Area Covered	License Issue	Commencement of Service	License Period (in years)
PBTL/Citycell	AMPS and CDMA Cellular Service	Nationwide	1989	1993	20
Grameen Phone	GSM Cellular Service	Nationwide	1996	1997	15
TMIB/Aktel	GSM Cellular Service	Nationwide	1996	1997	15
Sheba telecom/ Banglalink	GSM Cellular Service	Nationwide	1996	1998	15
Teletalk Bangladesh Ltd.	GSM Cellular Service	Nationwide	2004	2005	15
Warid Telecom	GSM Cellular Service	Nationwide	2005	2007	15

BTRC is yet to formulate the guidelines and provide licenses. If brought into action, the cell phone users will be able to make overseas calls at a very cheap rate, a facility that is presently being enjoyed by the BTTB subscribers. In the annual budget for 2004-2005, the import tariff on mobile phone handsets was set at a flat rate of Bangladeshi Taka 1500 (US$22), which was as high as Taka 4000 (US$59.38) in the previous year. In the 2005-06 budget, the import duty was lowered to Taka 300 (US$4.45). However, the government imposed a new charge of Taka 900 (US413.36) for each new connection thus raising the level of the barriers of entry.

In the year 2004-05, people observed an intense competition in the cell phone market characterised by the introduction of new products and services at lower prices by the operators in an attempt to strengthen their respective positions. Also, the operators followed aggressive policies with regared to the promotion and communication in the market. The *Grameen Phone* signed separate agreements with the other operators for voice and SMS traffic. This has greatly added to the consumer satisfaction. The inter-connection agreement with the BTTB, the state-owned monopoly provider of fixed line services, has also been undertaken by different operators. The companies have began to introduce the Enhanced Data Rates for GSM Evolution (EDGE) technology which if fully implemented would enable the subscribers to access the high speed data and internet facilities. Since the rural people will have access to the internet (the information highway), this is likely to abridge the 'digital disparity' between rural and urban areas.

3.3 Overview of the Cellular Phone Sector in Bangladesh

Size and Growth of the Cellular Phone Sector

Figure 3.1 suggests that during 2004 and 2006, the cellular phone sector registered on an average, a phenomenal growth rate over 100 percent. In 1997, the growth was 550 percent owing to the entry of a second company in the market ending a five-year monopoly of PBTL (Citycell) and also to the narrow subscriber base. The cell phone subscribers now comprise around 90 percent of the total telecommunication subscribers.

Figure 3.1: Cellular Phone Subscriber Growth (in percent) in Bangladesh

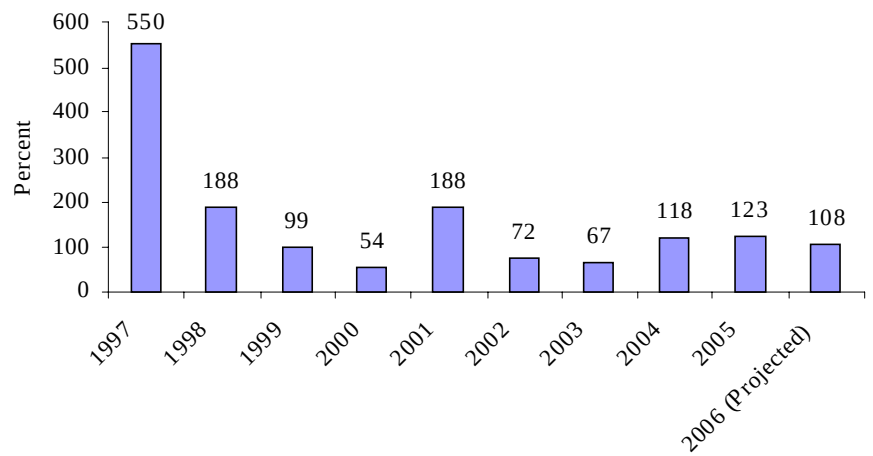


Figure 3.2: Growth of Subscribers (Cell Phone and PSTN)

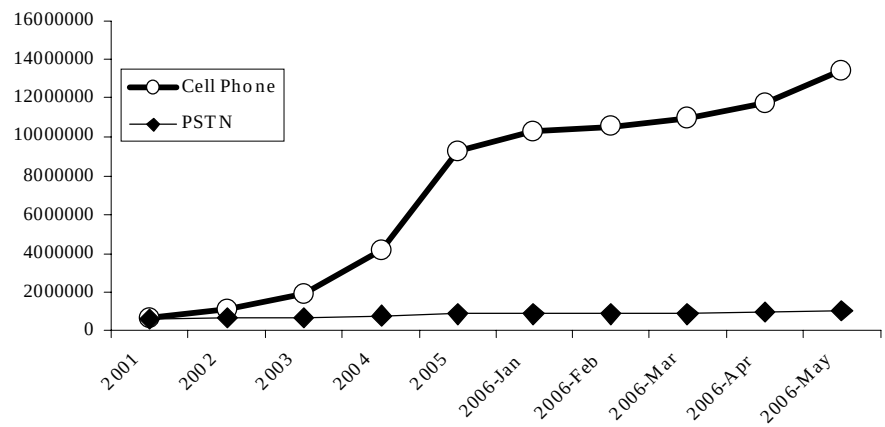
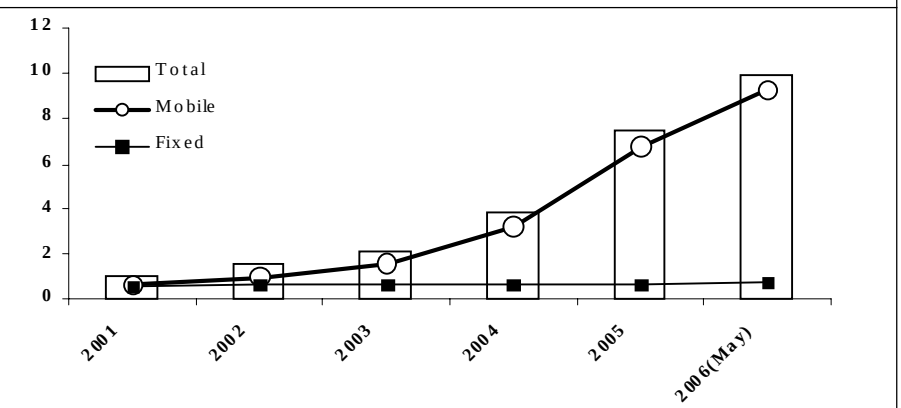


Figure 3.2 provides a comparison between cell phone and PSTN in terms of the growth of subscribers. In 2001, there were 660,000 cell phone subscribers relative to 560,000 PSTN subscribers. By mid-2006, these numbers increased to 13,000000 and 1,000000 respectively. Whereas in 2001 the ratio of number cell phone subscribers to that of landline subscribers was 1.18:1, in 2006 the ratio changed dramatically to 13:1.

The cellular phone companies are playing a crucial role in increasing the country's telephone penetration rate, which is one of the lowest in the world. Figure 3.3 shows the tele-density per 100 people in Bangladesh during 2001 and 2006. In 2001, the tele-density for fixed telephone was 0.49, which in May 2006 increased to only 0.69. On the contrary, the tele-density for cellular phones, has increased from a mere 0.58 in 2001 to 9.28 in 2006 (May). When both cellular phones, and landline phone are considered, tele-density rose from 1.07 to 9.97 between 2001 and 2006 (May). Though the cell phone companies with their spectacular growth have set up large networks with wide coverage around the country, the tele-density is still among the lowest in the world.

Figure 3.3: Tele-density in Bangladesh (per 100 persons)



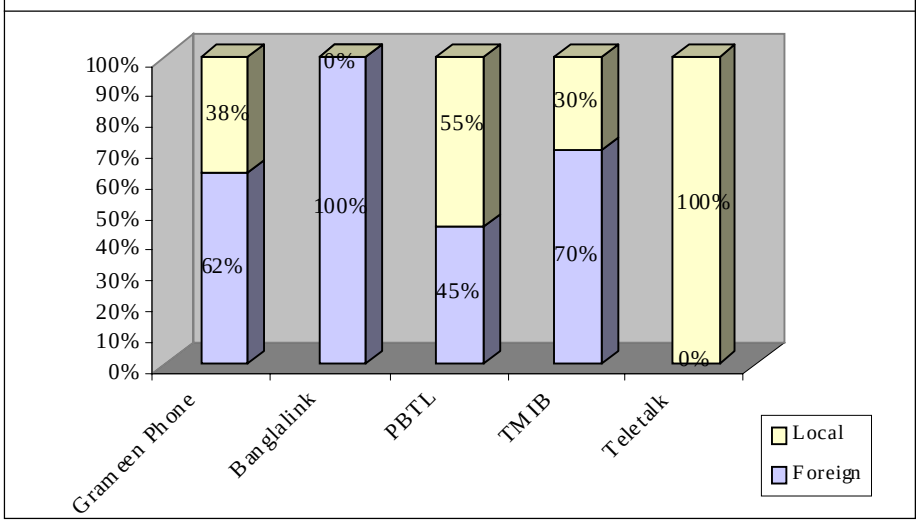
In sum, it can be argued that factors which helped the growth of the cellular phone sector in Bangladesh are deregulation measures in the telecommunication sector, a lower level of tele-density, inadequate and inefficient fixed phone infrastructure, increased competition in the cellular phone sector resulting from the entry of new operators, reaching the people through improved network, and easy availability of cell phones. On the other hand, BTTB is characterised by long waiting times, limited network and capacity and outdated technology.

Competitive Environment in the Sector

In 1989, the government issued license to only one operator to provide cellular phone service. The operator, the Citycell, entered the market in 1993 and enjoyed monopoly power for four years. During this period, the growth of the sector was very slow, and the cell phone was only for people in the upper (income) echelon of the society. The second cell phone operator, the GP, entered the market in 1997. Though the call charge fell, it was not sufficient to transform cell phone's image from a 'luxury' to a 'necessity'. Probably the most important changes came when Orascom took over the Sheba Telecom Ltd and began functioning as Banglalink. To capture the market, it launched some lucrative offers of lower call charges that forced other operators to reduce their call rate. In 2005, another operator, the 'teletalk', entered the market with low call rates and PSTN access (Teletalk is a BTTB project). Thus, the price of cell phone services has fallen with the increased level of competition, leading to enlarged consumer benefits.

However, the market is still highly concentrated as only five firms are currently providing the services. The three largest operators (GP, Aktel and Banglalink) hold 93 percent of the market share in terms of the number of subscribers and 94 percent of the total market when the revenue earning is considered. The liberalisation in the telecommunication sector has also attracted a large amount of foreign investment. The Banglalink is completely owned totally by a foreign investor, whereas the whole investment in teletalk is from a local source. In GP, Aktel (TMIB), and Citycell (PBTL) the share of foreign investment is 62, 70 and 45 percent respectively. Since the government allows 100

Figure 3.4: Share of Local and Foreign Investment in Different Companies



percent foreign equity and the foreign investors can repatriate their share of profit completely (and since the market is expanding rapidly), a number of foreign firms have shown their interest to operate in the market.

To keep pace with the rapid expansion of the sector, the companies are making huge investments. For example, the Aktel made an investment of Taka 3.4 billion (US$50.5mn) to enter the market. The company's investments in 2004 and 2005 were Taka 2.12 billion (US$31mn) and Taka 11.7 billion (US$173.7mn) respectively. While entering the market the *Grameen Phone* made an investment of US$52mn. In 2004 and 2005, the company's investments were US$189mn and US$388mn respectively. The investment decisions of these two companies during these years indicate how rapidly the sector is expanding with a huge potentiality.

Employment Generation

The rapid growth of the cell phone sector has an important impact in terms of employment generation – both direct and indirect. The expansion of this sector during the last decade has created a discernible demand for skilled labour which has also its bearing on the academic as well as professional degrees sought by the young generation. These increased working opportunities have also other positive externalities.

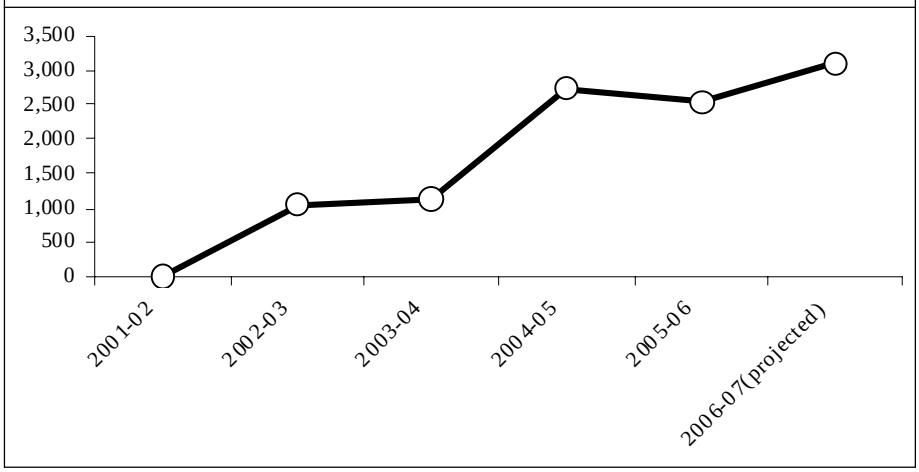
Direct employment in the *Grameen Phone* during the first two years of its operation was a mere 591 persons, which reached 3970 in 2006. Among them 2490 (63 percent) are semi-skilled labourers, while the rest 1480 (37 percent) are skilled labourers. In addition, 84 percent of the employees are male while 16 percent are female and 99.5 percent (3950) of the employees are local people while foreign nationals are only 0.5 percent (20) of total employees. The Citycell started with 80 skilled workers and now 611 skilled employees (as of February 2006) are working for the company. Within the first two years of its operation, the Aktel employed 112 workers (only four of them were foreign nationals) and now (as of August 2006) 1265 people are working (25 of them are foreigners). This statistics is for skilled labour only. 86 percent of the employees of Aktel are male and the rest (14 percent) are female.

Around this sector, a huge network of dealers, sub-dealers, agents, distributors, suppliers and contractors has been formed. A large number of people are engaged in those activities. Many people are involved in the retail business of SIM and scratch card sales and telephone services. The demand for stationary, printing and technical services has increased substantially. The cell phone companies are spending a significant amount of money for advertising. This has led to the inception as well as the expansion of many advertising firms. Also, a number of legal and professional bodies have benefited from the expansion of this sector.

Earnings of the Cell Phone Sector

Figure 3.5 displays the trend in revenue of the cell phone operators in recent years. The largest increase in revenue took place between 2003-04 and 2004-05. Though the revenue fell slightly in 2005-06, it rose in 2006-07. The total gross revenue of the *Grameen Phone* was Taka 231 million (US$3.4mn) in 1997 which stood at Taka 29.6 billion (US$439mn) in 2005. The Aktel earned Taka 177 million (US$2.6mn) as revenue in 1998, which increased to Taka 9.27 billion (US$137.7mn) in 2005.

Figure 3.5: Revenue of Cell Phone Operators (million TK)



The revenue is distributed according to the investment shares of investors. As a result, the greater part of this revenue has accrued to the foreign investors. In 2004-05, the distribution of revenue was such that 32 percent of the total revenue went to local investors, and the remaining 68 percent went to foreign investors.

Constraints in the Development in the Sector

The cell phone operators regard Government bureaucracy and political instability as major hindrances for their business expansion. However, these two obstacles are often considered as common problems for the investors in Bangladesh – both the existing and potential. The country usually ranks among the poorest performers in terms of investment climate and corruption. Widespread corruption (involving unofficial payment) in the public institutions usually raises the cost of doing business. It also gives a wrong signal to the potential investors.

The cell phone operators view various types of license and annual fees imposed by the BTRC as constraints. Also, taxes being levied on SIM card and scratch card increase their prices substantially. Moreover, the supplementary duties imposed by the National Board of Revenue (NBR) raise the prices of the services provided. During the last few years, competition has increased substantially in the cellular phone sector. When interviewed, the Citycell, the once monopoly service provider, described massive competition as a challenge. However, this is not a constraint since in an increasingly competitive arena, the inefficient firms are likely to suffer and some of them are even driven out of the market if their operating policies are not adjusted to the changing market.

Corporate and Social Responsibility

The cellular phone companies are supporting various socio-cultural activities. They have various Corporate and Social Responsibility (CSR) programmes as they consider CSR as an integral part of their overall operation. Ranging from sponsoring games and sports to donation for tsunami-affected children of Sri Lanka and Maldives, a wide

variety of programmes have been undertaken by the companies. However, not all the programmes are beyond the mere profit-making motive since many of the CSR programmes are carried out only to build or enhance a positive market image.

3.4 Contribution of the Cellular Phone Sector to Poverty Reduction

It should be noted that 10 years earlier the telecommunication services were inadequate with a tele-density of less than one percent. A highly undeveloped telecommunication sector was a major obstacle for the expansion of business. It also affected the welfare of the people. However, during the last 8-9 years, thanks to the rapid expansion of the cell phone sector, the adverse impact of the undeveloped telecommunication sector has been mitigated. The cellular phone sector has revolutionised the way people think, the way they talk and also the way they do their businesses.

The cell phone sector is exerting direct and indirect impacts on poverty alleviation. Owing to the liberalisation measures in the telecommunication sector, the evolution of the cellular phone industry took place and now it is experiencing a rapid growth. This sector has generated both direct and indirect employment opportunities for many people, especially the indirect employment generation has been immense. Also, the improved flow of information between individuals has increased the overall market environment by reducing the uncertainty related obstacles and thus resulting in market expansion (in terms of quantity or revenue). All these are the direct sources of income. So the evolvement and the growth of the cell phone sector have influenced the existing poverty situation by providing new/more income opportunities for people.

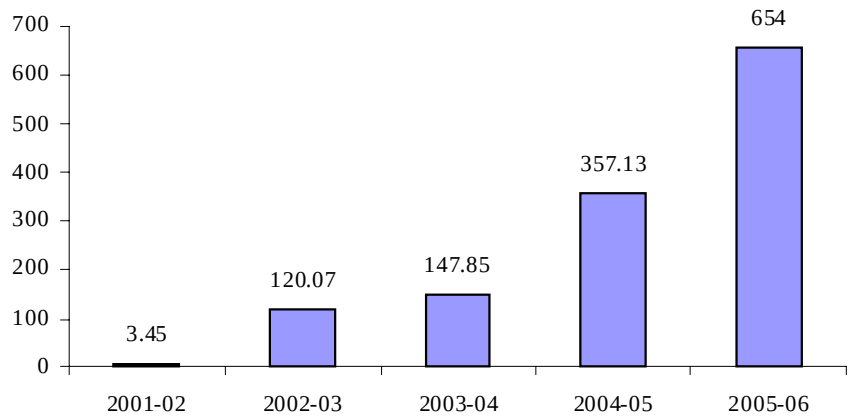
In addition, the government is receiving huge revenue from this sector which may enable it to take more anti-poverty measures, as more resources are now available. The cell phone companies are also involved in a number of community services, some of which help the poor the most (flood relief programme, fun for human welfare, computers for rural schools). Hence, the cellular phone industry has important contribution in reducing the incidence or the consequences of poverty.

Contribution to the Government Exchequer

The cell phone sector has become an increasingly larger contributor to the government exchequer. In 2005, *the Grameen Phone's* contribution to the government treasury was Taka 16.2 billion (US$240.6mn), which was much higher compared to its inception year. Similarly, the Aktel now contributes around Taka 3677 million (US$54.5mn) to the treasury (see Figure 3.7). The earnings of the BTRC have substantially increased because of the rapid growth of the cell phone sector (see Figure 3.6). In 2001-02, the BTRC earned Taka 34.5 million (US$0.51mn) as revenue which in 2005-06 stood at Taka 6.5 billion (US$97mn). Given the slower growth of PSTN subscribers, the lion's share of this increase is attributed to the highly growing cell phone sector.

The revenue that comes in the form of annual license fees has a fixed as well as a variable component. The fixed amount varies depending on the maturity of the license as it is US$400,000 for the first five years, US$800,000 for the second five years and US$1,600,000 for the third five years. The variable portion of the annual fee is calculated as one percent of the collected rent and call charges. Moreover, the government also receives an application and entry fee. For example, the Warid Telecom, the last of the six operators

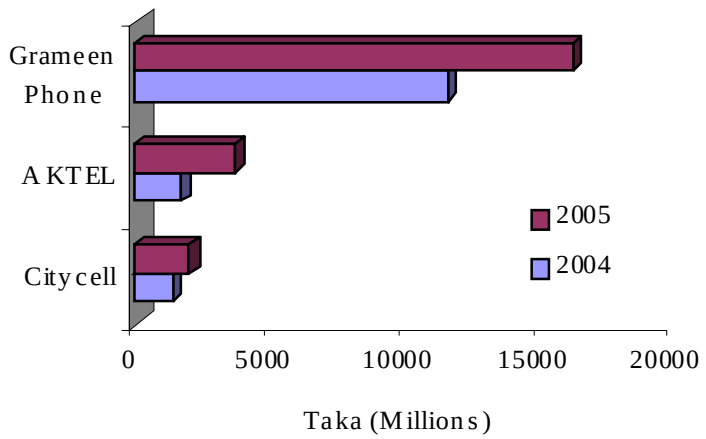
Figure 3.6: Earnings of the BTRC (in Taka crores)



to receive a license, paid Taka 20 million (US$296,939) as application fee whereas it paid US$50mn as entry fee.

The cell phone sector has become an increasingly larger contributor to the government exchequer. For example, the *Grameen Phone* has become one of the largest contributors to the government exchequer. Since its inception, in the first eight years of operation the company has contributed around Taka 30.46 billion (US$252.2mn) to the treasury on account of various taxes, levies, license fees and interconnection charges. Figure 3.7 shows the *Grameen Phone's* contribution to the government's exchequer. Similarly, the Aktel was contributing Taka 92 million (US$1.4mn) in 1998 and now it contributes around Taka 3.6 billion (US$54.6mn) to the treasury. Also, from 2004 to 2005, the Citycell's contribution to the treasury has risen from Taka 1.3 billion (US$19.7mn) to Taka 2 billion (US$29.6mn). The contribution of the sector is expected to grow with the expansion and growth of the organisations.

Figure 3.7: Contribution to the Government Treasury by Individual Companies



Consumer Surplus

At the individual level, the degree of communication has become more frequent and easier after the advent of the cell phone. The consumer surplus has increased, since a phone call costs much less than a physical trip or other alternatives of information transfer. This surplus will depend on the essentiality or the value of the information. The savings range from 2.5 to 10 percent of mean monthly income for a rural household.

Linking the Relatives

In recent years, labour migration (mobility) – both intra and inter country – has increased. The cellular phone has become the prime means to establish a link between the migrant and his/her relatives residing at some other places. Probably the benefit has been higher for the rural people where the fixed line facility is highly limited and where many people work outside the locality (in cities or outside the countries mostly as unskilled labourers).

Remittances

Information about remittances is now more accurately and frequently available to the family members residing in the country particularly in a rural village. Thus, the risk of remittance transfers from overseas has been largely diminished.

Better Market Information and Access

Market information is now more readily available resulting in better market access and coverage and has benefited the rural and small traders most. The pricing system of rural commodities (agricultural products, handicrafts etc.) has largely improved. The role of middlemen has been largely diminished as traders can now directly talk to each other and gauge the prevailing market situation more correctly. For a number of commodities (mainly from rural areas), significant market expansion has taken place. All these are likely to have positive influence on output and productivity. Because of instant information exchange facility provided by the cell phones, market adjustments have become quicker. A better flow of market information also raises the efficiency of the market through greater competition and diminishing the levels of uncertainty and transaction costs.

Reducing Uncertainty

Perhaps the most important and genuine impact of the cellular phone is that it ensures instant flow of information between individuals and thus helps to create a sense of certainty. Hence, an increased and more accurate flow of information has diminished the extent and impact of uncertainty at the individual level. However, the benefit from diminished uncertainty largely depends on the relationship (correlation/connection) between individuals (ranging from kinship to trade).

Empowering Rural Females

In rural areas, many women now are the owners of cellular phones. They use it for communication and more importantly they sell the phone service and earn a significant portion of the family income. Female traders (women selling various home made products) have also benefited from the cell phone. So the advent of the cellular phone has directly/ indirectly increased the economic opportunities for women, which in turn, implies a higher level of female empowerment.

Health Information and Community Services

With the help of the cellular phone, people are now able to communicate with health service providers more easily. The cell phone companies are also involved in various community services like fund-raising programmes for human welfare, promoting sports and sponsoring various sports tournament, participation in flood relief programmes, promoting various issues to raise social consciousness (promoting awareness about earthquake, supporting the Acid Survivors Foundation etc.), orphaned helping the disabled children (supporting their education and improving their learning ability), helping orphaned children, donating computers to the educational institutions, distributing warm clothes among the distressed people during the winter, and contributing to improve the quality of primary education in the country.

3.5 Views on the Cell Phone Sector and the Extent of Liberalisation

It is interesting to note that most of the stakeholders were aware of the impact of the liberalisation though most of them unaware of the exact regulatory changes that had taken place[1]. Many of the stakeholders think that the rapid growth of the cell phone sector has created demand for skilled labourers. Diffusion of technology is also another aspect of the sector's contribution that has been identified by the stakeholders. Local employees are being introduced to advanced technologies and trained thus raising their technical skills level. Though the stakeholders appreciated the current level of competition in the sector, they think that the degree of competition must be increased by allowing more firms to operate in the market. According to the stakeholders, the role of the regulatory body is crucial here since collusive oligopoly may arise in its 'tacit' form.

However, some of the consumers accused the cell phone companies of influencing the regulatory authority to prevent large international companies from entering the market. The service providers argued that the tax burden on handset and telecom equipment was high in Bangladesh, which was hindering the growth of the sector. Some of the stakeholders held the view that lower access to electricity is also a problem because in many rural areas people do not use cell phones for difficulties in recharging the battery. According to them, if the cell phones could be charged using the sunlight, then its use would have been much higher. It was also mentioned by some stakeholders that since the lion's share of the investment in the cell phone sector is foreign investment, and if these foreign investors transfer all their earnings outside the country, which they are allowed to do, significant pressure would be on the country's balance of payment (BoP).

3.6 Conclusion

There is no denying that because of liberalisation in the telecommunication sector, the cellular phone industry has developed and now growing at more than 100 percent per year in recent times. One concern is that though the subscriber base is expanding significantly, the cell phone operators are often unable to provide good quality service to all the subscribers. Also, the major portion of the population is still not connected. Rural access to cell phones is still very low compared to urban areas. Hence, the current growth of the cell phone sector seems to be biased against rural areas, especially against the poor people even though some efforts have been taken to reach the poor. However, to reach the poor, handset prices and call charges should be reduced or special offers for the poor should be introduced.

The regulatory authority should ensure a fair playing field for each and every operator in the country just to make sure that none gets any unreasonable advantage over their fellow operators. The regulatory authority and the cell phone operators should act together to improve the access of new subscribers, especially that of the poor people. If they can be reached, the low telephone penetration rate of the country will increase, and the lives of a large segment of people will be changed.

References

Balit S, Calvelo Rios, M and Masias, L (1996), "Communication for Development for Latin America: A Regional Experience", FAO, Rome Italy

Calvelo-Ríos, M, *"El Papel de las Tecnologías de Información y Comunicación en el Desarrollo Rural y la Seguridad Alimentaria"*, presented in the First Consultation on Agricultural Information Management, June 2000

Endnote

1 Interviews were carried out with some key and informed stakeholders to better understand the weaknesses, constraints and prospects of the cellular phone sector. The stakeholders interviewed were the regulatory authority (BTRC), the service providers (*Grameen Phone, Aktel, Banglalink, Citycell and Teletalk*) and consumers (consumers were selected from different segments of the society (urban users, village phone users, rural traders etc.)

4

CHAPTER

The Cambodian Garment Industry

– Neak Samsen and Yem Sokha

4.1 Introduction

Since the economic reforms in 1989, trade liberalisation has been promoted in Cambodia as a source of economic growth and major weapons to fight poverty. Trading activities, in terms of both commodity and destination, have been rapidly and substantially expanded. Garments, the dominant outward-oriented and only fast-growing industry, has been viewed as one of the main contributors in boosting economic growth and in reducing poverty. Despite the industry's positive impact on economy and poverty, the distribution of benefits appears to be unequal. The benefits from this industry's growth vary depending upon groups of population and geographical areas. Therefore, by examining this industry, this paper attempts to find out if there is a link between trade and poverty reduction. This study specifically examines the significance of the garment sector in the economy, the factors through which trade in garments affect poverty, and the trade policies of the garment industry.

4.2 Overview of the Garment Industry in Cambodia

The garment sector is one of the fastest growing industries in Cambodia. The number of factories has increased drastically over the last few years. In 1998, there were 129 factories, which increased to 229 in 2004 and to 258 in 2005 (see Table 4.1). With the increase of factories, the total production of the industry increased rapidly. It increased from US$400mn in 1998 to US$2.2bn in 2005. However, the industry produced mostly finished

Table 4.1: Evolution of Garment Production in Cambodia, 1998-2005 (in US$mn)

	1998	1999	2000	2001	2002	2003	2004	2005
Number of factories	129	152	190	186	188	197	229	258
Local value added (in US$mn)*	113	166	296	347	387	474	591	659
Raw material imports (in US$mn)**	238	348	621	728	813	995	1,240	1,384
Garment exports (in US$mn)	378	553	985	1,156	1,291	1,580	1,969	2,197

Sources: USAID (2005), GMAC, Sok Hach et al. (2001) and authors' calculation

* Local value added was calculated as 30 percent of total garment exports based on an estimate of 28.6 percent of local value added to total garment exports by Stuart-Smith et al. (2004) and estimate of 1/3 of total garment exports by Sok Hach et al. (2001);

** Value of imported raw material is estimated at 63 percent of total garment exports in Sok Hach et al. (2001)

garment products. The industry relied almost exclusively on imported raw materials such as yarns, woven and circular knitted fabrics, accessories and almost all packing and presentation materials from China, Hong Kong, Taiwan and South Korea (Stuart-Smith, 2004; Bargawi, 2005). The proportion of local contributions (mostly labour and some materials like cardboard cartons & poly bags) remained basically unchanged between 2000 and 2005. Making up around 30 percent of total exports in absolute value, this industry's local value added was estimated at US$113mn in 1998, which rose dramatically to US$659mn in 2005 – an increase of more than five times in only six years.

Although there are a considerable number of formal and registered garment factories, and are also a large number of cottage garment factories in Phnom Penh for sub-contracting supplies to them during the peak order season. It is very difficult to get the exact number of these cottage garment factories as they remain informal and unregistered. Beside these two types of garment industries, traditional and family-based textile and garment productions for local markets also exist.

These garment products are mainly exported to supply huge and lucrative markets in developed countries. Only outlet products are sold at very low prices in local markets, of which the Russian market (Phnom Penh) is the most popular and well-known one. Garment exports have seen an impressive performance since the resumption of private production in the early 1990s. Table 4.2 shows that from a low base, garment exports grew by 66 percent in 1998, 46 percent in 1999, and 78 percent in 2000. Since then, the industry's growth continued to increase, but at a much slower rate mainly because of a higher base. In 2004, the growth rate was 24 percent, and due to the MFA phase out, the growth rate declined to 11 percent in 2005. Table 4.2 also indicates that the US and EU markets are the most important buyers of Cambodian garment products. During 1998-2005, on average, exports to the US accounted for 74 percent those that to the EU accounted for 23 percent. Exports to other markets, mainly Canada, Australia and Japan, remained minimal, but showed an increasing trend.

Table 4.2: Exports to External Markets, 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005
Total garment exports (in US$mn)	378	553	985	1,156	1,291	1,580	1,969	2,197
Growth rate (in percent)	66	46	78	17	11	22	24	11
Export to US (in percent of total exports)	79	88	76	71	71	69	64	70
Export to EU (in percent of total exports)	20	10	22	26	26	25	29	22
Export other markets (in percent of total exports)	1	2	2	3	3	6	7	8

Sources: Total exports of merchandise from EIC Database Online (2006); Total garment exports from Customs and Excise Department (2005)

Three main reasons have been observed to explain the continued increase of the Cambodian garment industry, according to the Economic Institute of Cambodia's (EIC's) Cambodia Economic Watch (2006). Firstly, the industry benefited from safeguard measures imposed by the US and the EU to restrain Chinese exports. Secondly, garment factories maintained their good labour compliance. Finally, the industry benefited from the recent improvement in trade facilitation reforms which reduced time and costs related to shipments of imports and exports.

Investment in this industry has been mainly sourced from foreign capital; there are a few local investors. Most foreign investors are from Hong Kong, Taiwan, and China. These three top investor groups control more than 70 percent of total garment factory owners (Sok Hach, 2005). Moreover, despite the industry's good performance in 2005, the future is uncertain due to fierce competition from other countries in the region to attract foreign investment. One potential competitor is China, where safeguard measures by the US and the EU against its T&C exports will be lifted after 2008. Another potential source of competition will occur when Vietnam is expected to join the WTO in 2007. This new membership may divert FDI away from Cambodia and force some factories to move, given the cheaper costs of displacements incentives.

4.3 Government Policies and Institutions

Concerning policies, the industry partly played a role in encouraging the government to normalise trade relations with the West after 10 years of the country's isolation (1980-1990). This normalisation led to Cambodian garment products benefiting from the most-favoured nation (MFN) rate provided by the US in 1996 and GSP rate provided by the EU in 1999. These agreements, together with generous government investment incentives, have attracted a considerable amount of investment in the garment sector. According to Sok Hach (2004), 50 percent of US$1.3bn investment capital stock has been absorbed by investment in industry, in which investment in establishing garment factories took the main share.

In 1997, the government promulgated Labour Code and ratified several International Labour Organisation (ILO) conventions on labour issues. Last but not the least, the industry was one of the major forces in influencing Cambodia to join the Association of Southeast Asian Nations (ASEAN) in 1999 and the World Trade Organisation (WTO) in 2004. In addition to these direct policies, the industry, to some extent, also put pressure to the establishment of a better environment for trading activities and investment climate as the government launched its trade facilitation reforms in 2004. These reform efforts

Table 4.3: Average Times and Costs of Processing Imports and Exports

	2003	2005
Time of Exports	- 15 days	- 20.2 hours
Costs of Exports	- US$942	- US$598-612
Times Imports	- 11 days	- 45.5 hours
Costs of Imports	-US$2,477	-US$673

Source: EIC Cambodia Economic Watch Table 9.2, Issue 4, 2006

have produced remarkable achievements. According to the Cambodia Economic Watch (2006), the time and cost of shipments of import and export goods have been substantially reduced (see Table 4.3).

To ensure that the sector establishes itself institutionally, the government encouraged the creation of factory associations and trade unions. The Garment Manufacturers Association in Cambodia (GMAC) was established in March 1996. As of August 2006, there were 278 active members. GMAC has played an important role in the development of the garment industry through lobbying the government to seek GSP and MFN status and advising the government in relevant policies to promote the industry (Sok Hach, 2004). At the same time, the association of factory owners and the government recently tried to lobby the US Congress to award the Trade Act, which will allow Cambodia to export clothing without tariffs and quotas.

Labour unions also played an active role in ensuring the respect of the ILO core labour standards and Cambodian labour law. There have been many complaints, strikes and demonstrations which were facilitated/organised by trade unions. It was estimated that in 2005, there were 823 labour unions under 24 labour federations, according to records provided by the Ministry of Social Affairs, Veterans and Youth Rehabilitation. These labour unions organised 76 strikes in 1999 and about the same number in 2000 (Sok Hach, 2004). However, strikes have steadily declined in recent years. In 2005, there were 66 strikes, according to the Ministry of Social Affairs and GMAC. Labour unions have had a notable success in negotiating with factory owners and the government in raising minimum monthly wages from US$27 to US$40 in 1997 and from US$40 to US$45 in 2000. More recently, in July 2006 the unions again tried to negotiate with the factory owners to increase the minimum wage from US$45 to US$82. However, by July 27 2006, according to *The Cambodia Daily*, they reached a basic agreement to increase the minimum wage. Yet, the exact amount has not been set as further negotiations are expected.

The ILO Better Factories Cambodia was established in 2001 after the country had signed a deal with the US to improve working conditions in exchange for better access to the US market. This programme aimed to oversee the labour compliance to ensure a "sweat shop free" industry in the country. In 2005, Better Factories Projects executed by ILO – formally funded by only the United States Agency for International Development (USAID) – was jointly funded by the government, the association of apparel manufacturers GMAC, international buyers, USAID and Agence Française de Développement (AFD) of France.

The Arbitration Council, whose members are representatives nominated by trade unions, GMAC and Ministry of Social Affairs, Veteran & Youth Rehabilitation was established in 2003. The Council's main function is to resolve collective labour disputes, which cannot be resolved through negotiation or conciliation. Other key institutions were also established. The Garment Training Centre was established in 1999 to train Cambodians to become supervisors at the management level; currently this centre-is providing basic sewing rather than supervising skills to workers. However, the Garment Industry Productivity Centre was established in 2005 to provide training and consulting in improving the productivity of the garment industry.

4.4 The Effects of Garment Trade on Poverty Reduction

Export Performance and Economic Growth

The outward-oriented garment industry has helped the country in foreign exchange earnings since 1995 when the industry started to emerge. Its role in boosting foreign earnings has been significantly increased from a six percent share in total exports in 1995 to approximately 65 percent in 2000 and to more than 76 percent in 2005. The industry's performance continued to grow despite the industry having to compete freely in the international garment markets after the phasing out of the MFA at the end of 2004.

In addition to the vital role of the garment industry in keeping a trade balance, it has contributed to the country's GDP and has been a major driver for the country's economic growth since the mid 1990s. Contribution of the industry to the GDP constantly increased from one percent in 1995 to 15 percent in 2005. An estimate by EIC's Cambodia Economic Watch stated that in 2005 the garment industry contributed to around three percentage points out of 10 percent rate of economic growth.

Spillover Effects to Other Industries

There has been no attempt to empirically and thoroughly examine how the garment industry has impacted on supporting and related industries. Nevertheless, a rough and preliminary exercise by the EIC – based on the Input/Output Model – estimated that a 10 percent increase in demand of garment products would result in a 17.5 percent increase in total domestic production. More specifically, this would lead to increases in domestic production of trading business by about 2.4 percent, transportation by about 0.5 percent, electricity by about 0.4 percent, hotels and restaurants by about 0.3 percent estimated that a 10 percent increase in demand of garment

Employment

This sector has provided a significant number of jobs to the low-skilled labour force. In 1998, the sector employed only 79,000 people. In 2004, the sector employed approximately 246,000 workers, 42 percent of total industry employment and 4.3 percent of total country employment. Female workers make up the majority, as much as 85-90 percent, which improved this industry's employment share in the total female workforce to 20 percent.[1] These women migrate from provinces where livelihoods are at risk due to frequent problems in agricultural production. According to an Asian Development Bank (ADB) sponsored survey in February 2004, the populous and nearby provinces of Prey Veng, Kompong Cham and Kandal were among the top three that provided women worker migrants.[2] Besides this vast amount of direct employment, indirect job creation has provided necessary support services to this sector. Approximately 150,000 informal jobs around the factory location, including beauty parlours, street vendors, motor-taxi drivers, home workers and pieceworkers, have all been benefiting from the existence of this industry.

Wage and Income

As mentioned earlier, the garment industry contributed to the economy by providing more than 280,000 jobs as of December 2005. This industry also made some significant impact on poverty in terms of income, empowerment (transformation of economic and social status) and rural livelihoods. The sector created jobs and thus income for nearly

half a million people. The income of workers in the garment sector was around 13 percent of total garment sales from 2000 until 2003, according to Sok Hach et al. (2001) and Sok Hach (2004) who estimated that wages accounted for 13 percent of total production costs. Approximately US$135mn was earned by garment workers in 2003, according to Stuart-Smith (2004). A garment worker in 2004 received an average wage of US$60 per month. About 50 percent of this amount is spent on basic living (food, accommodation and utilities) and transportation to and from work and the remaining amount (about US$30) is sent to their families in the rural areas to support another four or five members.

According to the World Bank's Cambodia Poverty Assessment 2006, remittance has been used in productive investment such as buying fertiliser or buying pigs to raise, renovating their homes, digging wells, investing in farm inputs or livestock, purchasing motorbikes and TVs, and sending their younger children to school. The money was also used to sustain low levels of immediate consumption, allowing flood and drought affected households to purchase rice and other food, settle health expenditures, invest in restarting rice production, and pay off debts. Hence, the impact of income from this sector goes far beyond the workers employed in this sector.

Nevertheless, as garment workers try to save a part of their relatively small salaries, their overall livelihoods are affected. Garment workers tend to reduce their spending as much as possible (Stuart-Smith 2004) by: (1) reducing spending on food; and (2) minimising spending on accommodation by sharing small and narrow rooms. Thus, their health can deteriorate. After the end of the quota system, worker's welfare seemed to deteriorate due to the drop in purchasing power (lower income and high inflation). Workers' earnings decreased by 2.7 percent due to decreasing garment prices, the closure and reopening of some factories, short working contracts, and less overtime work.

The latest survey from ADB Phase I in December 2004 reports that as much as 90 percent of these garment workers are women. They typically come from large families and from villages which suffer frequently from droughts and floods. Thus, jobs in the garment sector have made them better off. Furthermore, this economic opportunity has broken down the prevailing social norms and traditional attitudes such as "girls should stay at home doing housework" and "girls should not go to work outside and away from parents". Through the garment industry, the whole society has started recognising the important contribution of women for the country's economic development. Nevertheless, female garment workers face many risks such as losing their reputation and chances of marriage when they leave home to work in this sector (Stuart-Smith, 2004; FitzGerald, 2005). They also risk their health and livelihoods, inside and outside garment factories. Working overtime and returning home late at night are safety risks. Unfavourable factory working environments and insufficient sanitation facilities are also health risks.

Though there are noticeable detrimental affects to these women working long days in the factories, the monthly remittance of US$10-30 of a typical garment worker to his or her family has a very positive effect on rural livelihoods. According to the ADB Phase I survey, around 90 percent of 15,000 respondents sent their remaining wages to their families. If one was to imagine that, in 2004, 90 percent of garment workers sent such remittances to their families, then about US$80mn would have been circulated into the rural economy. This money has been used both directly and indirectly to reduce the

incidence of poverty by ensuring enough food to eat, housing repair and supporting the education of younger siblings. According to the World Bank-Cambodia Poverty Assessment 2006, about 13 percent of rural households received some remittances from family members working in cities. Having a daughter working in the garment industry was considered to be one of the primary factors in allowing families to move out of poverty.

Human Development Effect

More than 90 percent of garment workers are young women who have little education. According to a survey by Cambodian Researcher for Development commissioned by ADB in 2005, about 90 percent of 1,538 respondents in the sample survey did not complete lower secondary education. Of these, 54 percent had primary education. After being employed in this industry, they only have been able to improve their skills through daily jobs; many of these jobs are assigned to sewing. However, they do not have opportunities and time to acquire new skills as most of them spend around 10 hours in the garment factories including overtime work, according to interviews with trade unions, According to a rough estimate through interviews with labour unions, only 2-5 percent of garment workers study English or computing or hair dressing while 90 percent do not spend time learning anything else besides working in factories. This, in turn, limits their opportunities to engage in other economic activities if jobs in the garment factories were to be reduced.

Concerning their health conditions, responses from various interviewees stated that the health of workers has deteriorated. This negative health impact was because workers themselves limit their daily expenses on food and accommodation so that they could maximise their savings for other purposes. Health problems were also caused from overwork load due to the fact that factories make their workers work overtime to meet the increasing orders. Another reason for this negative health impact is from the working conditions and the working place, where heat and dust were found to be the most common health problem.

The garment industry has widened opportunities for women to participate in the country's economic activities. In addition, it is even beyond direct contribution of these young women in contributing to the economy. Indirectly women play an even more important role in the society through their support to poor family members in rural areas. According to a study by the Committee for Research on Worker's Salary in 2002, a garment worker supports another three family members. Empowerment of workers has also been improving through union membership of female workers. 40 percent of 1,538 garment workers interviewed reported to be members of trade union, according to a CRD survey in 2004 for ADB. Through union participation, female workers can express their concerns to their representatives so that their voice becomes more powerful and necessary actions can be taken for their common interest. In this context, trade in garments has changed the mindset of women themselves and social stigma that only men should be involved in the economic and union activities.

Interviews with government officials, trade unions and civil society organisations (CSOs) indicated that garment workers have a subsistence wage level. Some people even argued that earnings of approximately US$80 are not livable income in the capital city if half of

this amount is to be sent back to their families. Responses from interviews and observations, thus, pointed out that given this 'just-enough' earnings, workers have minimised their spending on consumer durables and cannot afford expensive items such as motorbikes. Generally, in a rented room where three to four female workers stay together, there is one TV and radio.

On the measurement of wealth of their family in rural areas a survey was conducted by the CRD in 2004 asked the worker to report their family wealth with regard to possessing a TV, radio, motorcycle, car, home, home construction type, farming land, land size. Results showed that 81 percent of workers had average scores lower than the moderate scores which were considered as having moderate wealth. Given the nature of the garment industry which is fragile and can relocate to other countries within a few days. In addition to other limited job opportunities in other formal sectors and their low level of education, garment factory workers are extremely vulnerable to job loss if economic or social or political upsets occur. The vulnerabilities of workers, especially female workers, also result from their lives whereby they are living in rented accommodation away from their parents and family members. Hence, they are the targets of such social ills of the sex trade, robbery, gang rape and harassments.

4.5 Conclusion

Although the history of Cambodia's garment industry is relatively short, it is a good example of a success in trade liberalisation in the past decade. Also, it is a model to understand the connection between trade and poverty reduction. The sector's success underscores its vital role as not only an engine for economic growth but also a weapon to fight or at least a means to reduce the pressure of poverty in both urban and rural areas.

The industry has made a considerable contribution to ensure an average annual economic growth of 6-7 percent and has played a prime and dominant role in earning foreign exchange, thereby balancing the country's trade account. The industry had spillover effects to other supporting industries, for positive effects on increasing in domestic production were noticeable. Another structural effect on the establishment of several institutions to facilitate the industry growth was also observed. In addition, the garment industry has reduced the increasing number of a young low-skilled labour force. It has also decreased the pressure of extreme poverty in rural areas, which have been plagued by insufficient food, shelter and clothing and by illness and illiteracy. At least one million people in the country benefited from garment exports through direct and indirect employment, income and remittance.

Last but not least, the industry proved to have a positive impact on other non-income dimensions of poverty. Health and education of worker's family members in the rural areas have been relieved, if not much improved; remittance was used for supporting family healthcare and education. The industry provided opportunities for the rural low-educated female labour force to participate in economic and social activities. Nonetheless, workers were subject to health deterioration and at risk of various upsets as a result of job loss and social ills such as sexual trading, robbery, gang rape and harassment.

The key to the industry's success was a combined result of relevant local and international players. Out of the many factors, Cambodian policies to gain trade deals with the US and the EU and maintaining good labour standards, which are coherent with global policies of trade in garments should be particularly praised.

References

Asian Development Bank, (2004), "Garment Employers in Cambodia: A Socio-economic survey", prepared by the Cambodian Researchers for Development, Phnom Penh, Cambodia

Bargawi, O (2005), "Cambodia's Garment Industry – Origins and Prospects", ESAU Working Paper 13, October

Economic Institute of Cambodia, (2006), "Cambodia Economic Watch", Issue 2, Phnom Penh: Economic Institute of Cambodia, April

FitzGerald, I (2005), "Exempt from Growth? The Impact of Trade Liberalization on Women in Cambodia's Garment Sector", Phnom Penh: UNDP/UNIFEM Gender and MDGs Project

Garment Manufactures Association in Cambodia (GMAC), 2004

Sok Hach, Chea Huot and Sik Boreak (2001), "Cambodia Annual Economic Review 2001", Phnom Penh: Cambodia Development Resource Institute

Sok Hach (2004), "Investment Policies and Human Development in Cambodia", Paper prepared for the *Asia Trade Initiative Project* sponsored by UNDP, in Cambodia Economic Report, pp28-46. Phnom Penh: Economic Institute of Cambodia

Sok Hach (2005), "The Cambodia's Garment Industry in 2005 and Beyond: A Quantitative of Critical Challenges", in EIC Economic Review. Volume 1, No. 5, p. 2-7, Phnom Economic Institute of Cambodia

Stuart-Smith K, Dayal R, Brimble, P & Sam Holl (2004), "Cambodia's Garment Industry: Meeting the Challenges of the Post-quota Environment", TA report for the Asian Development Bank, Draft report

USAID (2005), "Measuring Competitiveness and Labor Productivity in Cambodia's Garment Industry", June, prepared by Nathan Associates Inc. and its partner organisations for review by USAID

Endnotes

1 UNDP/UNIFEM report prepared by Fitzgerald, I. (2005) estimated 200,000 women employed in the garment sector in 2003 and this number translated to 85 percent of total jobs in the garment sector, and six percent of the total female workforce; ADB socio-economic survey of employees in garment sector phase two asserted that almost 90 percent of workers in garment industry are female

2 Other provinces, in ranking order are Takeo, Svay Rieng, Kampong Thom, Kampong Speu, Kampot, Kampong Chhnang, Pursat, and Battambang, according to ADB-sponsored survey: Garment employee in Cambodia: A socio-economic survey

5 CHAPTER The Cambodian Fisheries Sector

– Neak Samsen and Ek Chanboreth

5.1 Introduction

In Cambodia, trade in fisheries, especially exports of high value fish to external markets, increased significantly after the complete opening of trading activities in 1993. Nevertheless, rural communities around the Great Lake Tonle Sap and along the Mekong River – where livelihoods in the form of food security, employment and income sourced mainly from fishing activities – remain high and pervasive incidences of poverty. Furthermore, the standard of living of workers engaged in fish exports was also generally observed as being low. The increasing exports of fisheries pose a question on the pattern of distribution of gains from this sector's trade to different groups of population and geographical areas. Therefore, it is necessary to examine the link between this sector's trade and livelihoods and poverty. This chapter examines the significance of the fisheries sector in the Cambodian economy, the links through which trade in fisheries affects poverty among rural households engaged in fishing activities and workers in exporting companies, and the policies for the fisheries sector.

5.2 Overview of the Cambodian Fisheries Sector

Fish resources in Cambodia are dominated by inland fish while marine fish and aquaculture remain small, thereby not having a significant influence on total production. Fish resources support more than two million people directly and indirectly, in particular the population living by the Tonle Sap Great Lake and in nine provinces around the Tonle Sap region where basin and its sub-basin and the Mekong River cross. On the production side, annual fish catch from this lake was estimated at 400,000 tonnes per year, which was ranked fourth in terms of fish productivity (Yim Chea & Bruce Mckenny, 2003; DoF, 2001, Keang Seng 2006). Furthermore, fish stock in this Tonle Sap is potentially five times higher than in other tropical areas, according to the Ministry of Environment (2003). With such endowments, fisheries contribute to approximately 8.8 percent of GDP in 2004, according to the World Bank (2006).

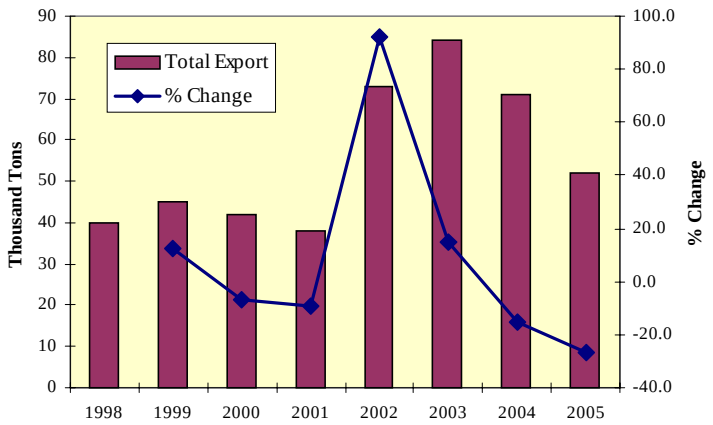
The total fish production was 112,510 tonnes in 1995, increasing to 296,000 tonnes in 2000 due to the significant increase in inland fish production, representing 83 percent of the total production. The average annual increase of total production was approximately 31,000 tonnes. The production continued to grow in 2001 with 441,000 tonnes, but decreased gradually between 2002 and 2004 due to increasing over-exploitation. However, 2005 showed positive signs for fish production recovery, resuming to 410,000 tonnes, a 26 percent increase from the 2004 production. The recovery was mainly from the increase in inland fish catches and aquaculture.

Until now, there has been no exact single estimation of the total currency value of fish production. Early estimates by the Interim Mekong Committee in 1992 put the value of total inland fisheries production to US$30-40mn for the total production of 100,000 tonnes. The estimation was based on the average price of US$0.3-0.4 per kg at farm gate price. Ferdous (2000) estimated the value of total fish catches of 300,000-400,000 tonnes worth US$100-200mn at landing sites and US$250-500mn after moving through the marketing chain. Thus, this translated to fish production being worth between US$300-400 tonnes at farm gate price and doubled in price after proceeding to consumer markets.

Fish is a staple food of the normal Cambodian household diet, more so for fishing communities. According to the ADB (2005) and Keang Seng (2006), fish provides about 75 percent of the animal protein requirements of Cambodian households. As a result of this significant consumption of fish, in terms of both fresh and processed form, domestic trade of inland fish plays an important role in distribution amongst different provinces. Unfortunately, there is no official data on trade flows among these provinces. But many believe huge amounts of fish, in particular high value fish, are marketed across the country, primarily from regions around Tonle Sap to the capital city, Phnom Penh. Besides significant domestic consumption, Cambodia has exported about 10 percent of total fish production a year in the last eight years. This means that the average annual external fish consumption was about 56,000 tonnes.

Cambodia exports fish in the form of both fresh/live and processed fish to overseas markets. An estimated amount of fish exports is demonstrated in Figure 5.1. Export of fish was approximately 56,000 tonnes per annum during 1998-2005. However, in recent times, exports of fish are in decline after peaking to 84,000 tonnes in 2003. The main markets for Cambodian fish are neighbouring Thailand and Vietnam, together accounting for more than 95 percent of total Cambodian exports, according to Keang Seng (2006). Other destinations include Hong Kong, China, Singapore, US, EU, and Australia. On the export supply side, Kampong Chhnang ranks first in export volume of marine fish,

Figure 5.1: Cambodia's Fish Exports (1998-2005)



Sources: 1993-2003, Department of Fisheries (2006); 2004, EIC Database.

representing 50 percent of total exports. Siem Reap is the second largest fish-exporting province accounting for approximately 27 percent of exports, with other provinces exporting only 23 percent combined in 2004.

On the import side, the country imports a minimal amount of fish from abroad given the country's large endowment of its resources. Fish was never imported into Cambodia until 1979 because local fish was more than enough to meet domestic demand. Since then, some types of fish have been imported from Vietnam, Thailand and even China, especially during the 1990s, through Vietnam. Three provinces are notable fish import gates: Kampot, Kampong Cham and Kandal.

5.3 Government Policies and Institutions

Fisheries Law

Due to the importance of the fishery sector, the Cambodia Government has established a fisheries policy, and the National Assembly has recently enacted the Fisheries Law aimed at improving fisheries conservation and management, stimulating sustainable development of the rural poor and ensuring the equitable use of the fish resource base. It is expected that the new fisheries law will encourage integration of fisheries management with rural development by extending responsibilities for fisheries management to fishing communities and increasing the protein and sustainable use of fishery resources. The management of mangroves, flooded forests and other aspects of wetland use are also included in the law.

Inland Fisheries Sector Strategy

The Inland Fisheries Sector Strategy has also been seriously taken into account in the National Export Strategy. This strategy's vision is to achieve significant economic growth for Cambodia and reduce poverty among the rural population through sustainable development of the inland fisheries sector, stimulated through quality standard, value addition and retention, and within a public-private sector consultative framework.

Fishing Lot Reform

The fishery policy reform was introduced in October 2000. Of the total lot areas of 953,740 ha, 56 percent (536,288 ha) was released for local fishing communities in 2001. According to the National Institute of Statistics (NIS), Phnom Penh, there are 164 fishing lots and 13 reserved fishing areas. In addition, on February 19, 2001, the Royal Government issued the sub-decree No. 24, exempting fishing fees for all middle-scale fishers to help alleviate financial pressures on middle-scale fishing. This aims at providing more access to fishery resources for the community and also at reducing the conflict between small-scale fishermen and lot owners.

To reach its objectives, the government has conducted an impact assessment of the fishing lot reform, and continues to expand fishing areas for local fishing communities. Since boundaries between fishing communities and fishing lot areas are not yet clearly demarcated, the government will define the frontier of these areas. Information dissemination to fishing communities has also been done. The government continues to provide more areas to fishing communities. Currently, about 217 communities have been established in the areas released from fishing lots.

Conservation and Research

To better conserve the local fishery sector, studies on fishery production and resource management are needed. The Inland Fisheries Research and Development Institute (IFReDI), Phnom Penh will have an important role in its research related to factors that affect fishery resources. Priority actions include: (i) studying the potential for conservation areas derived from fishing lot areas; (ii) continuing research on potential areas for conservation of both inland and marine waters; (iii) disseminating information and education curriculum on the impacts of fishery depletion caused by illegal fishing activities; and (iv) continuing the process of preventing flooded forests.

The Department of Fisheries has cooperated with the Ministry of Water Resource and Meteorology (MWRM) to conduct a study on barrage postings in four places along rivers within former fishing lots 04 and 06 in Kampong Cham province. It has also conducted a survey and evaluation of the fishing season year 1999-2003. In addition, it has identified areas in front of the Royal Palace in Phnom Penh where fishing should be prohibited.

Community Development and Management

Fishing communities have been established to improve the livelihoods of local people through access to natural fish resources, to protect such resources by giving resource ownership to the local community, and also to reduce the conflict between local small scale fishermen and lot owners.

To achieve these objectives, the Department of Fisheries has been building the capacity of fisheries officials and fishing communities through trainings, workshops, and site visits to other countries. It has also established fishing communities, protected areas and community fisheries refuge ponds. As a result, the draft law on fishing communities has been finalised. About 375 fishing communities (101,923 families) have been established so far. However, many fishing communities are still weak and lack member participation mainly due to a lack of financial resources.

Improving Rural Aquaculture Development

With population growth, fish resources are expected to come under greater pressure. Rural aquaculture has been considered an option to ensure food security without threatening the environment and natural resources. The objective of rural aquaculture development is to improve food security, nutrition, and farm incomes; and identify appropriate aquaculture technology.

The government has introduced small-scale aquaculture technologies and also promoted exchange activities. Given these actions, fish and shrimp farming increased by 60 percent in 2004. However, aquaculture in Cambodia remains less developed compared to neighbouring countries and overall, aquaculture's contribution to total production is still low though its production remains stable.

Enhancing Post-Harvest Development

Last but not the least, the fishery policy focuses on the enhancement of post-harvest development. The objective of the policy is to diversify the basis of rural livelihoods, improve access to markets, finance, and quality of fish products. Fish processing is

important in enhancing post-harvest development. The Department of Fisheries has formulated a post-harvest fishery policy framework. It has also identified policies to support the sector with pilots in identified areas. Furthermore, it has done capacity-building of government staff to respond to the needs of the post-harvest sector.

Fishery processing production, including inland, marine fish and fish sauce, increased in 2004. Despite the increase, the fish-processing industry in Cambodia is still less developed compared to neighbouring countries. Production is generally not for export but rather for local consumption.

5.4 Effects of Trade in Fisheries on Poverty Reduction in Cambodia

Export performance and economic growth

With an approximate 30,000-40,000 tonnes of fish shipped to external markets, this commodity trade did not earn much foreign exchange. The Department of Fisheries estimated that the total export fish value of US$30-40 every year, accounted only for one percent of the total export commodities. Nonetheless, it is believed that the value of exports was higher than this estimate, as exports through informal channels actively take place.

Table 5.1 shows that value added of the fisheries sector was estimated at US$416mn in 2001. It increased only slightly in 2002 and 2003. The sector's value added rebounded in 2005 when value added was about US$460mn, 12 percent increase compared to 2004. The proportion of fisheries to GDP, however, declined constantly, although its production in real terms rose gradually. For instance, the share of fisheries in total country GDP was 11 percent in 2001, and fell to 9 percent in 2005, even though its value added increased from US$416mn in 2001 to US$460mn in 2005, or a 10.8 percent growth.

The Government earned around US$2mn per year from the fisheries sector in terms of collecting fees from commercial and industry fishing lots biddings and penalty fees from illegal fishing activities.

Employment

The exact job figures created by this sector remain difficult to estimate, if not impossible since a great number of rural dwellers, including inhabitants who do not permanently

Table 5.1: Performance of Fisheries Sector 2001-2005

	2001	2002	2003	2004p	2005p
Value Added of Fisheries at Constant 2000 Prices (in US$mn)	416	419	425	412	460
Share of GDP by Fisheries at Constant 2000 Prices (in percent)	10.8	10.3	9.8	8.8	8.9
Real Output Growth Rate of Fisheries (in percent)	5.9	0.6	1.7	-3.3	11.8

Sources: World Bank (2006); EIC (2006).
Note: "P" indicates preliminary estimates

stay along the Mekong Rivers and around the Tonle Sap, are fishers as a secondary or tertiary occupation.

To attempt to state what is the total labour force absorbed by this sector, one has to be cautious with the figures. According to the World Bank (2006), fisheries accounted for 4.8 percent of total a total of 7.4 million employed people, which translates to 356,000. This number is close to an estimate by Cambodia Statistical Yearbook 2005 of National Institute of Statistics, which put the employment figure in fisheries to 360,000. However, data recorded by the Department of Statistics of the Ministry of Agriculture, Forestry and Fisheries (2005), which also counted the number of labour fish in rice field, counted the total employed in this sector to 573,000 people employed in fisheries sector. Therefore, it is safe to say that approximately 360,000 people – in 2004 – primarily engaged in the sector which ranges from fishers (in the form of family-scale, middle-scale and large scale industry fishing) to post-harvest activities such as processing, storage and trading.

On the issue of spillover effects on employment, nonetheless the sector provides benefits to millions of Cambodia. It is widely agreed that at least two million benefit from this sector and its related activities as several sources put the figures around two million, for example, the Department of Fisheries (2005a) 2.3 million, Ek Heng (2006) two million, Hap Navy (2006) two million, Department of Fisheries (2005b) at least two million.

Wage and Income

A survey by the Department of Fisheries in 1995-1996, focusing on 13 provinces in proximity to the Mekong and Tonle Sap, showed that people in these areas depended mainly on farming and fish resources. Homestead land and water, as indicated in the survey, accounted for 61 percent of gross income, agricultural land 19, common property resource 6 and others at 14 percent. In Cambodia, fish production is for domestic consumption and external trade, benefiting populations dependent on fish resources. The most important source is inland fish, which provided the government's gross revenue of about US$2mn in 2000 but declined to only US$1.7mn in 2003.

Even though the fishery resources of the Tonle Sap rank first in the world for their productivity and fourth for their total catch, the average incomes of people in the surrounding Tonle Sap area remained low. The annual per capita income of a typical fishing household in the Tonle Sap area was US$110, lower than a non-fishing household (i.e. US$180) in 1998. The amount of this income is even lower when compared to the national per capita income which was about US$250 in 1998.

According to the Report on Fish Export and the Livelihood of the Poor by Seng (2006), in 2003, the incomes of workers in the fish export chain were different and varied in the three common export gates, namely Poi Pet, Koh Kong, and Sihanoukville (see Table 5.2). In Poi Pet, daily income of labourers in fish trade was about US$1.25 per working day. These labourers had to spend their income on daily food, medicine, hut-rental, clothes and other family supports. In Sihanoukville, workers in Sun Wah factory, a large-scale exporter, could receive a salary ranging from US$60 to US$115 per month or about US$2 to US$3.8 per day. Furthermore, they received food, healthcare and shelter. In Koh Kong, the average salary of a worker was only US$40 per month, which was lower than

Table 5.2: Wage Rate of Fisheries Worker in 2003		
Gate	Wage Rate (US$/month)	Facility
Poi Pet	37.5	No facilities, such as housing, healthcare, etc.
Koh Kong	40	Food, house and some healthcare (small-scale export)
Sihanoukville	60 – 115	Dormitory and some healthcare (large-scale export)
Source: Department of Fisheries (2006)		

those in Sihanoukville. Most of them lived with fish collectors, and they are also provided with food, clothes and healthcare. Income from these wages, nevertheless, was barely enough to survive, according to Keang Seng (2006). Moreover, simply comparing these wage rates and rural poverty line the rate was just twice as high the rural poverty line of US$0.44.

Human Development Effect

Poverty in Tonle Sap areas is not only demonstrated by low income/consumption dimension but also demonstrated by other social indicators. Table 5.3, which is based on the available data from General Population Census in 1998 and Inter Census Population Survey in 2004, shows some main social indicators in six provinces located around the Tonle Sap. Based on these indicators, Table 5.3 suggests that the living standards of people in provinces around the Tonle Sap were low when compared to the national average.

On the education indicators, the proportion of children who did not complete primary education was much higher than the country's average in 1998, with the situation continued in the same trend in 2004. The literacy rate for both males and females in these provinces (except Battambang province), despite improvement since 1998, was also higher than average. It is even lower when looking at a rural fishing commune rather than the aggregate figure for an entire province. In the case of Anlong Rang's 18 fishing community in Pursat province, for example, there is only one classroom for children and one health centre, both of which are of very low standard. Concerning health indicators, access to clean drinking and sanitation water was very limited. Rural dwellers in these provinces still utilised water from the Tonle Sap and other streams as main sources of drinking water. Access to electricity was also minimal. Only between 10-15 percent of people used electricity as lightning, the majority still uses kerosene.

Effect on Poverty

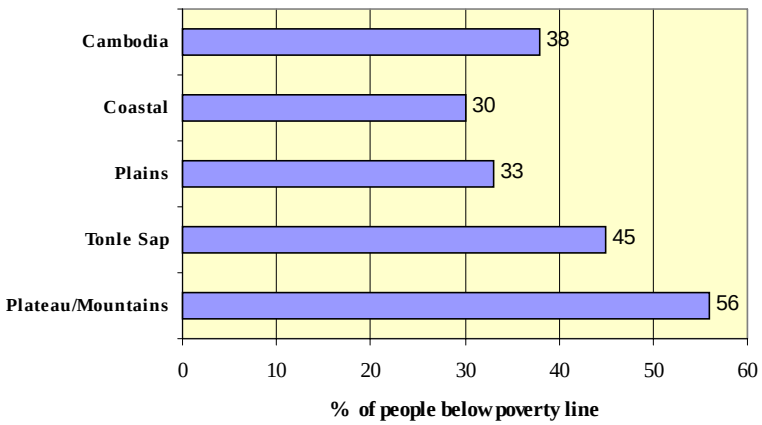
Figure 5.2 illustrates the rate of rural poverty of the Tonle Sap zone against other zones in 2004. In rural Tonle Sap region, where a significant number of people rely heavily on fishing, the poverty rate was of 45 percent which was higher than the national average of 38 percent. According to the World Bank (2006), the number of poor in the Tonle Sap region (both in rural and urban areas) accounted for 37 percent of the country's total poor. This rate translated to 1.8 million people around Tonle Sap living below the poverty

Table 5.3: Main Social Indicators in Provinces around Tonle Sap (1998 and 2004)

Indicators	Banteay Meanchey		Battambang		Kompong Chhnang		Kompong Thom		Pursat		Siem Reap		Country Average	
	2004	1998	2004	1998	2004	1998	2004	1998	2004	1998	2004	1998	2004	1998
Population (in thousands)	809	578	1013	793	532	418	607	569	456	360	755	696	13,091	11,438
Average household size	5.1	5.1	5.2	5.3	4.9	5.0	5.1	5.3	5.2	5.2	5.4	5.4	5.1	5.2
Population density (per sq km)	64	87	83	68	99	76	45	41	37	28	75	68	74	64
Educational attainment:														
Primary not completed (in percent)	65	9.9	65	63.4	70	69.9	63	70.7	69	68.3	67.0	73.2	54.07	56.6
Literacy rate (in percent)	72.4	66.9	74.4	70.8	66.4	63.9	70.8	60.4	70.5	70	64.5	52.7	3.6	67.3
Males (in percent)	84.0	79.4	85.2	82.1	79.2	76.5	79.8	71.3	82.1	82.5	75.5	63.9	84.7	79.5
Females (in percent)	61.6	55.6	64.7	60.7	56.2	53.7	63.0	51.3	60.8	59.5	54.4	43.1	64.1	57.0
Main source of drinking water														
Protected dug well (in percent)	1.9	26.2	1.3	37.8	2.5	52.9	3.9	77.5	1.9	53.3	4.2	69.7	3.0	40.29
Unprotected dug well (in percent)	7.0		12.0		55.8		68.5		39.6		61.5		26.6	
Spring, river, stream (in percent)	60.1	44.0	50.8	39.1	18.2	24.3	12.5	16.2	48.8	29.0	7.4	10.9	28.5	28.2
Kerosene as main source of light (in percent)	74.4	84.6	75.0	83.2	83.1	89.9	72.3	89.4	82.9	88.1	83.7	88.8	64.5	79.9
Firewood as main source of cooking fuel in percent)	81.2	90.6	84.8	92.4	93.8	95.8	94.9	95.6	92.	94.9	93.1	96.1	86.0	90.0

Sources: MOP (2005a) and MOP (1998)

Figure 5.2: Rural Poverty Headcount by Region, 2004

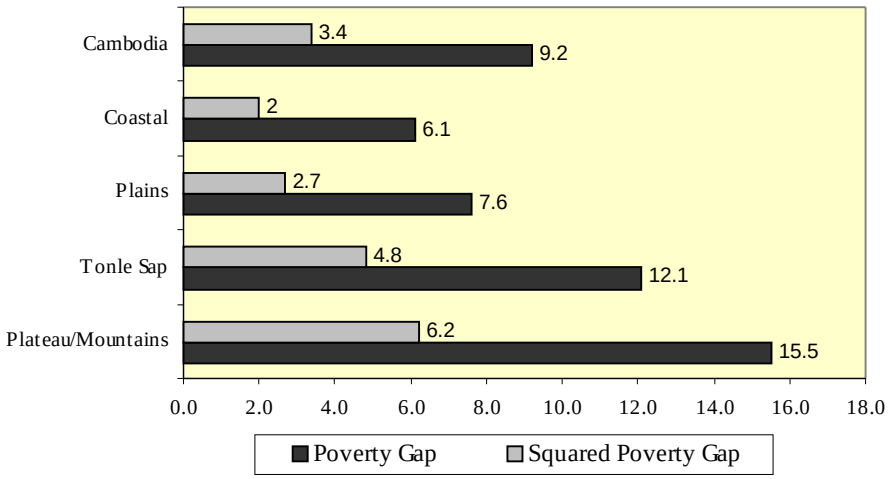


Source: World Bank (2006)

line. Deeper analysis in the incidence of poverty under the Tonle Sap Initiative stated that half of the villages in Tonle Sap estimated to have 40-60 percent of people living below the poverty line and in some areas even 80 percent of people living under the poverty line (ADB, 2005a).

In terms of depth and severity of poverty, the Tonle Sap region also had the worst incidences (Figure 5.3). The poverty gap index was 12.1 while poverty severity index was 4.8. Both were higher than in other regions (except mountain regions) and the country indices.

Figure 5.3: Poverty Gap and Squared Poverty Gap by Region, 2004



Source: MOP (2006)

5.5 Conclusion

The fisheries sector contributes significantly to livelihoods and direct and indirect employment for the poor in many provinces along Tonle Sap and the Mekong in Cambodia. The fisheries sector mainly provides nutrition for daily food consumption, which can prevent extreme poverty incidences. Yet, it is not significantly connected to sufficient income to move out of poverty and income which are necessary to cover spending for health, education and other durable assets and to prevent great vulnerability.

On the benefits from trade in fisheries, earnings from fishing activities of fishermen at the landings remain very low. Wage earnings of workers in fish exporters are low, too. Income generation from the fish trade is barely enough for living for both trade-related workers and fishers. This ultimately leads to low levels of other poverty indicators such as poor health, low education, and little possession of durable assets.

Low income is due to the limited amount of fish trading as fish production is mainly used for household consumption of family fishing. On the other hand, the low wage rate of workers in trading companies was a result of the dominance of informal small traders who frequently do not provide job security and safety for workers. Low wages were also the result of surplus supply of labour, thereby employers give lower salaries.

Low incomes by workers and fishermen were largely due to the minimal amount of fish exports and the large number of low skilled labour. The low incomes were also partly hampered by the high cost of trading due to high transportation costs and informal fees. The lack of transparency allows checkpoint officials and other unauthorised institutions to demand informal fees from fish traders at the expense of workers and fishers. Thus, profit from fish exports is very low, which makes the price of fish at fishing sources relatively low and forces the workers to have low earnings.

References

Asian Development Bank (2005), "The Tonle Sap Initiative: The Tonle Sap and Its Fisheries", ADB

Department of Fisheries (2001), "Social and Economic Framework Review", Technical Paper No 8. Phnom Penh: Department of Fisheries

Department of Fisheries (2005a), "Fisheries Development in Cambodia", Phnom Penh: Department of Fisheries, MAFF

Department of Fisheries, (2005b), "Overview of Community Fisheries Development Office Cambodia", Phnom Penh: Department of Fisheries, MAFF

Economic Institute of Cambodia (2006), "Cambodia Economic Watch", Issue 4, Phnom Penh: Economic Institute of Cambodia

EK Heng (2006) "Impacts of the Fisheries Policy Reform on the Post Harvest Sector in Phnom Penh", Kampong Chhnang, Department of Fisheries, MAFF

Ferdouse F (2000), “The Potential of Cambodian Fishery Products in the International Market”, INFOFISH

Hap Navy (2006), “The Role of Formal and Informal Credits in the Fish Marketing Chain”,

Keang Seng (2006) “Fish Export and the Livelihood of the Poor”, Working Paper 11

Ministry of Environment, (2003), “Environment Action Plan 1998-2002”

World Bank (2006), “Cambodia: Halving Poverty by 2015?” Poverty Assessment 2006

Yim Chea and Bruce McKenney (2003), “Domestic Fish Trade: A Case Study of Fish Marketing from the Great Lake to Phnom Penh”, CDRI, Working Paper 29

6 CHAPTER China's Export-Oriented Home Appliance Industry

– Yin He Dan Liu, Chunzan Wu, Guodong Zhang, Da Zhao

6.1 Introduction

The production of home appliance production concentrates in North America, Asia and West Europe. About 83 percent of the world's home appliances are produced in the above three regions, while 80 percent of the output of North American concentrates on the US and the US-Mexican border. Italy is the centre of home appliance production in Europe. The rise of East Europe is due to its cheap labour costs and vicinity to the western European market for home appliances.

China's home appliance industry enjoys huge advantages due to its large potential market demand, plentiful, cheap and experienced labourers and a complete set of spare parts supply system. After more then 20 years of reform and opening, China's home appliance industry is becoming one of the world's home appliance production bases. It is now a mature industry with a total market value of over US$300bn. Now-a-days, the output of air-conditioners, air-conditioner compressors, washing machines, rice cookers, electric fans and other small home appliances in China rank the first in the world. At the same time, China's home appliance industry becomes increasingly concentrated. In 2003, Haier, Kelong, Meiling and Xinfei produced 50 percent of the refrigerators in China, which was only 30 percent 10 years ago. The top three brands usually occupy over 50 percent of the market share with comparatively smaller sizes, such as microwave ovens, soya-milk machines and dish-washers. The markets where 36-50 percent of the shares concentrate in a few large producers include colour TVs, refrigerators, washing machines, fans and rice cookers. The home appliance industry is becoming one of the most competitive and advantageous industries of China.

After rapid changes have taken place in the production of home appliances, China's export of home appliances also rose substantially. From 1995 to 2004, China's export of home appliances rose from US$3.33bn to US$17.49bn, up by 25.1 percent per year in average. Meanwhile, the growth rate of China's imports and exports was only 16.6 percent. The percentage of home appliances in export rose from 1.57 percent to 2.95 percent. In 2004, China's export volume of major home appliances rose substantially. The export volumes of microwave ovens, air-conditioners, refrigerators and washing machines rose by 18.4, 42, 40 and 73 percent, respectively. The export volumes of other small home appliances also underwent two-digit growth.

The rapid growth of the home appliance industry not only promoted the growth of China's GDP, but also brought huge tax revenues to the places of production so that

local governments could have more resources to provide public goods. Besides, since the home appliance industry is labour-intensive, the growth of China's home appliance industry has created a significant number of job opportunities and absorbed a huge number of surplus labourers from rural areas and less experienced workers in the cities. For instance, Haier achieved a global sales amount of Chinese Yuan 71.1 billion (US$9.9bn) and created over 300,000 jobs in 2002. Its total number of employees was 250 times more than that of 1984[1]. In 2005, the per capita net annual income of Chinese farmers was only Yuan 3,000 (US$417), but the average salary of labours from rural areas working in Guangdong was more than Yuan 12,000 (US$1,670)[2].

In this chapter, the trade of China's home appliance industry and its impact on regional economic development and the reduction of impoverished population are examined on the basis of the study on the Pearl River Delta and the Yangtze River Delta – the two largest production bases of China's home appliance industry.

6.2 Home Appliance Industry in the Yangtze River Delta and the Pearl River Delta

Profiles of the Two Deltas

The Yangtze River Delta Economic Zone (hereinafter referred to as Yangtze River Delta) refers to the region made up of 16 region-level cities in Shanghai, Jiangsu and Zhejiang. The zone includes Shanghai, Nanjing, Suzhou, Wuxi, Changzhou, Zhenjiang, Nantong, Yangzhou and Taizhou of Jiangsu Province and Hangzhou, Ningbo, Jiaxing, Huzhou, Shaoxing, Zhoushan and Taizhou of Zhejiang Province. In 2004, the Yangtze River Delta covers a total area of 109,600km and had a population of 82,121,200, accounting for 1.1 and 6.3 percent of the national totals respectively. Pearl River Delta Economic Zone (hereinafter referred to as Pearl River Delta) refers to the 14 cities, counties and districts in the Pearl River valley of Guangdong Province. It includes seven cities of Guangzhou, Shenzhen, Zhuhai, Foshan, Jiangmen, Dongguan and Zhongshan, three counties of Huiyang, Huidong and Boluo, the urban area of Zhaoqing and the two county-level cities of Gaoyao and Sihui. It covers a total area of 41,500m^2 and has a population of 24,513,600, accounting for 0.4 and 1.9 percent of the national totals respectively.

After the reform and opening, these two regions became special economic zones (SEZs) thanks to their geographic advantages. Afterwards, the two regions were the first to benefit from a series of opening measures and favourable policies. After nearly 30 years of opening and development, both the Yangtze River Delta and the Pearl River Delta gradually became the most vigorous with high economic growth. In 2000, the GDP per capita of the two deltas was Yuan 21,545 (US$2,999) or 3 times of the national GDP per capita, i.e. Yuan 7,086 (US$986). In 2004, the number reached Yuan 39,546 (US$5,504) or 3.7 times of the national GDP per capita level, i.e. Yuan10,561 (US$1,470)) and the gap between the average GDP per capita of the two deltas and that of the nation continued to widen in the past several years. The GDP of these two regions was Yuan 4,216.9 billion (US$586.9bn) in 2004, accounting for 30.8 percent of the national GDP, i.e. Yuan 13,687.6 billion (US$1,905.3bn), up by 5.9 percentage points from the 24.9 percent in 2000.

In terms of the industrial structure, the portfolios of the three industries – the primary, the secondary and the tertiary industries – in the Yangtze River Delta and Pearl River

Delta in 2004 were 4.6:55.9:39.6 and 3.8:53.8:42.4, respectively. The percentages of the second industry in the two regions were roughly the same as the national average. The percentages of the primary industry were approximately 11 percentage points lower than the national average. The percentages of the tertiary industry were about nine percentage points higher than the national average. So, the industrial structures of the two regions were better than that of the whole country.

From 1990 to 2004, the industrial portfolios of the two regions underwent big changes: the portions of the primary industry in GDP declined substantially and the portions of the tertiary industry in GDP rose dramatically. The proportion of the primary industry declined most in Yangtze River Delta, from 15.8 to 4.6 percent, down by 11.2 percentage points. The portion of the tertiary industry rose most rapidly also in Yangtze River Delta, from 27.2 to 39.6 percent, up by 12.4 percentage points.

In the same year, the import and export value of the two regions reached US$743bn, accounting for 64.4 percent of the total import and export of the nation and up by 6.5 percentage points from the 57.9 percent of 2000. In the same year, FDI in the two regions totaled US$31bn, up by 37.9 percent from that of 2000 and accounting for 51.1 percent of the total FDI of the nation. With the rapid economic growth, the living standards also improved. In 2004, the urban household per capita disposable income in Yangtze River Delta and Pearl River Delta was Yuan 15,361 (US$2,138), 1.6 times higher than the national average per capita disposable income for urban households.

Shunde District in the Pearl River Delta and Its Home Appliance Industry

The Pearl River Delta is the origin of China's home appliance industry. For example, Shunde District of Foshan City at the centre of the Pearl River Delta is the world's largest fan, rice cooker and microwave oven supply base despite its small area of only 806 km. In fact, it is known as "the Kingdom of Home Appliances" and "Capital of Home Appliances". It has four home appliance listed companies – Midea, Kelong, Macro and Kodak. Shunde ranked No.1 among the top 100 county-level economies announced by the National Statistics Bureau in the four consecutive years from 2000 to 2003. Its computers and computer accessories, microwave ovens, containers, air-conditioners, electric boilers and electric fans are exported to over 100 countries and regions in the world. For example, 10 enterprises exported over US$100mn of goods in Shunde District by the end of 2004.

These leading enterprises, including a large amount of joint ventures, are the major forces of export in Shunde, but small and medium-sized private enterprises gradually become the fastest growing entities in the export of Shunde. Besides, although Shunde is only a county-level district, it has attracted huge amount of FDI and 25 of the "World Top 500" companies to Shunde.

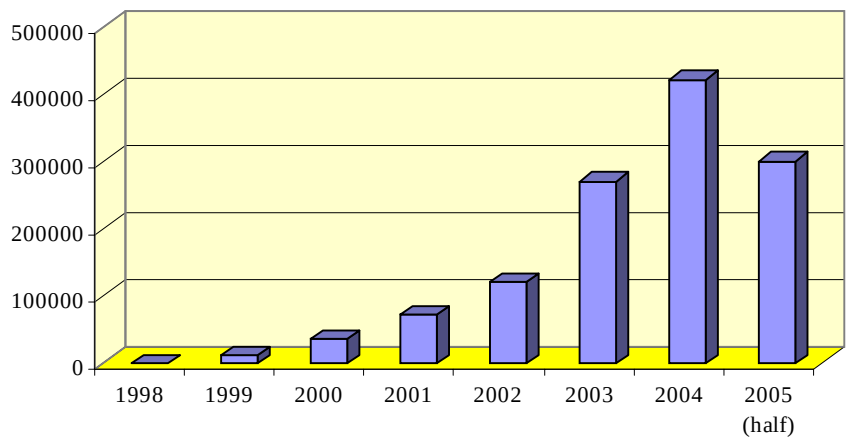
Before the reform and opening in late 1978, the economy in Guangdong province was below the national average level and its growth rate had been below the national average for 14 consecutive years. In 1979, the per capita industrial and agricultural output of Guangdong was Yuan 523 (US$72), 17.8 percent lower than the national average of Yuan 636 (US$88.5)[3]. However, in 2004, the per capita industrial and agricultural output of Guangdong was much higher than the national average. For example, the average income

in Shunde was Yuan 18,285 (US$2,545), which was higher than the national average of Yuan 16,024 (US$838). The private vehicle possession rate per 100 households was also the highest among all the county-level areas in China[4].

The authors visited Kelong Home Appliances Co., Ltd., Midea Group and Galanz Group in Shunde and found that the three enterprises had entered the home appliance industry in the early 1980s. The leaders of the three enterprises confirmed the decisive role of the first introduction of the reform and opening in Guangdong, the establishment of SEZs and a series of favourable tax and industrial policies that encouraged foreign trade in their entry into the home appliance industry. They underwent rapid development in the 1980s and IPO in the 1990s. After almost 30 years of growth, they are famous in China and worldwide. For example, exports of Kelong Home Appliances Co., Ltd. headquartered in Shunde increased from US$20,000 in 1998 to US$420mn in 2004 (see Figure 6.1). Shunde was awarded Top 100 Enterprises in the Global Emerging Markets by World Economic Forum in 1999 and Top 100 Listed Chinese Companies by the Fortune in 2001.

The three enterprises not only maintained rapid growth, but also made contributions to local economic development. Let's take Midea Group as an example. It has a total asset of Yuan 9 billion (US$1.32bn), employs over 30,000 workers and possesses five major production bases. Midea has paid over Yuan 3 billion (US$0.44bn) taxes and donated over Yuan 50 million (US$7.31mn) to social benefit and education undertakings since 1990. Meanwhile, Midea has also made contributions to the development of supporting industries and employment. Now, Midea has over 1,000 supporting enterprises, including about 300 in Shunde, 400 in Foshan and the rest in the other regions in Guangdong province. The total output value of its supporting enterprises amounted to Yuan 7.8 billion (US$1.14bn), including approximately Yuan 4.5 billion (US$0.65bn) in Guangdong. And these enterprises employed over 120,000 workers and contributed over Yuan 500 million (US$73.14mn) taxes.

Figure 6.1: Kelon Exports during 1998-2005 (in thousand US$)



Source: Kelon Home Appliances Co., Ltd.

In the interviews, it was learnt that the three enterprises adopted similar hiring and training mechanisms. Their employees came from the following three major channels:

1. Experienced senior technicians are mostly laid-off workers from state-owned enterprises (SoEs) companies. The corporate leaders pointed out that they were familiar with the technology and were responsible, but it was difficult for them to find jobs in the emerging industries after re-training due to their elder ages. At the same time, these workers had heavy family burdens. Their unemployment would lead to a huge impoverished population in the cities and hinder the education of the next generation. In addition, since the state offered favourable tax policies to those enterprises absorbing laid-off workers, the three enterprises were willing to employ these workers as technical backbones and provided them with more training. A mould tracking worker in Galanz from Jiangxi began his work with molding technology at the age of 17 and worked for less than Yuan 1,000 (US$139) per month before he had been laid off. He had tried to hunt for jobs for a long time in his hometown, Jiangxi province, but failed. His wife did not have a formal job and his son was still in high school, his unemployment threw the whole family into financial difficulty. Then he learned that laid-off middle-aged technicians could find jobs in Shunde and came to try his luck. He got his first job in Midea Group as a mould-tracking technician. His starting salary was Yuan 1,700 (US$236.6) per month, much higher than before. Since Midea provided technical training every week, he got used to his new job quickly and improved his techniques continuously. He was then appointed the head of the team and his salary was promoted. Finally he left Midea for Galanz and received his monthly salary of Yuan 3,500 (US$487). Moreover, he had a company-paid medical and serious disease insurance. After the employees' dormitory was completed, he would be the first group of employees to move in. He said that he had never imagined such benefits and this job saved his whole family from entering into poverty and even provided his son the opportunity to complete his high school study and go to college.
2. Junior technical workers were mostly migrants from rural areas and new graduates from technical schools. This group of young people is equipped with fundamental professional skills, but it is hard to find appropriate jobs not only because they do not have a college degree but also because the inland does not have large enough labo-r-intensive sectors. Although the salary of these young people is only Yuan 400 (US$55) per month for the first three months, they have the opportunity to accumulate their human capital from regular technical and safety trainings. After this period, they became formal contracted employees and their salaries would be doubled. They earned a salary much higher than that in rural areas and their inland counterparties and enjoyed the safety and medical insurance as well as food subsidy provided by the company. They also have the opportunity to be appointed team head in the workshop and earn even higher salaries through hard work and technique accumulation.
3. A graduate from Hunan University was very impressive during the interview. He was brought up in a poor village in Hunan and his parents were farmers with a living standard under the poverty line. They once ran a small business but the savings had been exhausted in order to promise this student to finish his college degree. He had been employed by Kelon two years ago, received a one-month training session and two-month probation in different departments, and then assigned to engage in the technical research and development (R&D) of air-conditioners. Now, he was the

head of his department and began to give guidance to new employees and junior technicians. He earned Yuan 2,000 (US$278) each month and was very proud of himself being able to take some money to his parents. Thanks to his two years in Kelon, he believed that he could give his parents a happy life. However, he had further plans of gaining more experience in Kelon for two more years and then go to Shenzhen or the Yangtze River Delta for a better job.

In the investigation, apart from the interviews with business leaders and employees of the three enterprises, information on the operation and employment of neighbouring tertiary industries were also collected. The workshops and dorms of three enterprises were surrounded by all types of stores: small restaurants, supermarkets, teahouses, etc. Most of the owners of such stores came from rural areas. They came to the coastal areas for a better living. Most of these people did not like repetitive technical work and long working hours and preferred more freedom. Therefore, after working for a few years, they used their savings to open small stores or restaurants near the factories where they used to work.

To sum it up, the export-oriented home appliance producers in Shunde not only promoted the national and regional economy and provided the government with a lot of tax revenue, but also directly and indirectly created opportunities to those who could not find jobs and reduced the potentially impoverished population. More importantly, these enterprises provided their employees with technical and safety trainings which helped the workers to accumulate their own human resources, thereby providing these people the opportunity and capability of getting out of poverty in the long-term.

Changzhou City in Yangtze River Delta and Its Home Appliance Enterprises

The authors also visited Donghua Group, a prestigious famous company in Changzhou City in the Yantze River Delta. Donghua grew rapidly in the last five years. Its sales amount rose from Yuan one million (US$139,201) in the late 1990s to Yuan two billion (US$278mn) in 2006. The impetus to the growth included competitiveness arising from innovation and the acquisition of a previously state-owned foreign trade company in the wave of the transfer of state-owned assets in 2000. The acquisition opened the export channels and was the starting point of Donghua's expansive terminal sales networks. The overseas sales of Donghua Group rose from less than Yuan 10,000 (US$1,392) at the very beginning to over Yuan 360 million (US$50mn) in 2004. The average growth rate of export orders was more than 200 percent per year. The number of employees rose less than 100 to nearly 6,000 employees, 60 percent of which came from rural areas of Gansu, Sichuan and Hunan, and their benefits have been improved continuously.

It was learnt from the Production Director of Donghua Group that the growth of Donghua was promoted by foreign trade orders. After the acquisition of the foreign trade company in the late 1990s, the company opened a production base in the development zone and grew rapidly in size and imported lots of machines and equipment afterwards. As the export orders stabilised, the temporary workers gradually became long-term contracted workers. It was revealed that most workers were labourers from rural areas, who knew little about production and technology and were trained in the company. These workers

might apply to become technicians after finishing the six-month training programme. Afterwards, they might get further concentrated training and about 1/3 of them could be promoted to technicians and enjoy higher salaries and better benefits.

As for the issues related to foreign trade policies, the interview with the Chairman of the company showed that the prolonged state policy that encourages the export of the home appliance industry was one of the major reasons why the company grew so rapidly. Before 2005, the export rebate rate was 17 percent, which greatly promoted the export of the whole home appliance industry including Donghua. The export of colour TVs grew at an annual rate of 60 percent for a long time and the growth rate of the export of air-conditioners once reached 100 percent. The export even surpassed the sales in the domestic market. However, the state reduced the home appliance export rebate rate by four percent, which increased the costs of enterprises and reduced the exports. Since the prices of many orders were based on the original tax rates, enterprises had to renegotiate with importers and many orders were thus postponed or even cancelled.

6.3 Conclusion

In the last 20 years, China's home appliance industry represented by the Yangtze River Delta and the Pearl River Delta prospered under the auspices of the open trade policies of the state and played an important role in China's economic development. It not only promoted the export, development and technological advancement of the whole manufacturing industry and pushed forward the rapid development of the Chinese economy as whole, but also provided the basis for the regional economic and social development. Moreover, since the production of home appliances was labour-intensive, the growth of China's home appliance industry created a large number of jobs for surplus labourers in rural areas and less educated workers and laid-off workers and prevented the emergence of newly impoverished population in cities. Besides, the training mechanisms also provided a sound platform for the further development of employees, so that they could find better jobs in relevant fields. Therefore, the growth of export-oriented enterprises represented by the home appliance enterprises played a positive role in promoting China's economic growth and reducing the impoverished population.

References

All data derived from "2005 Research on the Economic Development of Yangtze River Delta and Pearl River Delta", (Yang Jingying, Wang Qiang, Ren Xiaoyan), National Bureau of Statistics of China, http://www.cnfol.com

Data derived from the interviews with Midea leaders

Endnotes

1 "Successful case – Haier", http://www.vitnew.com/success_story/haier.html
2 http://www.labournet.com.cn
3 "Practice and Exploration of Guangdong's Reform and Opening" (syllabus of the report in the Philippines), Liang Lingguang, June 2002
4 http://www.shunde.gov.cn/ and "2005 China Statistic Almanac"

7 CHAPTER

China's Agriculture, Rural Areas and Farmers

– Jing Chen, Yin He, Bin Wang, Chunzan Wu

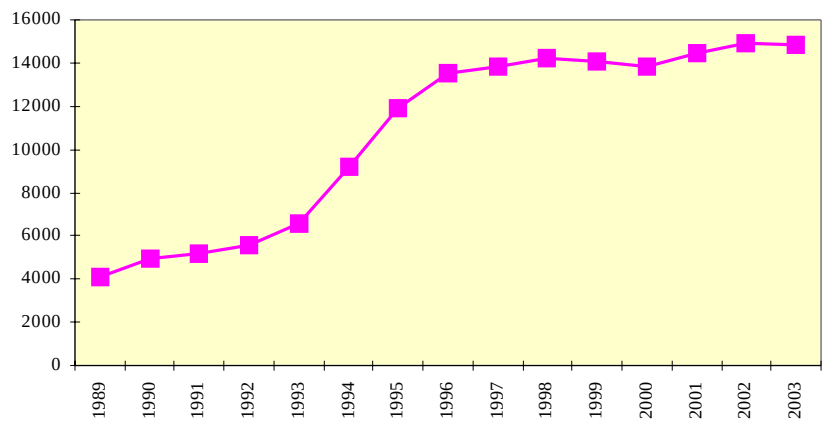
7.1 Introduction

Since the reform and opening in 1978, China's agricultural sector, rural areas and living standards of farmers have undergone substantial changes. The production capacity of grains and most produces rose dramatically. The total output of major produces ranked among the top few in the world and the per capita output has reached or exceeded the world's average. Thanks to sufficient supply, the market has changed from long-term shortage to overall balance between supply and demand. This chapter aims to explore the linkages between trade and poverty in the context of the rural agricultural sector in China.

7.2 Overview of the Agricultural Sector in China

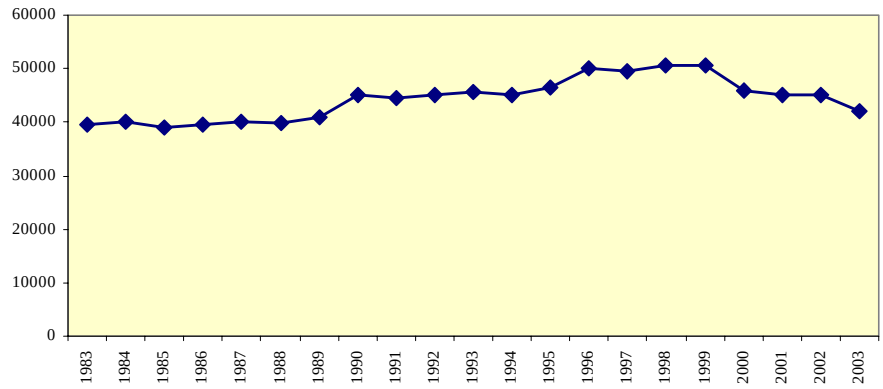
In China, during 1989-2003, though the produce acreage and grain acreage remained stable, the total agricultural output value increased slowly (see Figure 7.1). In terms of output, the annual grain of China remained at approximately 400 million tonnes in the last 20 years (see Figure 7.2). The increase in output has been due to a series of reforms

Figure 7.1: Total Agricultural Output Value of China (Yuan 100 million)



Source: China Statistics Yearbook, various years

Figure 7.2: Total Grain Output of China (10,000 tonnes)



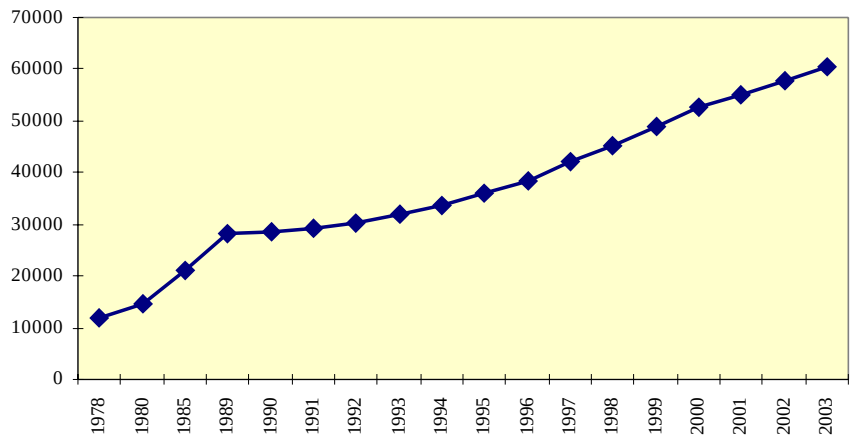
Source: China Statistics Yearbook, various years

in China's rural areas as well as enhanced agricultural technology, improved equipment and better technological and production conditions.

The total agricultural machinery power, an indicator reflecting the agricultural equipment level, continued to rise since the reform and opening policy was first adopted. It rose from 117,499,000KW in 1978 to 603,865,000KW in 2003 (see Figure 7.3). Simultaneously, the living standard of farmers has been improved greatly, but the gap between rural and urban household disposable income widened (see Figure 7.4).

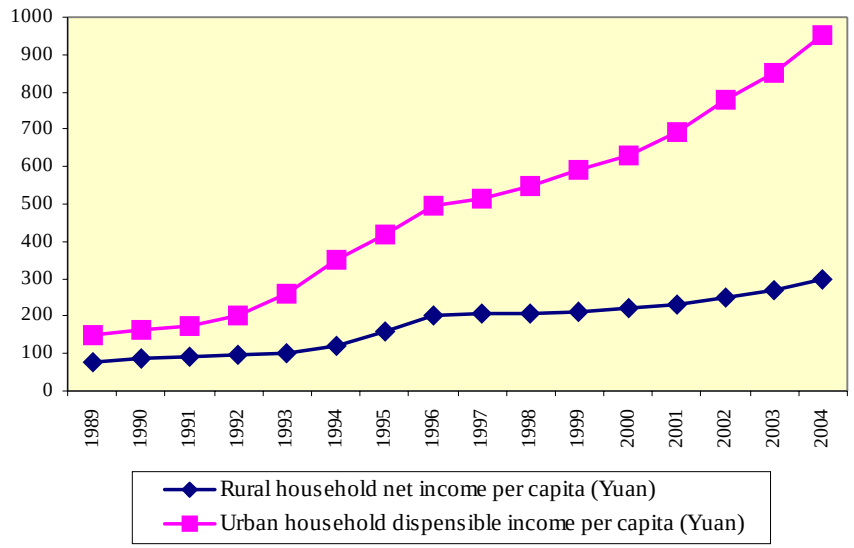
In the 1980s, due to the economic growth of rural areas arising from the economic reform and the introduction of all types of poverty alleviation policies in the 1980s, the impoverished population in China's rural areas declined substantially. The impoverished

Figure 7.3: China's Total Agricultural Machine Power (10,000KW)



Source: China Statistics Yearbook, various years

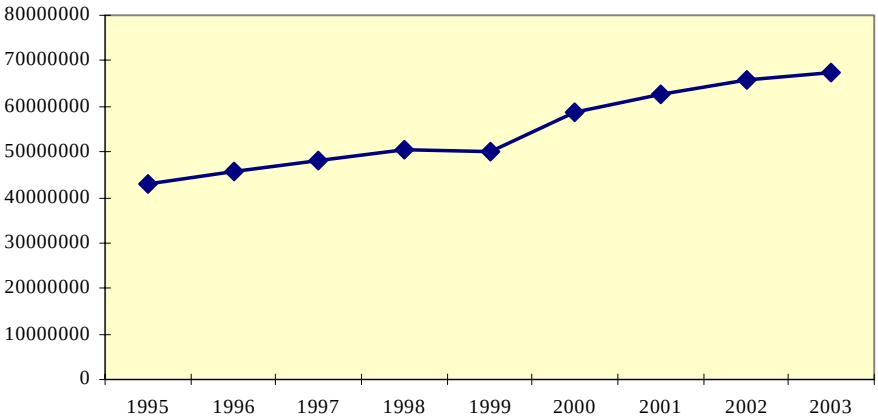
Figure 7.4: China's Household Income Per Capita



Source: China Statistics Yearbook, various years

population declined from 250 million in 1978 to 30 million by the end of 2000. The percentage of impoverished population in the total population in rural areas dropped from 30.7 percent to three percent approximately. In the 21st century, the impoverished population in China's rural areas further declined from 29.27 million at the end of 2001 to 23.65 million at the end of 2005[1].

Figure 7.5: Number of Students at County and Town Schools in China's Rural Areas

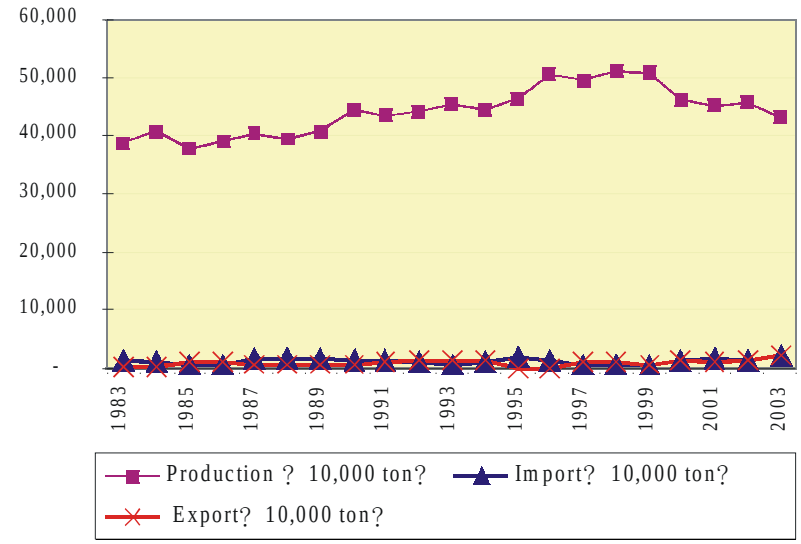


Source: China Statistics Yearbook, various years

The other two indicators of rural social development were inconsistent. In terms of medical conditions, the number of beds in county and town clinics declined from 1.24 million in 1983 to 1.015 million in 2003, but the number of beds in city hospitals increased from 869,000 to 2.15 million during the same period. This implies that the average distance for Chinese farmers to go to hospital increased but that for the urban residence decreased dramatically. However, the education conditions in China's rural areas have been unambiguously improved throughout the time. Although the number of county and town schools declined, the number of students at county and town schools rose from 42.869 million in 1995 to 67.302 million in 2003 (see Figure 7.5).

However, on the other hand, the import and export of grains in China lagged behind the overall opening of the whole country and the rapid growth of the trade of industrial products. In the last 30 years, the percentage of China's grain import and export of the total grain output remained under one percent and rarely changed (see Figure 7.6).

Figure 7.6: Production and Foreign Trade of Grains in China



Source: China Statistics Yearbook, various years

7.3 Profiles of Heilong and Yuchangping Towns

Heilong has 32.8 sq. km land area and 21 administrative villages, 8,111 households and 29,337 people. It is 60 km from Chengdu, the provincial capital of Sichuan Province, and 20 km from Meishan, a tourism city. Although all villages in the town have access to cemented roads, there is no provincial highway, state highway or railroad passing through the town.

Heilong Town has 1,100 hectares of cultivated land. The major produces are rice, corn, and wheat. In 2004, the town harvested 4,400 tonnes of rice, 58,400 tonnes of corn, 400 tonnes of tobacco, 240 tonnes of wheat and some vegetable. The produces are mainly

sold to grain processing enterprises through bulk orders. Apart from the cultivation of crops, the raising of livestock also plays an important role in Heilong Town. In 2004, the town raised 25,000 pigs (doubled the number in about 10 years), 380,000 small poultry (50 percent more than the level 10 years ago), 300 cattle (10 times of the number of 10 years ago), and 2,800 sheep. The livestock products were sold to residents of the town and large meat-processors.

Qingshen County government staunchly supports the agricultural production by providing agricultural technology and training. The government helped Heilong Town to set up town agricultural technology stations, agricultural service centres and adult education schools to provide guidance in agricultural science and technology by means of on-the-spot lectures and class-room trainings, as well as displaying audio-video programmes and the distributing sci-tech brochures.

Heilong Town barely had any industry 20 years ago with its industrial output only a few million Yuan. In recent years, the local government has been trying to promote the growth of local economy and its people's living standards by developing the industrial sector, such as paving the roads and constructing other infrastructures, as well as providing favourable tax and industrial policies, to attract enterprises. Heilong Town now turns into one of the key industrial towns in Sichuan Province. Enterprises in Heilong Town mainly involved in processing agricultural products or producing machinery and equipments, daily chemical products and handiworks. The annual industrial output is approximately Chinese Yuan 300 million (US$41.7mn). The leaders of Heilong Town expressed that, in order to maintain the rapid growth rate of Heilong Town, they had to focus on the industrial investment and development in the next five to ten years since the relatively close and underdeveloped of the rural areas and the agricultural sector had been a general situation in China.

At the same time, since the income from agricultural production was very limited, a large number of population in Heilong Town, like many of their counterparts in rural areas in central and western China had to rush into nearby cities or coastal regions to look for employment opportunities. During the field visit in Heilong Town (as a part of the current study), 95 percent of the people were found to be elderly, women and children. It appeared from the discussion with the villagers that in order to provide the families with better lives and support elderly people and children, most of the young labourers, especially the males went to nearby cities or other provinces for job. In 2005, the number of people who went out of town for job opportunities was approximately 8,000, or 28 percent of the total population in Heilong town. Most of these people worked in construction and export processing enterprises. They usually worked for 10 months every year and returned home only for the Spring Festival with some savings.

Although the per capita income of people working in the town doubled in the past 10 years, it was only about Yuan 3,000 (US$417) in 2004, much lower than that of nearby urban residents and the growth rate of their per capita income had also been lagged behind. While the per capita income for those who worked out of town were more about Yuan 15,000 (US$2,088) in 2004. If no one in the family worked out of town, a school-age child or any medium-severe illness of one of the family members would easily send the

whole family back to a life below the absolute poverty line. Thus, the money brought back by those who worked out of town significantly changed and secured the living standard of the Heilong people.

Heilong Town has two hospitals and 21 village clinics. Its medical conditions, equipment, technology and medicines are very limited. Fortunately, the primary and secondary education condition in Heilong Town had been greatly improved: the enrollment and graduate rate of primary schools have remained 100 percent since 1995, although there are only two middle and two primary schools in the town.

It appeared from the discussion with the leaders of Qingshen County that their biggest problem was the lack of money and talents. The country government owed Yuan 4.5 million (US$626,592mn) debt. If it failed to pay off the principle and interests, it would affect the security and social stability of the town. Besides, the government does not have enough money to build and improve the infrastructure, which would hold back the development of the whole economy.

Yuchangping Town of Hunan is similar to the Heilong Town. It is only 35 km from Changsha, the capital city of Hunan Province, covers a land area of 883.7 sq. km and has a population of 35,100. Its major crops include rice, sweet potatoes, wheat, potatoes, yams and vegetables. Livestock cultivation grew rapidly in the last 20 years. Different from Heilong Town, the crop and livestock cultivation products of Yuchangping Town are mainly sold to nearby markets instead of its own. However, the industrial development of Yuchangping Town lags much behind that of Heilong Town. Thus, although the agricultural products are sold in out-of-town markets, the income from this is very limited since the prices of produces in the domestic market are low and there are no export channels. Due to the lack of industrial production and low prices in the domestic markets, the per capita income of Yuchangping is Yuan 2,732 (US$380), lower than that of Heilong in 2004. Similar to Heilong Town, many young labourers in Yuchangping also chose to move out of town for jobs in Changsha and Guangdong. They remit most of their earnings back home.

Yuchangping has 25 village clinics and two town hospitals. The town hospitals can treat some common diseases and carry out small surgeries. With the newly initiated cooperative medical reform in rural areas, it is easier and cheaper for the villager to get access to the medical treatment in town. However, since the town is very close to Changsha, some villagers preferred to go to large hospitals there to look for more experienced doctors and better service. Yuchangping has not only improved its medical service, but also been providing better education to its villagers. The average education level was promoted from primary education 20 years ago to senior high and secondary technical school.

Finally, although insurance at the grassroots of rural areas has been advocated and encouraged in both towns, few of the villagers actually purchased insurance. The reasons claimed are that they do not think insurance is necessary with so low an income level. As a result, complaints about high medical expenses and heavy burdens in case of any emergency are popular.

7.4 Summary of the Findings from Interviews of the Farmers

The farmers in two towns were interviewed based on which they can be categorised into three types:

Type 1 – All members in town with low education: Usually the family has two elderly people, a middle aged couple and a kid. The family interviewed in the Heilong Town has a grade three senior high school student and two elderly with no working ability. The middle-aged man works in the county and his wife takes care of all the house and field work. Their house was built in 1988 when the family had four strong labourers without any burden from old or young people and the family income increased dramatically due to the operation of the family contract responsibility system in rural China from the early 1980s. Instead of making any type of investment, the family spent approximately Yuan 6,000 (US$835), almost all their savings, to build that three-floor brick house and a hog pen. The house was quite a view in town when it was first built. However, as the elderly couple became too old to work and the expense of supporting the child's education in senior high school kept increasing, the family can hardly make ends meet. Their house looks dilapidated and their only home appliances are a TV set and a telephone.

This aforementioned family has about half a hectare of land and they mainly grow paddy rice. The annual output is about 500 kg with the market value of Yuan 700 (US$87). But most of the rice needs to be used to feed the family itself. The family also plants a few economic crops and raises some pigs and poultry with an output value of about Yuan 1,300 (US$181). However, most of these are also used as self-supportive foods. Obviously, the family can only support themselves with a very low standard of living and cannot afford the tuition of the kid, let alone any medical treatment. Therefore, the family is heavily dependent on the income from the middle-aged man who works in the county for eight or nine months in a year and earns about Yuan 7,000 (US$1,024).

Besides the daily expenses, the major expenditure of the family is the tuition of Yuan 3,000 (US$417) each semester and the living cost of Yuan 200 (US$28) per month of the senior high school student due to the long distance between the school and their inhabitancy. If the middle-aged man is lucky to find a job in town, the family would be able to support this kid to continue his high school education. However, even if the kid gets admitted to college, there is no way the family would be able to support him with their own capability.

Type 2 – All members stay in town with relatively high education: A family of four in Heilong Town, including a young couple and the wife' parents was interviewed. The girl's father used to be the Party Secretary of the village. The young couple teaches in the primary school in town. Their annual income is between Yuan 15,000-20,000 (US$2,088-2,784) and they have all types of social insurance, including medical and housing public accumulated funds. Both parents can work in the fields for only a few numbers of self-needed crops and poultry. They purchase diversified food from the market and their agricultural income mainly comes from oranges, which was about Yuan 4,000 (US$557) in 2004. Their house is new and large. The family has all types of home appliances, including colour TV set, refrigerator, audio system, telephone, electronic fans, drinking water machine, etc. It is obviously a comparatively rich family in town.

Type 3 – Typical new era three-people family: In this family, both the parents are in their late 20s or early 30s, with the wife and the child remaining at home and the young man working in the urban areas. A family in Yuchangping sets a typical example. The family built their house in 1997, which keeps very good shape and has many home appliances such as a TV set, VCD players, electronic fans, washing machines and telephones. Since they live on their own without any parents, their income does not depend on agriculture. The family has only 1/5 hectare land. They plant very few rice and vegetables and raise a few pigs for their own consumption usage. The husband works in the field at home for half a year and then in Tibet for the other half to earn about Yuan 6,000 (US$835). The kid goes to kindergarten at a cost of Yuan 1,000 (US$140) per year. Therefore, if there is not much contingent cost, the family can save as much as Yuan 2,000 (US$280) per year.

7.5 Conclusion

After 20 years of reforms and opening, China's economy has achieved significant development. Income per capita increased substantially and the impoverished population has been reduced dramatically. However, accompanied by the continuous growth of the economy and the increase of the average income, the gap between the urban and rural residents and that between coastal and inland areas widened continuously. Thanks to convenient transportation, better infrastructure, more transparent institutional systems, and more openness to the international market, coastal regions and large cities are economically active and technologically advanced with a large number of foreign investment and international trade involved. However, rural China is still closed and its agricultural sector is far from technologically advanced or export-oriented. As a result, urban regions and their residents receive much less benefit from the opening in China. Although their absolute income increased over the years, some of the rural residents still live under the absolute poverty line or easily get back to absolute poverty, and the others face an increasingly severe problem of relative poverty.

Fortunately, rural areas in China benefited from the opening more through an indirect channel, remittance of the surplus labour working in the urban areas. The income of these better-educated migrant workers becomes the major income source of local households. Thus, although the agricultural income of the residents in these two towns did not increase much, the living standards of the farmers improved greatly, the education level of the farmers went up dramatically, and the number of migrant workers kept increasing. Besides, the exemption and reduction of rural taxes, capital and technical support to poverty-stricken regions and the investment in the infrastructure of rural areas and agriculture are all based on the economic growth and income increase promoted by trade and opening.

In the interviews, county and town leaders and farmers held the view that the families and the society in rural areas could be more stable and the average income of local residents could be increased substantially if the agricultural operations could be more open and advanced, more processing plants were established and more products were sold to other provinces and even to other countries. Also the policies or other methods which can divert migrant workers from the county and Northwest China to the more

export-oriented and more profitable coastal regions are desirable as through this process migrant workers can earn higher salaries, receive more technical training and have more promotional opportunities.

References

China Statistics Yearbook (various years), complied by National Bureau of Statistics of China: China Statistics Press, Beijing

Information on China's Poverty Reduction website: *http://www.help-poverty.org.cn/*

China Environmental News Digest: January 2006

http://ph.china-embassy.org/eng/sgdt/1983622.htm

Endnote

1 Data on poverty population come from http://www.help-poverty.org.cn/

8 CHAPTER

Handmade Carpet Industry of India

– Purnima Purohit and Prashmita Ghosh

8.1 Introduction

The carpet weaving industry in India is highly labour-intensive and it forms a considerable part of the handicraft industry. Its production is a long, arduous process – right from the stage of designing till the time the carpet finds its place at the shop or buyer's end. It is predominantly an export oriented industry. It provides livelihood to approximately 2.5 million artisans and earns significant foreign exchange for the country. Export earnings from the carpet industry have been increasing over the years especially from 1996 onwards. During 2005-06, over US$621mn were earned by the industry. This chapter looks at the importance of the carpet industry in the Indian economy, given its export potential and scope to generate large-scale employment opportunities mostly in rural India.

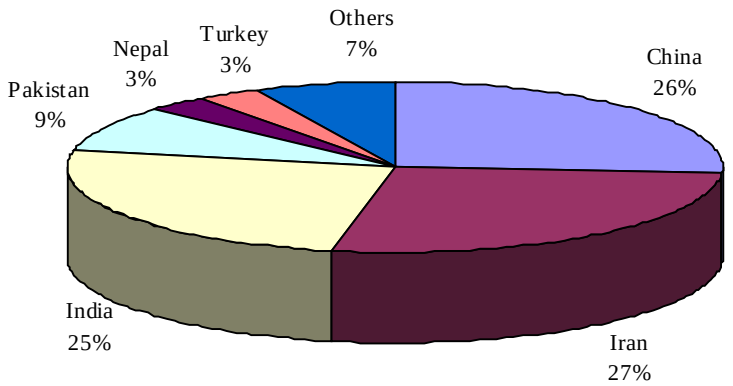
8.2 Historical Background and Geographical Spread in India

Indian carpet industry is one of the oldest industries in India. It is primarily rural in nature with minimal requirements. This industry has travelled a long distance since the time of 16th century (1580AD), when the Mughal Emperor *Akbar* brought some Persian carpet weavers to his palace in Agra and introduced carpet weaving in India (Prasad, 1907). Subsequently, Agra, Delhi, Lahore (now in Pakistan) became the prime production and training centres of Persian carpets.

The carpet industry is spread over some specific belts in India. The traditional carpet manufacturing regions are located in *Mirzapur, Bhadohi* and *Agra* in the state of Uttar Pradesh, *Jaipur* in the state of Rajasthan and in the Kashmir valley. In recent times, other parts of India such as *Gwalior* in Madhya Pradesh and *Panipat* in *Haryana* are also coming up in producing carpets, as the industry is spreading beyond its traditional centres. Each manufacturing region specialises in producing a certain kind of carpet. Kashmir specialises in weaving hand-knotted silk and woollen carpets. Agra specialises in producing high quality hand-knotted Persian, Turkish carpets using natural dyes. The Bhadohi-Mirzapur belt though produces carpets of all designs and quality, is known for world famous hand knotted carpets. The case draws its inputs from the field survey in two of the main carpet weaving regions – *Bhadohi*, Uttar Pradesh and *Panipat*, Haryana. The survey was conducted in April-May 2006.

Indian carpets are mainly exported to the US, Canada, Spain, Turkey, Mexico, Australia, South Africa, Belgium, Holland, New Zealand, Denmark and many other European countries. The industry, vibrant since the middle of the19th century, had to face rough weathers during the World Wars I & II and the Great Depression of the 1930s, due to

Figure 8.1: Percentage Share of World Markets of Handmade Carpets and Other Floor Coverings



Source: CEPC, Carpet-e-Journal, International Annual Journal 2006

recession and a slump in demand. Between 1947 and 1965, carpet exports ranged from Indian Rupees 32.2 million to 56.6 million (US$0.8-1.4mn). Today, the world market of handmade carpets is estimated to be around US$2.4bn, and the market share enjoyed by major carpet producing countries is given in figure 8.1. India commands third position in the world market of handmade carpets and is preceded only by China and Iran. Discussions with stakeholders from carpet industry reflected that China in particular is posing a strong competition to India because of its highly efficient production techniques.

8.3 Overview of the Carpet Industry in India

Trend in Exports

As can be seen from Table 8.1, the export of carpets from India has been increasing over the years. It is difficult to say how far the increase in exports is a result of trade liberalisation. Nevertheless, owing to increased trade across borders as well as newer and larger players in the world carpet markets over the time, Indian producers are increasingly realising critical need to be competitive not just to remain functionary in the market but also to expand their markets. During the field work of this case study which as mentioned earlier was mostly undertaken in *Bhadohi*, Uttar Pradesh and *Panipat* in Haryana, exporters expressed the view that India's export market has gone down in the recent years, though the export figures show an increase in exports. In the 1970s, India had been one of the major players in the world carpet market. At present, however, India is facing stiff competition from China on quantity front and Iran and Pakistan on quality front.

Indian carpets have potential to be a high quality product. However, to meet the increasing demand of low priced and large-quantity goods, the quality of carpets is being compromised. China's manufacturing structure is different from India's, which enables China to surpass India in volumes. China has large-scale production and since the carpets, especially production of the hand-tufted varieties is completely mechanised, India's market stumbles in the volumes of hand-tufted production. Though the Indian

Table 8.1: Export of Carpets from India			
Year	Total Value of Carpet Exports (in US$mn)*	Total Value of Handicraft Exports (in US$mn)**	Total Value of Exports (in US$mn)**
1996-97	446.41	5665	33470
1998-99	478.68	1177	33218
2000-01	512.03	1116	44560
2002-03	532.96	1186	52719
2004-05	591.40	936	80540
2005-06	621.34	642***	52284***

*Source: * http://indiancarpets.com/information.htm (CEPC's official website)*
*** Economic Survey 2000-01, 2003-04, 2005-06, Government of India*
**** April-October 2005*

exporters are trying their best to compete, the hands fail *vis-à-vis* machines. It was stated that the Chinese Government supports both the manufacturing and R&D processes to constantly innovate worker-friendly machines that can weave and produce more carpets in a short time.

Export markets have widened over the decades from the earlier favourites of Germany to the current market, namely the US and the Scandinavian countries. This market shift is a result of consumer preferences and emerging demand in new markets as globalisation takes on. This entire industry is based on demand. One exporter stated that Japan's market was for Pakistani carpets. Japanese highly value carpets from Pakistan; hence making a foray in Japan is difficult.

The Government of India has set up Indian Institute of Carpet Technology (IICT), at *Bhadohi*, in order to provide technical support to the carpet industry. The IICT is established to promote, aid in development of carpets, floor coverings etc., by strategically planning, introducing, and executing various programmes aimed at enhancing the quality and competitiveness of Indian carpets, floor covering and textiles.

Raw Materials: Sources and Processes

India specialises in the production of all types of carpets. Silk carpets need a lot of fine-tuning with concerted efforts; seven to eight months can be spent in weaving one silk carpet at times. Such silk carpets are of high quality and fetch high prices from abroad. However, the majority of carpets currently exported from India are woollen. In the carpet industry, manufacture/export of woollen carpets have gained prominence because of the increased availability of raw material, i.e. wool and also since they can be woven and manufactured within a comparatively short time.

The fine qualities of wool for weaving carpets are imported from New Zealand, Australia, Morocco and various other countries. Wool is imported because India does not produce the required quality of wool for carpet weaving. Also, the quantity of wool produced in India is sufficient only to cater to eight-nine percent of the carpet industry's demand.

Given these conditions, the major chunk of domestic demand for wool is imported from New Zealand. The imported wool has better shine and length than the Indian wool and is also cheaper than the Indian variety (perception of the carpet manufacturers).

Dyeing presents another important step in the carpet weaving process and is also one of the prime support industries for carpet weaving. Before the introduction of chemical dyes in the second half of 19th century, only natural dyes were used extracted from indigo plant, cochineal insects, fruit, wild rose and other indigenous products to produce the vibrant shades of red, blue, green and other colours. Nowadays, chemical dyes are used to colour the wool. Nevertheless, there is an increasing demand and also a trend to use vegetable dyes for colouring the wool. Agra is famous for carpet production using natural dyes.

Once the wool is imported, it is sent for dyeing. In the carpet industry, the wool providers supply different colours of wool as per the requirements of the manufacturer. Wool can be dyed in various colours like green, blue, maroon or the natural colour of wool is maintained. The dyed wool, now in the form of yarn, is to be rolled into balls to be used for weaving. Mostly the female workers roll the wool into balls. On an average, a medium size carpet manufacturer with a yearly turnover of Indian Rupees 80-90 million (US$2-2.2mn) can employ around 15-20 women for rolling wool yarn into balls. However, since the carpet industry is primarily a handicraft industry, weavers often take wool to their villages where the women of the family roll them into balls. Thus, it becomes difficult to estimate the employment generation capability of this industry. But women constitute a majority of the labour force without being accounted for. This is largely due to the unorganised nature of this sector. The labour structure is mainly contractual in nature and export demand driven, i.e. when export orders are high there is more labour required compared to the lean seasons, if any.

Domestic Demand

The carpet industry is one of the prime industries that are entirely demand-driven. Indian carpet exporters are now manufacturing woollen hand-tufted carpets that are in demand abroad. Demand within India is minimal because of the tropical climate. Also, carpets are one of the high end furnishing items for a middle-class Indian. For example, it was found during the survey that a medium quality, average sized (5 by 8 feet) carpet would cost around Indian Rupees 25,000-30,000 (US$542-651). The price of Indian-made carpets thus becomes comparatively high for Indian households. Moreover, these days competition from machine–made Belgium carpets priced at around Indian Rupees 3000-4000 (US$65-87) caters for demand at home.

Carpet Export Promotion Council

The Carpet Export Promotion Council (CEPC) was set up by the Government of India in 1982 to promote the exports of hand-knotted carpets and floor coverings. The CEPC advises the government on carpet export promotional measures and helps the exporters by bringing their problems to the attention of the government. It identifies potential markets, conducts promotional fairs, buyer-seller meet, exhibitions for display of Indian carpets within and outside India. The CEPC also provides financial assistance to new exporters to enable their participation in the fairs abroad. The CEPC is headquartered in

New Delhi with its representative offices in the major carpet producing centres. It informs the exporters through its regularly updated website about any change in government policy with respect to duty drawback schemes and the like for the benefit of the exporter. The carpet exporters are members of the CEPC. This helps them in availing the export promotional measures undertaken by the CEPC.

However, discussions with the exporters at the field suggest that they in general, seem to be less satisfied with the current functioning of the CEPC. According to the exporters, the export figures provided by the Directorate General of Foreign Trade (DGFT), Kolkata are exaggerated. For example, the carpet industry is under recession for the last two years, but the CEPC figures show no decline. The exporters also hold the views that generally most of the members of the CEPC delegation are only interested in promoting their own business interests in the visiting countries rather than carpet export promotion. In this respect, the stakeholder perception was that the representatives of the CEPC should have a genuine interest for the welfare and promotion of the carpet industry as a whole. They should be able to take the open world market opportunities to facilitate maximum gains for the carpet industry.

Finally, the exporters suggest that the CEPC must be fair on fairs and exhibitions. Merely sending a delegation to the buying countries would serve no purpose: it must ensure stands in all carpet fairs. It should also allow even small exporters to participate in them with new quality and varieties at a nominal stall rent. For this, Market Development Assistance Grant and the CEPC's own fund could make up the balance. In addition, the CEPC should be more active in promoting Indian carpet exports. Updated and complete information with regard to various carpet fairs organised anywhere in the world should be made available. Details about the participating exporters, visiting buyers, and quantum of business generated, products exhibited, special range of products needed in that country should be incorporated in such reports.

8.4 Employment Structure

The Indian Carpet Industry is a skill-driven, labour-intensive industry, which is dependent entirely on the shoulders of the labour community. All the activities, from the processing of wool to the shipping of the carpet, are labour-dependent.

Employment Opportunities

A medium-sized manufacturing unit can produce up to one hundred thousand square metre of carpet a month. The mill can employ 400-500 weavers spread over the entire manufacturing unit. This number does not include the people employed in other subsidiary industries of dyeing and washing. Weavers and all other employees work on a contractual basis. Permanent employees are people in the administration unit and the security guards. Even the designers are recruited on a contractual basis. This is mainly because carpet production is a skill-driven and currently a demand-driven industry. On an average, a carpet weaver can earn Indian Rupees 100-150 (US$2.17) per day. However, since the work also depends upon the number of hours a labourer can put in. If someone works for more than eight hours he is paid more. In fact, this particular feature of carpet industry is seen by the rural populace as a means to earn quick money during the agricultural lean season.

During the survey, a manufacturer-cum-exporter explained the potential that this industry has in providing employment to rural poor people. He gave an approximate figure of number of people who are engaged at different stages in the making of 'one' carpet in the industry. On an average, one tufted carpet goes through approximately 30-35 pairs of hands from the time order for a carpet is placed before an exporter.

The carpet industry provides job opportunities to the rural artisans and other poor sections of the society. Apart from providing direct employment to currently more than 2.5 million artisans with a total of more than Indian Rupees 2 billion (US$50.8mn) export business, it also gives indirect employment to several thousands of people who work in raw material and other sectors connected to the carpet industry such as the transport sector, which forms an important backbone for sustenance of this sector.

Given the informal nature of the carpet industry, getting a correct picture of the number of people employed in the sector is difficult. It is practiced as a family art besides agriculture as the primary occupation. Apart from working in the field, women also take up the weaving of carpet in their spare time. In and around *Bhadohi, Panipat, Jaipur* and Kashmir region, there are villages where carpet is woven in almost every family. This work is seen more as a family tradition than as a source of income.

Wage and Income

It was learnt from the carpet weavers that they could earn Indian Rupees 3000-4000 (US$65-87) per month in carpet manufacturing units. The weavers are from rural India with little or no education. They come to weave carpets during the lean agricultural season and save up to Indian Rupees 2500 (US$54) a month to their families in their villages. Many people from rural areas join the carpet industry to earn quick money to meet their financial requirement at home. This temporary inclination of their stay in the carpet belts is facilitated by the contractual nature of the job. Usually, most of the weavers work for three-four months before going back to their home during the harvest season or any festivities. They spend two-three months at home and when again financially strained, they find their way back to the carpet belts.

The labour scenario in the carpet industry is a very good example of migration to industrial belts by the rural populace for increased income. However, if there were regular employment structures in the villages they would not have migrated to the carpet belts, as was opined by the weavers. This migration is driven by the lean season in agriculture and the structural uncertainty within Indian agriculture.

8.5 Impact on Poverty Alleviation

The impact of the carpet industry on poverty reduction in rural India is difficult to estimate. This may be attributed to a certain mindset rural people have and also the informal nature of this industry. Undoubtedly, for a man/woman who wants to improve his/her economic condition, carpet industry gives ample opportunity to earn. However, mostly rural people would like to go back to the not-so-profitable subsistence agriculture that they have been practicing for ages. Sometimes it is suggestive that the land is of immense value to the rural people who come to work temporarily in the carpet industry. Even though Indian agriculture is going through a lean phase, which affects especially

these small farmers who either work as hired labourers or have their own plot, they would not leave their farming to earn and get skilled in the carpet industry.

Though it is difficult to estimate the poverty reduction impact of this industry, one fact that can be ascertained is that villagers regard the carpet industry as one where it is relatively easy to get a job in times of need to earn a considerable amount over a period of three-four months to tide over financial difficulties. Since a labourer never starts working without advance, hence his initial financial needs are taken care of. This very uncertain nature of labour availability poses a problem to the manufacturer/exporter.

The carpet industry is becoming a big source of income for women in the villages. Since particularly women in rural areas have limitations in coming out of their homes to work due to traditional social structures, carpet weaving is becoming an important tool for fighting unemployment among rural women. A woman working in a household translates into more income for the family. In addition, there is also a demand from the exporters to encourage female workers for carpet weaving through training and employment benefits. This could solve the problems of scarcity of skilled weavers and unstable workforce prone to migration whenever there are better opportunities.

8.6 Importance of the Carpet Industry and its Future

The Indian hand-made carpet Industry is an ideal industry for the Indian economy for a number of reasons. The sector is highly labour-intensive, thus providing employment to 2 million artisans and their families. Furthermore, it is 100 percent export-oriented and earns foreign exchange to the value of US$600mn per annum. It is a rural-based cottage industry, providing gainful employment to the artisans in their own dwellings. With no minimum educational requirements, it provides immense employment opportunities to the vast rural uneducated population. India creates a huge value addition, as wages constitute a large part of the cost of the carpet. The actual production of carpets can be started by a loom owner at a very low capital investment, as the cost of installing a new loom in the loom-owner's home is low at Indian Rupees 5000 (US$120).

The industry has huge potential for growth. India has around 25 percent share of the world market for handmade carpets and floor coverings. Handmade carpets constitute approximately four percent of the total floor covering market worldwide and therefore the share of Indian handmade floor coverings is only one percent of the total world market. In this situation India's carpet exports can be doubled if it increases its share in the world floor coverings market by only one percent.

The CEPC is launching an action plan to double the exports of Indian carpets during the next five years, i.e. up to the year 2010 and then to double the exports again in the next five years, i.e. from the year 2011 to the year 2015. This will lead to a huge increase in employment and it is hoped that by the year 2015, more than 5 million people will be employed in the carpet industry in India (VR Sharma, Chairman, CEPC & Joint Fair Committee, Carpet World, International annual Journal 2006). These objectives of the CEPC also coincide with the objectives of the Foreign Trade Policy, which are to double India's percentage share of global trade within the next five year, and to act as an effective instrument of economic growth by giving a thrust to employment generation particularly in the rural areas.

8.7 Experiences and Perceptions from the Ground

As referred earlier, the authors interviewed carpet manufacturers, exporters, weavers and workers, mainly belonging to *Bhadohi* (Uttar Pradesh) and *Panipa*t (Haryana) carpet belt and secondary stakeholders in New Delhi and *Bhadohi*. These carpet manufacturers represented small and medium scale carpet enterprises. A few big prominent exporters were also interviewed in *Bhadohi;* some of them were very experienced and have progressed from the level of mere labour working in a carpet firm to becoming an international carpet exporter by their sheer hard work, workmanship and good practice. The authors also visited the Indian Institute of Carpet Technology (Bhadohi) and the CEPC located in Bhadohi and New Delhi. This section elaborates on the experiences of the people and their perceptions of working in the carpet industry.

Changing Businessmen Priorities and its Impact on Business

About a decade ago, the scenario in the carpet industry was a different one. Most of the businessman preferred a 'Programming' mode of business (taking/placing orders at a set deal and then supplying carpets). Nowadays, most of the buyers are not interested in this type of business transaction anymore. The reason behind it is that they want to be able to choose their preferred colours and designs. Moreover, it is comparatively easy to do ready stock business. Above all, prices can be easily manipulated and goods can be acquired at cheaper prices. So, most of the buyers have switched over to the ready stock business.

Change in Consumer Priorities Abroad

Earlier on, people were aware of the aesthetic and cultural values of the oriental hand-knotted carpets and proud of possessing it. It was a prestigious item and people appreciated its antique value. These unique carpets evoked in them a kind of cultural elation and satisfaction. This perception however has changed over the time. The new generation's thinking has undergone a radical change, as most people are no longer aware of the cultural background and aesthetic qualities of hand knotted carpets. A carpet is merely regarded as a floor covering. People are not ready to spend a substantial amount to buy carpets. For this reason, cheaper and low quality carpets are preferred. Today's consumers go for other consumer goods like television, computer and electronic items or also spend on gold, silver, diamonds and other precious items.

Unethical Business Practices and its Chain Effect

Some carpet importers are relentlessly misguiding and pressurising carpet exporters in India. The importers approach one or two small and inexperienced exporter and express the intention of purchase from them. When the price aspect is discussed, the small exporter would be told that the big exporters have offered much cheaper rates. Thereby, the small exporter is put under pressure to sell his good at cheaper rates. If the exporter finally decides to sell in cheaper rates, the importer can then effectively negotiate with the big exporters and in the course of time drive down the price of the product and increase his margin. Many poor small exporters have fallen in this trap and agreed to sell their goods at remarkably low rates.

A general mistrust between the competitors and a lack of willingness to share information between peers has led carpet importers and middlemen to cash in by lowering the market

price. As a result of the above practice of driving down the prices, manufacturers/ exporters will be forced to make compromises in quality by using cheap yarn and other cheap raw material in order to compensate the losses. Ultimately, this will create bad image for Indian carpets as a whole.

Problem of Advances to Weavers/Loom Owners

While placing orders with the contractors, weavers or loom owners for the weaving of carpets, the exporters have to pay a reasonable sum in advance in the form of cash and/ or raw materials along with the map of the carpet. It is a common practice prevailing in carpet belts. It may be all right considering the financial condition of weavers/loom owners. However, a problem arises as some weavers/loom owners try to cheat on the exporters by selling the final product to somebody else. Owing to such practice by the weavers/loom owners, the exporters have to suffer financial losses and are subject to severe mental tensions. They might also not be able to fulfil their commitment to their buyer. In certain cases, the buyers even cancel orders, as exporters could not fulfil the given commitments. Hence, it was suggested by an exporter that insurance companies should help exporters in this regard by taking reasonable service charges. In case of non-realisation of advances, insurance companies should reimburse it to the exporter. Insurance companies can recover such amounts with the help of the government by treating the advances as government revenue.

Dishonouring Orders by the Clients

Nowadays, the frequency of buyers dishonouring their orders has increased. After fixing prices and placing orders, some importers do not accept the order at the time of shipment. The exporters are left with only two options (both detrimental to the interest of the exporters): find alternative buyers or give into the unjustifiable demand of the original buyer at reduced prices.

Child Labour: Fighting with a Bad Image

Child labour is no more a serious problem for the industry. Because of consistent campaigning, the exporters are now aware that engaging any children in carpet manufacturing will cause the company to be blacklisted by the CEPC.

Overall Depression in Global Markets

Exporters expressed the view that overall depression in global markets and cheap quality machine-made Belgian carpets are badly affecting Indian carpet exports. Another reason given is taxes imposed on imports of Indian handmade woollen carpets in countries like Turkey. It was emphatically recommended to the Indian Government to come forward and promptly support the woollen carpet industry by reintroducing different schemes of Passbook, Cash Incentive, License, etc. The government should also immediately announce Income Tax Holidays to this 'cottage' industry since products are becoming more costly. Consequently, exporters are not being able to meet the international competition, especially from China, Pakistan and Iran.

8.8 Recommendations from the Stakeholders

The stakeholders during interviews have put forward a number of suggestions, which are as follows:

1. Indian hand-knotted carpets have a great future if the real value – cultural and aesthetic aspects – is effectively and regularly publicised in the present buying countries and other countries where there is potential scope for Indian carpets. People should be made aware of various aspects of hand-knotted carpets. Its uniqueness, cultural heritage, nuances of manufacturing, history behind it, royal patronage, qualitative aspects, durability and health utilities etc., should be publicised through media. The message should be clear and attractive.
2. Everybody should be convinced that buying a hand-knotted carpet is not just a consumer product and the skilled and imaginative artisans and weavers create a piece of art. People do not hesitate to buy art pieces created by great painters and artists spending a lot of money because they know that they are spending on art. They proudly display such works on their house walls. Hand-knotted carpets are also works of art and although the artisans may not be famous, their craft reflects historical and aesthetic values. If these aspects are artistically conveyed to consumers all over the world, more and more people will come forward to buy qualitative carpets from India. They will think that possessing a carpet being an art piece is not only a matter of pride but also an asset.
3. The creation of new designs, based on Indian culture, tradition and mythology, should be improved.
4. There should be prompt availability of working loans to needy units to help them start manufacturing activities.
5. The manufacturers are fully dependent on Bikaner and *Panipat* for procuring quality wool. They have to bear high transportation cost and a loss of valuable time during transportation. The government should provide manufacturers at least one Governmental Wool Spinning Mill in the *Bhadohi* area to make the process of wool procurement cost and time effective. For this structural drawback, India's competitiveness is affected in the world carpet market.
6. The media should be taken into confidence in the efforts of image-building of the industry in the carpet importing countries. The CEPC should release informative articles and advertisements of Indian carpet industry through both the print and electronic media. The media played a critical role a few years back in tarnishing image of the Indian carpet industry as an exploiter of child labour. Some journalists had published one-sided stories exaggerating the extent of child labour in the sector. It had enormous impact on livelihoods of the small weavers and the producers. The influence of the media is evident and there should be a regular communication to the world market via media about the improved status of the sector.

8.9 Conclusion

The carpet industry is one of the best examples of utilising India's comparative advantage, i.e. its vast labour force. It is an industry that has transcended from private homes to a separate manufacturing unit; from being a piece of art to being one of the important export industries in India. With a concerted effort by the CEPC and government officials, the issues of the manufacturers/exporters in this industry can be addressed and the rural employment status be improved. The industry provides alternative employment opportunities for rural uneducated people. Given the employment potential, the carpet industry can serve as an important occupation avenue for these people. Therefore, to take the full benefits of an export-led growth strategy, carpet industry should receive

suitable incentives to be able to compete in the world market and to promote inclusive and sustainable growth in rural India.

References

Agarwal, Gopi Nath (2006), "Carpet-e-World", Volxxvii, Purvanchal Publications, Varanasi, Uttar Pradesh

Prasad Kumar Jagdish (1907), Monograph on "Carpet Making in the United Provinces", Chapter 11, Uttar Pradesh

Economic Survey, 2000-01, Ministry of Finance, Government of India

Economic Survey, 2003-04, Ministry of Finance, Government of India

Economic Survey, 2005-06, Ministry of Finance, Government of India

9 CHAPTER Oilseed Sector in India

– NC Pahariya

9.1 Introduction

In the oilseed sector, India pursued a strategy of import substitution until 1991 (up to 1994-95 in edible oil sector), which delivered significant benefits. It turned from once-rising deficits in domestic consumption of edible oil (necessitating imports) to almost self-sufficiency in the production of oilseeds. It was not only able to double output and stabilise the oilseeds production, but diversify to produce new crops such as soyabean, sunflower etc., even to those rain-fed areas where poor farmers typically face more limited growth opportunities. As a result, India became almost self-sufficient in edible oils and a major exporter of oilseed meal by the early 1990s. However, the situation reversed soon. By the mid-1990s, cheaper imports and faster economic growth facilitated the acceleration of demand for edible oils which was increasingly being satisfied through the imports liberalised in 1994-95. But continued inefficiencies in marketing and processing of oilseeds and also their supply bottlenecks deprived both the oilseeds processors and the farmers from capturing a larger share of market opportunities offered by trade liberalisation.

The trade liberalisation in the oilseed sector was initiated in 1994-95, and pursued gradually between 1999 and 2004-05. All quantitative restrictions (QRs) were removed and tariff rates were cut down significantly. As a consequence, import of edible oils rose from a low level of a million tonne in 1995-96 to a whopping five million tonnes in 2003-04, making India the largest importer of edible oils in the world. The domestic condition of oilseed became grimmer. Trade liberalisation measures were undertaken without bringing in place much-awaited domestic reforms in marketing and processing the sector.

Hobbled by a regime that arbitrarily restricts the domestic (inter-state) movement of oilseed products and reserves the processing of the oilseeds to small scale industry (SSI) reservation and usually inefficient enterprises, processors cannot invest in modern equipment and integrated processing plants that would enable them to reduce high losses of oil, improve the quality of oil meals, buy raw material from the cheapest sources on the domestic market, and raise their low capacity utilisation rates. Banned from participating in forward and futures markets, traders and processors are at the mercy of the price volatility and imperfect information flows in a fragmented market that is a far cry from a needed, common, domestic market (World Bank: The Indian Oilseed Complex: Capturing Market Opportunities, July 31, 1997, pp.2).

It was expected that the increased availability of a wider range of goods in the market place (due to a liberalised trade regime) would enhance competition and thus benefit common consumers in the long run, giving them more choices. At the same time, it was true that increased imports might lead to a difficult situation for domestic producers, especially small farmers and domestic processors (small inefficient ones) who might not be able to withstand the pressure of the new and liberalised market environment.

There are three policy options available for the benefit of various stakeholders: farmers, processors, government and consumers. Among them, the idea of removing the ban on oilseed imports appeal to processors ready to invest in modern, large-scale facilities in port cities, gaining efficiency that small-scale crushers could not emulate. Another approach favoured by farmers, would raise tariffs on the imports of edible oils, thereby strengthening the growers' position (and prices) in the domestic markets at the expense of consumers.

The edible oil and oilseed sector faces many challenges in the new environment of liberalised trade. Government intervention is faced with the task of balancing the interests of different stakeholders in the oilseed complex. Providing benefits to some at the cost of others may cause some social tension at least in the short run. Imports of low priced oils, for example, benefit the consumers but tend to reduce the margins on domestic oils for the processors. Similarly, protection to oilseed growers can make oil and oil meal products internationally uncompetitive. The question therefore is: what does the state do to facilitate the restructuring of the affected sectors and take care of the interests of the different stakeholders?

9.2 Some Facts on Oilseeds

The Indian vegetable oil economy is the fourth largest in the world, next to the US, China and Brazil, accounting for about 14 percent of the oilseeds area and 8.5 percent of the world's oilseeds production. The oilseeds sector occupies a distinct position in the Indian agriculture sector after cereals, accounting for 13 percent of the country's gross cropped area, a three percent of Gross National Product (GNP) and 10 percent of the value of agriculture product.

Trade in oilseeds has been completely deregulated within a short span of time and oils are now freely importable with relatively low incidence of custom duties. The impact of liberalisation on the import of edible oils has been phenomenal and from 0.10 million tonnes in 1992-93, India's import reached to 4.3 million tonnes in 2002-03. The share of bills for the import of edible oils in the total agricultural imports has ranged from 6 percent to 52 percent during 1991-92 to 2002-03. Almost four out of 12 years (since 1990-91), the country spent 50 percent of the total expenses on agricultural imports for the import of edible oil. The dramatic decrease in self-sufficiency in the last five years is a clear indication that globalisation has already had an impact leading to far reaching consequences for this sector. The country was almost self-sufficient in edible oils during 1991-92 to 1994-95 when the sufficiency level was in the range of 95 to 98 percent. However, gradually it has declined to about 53 percent in 2002-03.

The Indian oilseed sector accounts for a domestic turnover of Rs 600 billion (US$15bn), while export-import trade is worth Rs 130 billion (US$3.2bn) per annum. These figures

Table 9.1: India's Position in World's Area & Production of Oilseeds (2003)										
Oilseeds	Area		(in percent) Share	Rank	Next to	Production '000 MT		(in percent) Share	Rank	Next to
	World	India				World	India			
1.Groundnut	26463	8000	30.2	I	-	35658	7500	21.0	II	China
2.Safflower	743	350	47.1	I	-	648	157	24.2	I	-
3.Castor	1163	625	53.7	I	-	1144	580	50.7	I	-
4.Linseed	2456	459	18.7	I	-	2091	173	8.3	III	Canada China
5.Sesame	6566	1940	29.5	I	-	2942	620	21.1	II	China
6.Rapeseed	22943	4419	19.3	II	China	36146	3842	10.6	III	China Canada
7.Sunflower	22333	1940	8.7	IV	Russia Ukraine Argentina	27740	1220	4.4	IX	Argentina Russia Ukraine US China France Romania Spain
8.Soya bean	83695	6450	7.7	IV	Brazil Argentina China	189234	6800	3.6	V	US Brazil Argentina China

Source: Oilseeds Situation: A Statistical Compendium, 2005 published by Directorate of Oilseeds Research, (ICAR) Hyderabad, Table 1.4 pp..

account for about two percent of GDP and 17 percent of the value of agricultural output, claiming just two percent of total export-import bill for the country. Three oilseeds – groundnut, soyabean and rapeseed/mustard together – account for over 80 percent of aggregate cultivated oilseed output. Cottonseed, copra and other oil-bearing material too contribute to domestic vegetable oil production.

There has been a significant improvement in the productivity and yield rates in India during the period 1986-2003, with the rate of increase reaching 133 and 76 percent respectively. The area under the oil seed production rose by 25 percent during the same time. The nine oilseeds crops in terms of area, production and productivity growth (yield) during 1980 to 2004 period have shown a mixed performance. While the performance of the oilseed sector during the first phase (1980-81 to 1989-90) made the country self-sufficient in oilseeds, the second sub period (1999-91 to 1999-2000) has seen a clear slow-down in output growth by 1.42 percent, for reasons like slow growth in irrigation availability to such crops etc. Again, during the sub-period there has been an impressive improvement in yield rates (5.95 percent) giving rise to significant growth in the output of oilseeds (6.14 percent). Starting from the 1970s, the Indian oilseed sector was dominated by the production of groundnut and rapeseed-mustard

Table 9.2: Area, Production and Yield of Nine Oilseed Crops in India			
Year	**Area Million hectares**	**Production Million Tonnes**	**Yield kg/ha**
1950-51	10.73	5.16	481
1955-56	12.09	5.73	474
1960-61	13.77	6.98	507
1965-66	15.25	6.40	419
1970-71	16.64	9.63	579
1975-76	16.92	10.61	627
1980-81	17.60	9.37	532
1985-86	19.02	10.83	570
1990-91	24.15	18.61	771
1995-96	25.96	22.11	851
2000-01	22.63	18.43	791
2003-04	23.69	25.29	1067

Source: Oilseeds Situation: A Statistical Compendium, 2005 Published by Directorate of Oilseeds Research, (ICAR) Hyderabad. Table 1.2 pp.1
Note: The nine oilseed crops are Groundnut, Safflower, Castor, Linseed, Sesame, Rapeseed, Sunflower, Soyabean and Niger.

production. However, from the beginning of this century the growth performance is led by soyabean followed by rapeseed-mustard and groundnut.

Oilseed crops account for about 14 percent of the gross cropped area in India. Madhya Pradesh is the leading oilseed producing state and accounts for 21.4 percent of the total oilseed production in the country followed by Gujarat (17.8 percent), Rajasthan (15.1 percent), Maharashtra (10.7 percent), and Andhra Pradesh (7.8 percent). The rest of the states account for the remaining 27.2 percent of the total oilseed production. Nevertheless, cropped area, production and yield of oilseeds in India have been fluctuating because of several biotic and abiotic stresses affecting the crops. Another important factor contributing to insufficient domestic production/productivity of oilseeds has been the small area under irrigation, which has increased by merely three percent in the last decade from 23.2 to 26.3 percent. India's domestic price support programme, which has often favoured production of crops that compete for area with oilseeds, is also responsible for this scenario.

9.3 Import Policies

Import policies have played a key role in determining the overall level and type of India's edible oil imports for decades. Although significant imports were permitted prior to 1994, they were controlled directly by the State Trading Corporation (STC) and subject to import quotas. In 1994, the import regime changed fundamentally when, as part of its obligations under WTO rules, India eliminated the state monopoly on imports

and placed imports under the Open General License (OGL) system. Under the new rules, India agreed to eliminate import quotas and placed upper 'bound' (maximum) limits on tariff levels. These changes made the rules governing edible oil imports more transparent and imports more responsive to market forces.

WTO Agreement on Agriculture & its Implications on the Oilseeds Sector

In accordance with the flexibilities given to India under the WTO Agreement on Agriculture (AoA), India was permitted to offer ceiling bindings instead of tariffication, which were not subject to the reduction commitments. India bound its tariffs at 100 percent for primary products, 150 for processed products and 300 percent for edible oils. India initially bound its tariffs for 683 agriculture commodity lines at 6–digit HS classification. India was initially allowed to maintain QRs in agriculture products on account of balance of payment (BoP) problems. However, due to its improved BoP position during 1999-00, India lost the plea for retention of QRs and accordingly removed QRs on 714 items, including 142 commodities belonging to the category of the agriculture commodities. India further removed the QRs on the remaining 715 items by March 2001, which included 42 groups belonging to agriculture. India did not have any market access commitments and was also not entitled to use the Special Safeguard Measures (SSG) of the AoA.

After QRs were removed in 1999, India was allowed to renegotiate the tariffs bindings on those commodities for which it had very low or zero tariff bindings. The tariff binding levels were suitably revised upward to provide adequate protection to the domestic producers. Out of these low bound tariff lines, bindings on 15 tariff lines, included rapeseed, colza or mustard oil etc, were revised to a level ranging from 45 to 75 percent.

Export subsidies of the kind listed in the AoA are not extended to India. The only subsidy available to Indian exporters of agricultural commodities are in the form of income tax exemptions on the profits from export sales and subsidies on the cost of freight of certain products like fruits, vegetables and floricultural products. Under domestic support given to the agricultural sector, the only measure that is relevant for the calculation of the product specific support in India is the market price support, since the other two namely the Non-Exempt Direct Payments and other Product Specific Support do not constitute a significant proportion of support. At the 6th WTO Ministerial in Hong Kong, India gained in terms that both the state governments and the central government would be free not only to continue with the existing subsidy programmes but also to increase the same. India is also allowed to provide transport and marketing subsidies for exporting of agriculture products till the end of 2018.

Under WTO, India can impose a tariff up to 300 percent on imports of palm oil, sunflower, cotton and others and up to 100 percent on vegetable oils, except for soyabean and rapeseed oil and sunflower and safflower oils, for which maximum tariff is fixed at 45 and 75 to 85 percent respectively. Presently, imports of edible oils are made under OGL at 45-85 percent import duty. The maximum tariff ceilings bindings established by India for the oilseed sector is much below the bound tariff for Refined Bleached Deodorised (RBD) and palmolein.

In 1995-98, India's tariff structure was relatively simple and increasingly liberal – with a common applied *ad valorem* (percent) tariff for all oils progressively lowered to uniform rate of 16.5 percent by the middle of 1998. With the surge in imports of edible oils, Indians began making frequent tariff adjustments since 1998 onwards with a view to slow the growth of imports and protect domestic oilseed growers and processors from imports and smooth the effect of fluctuating world prices on domestic consumers.

The tariff hikes also made the tariff on soyabean oil increasingly preferential since tariff on palm, rapeseed and sunflower oils could be raised well above the 45 percent tariff binding on soyabean oil. In addition to adjusting tariffs, the government established a Tariff Rate Value (TRV) system for palm oil in August 2001 and for soyabean oil in September 2002. The TRV system is intended to prevent under-invoicing (reporting low import prices to evade tariffs) by importers and establishes a government reference price for tariff calculations.

Oilseed and Edible Oil Scenario in Rajasthan

Rajasthan is the third largest oilseed producing state in India with a share of 15.1 percent of the total oilseed production in the country. Rapeseed-mustard and groundnut are the two principal oilseeds crops raised in all 32 districts in the state. Other oilseed crops include soyabean and taramira, sesasum etc. Groundnut and soyabean are the major *kharif* crops largely dependent on rainfall conditions while rapeseed-mustard and taramira is important *Rabi* crop in Rajasthan.

The state claims first position in the production of rapeseed-mustard in India with a share of 45 percent. The area under oilseeds, especially under rapeseed-mustard has increased over the years starting from the early 1970s. Application of technology in agriculture as initiated in the country had a positive impact also in this state through an increase in the yield per hectare. Along with this, there also has been a significant qualitative improvement in the oilseed production in the state. The irrigated area as a percentage of the total area under rapeseed-mustard also increased significantly from 64 percent during triennium ending (TE) to 78 percent in TE 2001-02. In addition to it, use of fertilisers, plant protection and agronomic practices have considerably improved.

The contribution of the oilseeds like groundnut, rapeseed-mustard, sesame etc., in the incremental output of oilseeds was almost 80 percent and the percentage share has increased subsequently till 1980s. However, during the 1990s the oilseed situation in Rajasthan changed with soyabean as *kharif* crop emerging as a significant one, capturing the share in incremental output during TE 2001-02 almost equal with that of rapeseed-mustard. Soyabean became an important crop in the state with its share in the total agriculture output reaching a significant high of 21 percent during TE 2001-02. The share of rapeseed-mustard in total oilseed production declined from 70 to 66 percent during the same period.

Rajasthan alone contributed 15.5 lakh tonnes or 49 percent of the incremental production of oilseeds between the TE 1980-81 and TE 1990-91 in the country. The significant increase in the oilseed production in Rajasthan during the period 1980-81 and 2001-02 however came about largely at the cost of pulses and to a lesser extent of cereals. There has been a replacement of crops within the oilseeds with production of sesamum,

linseed and taramira experiencing significant decline in the production in favour of rapeseed-mustard and soyabean. However, the cost of production of the oilseeds during the period 1980-81 and 2001-02 did not increase in Rajasthan.

Out of the 21 districts in India which were predominant in the area and production of rapeseed-mustard production in 1985-86, 12 were from Rajasthan. In 2001-02, out of 28 districts in India producing rapeseed-mustard, predominantly 13 were from Rajasthan. Ganganagar district of Rajasthan continued to hold the number one position in the country in terms of both area and production of rapeseed-mustard, capturing 5.23 percent of area and 5.42 percent of the country's total production of rapeseed-mustard. The other districts in Rajasthan important for the rapeseed-mustard production include: Alwar, Bharatpur, Bhilwara, Chittorgarh, Dholpur, Jaipur, Jalore, Kota, Nagaur, Pali, Sawai Madhopur and Tonk.

The area under rapeseed-mustard at the district level in Rajasthan has been unstable as district wise rainfall has been uneven and uncertainty affecting the irrigation available and the sowing area under the crop. There has also been a shift from rapeseed-mustard other crops offering better remunerative prices to the farmers, such as soyabean and to other horticulture and fodder crops. Post-harvest management plays a crucial role both in the oilseeds and edible oil economy in the state, since it affects the prices received by both the grower and the processor of oilseeds and also the consumer whose preference dictate farming as well as processing of particular oilseed/edible oil.

9.4 Survey Results & Analysis

For this study, a field survey was carried out in eight districts of Rajasthan. Five districts (Alwar, Bharatpur, Sawai Madhopur, Baran, Ganganagar) have the largest sown area and largest producers of rapeseed-mustard crop and the other three major districts (Jaipur, Bikaner, Chittorgarh) have the highest sown area and production of groundnut crop. The survey was carried out in 16 blocks covering 80 villages and 800 households spread over these eight districts of Rajasthan.

The study highlights that literacy played a vital role in terms of enhancing productivity through adaptation of new and scientific cultivation, including education playing a significant role in making one's mind so that adaptability to new machines becomes easy and economical. Most of the farmers are found to be illiterate with maximum illiteracy in Sawai Madhopur. Only about 34 percent of the respondents had schooling up to primary level, another about 30 percent had it up to school level and the rest meager 6 percent of the respondents were college attendants. The illiteracy rate was higher (41percent) amongst groundnut growers and Jaipur district tops with 43 percent due to the fact that 44 percent of the interviewed farmers belonged to the Other Backward Caste (OBC) category, among which schooling is not considered to be important. The average family size was the highest in Jaipur district with 12 persons per household, while it was the lowest in Bharatpur district with 06 persons per family. In other districts, the family size stands at an average of 08.

The households are predominantly occupied in agriculture with maximum percent. The other occupations were related to services, self-business and casual labour. These agriculture households were having subsidiary occupation related to animal husbandry

(30 percent), casual labour (7 percent) services (2 percent) and others. 45 percent of the farmers have average land holdings as marginal as less than 2 hectares, 32 percent had a small holding between 2-5 hectares, while only less than 10 percent farmers had large holdings of above 10 hectares. The average size of a farm is still for groundnut growers as compared to rapeseed-mustard growers. Nearly 72 percent of the respondents reported fragmented farms with small farms located at more than one place. The problem of fragmentation of holdings was more acute in Baran, Bharatpur and Sawai Madhopur. In Baran, 89 percent of the farms receive irrigation mostly from tube wells. Bikaner and Chittorgarh districts receive less irrigation. Bharatpur, Alwar and Ganganagar districts raise rapeseed-mustard cent percent with irrigation facility.

The households producing rapeseed-mustard earn more (total as well as hectare) compared to groundnut. Only 27 percent of the farm families in the project villages surveyed for rapeseed-mustard earned annually up to Rs 50,000 (US$1,250) from agriculture. This was 37 percent for groundnut. Nearly 1/3 of the rapeseed-mustard and slightly less than a quarter of the growers were reported earning annually between Rs 50,000-1,00,000 (US$1,250-2500) respectively for rapeseed-mustard and groundnut. 16 percent of the families for both the crops were earning more than Rs 1,50,000.(US$3,750). The earning levels of the marginal farmers are very low with more than 60 percent of such families falling under below poverty line (BPL) norm. This percentage is much higher in Bharatpur and Chittorgarh districts. An important observation of the field study is that farmers in remote and relatively backward areas/districts were found to be more enthusiastic about the introduction of new crops and even hybrid seeds compared to relatively rich districts.

Nearly in all parts of the state, the impact of modern machinery such as tractor, thrashers etc., is visible. Farmers of the relatively affluent districts such as Ganganagar, Jaipur and in some parts of Alwar own these machineries, while a majority of the farmers in all these districts secures farm machinery on rent. Nearly 45 percent of the farmers are using hybrid seeds and the other 65 percent surveyed use both hybrid and indigenous seeds. The average consumption of the chemical fertiliser has also gone up to nearly 32 kg per hectare in the project area. Farmers raising rapeseed-mustard are using more fertilisers and pesticides. Nearly 89 percent of the farmers use plant protection measures. Storage facility is available to nearly 65 percent of the farmers growing rapeseed-mustard and groundnut. Most of the farmers reported non-availability of government warehouse, some farmers who reported availability state that government warehouses are very expensive and red tape and corruption are rampant. About 96 percent of the farmers are benefited by credit facility, most credit (nearly 63 percent in case of rapeseed-mustard and 39 percent for groundnut) was made available through the cooperative societies. The other sources of credit are regional rural and commercial banks.

The regulated markets (*Mandis*) are becoming an increasingly important method of marketing for rural farmers in Rajasthan. More than 57 percent of the farmers are going to *Mandis* to sell their produce. The government purchase mostly through cooperative societies is limited to only 18 percent. About 1/5 of the farmers have to sell their produce immediately after the harvest to the local trader as their retention power is extremely limited owing to the pressure of the moneylender to repay old debts and non-availability of storage facilities.

Almost all farmers are ignorant about WTO AoA. However, when informed that their yields rates are low and the cost of production is high and these two factors will not sustain in the new trade regime, as the imported oil seeds are cheaper- all these questions/ information suddenly put them in quandary. They felt that if irrigation, electricity, seeds fertilisers, pesticides and extension services etc., are provided in the right quantity and quality and on time, they will be able to withstand the pressure.

Most of the surveyed rural and urban people consume rapeseed-mustard oil as their staple edible oil. Almost 92 percent of the total surveyed rural consumers buy edible oil in loose form. In urban areas nearly 1/3 of the surveyed consumers buy loose oil. More than 60 percent of the urban consumers are now buying oil in packed form. Nearly 44 percent of rural and almost same percentage of the urban households go for non-branded oil products. As regards the choice of domestic *vis-à-vis* foreign (imported oil), 47 percent rural and 60 percent of the interviewed prefer imported oil, if available cheaply. Both in rural and urban areas, price plays the dominant determinant for buying oil, followed by quality consideration and other factors.

Regarding the awareness about WTO AoA, 68 percent of the urban and 80 percent of the rural consumers did not hear about such developments. However, both urban and rural consumers are in favour of an opening up of edible oil trade to export and import. At the same time, they also suggested a variety of measures like subsidies to domestic firms, technology assistance by the government, raising the scale of operation of domestic firms, reduction of taxes, etc., to boost the domestic oilseed sector.

Impacts of WTO AoA on Oilseeds/edible Oil Sector in Rajashtan

In this section[1] we discuss the likely impact of the dismantling of the QRs on oilseeds/ edible oil sector on the Indian agriculture, in general, and Rajasthan state in particular[2]. India is a vast country and its agriculture production pattern and level of economic development varies considerably across states. Similarly, the consumption pattern also varies across states. In some states, rice is the main staple food while in others wheat is a prominent foodstuff. The crop patterns varies considerably across states and different states specialise in the production of different crops. Therefore, the impact of trade liberalisation is bound to affect different states in different ways.

Ramesh Chand and D Jha (2001) have made an attempt to estimate the impact of trade liberalisation (inclusive of dismantling QRs) for selected crops and crop groups such as cereals, pulses and oilseeds and have found that the import liberalisation of edible oil is found to have the worst impact on Gujarat, closely followed by Madhya Pradesh and Rajasthan. The impact of trade liberalisation is to show the price of rapeseed/ mustard oil at a wholesale level and the price of rapeseed/mustard seed at the farm level. Kanpur in Uttar Pradesh was selected as the reference market for analysing the impact of trade liberalisation on the wholesale rapeseed/mustard *vis-à-vis* the price of rapeseed-mustard oil, and Rajasthan for analysing the impact of trade liberalisation on farm level prices.

The impact is studied under both state scenarios, namely liberalisation at actual import and international prices. India paid Rs 23418 (US$508) per tonne of imports of rapeseed/ mustard oil while the price in the domestic market was Rs 31608 (US$685). When

transportation and other costs involved in taking the produce from port to reference market (Kanpur) are added, then the price of imported oil increased to Rs 25372 (US$550), which is still about 20 percent lower than that in the domestic market. Liberalisation of trade, which brings an equilibrium between existing cost, insurance and freight (CIF) and domestic prices would raise the domestic wholesale price of rapeseed/mustard oil by about 20 percent and farm level prices of rapeseed/mustard seed by 14 percent (Ramesh Chand and D Jha, 2001, pp. 66).

The impact of trade liberalisation on rapeseed/mustard is studied under the 'importable' hypothesis. In the first scenario, when domestic prices are depressed by import liberalisation to bring them in line with the actual CIF prices, rapeseed/mustard producers suffer a loss of Rs 1093 billion (US$27.3bn) due to the decline in the price of rapeseed/ mustard seed. On the other hand, a decline in the price of rapeseed/mustard oil due to liberalisation increases in consumer surplus by Rs 1177 billion (US$29.4bn). This way, the liberalisation of rapeseed/mustard oil imports results in a net social gain of Rs 843 million (US$21mn). India has been importing rapeseed/mustard oil at a price which is about 8.5 percent higher when compared to CIF price (corresponding to international prices).

When domestic prices are adjusted downwards to be in line with the international price, the net social gain increases to Rs 142 billion (US$3.5bn). India continues to be attractive for imports as domestic prices are higher than international prices. Even when moderate tariffs are imposed on import of edible oils, the level of the international price of these oils is making it difficult for domestic producers to compete. During the last 20 years or so, the government implemented various programmes and schemes which were aimed at raising the output of edible oils and also attain self-sufficiency in such oils. Farmers have responded positively to various incentives brought about by these programmes and there has been a significant increase in the output of edible oils, which has resulted in expansion in oilseed area and yield. The growth in oilseed crops has largely occurred in agriculturally backward areas where the green revolution could not have much impact and where there was not much potential for other alternatives.

The new trade regime involving the removal of physical restrictions on imports has posed serious challenges to these oilseed growing areas (especially in states like Rajasthan). One reason for domestic prices being considerably higher than international prices seems to be the high level of subsidies given to producers in edible oil exporting countries of Europe. Though some input subsidies are given to producers in India, input subsidies given for oilseeds are very small. According to yet another study by R Chand (1999), oilseed production in India receives less than one-fourth of the input subsidy for rice. Until the level of farm subsidies in exporting countries is brought down to relatively comparable standards. India should impose a moderate tariff on the imports of edible oils. There is also a need to look into the R&D aspect for reducing the cost of production of oilseeds in the long run (Chand, 1991).

Box 9.1 Steps to be Taken by the Government of India in Promoting Oilseeds Production
1. The Government of India can ban or restrict the import of palm oil. This oil is being imported in crude form to save higher custom duty levied on refined palm oil. The disproportionate tariff value on Crude Palm Oil (CPO) has resulted in multiple distortions in the market, imbalance in the prices of palm oil and other oils and thereby loss of economic efficiency. Therefore, the custom duty on CPO needs to be increased. 2. Exempt oilseed and its derivates from Sales Tax like rice bran oil. 3. Increase palm plantation and popularising the usage of edible rice bran oil 4. To stop excess import of oils, particularly CPO, Government of India should levy safeguard duty provisions and if required review it from four percent to more, to protect domestic market. 5. A committee should be formed comprising members from the Government and the industry to review the demand and supply of edible oil from time to time and fix the custom duty structure to avoid unnecessary import.

9.5 Consumer Perception Survey

The success of any economic policy depends ultimately on how people (the consumers) are affected and how they view the changes. If the policy change is related to their food consumption (the necessities) such as edible oil, which is an integral part of the consumption basket of every consumer, then the success of any policy change will largely depend upon their responses. Since dismantling the QRs on imports of oilseeds and edible oils there emerged a greater competition between the domestic producers and the foreign ones and as a consequence prices of edible oils react very sharply and in the process prices do get reduced which benefit the consumers who are now able to buy edible oils by spending less. Edible oils have a large number of substitutes and preferences of the consumers decide the demand for a particular type or variety of oil, therefore, consumers' perception to the edible oil scenario is worth analysing under the backdrop after coming into force of the WTO AoA (since January 2005).

The consumption basket differs substantially between rural and urban consumers, but edible oil is a necessary item to both types of consumers. The preference for a particular edible oil differs greatly across rural and urban areas. Inhabitants of several regions of India have developed specific preference for certain oils largely depending upon the oils available in the region. For example, people in the Southern and Western part of the country prefer groundnut oil while those in the East and North use mustard-seed/ rapeseed oil. Likewise, several pockets in the South have a preference for coconut and sesame oil. Inhabitants of the Northern plain are basically hard fat consumers and therefore prefer *Vanaspati*, a term used to denote a partially hydrogenated edible oil mixture. *Vanaspati* has an important role in India's edible oil economy. It has the ability to absorb a heterogeneous variety of oils, which do not generally find direct marketing opportunities because of preference of the consumers for traditional oil such as groundnut , mustard, sesame oil etc. For example, newer oils like soyabean, sunflower, rice bran and cottonseed and oils from tree and forest sources have found their way to the edible pool largely through *Vanaspati* route.

Of late, things have changed. Through technological means such as refining, bleaching and de-odourisation, all oils have been rendered practically colourless, odourless and tasteless and therefore, have become easily interchangeable in the kitchen. This modernisation process has resulted in adulteration and made edible oil highly lucrative for unscrupulous traders and businessmen who with great ease mix low quality cheaper edible oil with high quality costly edible oil. For example, one kg of pure high quality mustard oil Rs 40 per kg (US$0.86) can easily be mixed in a tin of 14 kg of palm oil at Rs 24-25 (US$0.52-0.54) per kg and the trader is able to sell the palm oil tin as mustard oil at Rs 40-45 (US$0.86-0.97) per kg to the consumer, who would not be able to distinguish the difference and in the process get cheated by paying as much as 40-45 percent higher price than originally required and that too for an adulterated one[3]. When this kind of corrupt and unscrupulous trade practice was explained to both rural and urban consumers, (no one knew about it before) they were caught by surprise.

The urban and rural consumers were surveyed separately, the reason being the perceptions, marketing practices, choice of oils, price sensitivity, and the likes differ greatly between two types of consumers. The farm households in rural areas, which were surveyed for rapeseed-mustard and groundnut, 50 percent of them were included in a rural consumer survey and the other 50 percent were non-farming households which were occupied as agricultural labourers, cottage industry workers, government servants, traders etc.

9.6 Summary, Conclusions and Recommendations

India attracted over 15 percent of global vegetable oil imports in 2002-03, making it the world's leading importer, ahead of the EU and China. Imports represented about 55 percent of India's edible oil consumption and about half the value of its total agricultural imports. With more than a billion consumers – with a pattern of sustained economic growth – imports are likely to remain an important source of supply for India's growing edible oil consumption. Its actual level of imports though will continue to be influenced by important trade policy changes adopted in the mid-1990s, as well as other policies that have contributed to inadequate domestic oilseed production and an inefficient processing sector.

Reflecting on the importance of policy developments, India's ascendance from a relatively small importer of edible oils in the mid-1990s to the world's leading net importer since 1998 was quite rapid. Currently, India accounts for seven percent of the world's oilseed output, seven percent of the world's oil meal production, six percent of the world's oil meal export, six percent of the world vegetable oil production, 14 of the world's vegetable oil import and 10 percent of the world's edible oil consumption. With a steady growth in population and personal income, Indian per capita consumption of edible oil has been growing steadily. However, oilseeds output and in turn, vegetable oil production have been trailing consumption growth, necessitating imports to meet supply shortfall.

In the late 1980s and early 1990s, India pursued self-sufficiency in vegetable oil production, but trade policy reforms in the mid-1990s, followed by declining domestic oilseed production, fuelled the resurgence of imports. As a result, total vegetable oil imports – mostly palm and soyabean – rose from an annual average of about 0.3 million tonnes in 1988-89 to 1993-94 to 5.2 million tonnes in 1998-99 to 2002-2003.

India's vegetable oil economy is the world's fourth largest after US, China and Brazil. Oilseed cultivation is undertaken across the country in two seasons, in about 26 million hectares, mainly on marginal lands, fully dependent on monsoon rains (un-irrigated) and with low levels of input usage. Yields are rather low at less than one tonne per hectare. The Indian oilseed sector accounts for domestic turnover of Rs600 billion (US$15bn) while export-import trade is worth Rs130 billion (US$3.5bn) per annum. Three oilseeds, groundnut, soyabean and rapeseed-mustard together account for over 80 percent of aggregated cultivated oilseed output. Cottonseed, copra, and other oil-bearing material too contribute to the domestic vegetable oil pool. The Indian vegetable oil industry comprises over 15000 oil mills, 600 solvent extraction units, 650 refining units and 250 *Vanaspati* units, employing directly and indirectly over one million people across the country operating between 30-50 percent capacity.

Trade liberalisation affecting Indian agriculture began in the early 1990s with the progressive reduction or removal of trade restrictions of various types. The process accelerated from the late 1990s, especially after the decision of Dispute Settlement Body (DSB) of the WTO in 1999 declaring use of QRs unnecessary under the guise of BoP difficulty (which was no longer severe any more). The QRs on imports and export restrictions on groundnut oil, agricultural seeds etc., were all removed by April 2000. Almost all agricultural products are now allowed to be freely exported as per the current trade policy. The removal of QRs has been associated with a reduction in import tariffs except the in case of soyabean where the tariff levels have reached the bound levels. In any case, the optimism surrounding the signing of the Uruguay Round agreement was such that for a range of important agricultural commodities, including oilseeds, India had declared zero rates of tariff binding. After world trade prices of various crops started crashing from 1996 onwards, the Government of India was forced to renegotiate the bound tariff levels for as many as 15 agricultural items.

As Table 9.3 shows, that the tariff rates for most agricultural commodities were low or zero in the early 1990s, largely because QRs on imports rendered tariffs irrelevant, and also because world prices were substantially higher than Indian prices over that period. Subsequently, and especially after 2000, tariff rates have generally been coming down, and (except in the case of soyabean) have been significantly below the bound tariffs. What is possibly even more significant, however, is that tariff rates have been relatively stable despite tremendous volatility in world trade prices, so that Indian agriculturalists effectively had to deal with all the volatility of world prices.

The implications of such movements in actual tariff levels and bound tariffs are quite obvious, as Jayati Ghosh states, "……this meant that even as the uncertainties related to international price movements became more directly significant for farmers, progressive trade liberalisation and tariff reduction in these commodities made their market relations more problematic. Government policy did not adjust in ways that would make the transition easier or less volatile even in price terms. Thus, there is no evidence of any coordination between domestic price policy and the policies regarding external trade and tariffs. For example, an automatic and transparent policy of variable tariffs on both agricultural imports and exports linked to the deviations of spot international prices from their long-run desired domestic trends, would have been extremely useful at least in protecting farmers from sudden surges of low-price imports,

Table 9.3: Import Tariff Rates for Selected Agricultural Commodities (Percentages)							
Item	**1991-92**	**1995-96**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**Bound Tariff**
Non Basmati Rice	0	0	0	92	77	70-80	70-80
Wheat	0	0	50	108	100	50	100
Maize	0	0	0	60	50	50	70
Pulses	10	10	5	5	5	10	104
Oilseeds	*55*	*50*	*35*	*35*	*35*	-	*100*
Soyabean oil	45	30	18	45	38	45	45
Groundnut	45	35	18	35	35	75	300
RBD Palm oil	—	—	—	75	75	65	300
Refined Palm oil	—	—	—	100	85	75-85	300
Cotton	35	50	40	25	35	5	—
Sugar	35	0	40	100	60	60	150
Source: As given in Footnote-1							

and consumers from export price surges. Such a policy would prevent delayed reactions to international price changes, which allow unnecessarily large private imports. It would therefore, have allowed for some degree of price stability for both producers and consumers, which is important especially in dominantly rural economics like that of India".

The performance of any sector must be seen in the light of goals set for that sector. The main objective of the Indian agricultural policy, till the end of the 1970s was to achieve self-sufficiency in food grains. Up to the middle of 1960s, no positive policy for agricultural commodities was in place and till that time, the growth in output of both cereals and oilseeds were comparable; however the growth in output in both these crops were mainly coming from area expansion. In the post green revolution period, i.e. 1966 to 1980, the HYV of wheat and rice supported by use of yield raising inputs and a policy of assured market clearance at remunerative prices, which enhanced the pay-off from these cereals relative to technologically lagging oilseeds and pulses.

The irrigated and fertile land got diverted to wheat paddy and oilseeds – pulses were pushed to marginal land (SS Acharya, 1993, pp.332). Thus, the post green revolution period shows a clear and perceptible change of policy in favour of wheat rice, thus marketing choice between reduction in the imports of cereals and that of edible oils. It was indeed more rational for the country at that time to have increased the production of cereals rather than encouraging the production of oilseeds in the areas where higher yields of cereals could be obtained. The interaction of price policy and technology, which was a success story for wheat and rice in the 1970s, saw a replication in oilseeds during the 1980s. The government brought out policy changes in favour of oilseeds,

which were responsible for area expansion as well as yield enhancements of oilseed crops throughout the 1980s.

The growth rate of the production of oilseeds during 1981-82 to 1991-92 at 5.83 percent per annum was considerably higher than that of cereals or wheat and rice during the green revolution period. Apart from the impressive growth of production of oilseeds, there are some qualitative improvements, which included: (i) the contribution of improvement in yield per hectare to the growth of production has been substantial and the rate of growth of yield of mustard during the 1980s was more than that of rice and wheat during the 1970s or 1980s; (ii) the share of *Rabi* oilseeds including mustard whose production is subject to relatively lower fluctuations in the total oilseeds production has improved; (iii) substantial contribution in the incremental output has come from those states which do not have a comparative advantage in the production of cereals; (iv) the cost of production of mustard for those states which contributed the maximum in the incremental output of oilseeds has not increased in real terms during the last decade; and (v) the edible oil mix changed in favour of those oils whose cost of production is relatively lower.

There is now a lively debate over the changes in the cropping pattern that have taken place in the country in the last two decades or so and which have gone in favour of non cereal crops giving rise to deceleration in the growth of cereal output, a concern related to the country's food security as well. The expansion in area under oilseeds has occurred mainly through the increase in the cropped area and also through displacement of low yielding coarse cereals.

There are some serious challenges on the foreign trade front, particularly at the import front. With regards to cereals, when international prices drastically decrease, imports to India can become quite attractive thus causing an abrupt fall in domestic price. If such shocks are transmitted to farm level prices, they would destabilise both the crop pattern and supply. Such volatility would cause uncertainty in crop income and may result in a cobweb-like situation (Ramesh Chand and D Jha, 2001, pp.106). The vast majority of Indian farmers are either small or marginal; therefore do not have the resources or the capability to jump from one kind of crop pattern to another kind year after year. The cost of making such shifts in terms of crop-specific farm investments, arranging seeds and other inputs and production and marketing skills would be prohibitive for such farmers. Since under WTO obligations such temporary shocks cannot be checked through QRs, there is a need to be alert so as to impose appropriate tariffs to regulate unwanted imports.

It is argued that international prices of edible oils are considerably lower than domestic prices. Even when moderate tariffs are imposed on imports of edible oils, the level of the international price of these oils is making it difficult for domestic producers to compete. Some analysts attribute this difference to the inefficiency of official agencies that alone, until recently, were allowed to import oil. However, it may be mentioned that CIF import prices were found to be invariably higher even when private traders imported these oils. Ramesh Chand and D Jha further state (2001, pp.107) that during the last 10-15 years, the government implemented several programmes and schemes, which were aimed at raising the output of edible oils and attain self-sufficiency in such oils. Farmers

have responded positively to various incentives brought about by these programmes and there has been a significant increase in the output of edible oils.

The growth in oilseed crops has largely occurred in agriculturally backward areas where the green revolution did not have much impact and where there was not much potential for other alternatives. The new trade regime involving the removal of physical restrictions on imports has posed serious challenges to these oilseeds growing areas. The import tariff on products such as edible oils thus needs to be carefully monitored and maintained at reasonable levels, as these commodities are generally produced by resource-poor dry land farmers (like Rajasthan). One reason for domestic prices being considerably higher than international prices seems to be the high level of subsidies given to producers in oil exporting countries of Europe. According to a study by Ramesh Chand (1999), oilseeds production in India receives less than one fourth of the input subsidy of rice. Until the level of farm subsidies in exporting countries is brought down to relatively comparable standards India should impose a moderate tariff on the import of edible oils. There is also a need to look into the R&D aspect of reducing the cost of production of oilseeds in the long run.

References

Acharya, S S (1993), "Oilseeds and Pulses – Price Policy and Production Performance", Indian Journal of Agricultural Economics, July-September 1993, pp.332-333

Ghosh, J (2005), "Trade Liberalisation in Agriculture: An Examination of Impact and Policy Strategies with Special Reference to India", Occasional Paper, Human Development Report, 2005

Chand, R and Jha, D (2001), "Trade Liberalisation, Agricultural Prices and Net Social Welfare", in *Indian Agricultural Policy at the Crossroads*, edited by Acharya, SS and Choudhari, DP, Rawat Publications, Jaipur

Endnotes

1 For details see Ramesh Chand and Dayanatha Jha, "Trade Liberalisation, Agricultural Prices and Net Social Welfare" in Indian Agricultural Policy at the Crossroads, edited by SS Acharya and DP Choudhari, 2001, Rawat Publications, Jaipur, Chapter 2, pp.17-126

2 Though there is no attempt to quantify, through appropriate econometric tools the impact of QRs dismantling on the state's agriculture and oilseeds/edible oil sub-sector in particular, what we intend to do is to summarise the evidences so far available in the literature on the subject. There are a few empirical studies undertaken by SS Acharya, Ashok Lahiri, Ramesh Chand, D.P Choudhari, P Kumar, etc., which will be used to analyse the impact

3 As explained by one of the office bearers of Edible Oils Mills Association of Rajasthan to the Author

10 CHAPTER

Ready-made Garment Industry in Nepal

– *Manisha Pradhananga*

10.1 Introduction

The ready-made garment (RMG) industry has a special bearing in Nepal's economy in terms of both employment and export earnings. Its contribution to exports grew significantly during the 1990s, as a result of the quota system under the MFA. As the industry is labour-intensive and requires relatively low investment, it expanded rapidly. The RMG industry provided direct employment to a significant number of people. This chapter explores the trade and poverty linkages in Nepal by examining the experiences of the RMG industry.

10.2 Overview of the RMG Industry in Nepal

The application of the quota system under the MFA in 1974 was the main reason for the growth of the RMG industry in Nepal. In the early 80s Indian exporters, constrained by the lack of quotas, turned to Nepal and there was a sharp increase in the export-oriented garment manufacturers. As a consequence, the number of establishments rose sharply between 1986-87 and 1991-92 from 86 to 234 (see Table 10.1). The number of persons employed in the RMG industry also doubled during this period and reached 17260 in 1991-92.

However, the number of establishments and the people employed both declined between 1991-92 and 1996-97. A decline in the number of establishments was around 42 percent, and in 1996-97 RMG industry employed about 2000 fewer individuals as compared to 1991-92. However, the output during this period increased, which was perhaps due to an increase in productivity during this period. The increase in productivity (output per worker) is also reflected by the growth in average wages from Nepalese Rs 25,243 to 43,892 (US$402-700) 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 the Garment Association of Nepal (GAN), of which only around 25 are in operation.

Table 10.1: Key Indicators of the RMG 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	9.31
1991-92	234	17260	74	2528233	409160	23.71
1996-97	136	14848	109	3801673	374818	25.24
2001-02	115	18134	158	5771802	795932	43.89
Source: Census of Manufacturing Establishments, Central Bureau of Statistics						

After peaking in 1991-92, the number of establishments in the RMG 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 employees per establishment increased from 109 to 158 between 1996-97 and 2001-02. The average wages rose by 73 percent during the same period.

During the period between 1991 and 2002, at least 119 establishments left the RMG sector (the reduction could be due to mergers too). The decline mainly occurred in establishments having less than Nepalese Rs 10 million (US$159,403) worth of fixed assets. In this category, the number of establishments fell from 228 in 1991-92 to 84 in 2001-2. One popular misconception regarding the RMG sector in Nepal is that it employs mostly foreign nationals, mainly Indians. However, when we look at the numbers, this is not true 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 12 people employed by the industry was a not a Nepali citizen (see Table 10.2).

Table 10.2: Number of Employees by Nationality and Sex				
Year	Number of Employees (in percent)			
	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				

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

10.3 Contribution of RMG in Manufacturing and Exports

The export-oriented RMG 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 (see Table 10.3). At 26 percent, the share of this sector in manufacturing was still significant in 2003-04.

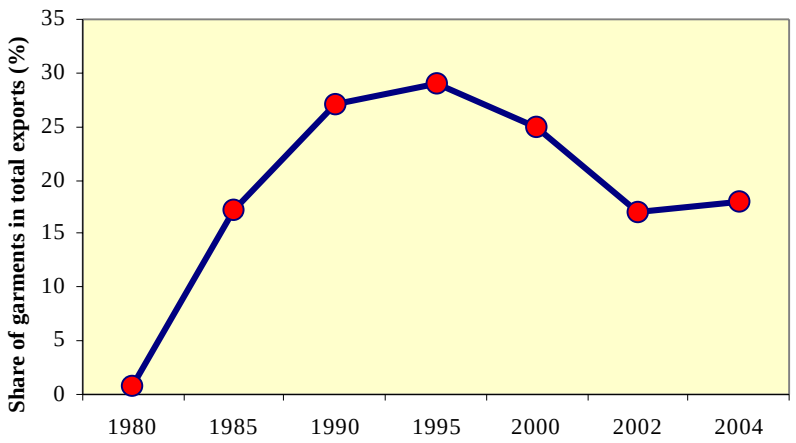
Table 10.3: Contribution of RMG Exports in Overall Manufacturing (Rs in million)

	1994-95	1996-97	1998-99	2000-01	2002-03	2003-04
RMG exports	5139	5955	9702	13125	11890	9550
Manufacturing exports	19555	24816	30337	35495	34337	36634
Share in Manufacturing exports	26	24	32	37	35	26

Source: Economic Survey (2005)

RMGs have also occupied an important position in the exports of Nepal. Figure 10.1 shows the share of this sector in the total exports.The share of RMG in total exports was 17.7 percent in the year 2003-04. If we exclude exports to India, this figure stands at 41.3 percent of total exports[1].

Figure 10.1: Share of RMG in Total Exports



Source: Economic Survey and Various Nepal Rastra Bank Publications

10.4 Export Performance of the RMG Industry

Nepalese RMG exports grew dramatically from Nepalese Rs 8 million (US$127,520) in 1980 to Rs 13.9 billion (US$221.5mn) in 2000. The US has been the main destination market for Nepalese RMGs. In 1990-91, 93 percent of Nepalese RMGs were exported to the US. In 2000-01, the exports to the US were at 86 percent of the total RMG exports.

Nepalese RMG exports started to decline after 2000 (see Table 10.4). Exports in 2004 were only 57 percent of exports in 2000. Exports to the US also declined, and in 2004 it was only 52 percent of the exports in 2000. One main reason for this is said to be the preferential market access granted to SSA countries by the US under African Growth and Opportunity Act (AGOA) in 2000. The uncertainties and apprehensions regarding the possible post-ATC scenario also seem to have contributed to the gradual decline in Nepalese RMG 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 since January 2005. The total exports and the exports to the US in 2005 were 30 and 40 percent less compared to 2004.

The decline in the US share in total exports continued in 2005 and it has been estimated to be 67 percent of total exports (see Table 10.4). It was, however, not due to a 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 RMG was governed by separate bilateral agreements signed with the respective countries. The agreement relating to trade in cotton textiles and RMG products with the US was done in 1986. Since then, Nepal has also been 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 generalised system of preferences (GSP) for Nepalese textile products. Since 1997, Nepal has been facilitated by the derogation from the EU GSP RoO, and the EU twice at Nepal's request has renewed the provision. Nepal is also a beneficiary of the EU's 'Everything but Arms' (EBA) initiative which provides DFQF market access to all LDC products since 2001. This allows Nepalese exporters to enter into the EU market with only one-step processing.

Table 10.4: Value of Exports (in thousand US$)

Year	US	Canada	EU	Total	Share of US in total ` exports
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: GAN and Trade Promotion Centre
Note: # indicates Export of first 11 months of 2005

The 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 exports to the EU in 2004 were less than that in 2000. Canada also announced GSP treatment to all RMG exports originating from LDCs under the new scheme in 2003. Nepal has already signed a Memorandum of Understanding (MoU) with the Canadian Government for duty free privileges for export of Nepalese RMG to Canada.

As mentioned above, Nepalese exports to the US were based on quota and subject to an average 14.6 percent duty (Shakya 2004). However, it is noteworthy that looking at the quota utilisation rates, lack of quota was never a restrictive factor for Nepalese exports to the US. Nepalese RMG 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 RMG exports to the US accounting for 60 percent of the total RMG exports (Bajaj 2004, 4). However, the quota utilisation in all the products categories except for cotton trousers and shorts has been very low.

The lack of diversification in product lines in Nepal's garment export was basically due to a 'spill-over' effect. Whenever there was a 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 (see Table 10.4). 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.

10.5 Post ATC Export Performance

As expected, the decline in Nepalese RMG exports continued after the expiry of the ATC in December 2004. The total exports of RMG in the first 11 months of 2005 were 30 percent less than that in the same period in 2004. However, the change in volume during the same period was only 24 percent.

The volume of exports in September-October and October-November of 2005 was significantly higher compared to the same period in 2004. The change in value during the same period was much less and even negative in October-November 2005. This is an indication that the per unit price of exported RMG was decreasing. Between 2004 and 2005, the average per unit export price of RMG decreased from US$3.24 to US$2.97, a decrease of 8.4 percent. This was probably in response to the decrease in RMG prices in main destination markets due to cheaper exports from China. However, it is not clear whether this came from increased efficiencies of Nepalese manufacturers, a cut in the profit of Nepalese exporters or a change in products exported.

There has been a significant decline in the number of operating RMG manufacturers with only 90 industries registered with GAN and around 25 in operation at the end of 2005. Also, Nepalese RMG exports to the US in the first 11 months of 2005 were 40 percent lower than those in the same period in 2004. Nepalese exporters were not able to significantly increase exports to non-US markets in the first 11 months of 2005.

10.6 Constraints Faced by the Nepalese RMG Industry

Other than stiff global competition in the RMG 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. The constraints are discussed below.

Supply Side Inefficiencies

The supply side of the Nepalese RMG industry is impeded particularly by low productivity and higher transaction costs. One reason for higher costs of Nepalese exports is the use of outdated and non-competitive technology, including the lack of methods to rationalise production. Neither the government nor an individual establishment has taken any initiative regarding the adaptation of new technologies, unlike the governments in the neighbouring countries who have already initiated various kinds of measures, including funds to upgrade technology to cope with the situation. An example of this is the absence of a sophisticated computerised system for pattern making, designing or for cutting like the computer-aided design/computer-aided manufacturing (CAD/CAM) system, which is used worldwide for these purposes.

The relatively low labour cost is the only distinct advantage that Nepal has, but low labour productivity remains an obstacle to competitiveness. Studies have shown that, except for Bangladesh, the per hour labour cost in the RMG industry in China and India is higher than in Nepal, but the productivity of Nepalese workers is lower by more than half of the Chinese or Indian workers. Labour productivity in the RMG industry in Nepal is about 60 to 70 percent of that of Chinese workers (Shakya, 2004). Therefore**,** it is important to note that the low labour cost alone has little significance to reduce the output cost among Nepalese manufacturers. Furthermore, compared to the cost of imported materials, the labour costs constitute a relatively small portion of the total cost to the manufacturers. For instance, the component of labour in the total cost for making a garment in Nepal is only about 29 percent as against more than 60 percent 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 to similar costs in India and Bangladesh (Joshi, 2002).

Apart from low labour productivity, the competitiveness of Nepalese products is also hampered by high transaction costs, owing to inadequate transportation and logistic facilities, 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 procedure which requires both time and money. For example, the cost for logistics and transit is approximately 20 percent of the ex-work price for RMG, mainly due to higher

costs for air and sea cargo rates. Transportation costs of both raw material and finished products are 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 than 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). Being a landlocked country, Nepal is also in 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 RMG industry.

In this regard, the facilitated transit point, such as the efficient implementation of Inland Container Depot (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 percent after full implementation of the ICD facilities in *Birgunj*.

In sum, the ability of Nepali manufacturers to compete in the post-MFA world depends not on cheap labour 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 labour productivity and a dearth of skill manpower can be overcome by activating the existing textile-training centre under the Department of Cottage & Small Industry.

Inadequate Institutionalisation

The problems with regard to institutional and trade support services in the RMG sector primarily relate to poor information on international markets and prices, delivery efficiency and a complicated export-financing mechanism. The lack of a direct marketing network by Nepalese RMG companies has held up their capacity to directly access international products, markets 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 organisation 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 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 RMG sector, among other export-oriented industries, has to pay relatively higher bank rates and is subject to higher collateral requirements than 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 materials 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 face administrative hassles to benefit from this facility. If the exports of RMG increase, then 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 facilities to these exporters.

Complicated Bureaucracy

A typical exporter faces several bureaucratic hassles ranging from acquisition of bonded warehouse facilities, bank guarantees and rebates on Value Added Tax (VAT). For instance, in order to release the bank guarantee, the new provision requires RMG exporters to get two separate recommendations, viz. 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 recognising 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 percent of the total production, the Department of Internal Revenue seeks 90 percent 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.

Stringent Labour Law

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

Lack of Backward Linkages

The share of imported inputs for manufacturing RMG in Nepal is relatively large. The industry depends on almost all imported materials such as zippers, buttons, 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 two percent, as they do not meet international buyers' requirement, *vis-à-vis* the standardised size and consistency in quality and colour. 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 has created difficulty of operation, and sometimes mismatching or creating shortages between imports of the materials and their requirements.

The establishment of the basic types of ancillary industries is important to add more value to the industry's output on 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 RMG industry cannot sustain without giving priority to efficient domestic ancillary suppliers in the long run if it wants to maximise the gain from preferential market access, which seeks the preferential RoO. For enhancing these types of ancillary industries, the industrial policy should treat the supply made by domestic ancillary industries to RMG industry as exports, based on authenticity. Such policy is expected to encourage low-cost ancillary industries needed for garment manufacturing.

10.7 Impact of Quota Phase-out on Poverty

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 comes from low-caste families and about half the workers are women. In order to empirically assess the conditions of workers, South Asia Watch on Trade, Economics & Environment (SAWTEE), Nepal, carried out 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 respondents were in the age group 20-30 (46 percent) and 30-40 (34 percent). About 40 percent of the interviewees had attended just primary level education or below, with almost five percent not being able to read and write. This shows that the T&C 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 covered the duration that spans over 10 years under which the employees left their work in the RMG factory. However, almost 80 percent of the unemployment occurred within the last four years, and other 10.5 percent of the total past employees left during the last 5-7 years. Among the total number of respondents, 73 percent were forced out of employment in the RMG factory, while the remaining 27 percent left the job willingly. Out of the total employees surveyed, 66 percent cited closure of the RMG factory as the major reason for leaving, while 26 percent expressed dissatisfaction with their work in the RMG factory due to low and late distribution of salary, poor working conditions, irregular and at times lack of work.

Relation between Unemployment in the RMG Sector and Removal of Quota

The sample data indicated that about 60 percent of all interviewees left their work at the garment factory during the last two years. This drastic rise in unemployment in the RMG sector during the last 2 years coincided 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 were removed. This is evident from the sharp fall in employment (of 60 percent) following the end of ATC on January 01, 2005.

The loss of employment in the RMG factory as a result of the 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 RMG factory during the last two years. While the closing of the RMG factory is a direct result of ATC phase-out, low salary might be its indirect effect. Salary in RMG factories is based on piece-rate. With an increase in production, the salary of the workers increases. Low salary, thus, might be a result of reduced production due to the removal of the quota system and hence the inability of garment factories in Nepal to compete in the international market.

Comparison of Monthly Wages

It appeared from the survey that only 30 percent of the RMG workers reported an increase in their basic wage during the post-ATC period, while 64 percent were of the opinion that there were falls in their wages. On average, 42 percent of the interviewees were under the poverty line of US$1 per day. This shows that there is not only a lack of employment opportunities in the post ATC period; but also a decrease in overall income across the employed workers.

Comparison of Expenditure

About 68 percent of the workers previously employed in the RMG sector felt that there was an increase in the expenditure allotted to food, while 17.3 percent mentioned that their food expenditure decreased. The main reason cited for the rise in food expenditures was growing inflation. Similarly, 60.9 and 47.4 percent of the workers were of the opinion that there were rises in housing and clothing expenditure respectively. However, 33, 30 and 48 percent reported a decrease in entertainment expenditure, remittance and savings respectively. These reductions were results of lower income and 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 females. Most of the employees (91.2 percent) were below 40 years of age. Among the female employees, 64.6 percent were below 30 years of age.

Income Status of Present Employees

A total of 23 employees (8.39 percent of a total of 274) reported their monthly income was below 2250 Nepali Rupees, which was less than US$1 a day. 16 out of 274 employees, 5.84 percent of the total, earned even less than Nepalese Rs 2000 per month (see Table 10.5). If measured by US$2-a-day a criteria of poverty line, 59.12 percent of the employees become poor (162 out of 274 employees). Only 14.59 percent of the RMG employees

Table 10.5: Monthly Income of the Employees		
Basic monthly salary	**Number of workers**	**Percentage**
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	274	100.00

earned more than 7500 Nepali Rs (US$100) per month. The findings are summarised in Table 10.5.

Impacts of Quota Phase-out on Present Employees

Table 10.6 suggests that 36.14 percent of the employees mentioned that their salaries were better during the survey period (after the quota phase-out) than in 2004 (before the full phasing out of the quota system). The major causes of such positive changes are up-gradation of their status (promotion), and increase in their efficiency (as they mentioned that they were more productive during the post-MFA period). However, 23.29 percent of the workers indicated that their salary level had decreased in comparison to their salary in 2004. Similarly, 40.56 percent of the workers pointed out that their salary level was unchanged.

However, given the fact that the prices of essential commodities went up, the real income of these workers decreased. 9.64 percent of the workers claimed that the working environment in RMG industry became worse during the post-MFA period. Similarly, 6.02 percent of the workers claimed worse factory management, 11.24 mentioned worse health conditions, 7.66 mentioned worse living conditions, 6.70 indicated worse children's' education, and 4.84 percent mentioned less social participation during the post-MFA period.

Though all of these factors cannot be cited as the direct results of MFA phase-out, the deteriorating income levels that were mostly associated with MFA phase-out, turned out to be the prime cause of such worsened conditions. Most of the workers reported worsening conditions in the most influential determinants of their well-being (salary, overtime work, overtime work rates and job contracts), that determined the total income of the workers and its stability. These four categories, i.e. salary, employment contract, overtime work and overtime rate are claimed to have worsened most after phasing out of the quota system.

Table 10.6: Workers Response on the Question "How do you compare the current situation of the following factors to 2004" (in percent)			
	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 & economic participation	23.79	4.84	71.37
Overtime work (number 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

The survey of both past and present employees of the garment factory reveals that the phasing out of quota has had an impact on the income status of the employees. In particular, those who lost their jobs due to the phase-out have had to cope with fallen incomes and rising expenditure. It is quite obvious that for workers who lost their jobs, the impact stretched beyond the individual level and affected their families, and in the larger context the welfare of the society as well.

10.8 Conclusion

The expiry of quota has resulted in a sharp decline in Nepalese RMG exports. The reduction in exports to the US, the major export market for Nepal, is significant. RMG exports to the EU market have not been affected as significantly as those to the US market. Nepal's quest for regaining its lost share in the international market is likely to be impeded by several demand and supply-side constraints. One of the major market access barriers facing the Nepalese RMG industry is the uneven playing field in the international RMG market. The US imposes high tariffs on Nepal's RMG exports, whereas it provides more favourable market access facilities to several other developing countries and the LDCs from the Americas and SSA countries.

A survey of the RMG workers conducted as part of the study reveals that despite the limited salary, benefits and unsatisfactory working conditions, jobs in the RMG sector have provided income security to the workers. The income was not only critical for sustaining the livelihood of the workers but also used in supporting their family members to fulfil their basic needs and make expenditures on sectors, such as health and education. This shows that the RMG sector has helped to advance the overall human development conditions of the workers and their families. The impact of the quota phase-out has been severe, particularly for women with limited educational attainments, as they have not been able to find alternate jobs.

References

Bajaj, Narayan (2004), "The Future of Garments Export After 2004 – Nepal Perspective", Paper presented at the workshop *'Business for Development: Challenges and Options for Governments and Business After the Adoption of the WTO July Package'*, Manila, Philippines, October 21-22, 2004

Central Bureau of Statistics HMG/N, Census of Manufacturing Industries 1986-87, Kathmandu: CBS

Central Bureau of Statistics HMG/N, Census of Manufacturing Industries 1991-92, Kathmandu: CBS

Central Bureau of Statistics HMG/N, Census of Manufacturing Industries 1996-97, Kathmandu: CBS

Central Bureau of Statistics HMG/N, Census of Manufacturing Industries 2001-02, Kathmandu: CBS

Sanjay D (2004), "Garment Quota Phase out: Clothed in Uncertainty", Spotlight Weekly, December 31, 2004 - January 06, 2005, Kathmandu

Gopal J (2002), "Garment Industry in South Asia: Rags to Riches?", ILO, New Delhi

Peter M (2002), "Changes in Global Trade Rules for Textiles and Garments – Implications for Developing Countries", USAID, Washington DC

Ministry of Industry, Commerce and Supplies/ HMGN (2004). Nepal Trade and Competitiveness Study. Kathmandu: MOICS

Kyvik N H (2004), "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing", WTO, Geneva

Bijendra S M (2001), "Nepalese Garment Industry under the Changing Global Trading Environment", theme paper presented in the seminar on *'Nepalese Garment Industry under the Changing Global Trading Environment'*, Kathmandu, December 26, 2001

Bijendra S. M., (2004). "Nepalese Garments Sector at Crossroads: Assessment of Adjustment Problems and Preparations for Quota Free Trade", theme paper presented in a workshop organised by Garment Association of Nepal (GAN) and cosponsored by ITC, Kathmandu, December 2004

Bijendra S M (2005), "Sustaining Nepalese Garment Industry After Quota"

Joshi, Gopal eds (2002), "Garment Industry in South Asia: Rags to Riches?" New Delhi: ILO

Shakya, M Bijendra (2004), "Nepalese Garments Sector at Crossroads: Assessment of Adjustment Problems and Preparations for Quota Free Trade", Theme paper presented in the workshop organised by Garment Association of Nepal (GAN) and cosponsored by ITC, Kathmandu, December 2004

Endnote

1 Economic Survey (2005)

11 CHAPTER Tea Industry in Nepal

– Gyanu Sharma

11.1 Introduction

The Nepalese tea industry owes its roots to the colonisation of India by the East India Company. Numerous tea plantations around the hill station of Darjeeling were promoted by the British. Hybrids of tea bushes were introduced in several districts in Nepal such as *Illam, Taplejung, Panchthar* and *Dhankuta* within a few years after their introduction in Darjeeling and the first tea estates were established in 1863 in *Illam* and *Jhapa*. But whereas the Darjeeling tea production soon emerged as a prosperous commercial industry, the Nepalese tea production remained low profile until the 1990s, unable to fulfil domestic demand.

Decades earlier, in 1966, the Nepalese Government had established the Nepal Tea Development Corporation (NTDC). Initially, Nepalese tea leaves were sold to factories in Darjeeling. Over the time, the Darjeeling tea bushes had become old and along with internal changes in the industry it led to a deteriorating quality of the Indian tea. These conditions made the Nepalese tea leaves a valuable input for the Indian factories. During the last decade, tea processing factories have been built and turned Nepalese tea production into a fully commercialised industry. Even today some farmers sell their tea to Indian factories as they get better prices from across the border.

In the early 1990s, large tea plantations run by the government mainly dominated the tea sector. Through reforms in 1993, the state owned NTDC was privatised. Its regulatory functions were handed over to the National Tea and Coffee Development Board under the Agricultural Ministry. To promote the industry further, the government launched a new tea sector policy at the end of 2000. This policy seeks to ease access to credit and land for tea producers as well as building human capacity and establish better opportunities for export promotion. A clear priority is also set for which type of tea processing should be promoted. This chapter examines the general trends in the Nepalese tea industry, its export performance and the impacts of liberalisation on small farmers as well as on commercial tea estates.

11.2 Overview of the Tea Industries in Nepal

Two types of tea are produced in Nepal: orthodox and CTC. Orthodox tea is grown in the hills of six districts in eastern Nepal, i.e. *Illam, Panchthar, Dhankuta, Terathum* and the new areas of *Sindhupalchok* and *Kaski*. The orthodox tea production accounts for 12-15 percent of the total tea production. Its total production amounts to 1500 tonnes and covers 6689 hectares of cultivated land. The primary contributors are small farmers who sell their leaves to buyers in nearby factories or to those in Darjeeling. The climatic

Table 11.1: Present Status in the Orthodox Industry	
Production (Mil. kg/yr)	**1.5**
Area / ha	9775
Tea estates	63
Small farmers	18750
Factories	19
Small farmers share in area (percentage)	77
Small farmers percent share in production	67.8
Export as percent of total production	96
Source: GTZ & handouts and WinRoc	

conditions in the Eastern hills of Nepal provide ideal conditions for the production of high quality orthodox tea. Another advantage compared to Darjeeling tea is that the bushes are young and produce better quality leaves. Because of the premium price paid to orthodox tea, 96 percent of it is exported while little is sold domestically, mostly in souvenir packages for tourists. More than 18750 farmers derive their livelihood from growing orthodox tea (see Table 11.1). Although there are 63 tea estates and gardens involved in the production of orthodox tea, almost 70 percent of the total tea produced comes from small holders. Since virtually all of the orthodox tea is exported at premium prices compared to other kinds of tea, growing orthodox tea has been an important source of income for many farmers in the eastern hilly region.

CTC is produced in *Terai* in the district of *Jhapa* and covers around 90 percent of domestic consumption. The CTC grown in Nepal is known to be of average quality. While small farmers form the backbone of the orthodox tea production, it is largely big tea estates which are behind CTC tea production (see Table 11.2). Most of the tea

Table 11.2: Present Status of the CTC Industry	
Production / tonnes	**13000**
Area (ha)	8951
Tea estates and gardens	94
Small farmers	8744
Factories	25
Small farmers percent share in area	26.62
Small farmers percent share in production	28.6
Export as percent of total production	40
Workers	50000
Source: NTCDB & GTZ	

estates have their own processing factories. It is estimated that around 66576 workers are employed by the tea estates as pluckers, factory workers and in other functions. Many of the daily-wage workers are landless and live in the estates on a permanent basis.

In both types of industries, CTC and Orthodox, the Nepalese tea industry has undergone large expansion during the last decade and has been an important source of employment. A Tea Policy came into force in 2000, which prioritised orthodox tea production given its natural qualitative advantage. Non-governmental organisations (NGOs) like the Deutsche Gesellschaft fur Techniche Zussammenardeit (GTZ) and WinRock are currently supporting orthodox tea promotion (marketing, branding, code of conduct and technical trainings). However, the coverage may be inadequate and there is a need for further assistance to many more farmers. The sector is facing a number of problems with inadequate infrastructure, excess use of chemicals, low-skilled labour, and the lack of well-planned strategy for upgrading the production process as well as marketing the finished good.

11.3 Nepal's Export Performance in Tea

Until 2003, the volume of tea exported annually from Nepal was around 80-100 tonnes, after which the tea sector saw an exponential rise in exports of more than a thousand percent, largely as a result of liberalisation carried out 10 years earlier. However, the value of tea per tonne was more or less constant until 2002 when it started to decline. The value per tonne in 2002 was US$4487.5 and declined to only US$1206 per tonne in 2004.

Over the last 10 years, Nepal has become increasingly self reliant on tea and import of CTC has decreased substantially. Initially, the import of CTC was meant to cover domestic demand, but now has been substituted by domestic production. Despite the relatively positive growth figures, Nepal's tea export is still very small and only makes up 0.2 percent of the world's total tea export. And whereas the value of the world's total tea export has had a negative growth rate of 1 percent per year between 1999 and 2003, Nepalese tea export has grown by 70 percent per year in value during the same period.[1] According to WTO/ United Nations Conference on Trade and Development (UNCTAD) COMTRADE database in 2004, the Nepal traded 3597 tonnes of black and green tea, 3481 tones of black (fermented) tea and 116 tonnes of green tea.

Tables 11.3, 11.4 and 11.5 provide an overview of Nepal's total tea exports in 2004, as reported by importing countries. It is noteworthy that it is a big difference in unit prices of green tea (see Table 11.3) when sales go to Germany and to the US compared to the exports to India. The tea exported to EU and US is most likely to be orthodox tea whereas the tea sold to India is CTC. The top two importers for Nepali black tea are India and Germany (see Table 11.4), same as with green tea. Similarly, the per unit value of tea exported is much lower (US$1,133) compared to the tea exported to Germany (US$7049) and Japan (US$11,500).

Table 11.3: Export of Nepali Green Tea to Major Destinations				
Importers of Nepali green tea (package not exceeding 3 kg)	Export value in US$1000	Export Quantity in tonnes	Unit value in US$/ tonnes	Export Growth In value between 2003-2004 5, p.a.
India	118	100	1,180	
Germany	110	9	12,222	36
US	12	1	12,000	0
Total	240	110	2,182	112

Table 11.4: Export of Nepali Black Tea (package not exceeding 3 kg) to Major Destinations						
Importers of Nepali black tea (package not exceeding 3 kg)	Export value in US$1000	Export Quantity in tonnes	Unit value in US$/ tonnes	Export Trend in value between 2000-2004 percent p.a.	Export Trend in quantity between 2000-2004 percent p.a.	Export Growth In value between 2003-2004 5, p.a.
India	2,005	1,769	1,133	127	112	423
Germany	289	41	7,049	110	91	58
Japan	23	2	11,500	24	23	109
Total	2,317	1,812	1,279	117	110	302

Table 11.5: Export of Nepali Black Tea (package exceeding 3 kg) to Major Destinations						
Importers of Nepali black tea (package exceeding 3 kg)	Export value in US$1000	Export Quantity in tonnes	Unit value in US$/ tonnes	Export Trend in value between 2000-2004 percent p.a.	Export Trend in quantity between '00-'04 percent p.a.	Export Growth In value between '03-'04 5, p.a.
India	1,556	1000	1,556	85	74	-27
Pakistan	728	631	1,154			-25
Germany	163	23	7,087	9	-3	-50
Netherlands	72	13	5,538			
Japan	19	1	19,000	-15	-28	5
Total	2,548	1,668	1,527	59	65	-27

From Table 11.5, it can be inferred that more expensive orthodox tea is being exported to Europe and the cheaper CTC tea is being exported to India and Pakistan. Nepal clearly receives a much better price for its tea in Europe, Japan and the US than it does from the Indian market. Nepal could do better by selling its tea to overseas markets, including Russia who is one of the major importers of CTC. However, one of the problems mentioned with sales to Europe is that there is a lack of coordinated and planned market strategy, where all tea is collected and not sold in piece meal. For example, a major obstacle for the Nepalese tea industry identified in the GTZ market analysis was that German buyers were not interested in buying small portions of tea. Similar problems seem to occur in the CTC industry when orders come from Russia and the US – the demanded amount cannot be met. Initiatives are being taken now by tea grower's association to try and collect the tea in big containers in order to fulfil bulky demands.

11.4 Policy Reforms and Increased Participation of Small Farmers

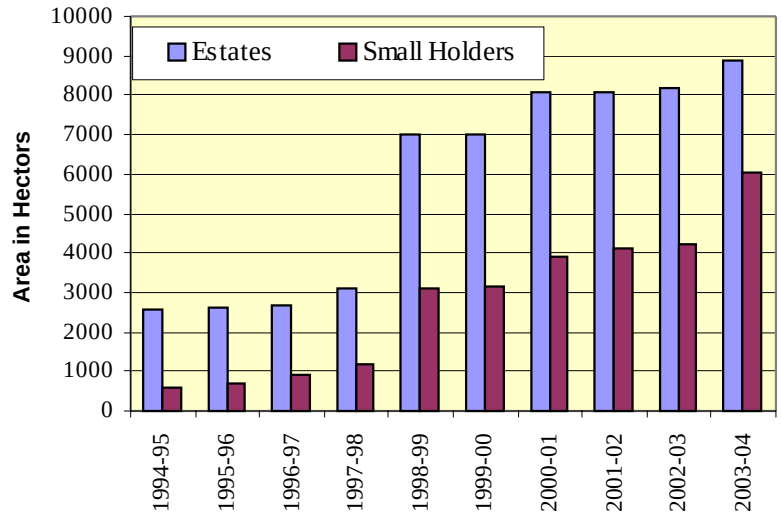
At present, the tea sector in Nepal consists of private producers, both large-scale tea estates and small-holders. This was not always the case. Prior to the reforms initiated in 1993, there was a government monopoly in producing, processing and regulating the tea industry. With the introduction of multi-party democracy in 1990, a concerted push was made to liberalise all sectors of the Nepalese economy to invite private participation in sectors previously reserved for the government owned corporations. As a result, NTDC was dissolved and its assets privatised (with some lingering suspicions on the transparency of the process). Nevertheless, privatisation of the tea business, along with reforms aimed at boosting the sector has increased the size of the sector significantly.

As a part of an effort to promote the Nepalese tea industry, the government in 2000 formulated the National Tea Policy in 2000. The primary goals of the policy were to provide financial incentives for encourage investment, ease the availability of land required to for plantations, develop institutions to foster export, market Nepalese tea and maintain quality. Additionally, the policy aimed to establish training centres to enable small farmers to participate in growing tea.

The liberalisation of the tea sector has brought about some noticeable changes. Currently, there are an estimated 136 large tea plantations, which accounts for 70 percent of land used for growing tea. Small farmers, who mainly live in the hills and produce orthodox tea, cultivate the remaining 30 percent of land. Most of the tea is consumed domestically with around 25 percent being exported (3597 tonnes out of the total 14500 tonnes). Nepal currently aims at increasing the production and export of green tea, which is non-fermented and linked to health benefit. With a view at increasing production, new districts like *Kaski, Dolakha, Sindhupalchowk, Solu* and *Nuwakot* have become involved in tea production.

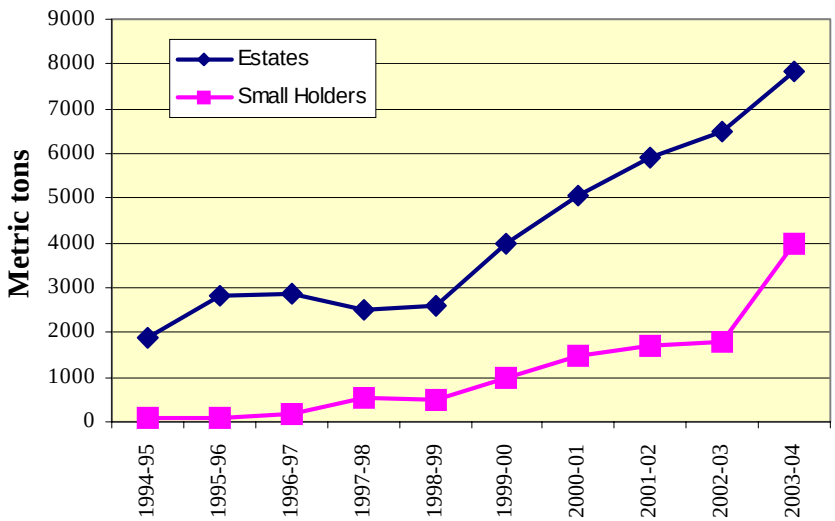
The Nepalese tea industry is growing in size, which is demonstrated by the fact that the total land used to grow tea in Nepal has increased over time. During 1994-95, 3,100 hectars were used for the purpose of growing tea. By 2003-04, the area increased to slightly more than 15000 hectars (see Figure 11.1). The five-fold increase in total land used for tea production shows that tea has come to be taken as an attractive sector to invest in with prospects of high returns.

Figure 11.1: Area Used for Tea Production



From a poverty reduction point of view, it is important to note that the growth in area used for tea production has been spurred by the participation of smallholders (see Figure 11.1). Their share of the total land used has grown from 20 percent of a total in 1994-95 to 41 percent in 2003-04. A large number of farmers are attracted by this cash crop and have given up traditional farming (when they used to grow multiple crops for their own consumption) to specialise in growing tea only and using the profits to buy the essential food grains. As such, districts like *Ilam*, where the participation of the

Figure 11.2: Tea Production by Tea Estates and Small Holders



small farmers in cash crops is noteworthy, have come to be seen as "trendsetters" to farmers in other similar locations in the country, primarily because specialisation in one crop has proven to increase the overall yield and promote commerce in agriculture outputs. The popularity of cash crops has in turn helped reduce poverty rates among small farmers in the tea growing regions.

Corresponding to the growth in the total area used for growing tea, there has been a remarkable growth in the total tea produced by the tea farms (see Figure 11.2). During 1994-95, the total amount of tea produced in Nepal stood at 1945 metric tonnes. By 2003-04, the total amount produced increased to 11,651 metric tonnes (a rise by almost 500 percent). Moreover, the share of the tea estates in total production has been declining. The steady growth of small holders' output gives a strong signal that the benefits of tea trade are not limited to tea estates owned by rich industrialists but are spread to local farmer with little or no access to capital.

11.5 Conclusion

Like coffee, tea is a cash crop with steady international demand. With hilly Nepal's climate and terrain suitable for premium niche product in the world market, tea has a potential to benefit large segments of the rural population and lift them out of poverty and stagnation. Growth in the tea sector in Nepal was spurred by the trade liberalisation policies adopted in the early 1990s. Since the end of state monopoly in 1993, numerous tea estates have been established by industrialists and businessmen. Simultaneously, small farmers have been attracted to growing tea as the demand and prices for orthodox tea bring higher returns than traditional crops. As an example, the amount of land used for growing tea has increased by five times and production has increased by more than 500 percent compared to the pre-liberalisation figures. More importantly, significant growth in land use and production both are due to increased participation of small farmers in producing tea.

In numbers, small farmers' share of the total land used for growing tea more than doubled in 10 years (from 20 percent in 1994-95 to 41 percent in 2003-04). Similarly, small farmers' share in total production also rose from 5 percent in 1994-95 to 33 percent in 2003-04. Furthermore, although the numbers vary according to their sources, the Nepalese tea sector directly employs around 105,000 people. The beneficiaries of these employees are many more and are estimated to be around 420,000 persons. These are encouraging figures which suggest an expansive role of this cash crop is playing in providing Nepalese farmers with alternatives to traditional, low-yield, subsistence farming.

References

WTO/UNCTAD COMTRADE

http://www.gtz.de/de/dokumente/en-PSD-conflict-guidebook-2008.pdf

Endnote

1 Source: International Trade Centre

12 CHAPTER The Cutlery Industry in Pakistan

– *Mohammad Qasim Qureshi*

12.1 Introduction

The cutlery industry in Pakistan comprises purely of SMEs, but it is lacking in modern technology. The major portion of this industry is situated in the areas of Wazirabad, Nazimabad and Allahbad in the Gujranwala district of the Punjab province. There are approximately 300 units present in this region – about half of them are registered SMEs with the Pakistan Cutlery & Stainless Steel Utensils Manufacturers & Exporters Association (PCSSUMEA). Approximately 25,000 people are directly or indirectly associated with this sector, producing 5000 pieces per day manually. This chapter explores the trade-poverty linkages in Pakistan through a case study on the cutlery industry in Pakistan.

12.2 Overview of the Cutlery Industry in Pakistan

The cutlery cluster in Wazirabad is world famous for its products. It is situated in the North of Lahore at one of the peaks of the triangle cities of Gujranwala, Sialkot and Gujrat. There is a high concentration of small-scale metal/light engineering industrial units that are concentrated mainly in its suburban areas. The industry faced a serious crisis after Partition in 1947 because the main business centres, Mumbai, Kolkata and Delhi fell on the Indian side of the border. With the largest home market lost, financers migrated to India. However, the hard-working labour force and craftsmen recaptured their fame within a very short time span.

In 1952, the government of Pakistan, recognising the strong and proud inheritance, made attempts to revive the industry. In spite of the substantial progress of the industry after independence in 1947, it has not fulfilled its potential and unable to contribute substantially towards the economic development of the country.

The average capacity utilisation in the sector amounts to 30-40 percent only. The export of cutlery from Pakistan (especially pocket-knives, kitchen knives and scissors) started in 1952. After 1958, tableware cutlery in stainless steel became the major items of production in Wazirabad and controlled the whole domestic market. But the export of these tableware items to the Middle East and some African countries was very limited in quantity. Over the time, the knife and sword industry progressed and now it has become a 100 percent export-oriented industry.

The cutlery industry in Pakistan is one of the sectors that have failed to benefit from trade liberalisation. This industry falls under the SMEs category and although cutlery exports increased by 11.4 percent between 2001 and 2003, the rate of growth of exports

decreased progressively by 28.6 percent since 1999-2000 (Ali, 2003). One of the major reasons for this slump is the lack of technological progress. Furthermore, the business operations in the industry are small and medium scale, thus they have not benefited from mass production. The province of Punjab houses about 65 percent of the total number of small industrial units (about 280,000) in the country, which includes, amongst others, the cutlery industry as well.

Within the SME sector, the bulk of enterprises are small entities that have less than 35 employees and have productive assets in the range of Pakistan's currency as Rs 2 to 20 million (US$32,001-320,010). Punjab, being a thickly populated province, has the greatest concentration of small enterprises, most of which are operating in the informal sector. Some SMEs in Punjab employ women workers and some are even owned by them. The Government of Punjab is striving to improve the business climate for firms by reduction in taxes, rationalisation of labour laws to promote employment and revamp industrial regulations including inspections relating to boilers, buildings, electricity, etc.

12.3 Policy Reforms and the Cutlery Industry

During 1995-96 and 2003-2004, significant tariff cuts on the import of raw material for manufacturing of cutlery took place. Custom duties on import of cutlery items ranged from 35 to 65 percent in 1995-96. These were reduced considerably to the range of 5 to 25 percent in 2003-2004, with most items in the 25 percent category. Custom duties on import of many items such as paper knives, letter openers, erasing knives, kitchen chopper, cleavers and mincing knives have further been reduced to 20 percent in 2005-06. Custom duties on import of stainless steel raw materials ranged from 15 to 65 percent in 1995-96 with most items within the range of 45 to 65 percent. These were reduced considerably to a range of 5 to 25 percent in 2005-06 with most items within the 5 percent and 10 percent bracket.

Regarding the import of cutlery and stainless steel, sales and income tax are being charged at the rate of 15 and 6 percent respectively. These figures have not changed in the last ten years. Export of cutlery products and stainless steel from Pakistan is free from customs duties. However, zero-rated sales and income tax at the rate of 0.75 percent of the proceeds of the exports of cutlery products are applicable, while income tax at the rate of 1.25 percent of the proceeds of exports of stainless steel is levied. Some of the other important liberalisation measures are discussed below.

Cluster Development[1]

Since its introduction in 1993, the United Nations Industrial Development Organisation (UNIDO) Cluster Programme has improved the competitiveness of SMEs in India, Indonesia, Malaysia, Mexico, Nicaragua, Honduras, Jamaica, Bolivia, Madagascar, Morocco and Tunisia. In June 2001, the Programme got underway in Pakistan, with a mission to identify a critical mass of SMEs sharing similar growth constraints, create awareness of the advantages of clustering, and identify counterparts and partners. By November 2001, five clusters were identified that met the criteria of the Programme, one of which is the willingness of partners and counterparts to share costs. The clusters chosen for the programme included the cutlery industries at Wazirabad (300 units, employing 10,000). The Small and Medium Enterprise Development Authority (SMEDA),

in collaboration with the Punjab Small Industries Corporation (PSIC) and UNIDO, has started a "Cluster Development Programme for SMEs" in Punjab. The objective of this Program is to help in developing the different SME clusters of Punjab.

Lending Scheme for Cutlery Manufacturers, Wazirabad[2]

The majority of the cutlery manufacturers purchase steel on credit of 60 days bearing 5 percent higher costs, which annually add up to 30 percent on nominal basis. Due to the unawareness of manufacturers regarding the different credit options available in the form of formal/bank credit, they avail supplier credits (30 percent) instead of bank credits (10-12 percent). By replacing the supplier credit with bank credit, the manufacturers can significantly reduce their cost of operations. A customised lending programme for SMEs working in the cutlery sector in Wazirabad will help meet their working capital requirements. SMEDA in cooperation with the PCSSUMEA and Bank of Punjab prepared a customised lending scheme proposal, which is in operation now.

Marketing

Keeping in view the marketing need of clusters, SMEDA Punjab has initiated a programme to develop and launch cluster-specific websites. These websites will be developed with the collaboration of trade associations, and SMEDA will help develop the websites and business associations, which will be responsible for maintaining and running them. Initially, websites will be developed for the cutlery clusters in Wazirabad.

Addition of AISI-200 Series of Stainless Steel to Importable List

At present, it is possible to import waste, seconds and cutting of stainless steel sheets and plates of AISI-300 and A1SI-400 series. The manufacturers have approached the Ministry of Commerce and requested them to allow the import of AISI-200 series stainless steel sheets and plates recently developed by the US for use in various components of food and surgical utensils, swords, knives and other items in the cutlery industry. It has been decided that AISI-200 series would be added to the list of importable items.

Allowing Import of Used Lab, Surveying Equipment

At this point in time, used instruments and equipment for laboratory, surveying and other purposes are banned for import. New equipment is expensive and also not locally manufactured. After consultations with the Ministry of Industries & Production and the Engineering Development Board (EDB), the import of this equipment will be allowed for laboratory, surveying and other purposes.

Finance

The banking community has agreed to extend financing facilities to the table cutlery sector on easy terms and conditions. Six banks, including Habib Bank Limited, Bank Al-Falah, Muslim Commercial Bank, Allied Bank, Soneri Bank and Meezan Bank have promised to honour SMEDA's scheme to finance the cutlery sector.

12.4 Trade in Cutlery

Exports of Cutlery from Pakistan

In 1999, the international cutlery trade value was above US$4.5bn. Major exporters of cutlery include China, UK, Germany and the US who export nearly 45 percent of the total

international market of cutlery products. Major importers include the US, UK, Germany and France, accounting for 45 percent of total cutlery imports. Pakistan is among the top 25 cutlery exporting countries. The major export markets are the US and the European Union (EU). The exports of cutlery witnessed an average 11 percent growth in 2002 from the base year 1998. The value in export of cutlery increased from US$18,270,000 in 1998 to US$30,881,000 in 2004 (Table 12.1).

Table 12.2 indicates that Pakistan is mainly exporting knives and swords etc., with the US being the largest export market for the Pakistani exports.

Table 12.1 Exports of Cutlery from Pakistan

Years	1998	1999	2000	2001	2002
Exports (US$ 1000)	18,270	20,678	26,819	24,947	26,464

Source: Statistics Obtained from Engineering Development Board, Ministry of Industries, Islamabad, Pakistan

Table 12.2 Categories of Exports of Cutlery from Pakistan (in US$ mn)

Product Description	1998	1999	2000	2001	2002
Knives, swords etc.	15.843	17.845	20.574	17.223	16.270
Razors including safety razors & open blades	1.103	0.556	1.171	1.425	1.672
Safety razor blades, blanks in strips	0.139	0.118	0.360	0.258	0.758
Parts of non electric razors	0.000	0.000	0.000	0.000	0.051
Scissors, tailors	0.360	0.908	1.139	1.031	0.831
Paper knives, letter openers, erasing knives, pencil sharpeners etc.	0.000	0.000	0.000	0.000	0.000
Manicure and pedicure sets and instruments (nail files)	0.000	0.009	1.519	3.508	5.054
Kitchen chopper, cleavers & mincing knives & other articles	0.686	0.870	1.598	0.951	0.736
Table ware sets plated with precious metal	0.000	0.000	0.000	0.000	0.054
Tableware sets without plating	0.001	0.003	0.000	0.001	0.058
Plated tableware articles not in sets	0.000	0.000	0.000	0.000	0.000
Tableware articles not in sets (without plating)	0.137	0.363	0.447	0.549	0.980

Source: Statistics Obtained from Engineering Development Board, Ministry of Industries, Islamabad, Pakistan

Looking at the break-up of Pakistan's cutlery exports (Table 12.2), the lion's share of total value exported is accounted by just one category, which is 'knives', i.e. 70 percent of the total cutlery exports. This ratio has come down from over 80 percent and there is an increase in the export of other articles of cutlery, i.e. from 4.3 to 16.5 percent, which is in line with the world trend since this category is the largest category in the global exports with a share of 44 percent. The export of cutlery products from Pakistan is rusting, as rising manufacturing costs and stiff competition from China have knifed into local manufacturers' global market share[3].

Imports of Cutlery into Pakistan

Pakistan also imports cutlery items. The value of imports initially decreased in 2002, compared to imports in 1998. In 2004, the import of cutlery items in Pakistan was US$ 2,979,000 in comparison with US$1,872,000 in 2002 (Table 12.3).

Table 12.3: Imports of Cutleries (in US$mn)

Years	1998	1999	2000	2001	2002
Imports	1,945	2,285	2,589	2,309	1,872

Source: UN COMTRADE

12.5 Cutlery Industry in Pakistan: Problems and Prospects

In a report on Pakistan prepared and published by UNIDO in 2001 on the *Cluster Development Programme for Small and Medium Enterprises: Cutlery Cluster, Wazirabad, Punjab, Pakistan* in Collaboration with the Export Promotion Bureau (EPB), incorporating statistics until 1996, it was stated that the cutlery sector in Pakistan had 13 major establishments with 481 employees and wages and salaries amounting to Rs 44.8 million.

The report mentioned five strengths of the cluster, which are: (a) cluster actors are well motivated, (b) the industry is 100 percent export-oriented, (c) skilled labourers are available because of the cutlery training institute of Pakistan at Wazirabad, (d) the sector is comparatively well-organised, and (e) the cutlery association as a platform is available for product development and resolution of the mutual differences.

The UNIDO report, however, mentioned few weaknesses of the cluster, which are: (a) poor infrastructure like roads and telecommunication, (b) high cost of utilities such as electricity, Sui Gas (natural gas) etc., (c) undue interference of various Government Departments, (d) cut throat competition among business community of this sector, (e) lack of quality manufacture, and (f) lack of design system and designers for the cutlery industry.

Although there are no official statistics, neither formal nor informal, available on the cutlery industry, it has been ascertained through field research that the figures and facts stated above in the UNIDO report have remained considerably stagnant. The size of the industry's output has not increased substantially and as it totally dependent on exports, this index of manufacturing output is reflected in the exports statistics. Also, employment

statistics in general have remained unaltered. The number of personnel employed in the industry has remained the same essentially and their salary and wages have not increased by any significant amount. The SMEs nature of the industry creates barriers in achieving consistent performance and development of industry and poverty alleviation. It is also found that the industry remains vulnerable to competition from Chinese imports in the domestic market. Furthermore, the quality of the goods produced has not improved significantly; an issue that needs to be addressed. Access to high-quality stainless steel, which has to be imported, remains considerably difficult.

In an article published in a daily newspaper[4], it has been identified that the sales tax, social security, old age benefits, and professional taxes are among the many hindrances faced by manufacturers/exporters. The basic raw materials for manufacturing cutlery items, such as stainless steel, are imported by commercial importers and sold to individual small units with the addition of taxes and higher profits, leading to a price rise of the end product. Lack of modern courses or training like CAD/CMA (computer software for designing) is another problem. So far no study has been undertaken for the pricing, branding, and designing of cutlery products, or for exploring potential markets.

SMEDA[5] identified a number of factors acting as barriers to growth of enterprises in the cutlery industry. They are: (i) lack of interaction between government and SMEs, (ii) inappropriate taxation policies, (iii) lack of financing, (iv) lack of labour legislation, (v) lack of skilled labour, (vi) lack of advanced technology, (vii) lack of market and industry information, and (viii) lack of infrastructure.

12.6 Results of a Perception Survey of Stakeholders

In order to analyse the post-liberalisation scenario, a perception survey of the stakeholders was conducted. The major objective of this survey was to fully understand the economic impact of reforms on the related enterprises, workers and individuals. The performance of the cutlery sector, effects on the labour market and benefits, if any, for the consumer were the major aspects covered in the survey.

Information was collected from seven manufacturing enterprises with respect to the impact of trade liberalisation on the sector's performance and labour market. A sample of 100 individuals, chosen on the basis of poverty profile of the population provided by the Centre for Research on Poverty Reduction and Income Distribution, were also interviewed.

The survey reflects that manufacturers feel that they have not been benefited from the trade liberalisation process. They observed that there has been no reduction in the custom duties on the raw materials and machineries used by them. Manufacturers were also unanimous in their views that the return on their investment has decreased over time, and there has not been any significant growth in export volume in this sector. Also, this sector has not experienced any significant technological advancement.

There are no comprehensive statistics on the wage structure in the cutlery sector. Further, any efforts to obtain official statistics or wage records from cutlery manufacturers were not successful due to the reluctance of manufacturers to reveal any such information. However, an informal research was undertaken whereby it appeared that the average

pay of the workers remained stagnant in terms of real income. The average salary of workers in the cutlery sector ranged from Pakistani Rs 3,000 (US$50) to Pakistani Rs 6,000 (US$100) per month.

Most of the consumers (88 percent) feel that the prices of cutlery items have decreased and that the quality has increased. Some consumers (37 percent) expressed that they have switched to imported cutlery items. The surveyed restaurants also expressed that the prices of cutleries have decreased and that the quality of the items has increased. 30 percent of the restaurants surveyed stated that they have switched to imported goods.

57 percent of the surveyed employees opined that there had been an increase in employment opportunities. All of them expressed the view that working conditions have improved and that wages have increased. However, 43 percent of them felt that technological advancements have not benefited them.

12.7 Conclusion

Economic globalisation is taking place through technological tools and systems. To compete in such a technological era, industry players have to be more developed and innovative in adopting technology to survive. But countries like Pakistan lag far behind developed countries in this regard. Most significantly, cutlery items from China have taken over the world market. Chinese cutlery item imports to Pakistan have also increased, thereby reducing the domestic market share of local manufacturers.

The developing countries consumer culture needs more luxury goods to consume on a mass level. Locally produced goods are not of the quality needed because design strategies and creative mechanisms do not exist. Products are not aligned with the fashion trends and developing consumption need.

Low technology, low quality, poor raw materials and high production costs are among the main reasons why this sector has not been able to meet expectations or its full potential. Pakistan's government should increase labour productivity through education, on-the-job training, skill up-gradation and the dissemination of new knowledge and latest techniques. This will translate into higher value-added and low-unit labour cost. The exporters need to invest in this area. However, given the fact that there are many small companies in this business segment, the government has to take an active role to ensure that training is available to all exporters.

The cutlery industry has a lot of potential, but it has remained stagnant despite trade liberalisation. In order to develop, certain measures are required. Whether these will create more employment and alleviate poverty will depend on the expansion of the industry in general and the entrepreneurs in specific.

References

http://www.ejad.org.pk/resource/cutlery.doc

Economic Survey of Pakistan, 2004-2005, Part-III

Endnotes

1 *http://www.unido.org/periodical.cfm?did=491749&pername=UNIDOSCOPE*
2 Progress Report: Provincial Office (SMEDA-Punjab) SME Cluster Development Projects; *www.smeda.org.pk*
3 *http://www.pakconhk.com/pakistan_chamber_of_commerce.htm*
4 Ali N (2003), Feature: "Cutlery Business Rusting on Rising Costs", Daily Times Newspaper, September 03
5 Supra Note 2

13 CHAPTER Telecommunication Sector in Pakistan

– *Farkhanda Sohail, Mohammad Qasim Qureshi*

13.1 Introduction

The telecommunication sector in Pakistan has done remarkably well in the past few years, primarily due to trade and investment liberalisation, privatisation and openness to modern technology. The share of the telecom sector in GDP has increased from 1.5 to 1.8 percent in the year 2004-05[1]. Besides being a major contributor to Government revenues, this sector has also been able to attract a huge FDI in recent years. This chapter analyses the channels through which expansion of the telecommunication sector has bearings on the trade-poverty nexus in Pakistan.

13.2 Evolution of the Industry

At the time of independence, Pakistan inherited a meager telecom base of 14,000 landlines, primarily meant to serve the administrative set up of the country. At that stage, Post Telegraph and Telephone were one department, later in 1962 both were separated to form an independent Postal Department and Telephone and Telegraph Department (T&T). These were the first ever reforms concerning the telecom sector in Pakistan. In the year 1990, keeping in view the changing global trends, Pakistan started taking gradual sector reform measures within the existing legal and regulatory framework. The focal point of these measures was deregulation to encourage private sector participation.

The T&T Department was converted into the Pakistan Telecommunication Corporation on December 15, 1990 by delegating the powers to the Board of Directors for better functioning of the telecommunication system in the country. Thereafter, on January 01, 1996, the said system was reorganised by establishing the Pakistan Telecommunication Authority (PTA), the National Telecommunication Corporation (NTC), Frequency Allocation Board (FAB) and Pakistan Telecommunications Company Limited (PTCL). The Government was further committed to deregulate and liberalise telecommunications industry through privatisation of state-owned monopoly, i.e. PTCL under International Telecommunication Union (ITU) and WTO Agreements. In the year 2003, Deregulation Policy for Telecom Sector was announced. It opened up the fixed line telecommunication sector in Pakistan and abolished the exclusivity of PTCL in basic telephony.

Due to the monopoly of the state-owned telecommunication department, Pakistan observed insignificant growth in tele-density over the years. However, after the deregulation, substantial growth has been observed.

13.3 Key Institutional Bodies

The three key institutional bodies within Pakistan for the telecommunication sector are:

1. **Ministry of Information Technology:** The key responsibility of the Ministry is the issuance of policy directives for implementation by PTA. The Government may issue policy directives on matters like the number and term of licenses, nationality of persons to whom public networks may be transferred and requirements for national security/ international relations, etc.
2. **Pakistan Telecommunication Authority (PTA):** It was established under the Telecommunications Act of 1996. The functions, powers and responsibilities of the Authority are to protect the rights of license holders, to make decisions promptly in an equitable, non-discriminatory, consistent and transparent manner, to act expeditiously, to give persons who are affected by its decisions due notice and the opportunity of being heard, and encourage fair competition.
3. **Frequency Allocation Board (FAB):** It is responsible for the management of spectrum plan for its usage in Pakistan. Applications for spectrum are in the first instance submitted to PTA but thereafter handed over to FAB for its allocation.

13.4 Fixed Network Operators

Under the Telecom Act (1996), PTA was made responsible for issuing licenses to the private sector under the policies of Government of Pakistan. The fixed line sector was divided into the Local Loop (LL) and Long Distance International (LDI) segments.

For LDI and LL, PTA received 96 applications for the grant of Local Loop (LL) and Long Distance International (LDI) licenses from the prospective investors. Out of these applications, 73 were for LL licenses while 23 were for the award of LDI licenses. So far, PTA has issued 12 LDI licenses to various national and multinational companies who deposited the initial license fee and fulfiled all other requirements. PTA has also issued 84 Fixed Local Loop Licenses to various companies for 14 telecom regions of Pakistan.

PTA decided to promote Wireless Local Loop (WLL) industry. In all, 20 companies have won the WLL spectrum in fourteen regions[2]. Fixed line services in Pakistan have also shown magnificent growth patterns over the years. This has been evident from the increased tele-density over the years. Currently, the tele-density has reached 3.4 percent, compared to just 2.2 percent in year 2000[3]. Deregulation and increased competition have drastically reduced tariffs not only for local but also for nation-wide and international calls. PTCL has been forced to bring in schemes for provision of fixed line connection on easy terms.

Pakistan Telecommunication Company Limited (PTCL)

PTCL has a network capacity of about 5.0 million lines, including 0.25 million WLL connections, out of which 4.5 million are in service. PTCL has a modern digital switching system and long distance and international network, based on fibre optic and satellite communication systems. A part of the equipment used by it is manufactured in factories working as Joint Ventures with recognised multinational corporations (MNCs) and PTCL.

PTCL is the dominant entity in the telecommunication sector of Pakistan. It generates about a billion dollars in annual revenues, primarily from its subscribers calling within local areas, domestic long distance, and international traffic[4]. PTCL's principal activity is the provision of telecommunication services providing domestic and international voice and data services throughout Pakistan. It also manufactures telecommunication-related equipment.

National Telecommunication Corporation (NTC)

The NTC has been mandated to provide telecommunication services to the Federal Government and some sensitive government organisations. In line with its policy to reorganise and de-regulate the telecommunication sector in Pakistan, the Government decided to wind up the Pakistan Telecommunication Corporation by December 1995 and created PTCL and NTC as its successors. Both entities were established on January 01, 1996 under the Pakistan Telecommunication (Re-organisation) Act, 1996. Unlike PTCL, NTC has a definite mandate to provide basic telecommunication services to its designated customers, which include Federal and Provincial Governments, their departments, autonomous organisations and defense services throughout the country.

According to an Order issued under the Pakistan Telecommunication (Re-organisation) Act, 1996, the Corporation was vested with 72,000 telephone lines and a countrywide network of microwave and fibre optic links. Initially, the telephones were provided at federal and provincial capitals, but now the NTC network is being expanded to district and *tehsil* level. NTC has grown rapidly and currently has an installed capacity of more than 100,111 lines, with 87,067 working connections (87 percent capacity utilisation)[5].

Telecard

Telecard, historically, is one of the largest payphone operators in Pakistan operating in thousands of locations across the country. The company officially commenced its nation-wide operations in February 1993, and went public in 1995, thus becoming the first listed, privately owned Telecom Company in Pakistan. Telecard is providing Code division multiple access (CDMA)-based WLL services in all major cities by the brand name of 'Go CDMA'. Telecard believes that the only viable way to substantially increase phone penetration in developing countries like Pakistan is through the wireless access route.

Wireless technology is considered to be the only solution for provision of telecom services as the fixed-line, copper and optic fiber solution has failed to produce the desired result in the face of rapidly changing technology and ever increasing demand. The company is in the process of expanding its CDMA network across the country and also plans to introduce 3G services in the Pakistani market in the near future. Telecard has also acquired a major shareholding in Instaphone and plans to launch nationwide CDMA 800 service in the near future.

Worldcall

Worldcall Private Limited is one of the leading telecom operators providing Payphone, Hybrid fiber-coaxial (HFC) and WLL services in the major cities of Pakistan. *Worldcall* launched its WLL services in Lahore in September 2005. *Worldcall* has introduced free

on-net calls and cheap nation-wide and international calls. Currently, *Worldcall* has a 42,000 WLL subscriber base. Like other WLL operators, *Worldcall* is also providing its services in major cities[6].

Long Distance, International gateway (LDI)

In all, 12 LDI licenses were awarded to the new operators. All 12 LDI companies are now operational carrying international traffic to and from Pakistan. Issuance of these licenses has allowed the mobile and WLL carriers to construct their own long distance backbone networks as well as operate an international gateway. All carriers believe that they have sufficient traffic of their own to justify this network and even go beyond the 14-telecom region points of presence. Competition in the LDI sector has already brought down the tariffs for the international incoming and outgoing calls. Warid telecom is the only LDI operator which has started the building up of a nation wide fibre optic network. It is likely that this will result in increased capacity in the marketplace and bring tariffs further down.

WLL operators were offered 20 years licenses with a view to increase the penetration rates in the under-served areas. However, it has been observed that almost all the WLL operators launched their services in the main cities and business districts. PTCL, *Telecard, Worldcall* and *GreatBear* are the only four operators that have launched the WLL service. There are almost 16 other WLL operators who are planning to launch their services in the near future coming months. Amongst the more serious ones are *DVCom* and *Burraq Telecom*. WLL Operators, except PTCL, are under no Universal Service Obligations; however, they are expected to participate in providing the service in under served areas using Universal Service Fund (USF).

13.5 Privatisation of PTCL

In pursuit of its policy of de-regulation and liberalisation, the Government of Pakistan opened up the fixed-line telecommunication sector. The exclusive rights of PTCL to provide basic telephone services (local, long distance, international, and leased line services), which it enjoyed under the Pakistan Telecommunication (Re-Organisation) Act 1996 ("Telecom Act 1996"), has expired as of December 31, 2002. In order to provide the regulatory guidelines for liberalisation of the telecom sector, the Government announced a Deregulation Policy for the Telecommunications Sector on July 13, 2003. The Policy is designed to achieve the objectives of increased service choice for customers at competitive prices, increased tele-density and expanded telecommunication infrastructure to un-served or under served areas of Pakistan[7].

The decision to award a license is preceded by an open and public hearing process. There are stringent technical and financial requirements to ensure the entry of serious bidders only. Tariff for both types of licenses will be levied only when the companies have attained the Significant Market Power (SMP), which will be determined by PTA. Later, in 2005, PTCL was open for privatisation. The Emirates Telecommunications Corporation's (Etisalat) offer of US$2.59bn was accepted. In April 2006, the management control of PTCL was transferred to *Etisalat International Pakistan* (EIP), a subsidiary of Emirates Telecommunication Corporation[8] .

13.6 Growth in Mobile Phones

In 2004, mobile licenses to two new companies, i.e. *Warid and Telenor* were awarded through open bidding against auction bidding price of US$291mn each. As per the new mobile policy, these licenses were kept technology neutral so that operators could decide the best possible option. The introduction of these two operators gave a tremendous boost to the mobile phone subscriber base in Pakistan, which increased by a phenomenal 182 percent, as shown in Table 13.1:

According to a United Nation's forecast, Pakistan's population is expected to grow to 190 million by 2018. Assuming that future cellular coverage reaches 95 percent of all urban population and 30 percent of rural population and taking into account the relative

Table 13.1: Cellular market in Pakistan from 1995 to 2005

Year End	Instaphone	Mobilink	Paktel	PTML (U-fone)	Telenor	Warid	Total	Growth Rate (%)
1995-96	20,950	16.385	30,703	-	-	-	68,038	
1996-97	43,029	52,600	39,398	-	-	-	135,027	98
1997-98	53,184	82,912	60,000	-	-	-	196,096	45
1998-99	108,058	87,556	70,000	-	-	-	265,612	35
1999-2000	112,000	114,272	80,221	-	-	-	306,493	15
2000-2001	220,000	309,272	96,623	116,711	-	-	742,606	142
2001-2002	330,000	800,000	218,536	350,000	-	-	1,698,536	67
2002-2003	420,000	1,115,000	319,400	550,000	-	-	2,404,400	41
2003-2004	535,738	3,215,989	470,021	801,160	-	-	5,022,908	108
2004-2005	454,147	7,469,684	924,486	2,579,103	835,727	508,655	12,775,364	182
March 06	396,756	12,990,643	954,933	5,750,516	2,332,117	2,578,043	25,003,008	96

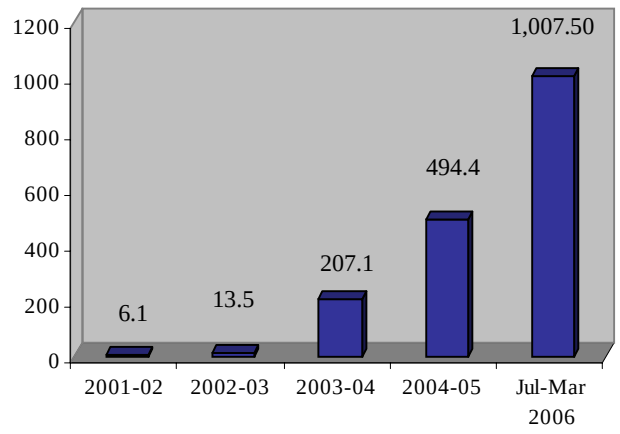
Source: http://pta.gov.pk/

geography and population density of each province, there is an expected demand of approximately 25 million cellular subscriptions by 2018[9]. This shows that there is a tremendous potential for growth in this sector in the future.

13.7 Investment Liberalisation in Telecommunication

Following the deregulation agenda, PTA has made a tremendous contribution by accomplishing the task of opening up of the telecom sector in Pakistan. Implementation by PTA of the policies of the Government of Pakistan has opened the door for local and foreign investors to seriously explore the opportunities in the Telecom Sector in Pakistan. PTA has created an investor-friendly environment by awarding licenses in a fair and transparent manner 10. It is evident from Figure 1 that since 2003 the telecom sector has attracted a large sum of FDI in the country. During the first nine months of the fiscal year 2005-06 this figure has surpassed the US$1bn mark[11].

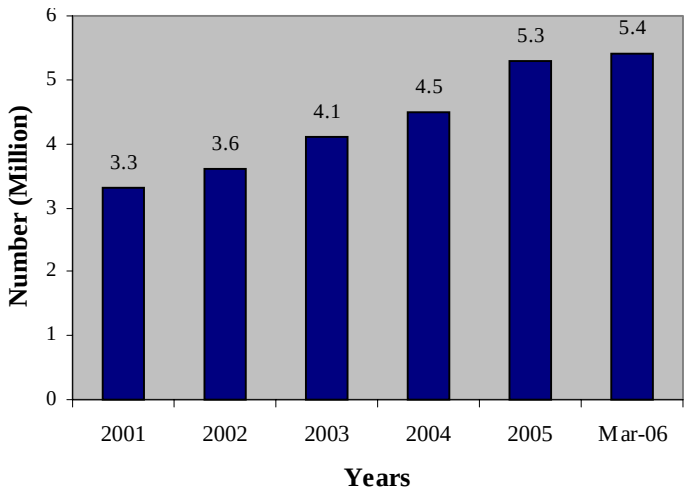
Figure 13.1: Foreign Direct Investment in Telecom (in US$mn)



13.8 Access to Telecommunication Services

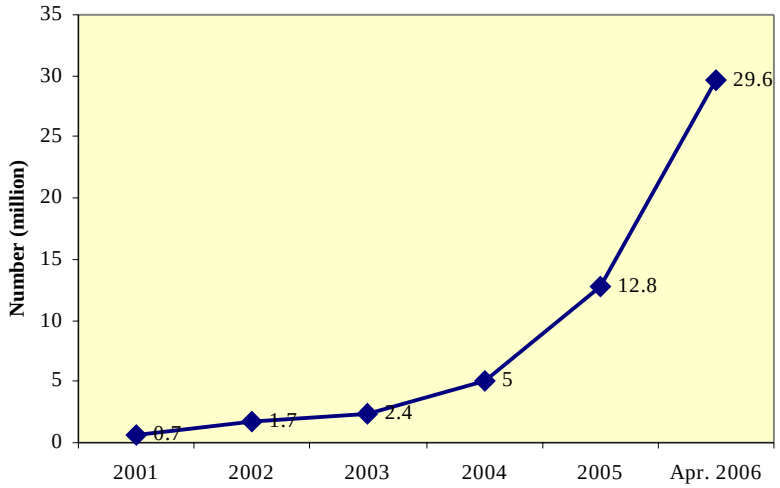
Although the number of fixed lines has increased from 1.2 million in 1992 to over 5 million in 2005[12] (see Figure 13.2), the tele-density (fixed line) is still low as compared to other countries. The tele-density in Pakistan is only 3.4 compared to that in India (8.4), China (20), Western Europe (60) and the US (70). Even within the country there are huge regional disparities as far as the provision of telecom facilities is concern. Geographically, Punjab and Sindh are the regions largely connected with telecom services and had tele-densities of over three percent in 2005. *Balouchistan* has the lowest tele-density in Pakistan, which is only 1.5 percent in 2005.

Figure 13.2: Fixed Line Subscribers (2001-2006)



Source: Pakistan Telecommunication Authority

Figure 13.3: Growth in Cellular Phone Subscribers



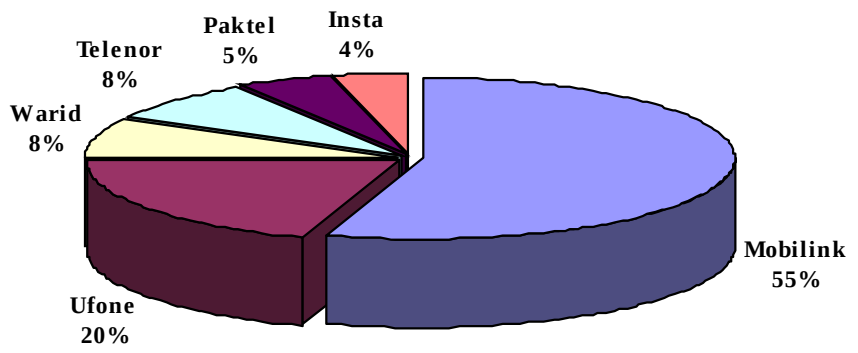
Source: Pakistan Telecommunication Authority

As discussed earlier, the mobile telephone service was launched in Pakistan in 1990 under license granted to two operators, namely *Paktel* and Instaphone. PMCL (Mobilink), the third operator, got the cellular license in 1992 for providing the nationwide GSM service. *Ufone* (PTML), a subsidiary of PTCL, launched its service in January 2001. Two more GSM licenses were awarded in 2004 to *Telenor and Warid*. Efforts are being made to bring cellular telephone penetration in Pakistan at par with other Asian countries. The industry has shown a tremendous growth in the years 2001-06 as the subscriber base has increased from 0.7 million to almost 30 million[13].

Pakistan's mobile industry at the moment is experiencing a growth explosion. At present, there are six cellular operators providing 29.6 million mobile connections[14]. Though the existing players are trying to meet the growing demand, still there is a huge amount of unmet demands in the under-and un-served parts of the country. *Mobilink* has the highest market share of 55 percent followed by *Ufone* with 20, *Warid* and *Telenor* with 8 each, *Paktel* 5 and *Instaphon*e 4 percent[15].

Even the cellular market leader, *Mobilink*, with the largest coverage has provided coverage to 95 percent of urban and 10 percent of rural population. The rural coverage only comes from the sites, which are primarily installed to cover the cities, Motorway and National Highways[16].

Figure 13.4: Market Share of Mobile Operators (December 2005)



13.9 Evolution of Pricing Policy

The state-owned Pakistan Telecommunication Corporation had a monopoly; it could set the desired price and the consumer had no choice but to pay the asked price. After the introduction of telecom reforms and more recently the issuance of WLL and LDI licenses to private sector, telecom facilities are becoming more and more affordable for the general public. Various measures have been taken to facilitate the operators and bring the tariff rates down. Recently, the royalty on mobile operators has been reduced from 4 to 1.5 percent of the gross revenue with a further reduction up to 0.5 percent for new entrants or for existing operators when they renew their licenses. For ISPs and card payphone operators, royalty has been reduced from 4 to 0.66 and two percent respectively.

For the promotion of telecom services in the province of *Balouchistan*, the license fee for ISPs has been reduced to 50 percent. The five percent royalty on telecom equipment sale has been abolished. For satellite services, license fee has been abolished and only registration is required. The type approval equipment fee has also been reduced to 50 and 39 percent on locally and foreign manufactured telecommunication equipments respectively. By the end of 2000, the number of mobile connections was 0.2 million, Instaphone and *Pakte*l were the two mobile service providers at that time. Mobile connections were very expensive, and only the rich could afford them. In 2001, PTA awarded a cellular mobile license to *Ufone* and introduced the Calling Party Pays (CPP) regime. Later, with the entry of new operators, competition increased and prices started to fall down, which benefited the consumer.

13.10 Telecom Sector and Revenue Generation

The Government has been quite liberal over the years to provide incentives to promote the telecom sector. Revenue generation, however, is inconsistent with the incentive structure. The contribution of telecom sector in the form of federal taxes has increased considerably over the years, but the tele-tax/GDP has been stagnant around 0.6 and 0.7 percent, indicating that only the natural growth effect has been captured by the tax system (see Table 13.2).

Table 13.2: Direct & Indirect Taxes from the Telecom Sector (in Pakistani Rs million)					
Years	Direct Taxes	Indirect Taxes	Total Taxes	Share in Federal Taxes	Share in GDP (in percent)
2002-03	15573	12273.1	27846.4	6.0	0.6
2003-04	21009.1	13345.8	34354.9	6.6	0.6
2004-05	19799.3	23002.2	42801.5	7.2	0.7
2005-06*	15641.7	19604.8	35246.5	7.2	0.6
*July-March Source: Central Board of Revenue					

The overall revenue from the telecom sector registered a significant growth of 24 percent in 2004-05. The revenue increased to Pakistani Rs 42.8 billion (US$682mn) in 2004-05 from Pakistani Rs 34.4 billion (US$548mn) in 2003-04. The contribution of sales tax made by the telecom companies operating in Pakistan registered a significant growth during last few years. The collection increased from Pakistani Rs 11.5 billion (US$183bn) in 2002-03 to Pakistani Rs 20.4 billion (US$325mn) in 2004-05. The sales tax collection through this sector during July-March 05-06 was Pakistani Rs 18.9 billion (US$301mn).

13.11 Direct and Indirect Employment Generation in the Telecom Sector

Trade liberalisation's effects on demand and supply of labour are reflected in the form of changes in wages, conditions and levels of employment. The fundamental structural reforms in the telecommunication sector have contributed positively towards creating employment opportunities in the country. In 2004, the Government declared the telecommunication sector as a priority area for employment generation and poverty reduction. This is the fastest growing sector of the economy and pace is likely to accelerate even further in the next few years, creating more jobs and raising the income

Table 13.3: Employment in the Telecom Sector		
Service	Direct Employment (In 2004)	Indirect Employment
Cellular Mobile	31,922	23,495
Long Distance International	2,687	8,061
Wireless Local Loop	653	9,032
Local Loop	120	160
Payphones	188,800	188,800
Manufacturing	1,145	2,912
ISPs	343	668
Sets & accessories sellers	6,000	120
Grand Total	231,670	233,248
Source: Pakistan Telecommunication Authority. Annual Report, 2004-05		

of people. Table 13.3 shows that the pay phone sub-future sector has generated the largest number of job opportunities in the telecom sector. In addition to direct employment, the telecom sector has also generated a significant indirect employment.

13.12 Findings from a Perception Survey

In order to analyse the post-liberalisation scenario, a perception survey of the stakeholders was carried out. The major objective of this survey was to understand the economic impacts of telecom reforms on the related companies, workers and individuals. Performance of the telecommunication sector, effects on the labour market and benefits, if any, for consumers were the major aspects covered in the survey.

Survey of Service Providers

In all, 10 service providers were surveyed with a questionnaire. About 70 percent of the companies admitted that there was a substantial decrease in the tariff of fixed line telephone since 2003 (after the announcement of telecom deregulation policy). Similarly, for mobile telephones this decrease was 80 percent. As far as the change in non-tariff barriers (NTBs) and barriers to investments is concerned, the respondents were not very clear, but they do admit that the liberalisation reforms have proven to be beneficial for the sector as a whole.

When the service providers were asked to evaluate the sector's performance, 80 percent agreed that the sector's performance was better after liberalisation. For 9 out of the 10 service providers, investment increased and for 8 service providers, return on investment improved. There are substantial increases or improvements in competition, technological advancement, network accessibility, workers productivity and working environment for most of the service providers. All respondents agreed that the sector has experienced growth during the post-liberalisation era.

Survey of Telecom Employees

A sample of 30 telecom employees was chosen for the perception survey. The results show that liberalisation has proved to be beneficial in some areas while it failed to provide desired results in other areas. For example, there are improvements in employment generation (80 percent respondents), working conditions (77 percent respondents) and technological progress (97 percent respondents). But the employees have not received enough training and education facilities to learn new technologies, and for 73 percent there was no change in the provision of these facilities. Similarly, 33 percent of the respondents mentioned that there was no change in wages in real terms, while for 10 percent respondents wages, in fact, have decreased. Though there has been a substantial technological advancement, 57 percent of the employees perceived it as having no benefits for them.

Survey of Consumers

Survey results for a sample of 100 individuals of all income groups reveal that telecom services have become extremely affordable for the people. There is a substantial decrease in call charges (for 92 percent of the respondents), connection charges (for 98 percent of the respondents) and mobile phone charges (for 94 percent of the respondents). As

far as the quality of service is concerned, almost half of the respondents admitted that there is an improvement (48 percent), however, for 34 percent quality deteriorated.

13.13 Telecom Liberalisation and its Impact on Poverty

The deregulation of telecom sector is part of the economic reforms that is expected to benefit the economy, in general, and the poor, in particular. The phenomenal growth of this sector followed by liberalisation is extremely encouraging. The telecom sector's aggregate scale has expanded; thousands of employment opportunities have been generated for the unemployed educated youth, which means increased income, and in turn. enhanced economic activity. Presently, when developing countries like Pakistan are still struggling with the chronic problems of being deprived from basic needs (health facilities, safe drinking water, housing, malnutrition), it is expected that innovations in communication systems can provide a paradigm shift in addressing such problems using new approaches based on Information and Communication Technologies (ICTs) affecting society, government and trade respectively.

Poor rural areas that have never seen telephones are beginning to have access to advanced digital and microwave telephone systems and pay phones that are low cost and efficient. Rural telecommunication systems range from very basic pay telephones on the walls of village stores to digital wireless cellular telephones and sophisticated community Internet systems. As a result of increased competition, international settlement rates have been lowered in many countries, which in turn, have led to lower calling prices for consumers. In essence, people can afford to make more calls, more often, creating closer ties between family and friends in urban areas and different countries. This has also enabled people in rural areas to strengthen business relationships.

Policy makers around the world are hoping for a positive outcome from trade liberalisation, i.e. promotion of economic growth and reduction of poverty. Liberalisation of the telecom sector in Pakistan has attracted FDI, brought about technological changes and generated employment opportunities. Since the liberalisation process started a few years ago, it will take some time for the market forces to mature so that the benefits could further trickle down to the poor masses.

13.14 Conclusion

In Pakistan, the liberalisation of the state-owned telecom sector has proved to be beneficial for the economy. The emergence of new players in telecom sectors has facilitated the economy. It has had a positive impact on business transactions as well as the daily life of the common man. The increased competition among service providers has benefited the consumers as they have a wide array of telecom service choices available at affordable prices. Liberalisation of telecom has boosted the economic activity and has generated numerous employment opportunities.

The results of liberalisation of the telecom sector are very encouraging for policy makers in Pakistan. It is expected that this experience will be replicated in other sectors of the economy but before that, a strong institutional framework has to be formulated to manage market dynamics and trade challenges for long term sustainability of economic growth resulting from liberalisation and deregulation.

References

'Business Recorder Islamabad' June 03, 2006

Central Board of Revenue, Quarterly Report, March 2006

Endnotes

1 Economic Survey of Pakistan, 2004 -2005
2 Pakistan Telecommunication Authority, Annual Report 2004-05
3 Economic Survey of Pakistan 2005-06
4 Sector Status Report For Ministry of Information Technology' by Inter Connect Communications Ltd 2006
5 Supra note 3
6 Sector Status Report For Ministry of Information Technology' by Inter Connect Communications Ltd 2006
7 "De-Regulation Policy for the Telecommunication Sector", Ministry of Information Technology, Government of Pakistan, July 2003
8 The Dawn, April 13, 2006
9 Mobile Cellular Policy January 2004, Ministry of Information Technology; IT & Telecommunication Division, Government of Pakistan
10 PTCL Annual Report 2003-04
11 'Business Recorder' June 03, 2006
12 Supra note 2j
13 Supra note 3
14 *Ibid*
15 Sector Status Report For Ministry of Information Technology' by Inter Connect Communications Ltd 2006
16 *Ibid*

14 CHAPTER The RMG Industry in Sri Lanka

– Dushni Weerakoon and Jayanthi Thennakoon

14.1 Introduction

The opening up of the Sri Lankan economy in 1977-78 saw the beginning of rapid changes to the structure of the country's economy. Manufacturing output accelerated, driven by the emergence of garments exports as a driving force in the transformation from a largely export agriculture based economy to an increasingly industrialised one. While the emergence of the garment industry in Sri Lanka was partly due to prevailing global trading rules in the sector – the MFA – the policy reforms institute in 1977-78, no doubt, also contributed a significantly in providing a conducive environment for both domestic and foreign investors.

This case study examines the linkages between trade policy reforms in Sri Lanka and the emergence of the garment industry. In particular, the focus of discussion will be concentrated in highlighting the net welfare benefits that may have accrued to the Sri Lankan economy and the channels through which the trade policy reforms had a direct bearing on the outcome.

14.2 Reform Package and Emergence of the Garment Industry

International Trading Environment in Textiles & Clothing

An important factor which contributed to the growth of the Sri Lankan garments industry was the global trading rules under the MFA. Despite the limitations on the principle of free trade, the bilateral agreements under the MFA have guaranteed small developing countries like Sri Lanka a certain degree of accessibility to foreign markets. It can be argued that smaller producers with comparatively low and underdeveloped technology might not have had the same success in penetrating US and European markets under a fully competitive environment. Whilst a rapid end to the MFA would have been more favourable to the major developing country exporters, the agreed slower phase-out would not be unwelcome to smaller producers like Sri Lanka. In fact, unlike its Asian neighbours such as China, India and Pakistan, Sri Lanka was content to prolong the phase-out programme in order to allow itself the necessary time to restructure the industry to meet the new challenges.

Domestic Policy Environment

It has to be borne in mind that availability of quotas alone would not have induced the relocation of firms if the country did not offer a conducive policy environment for foreign investment to take place. Despite the availability of quotas from the mid-1970s, the garment industry began its rapid take-off only after the implementation of economic reforms in 1977-78. Thus, there is little doubt that Sri Lanka's liberal economic conditions

by the late 1970s played a significant role in encouraging industrial re-location of the garments sector to take place.

The garment industry benefited from trade and payment reforms and specific measures undertaken to promote export-oriented industries. These included the dismantling of QRs and the introduction of a multi-band tariff structure that was lowered progressively; a significant devaluation of the currency and shift to a managed float and removal of foreign exchange restrictions; measures taken to encourage FDI – including the establishment of Free Trade Zones (FTZs) and granting of general tax incentives, etc.

The investment promotion policy package offered included 100 percent foreign ownership of investment projects, a 10-year tax holiday with complete tax exemption on remuneration of foreign personnel employed and royalties and dividends of shareholders during that period, duty exemption on imported inputs, and unlimited access to foreign currency credit (at interest rates prevailing in international financial markets). Steps were also taken to enter into Investment Protection Agreements and Double Taxation Relief Agreements with the major investing countries. A constitutional guarantee against the nationalisation of foreign assets without compensation was also provided for. Thus, the policy reforms undertaken by the government together with the availability of abundant and cheap labour made Sri Lanka an attractive location for labour-intensive industries such as garments.

Despite persistent calls by garment producers for duty free imports of fabrics, the domestic textile industry continued to enjoy relatively high levels of tariff protection close to 35 percent – albeit a significant decline from the pre-1977 imports protection levels. Garment producers argued for zero duty on fabrics on the basis of bottlenecks and delays in clearing goods at the point of entry; low quality of local textiles that made it unsuitable for the export-oriented garment industry; and significant leakages that were occurring from Board of Investment (BoI) enterprises. Taking these concerns into consideration, the government reduced the import duty on textiles from 50 to 30 percent in 1995 and further to zero percent in 1997.

Rural Industrialisation

Decentralisation of manufacturing firms from FTZs to rural areas has been gaining increasing attention in policy formulations in Sri Lanka in recent years. Given the lop-sided growth pattern resulted from post-1977 industrialisation which was biased towards the Western Province, rural communities were left out and marginalised from the main stream benefits of export-led growth. Policy makers having identified the inequity in distributional impact of growth, strategies were put forward and implemented in order to decentralise garment factories with primary objectives of reducing regional poverty, countering urban migration, combating economic dualism and reducing regional imbalances of unemployment levels. For instance, a policy of declaring the whole country as an export processing zone (EPZ) was introduced in 1992; a key feature of this was 200 garment factory programme (200 GFP), which was launched (PEFDA, 1998). It is also evident that the 200 GFP has gone beyond its initial objective of generation of substantial employment opportunities for communities in rural areas towards social mobilisation. Large-scale manufacturing firms have taken such initiatives

as part of their corporate social responsibility (CSR) and carried out several projects in order to deliver maximum social benefits to rural communities and uplift their social welfare by initiating social infrastructure projects.

In line with the underlying concept of the 200 GFP, the Government of Sri Lanka has recently initiated a similar proposal called the 300 factory programme with the intention of encouraging the establishment of manufacturing bases in areas outside the main Western Province of the country. The key objectives are to promote the decentralisation of firms and rural industrialisation. However, the proposed programme has been gaining less attention of manufacturers due to the limited incentives put forward so far. As highlighted by manufacturers interviewed, the government needs to consider the cost associated with poor infrastructure facilities, in particular road networks, power and water in rural areas and compensate potential movers accordingly by providing generous incentives, i.e. a similar package that is already given to encourage establishment of new firms in FTZs.

Those interviewed believe that the effectiveness of the programme as well as the responses of the garment industry will depend entirely on the final package of concessions given to potential manufacturers. However, as some pointed out, setting up new production houses in rural areas depends not only on the incentive packages but also on the potential international and domestic market, which will ultimately ensure a continuing demand for their products.

14.3 Structure of the Garment Industry in Sri Lanka

Available data suggest that there are currently about 860-890 firms in operation in the garment industry. Of these factories, around 80 percent are categorised as small and medium according to the value of exports. Even if the distribution of firms is looked at in terms of number of employees, 80 percent of establishments fall within the category of small and medium. These, however, account for less than 30 percent of total export earnings. The bulk of revenue (70 percent) is generated by the remaining 12 percent of exporters. In fact, it is estimated that 25 garment manufacturers in Sri Lanka account for 52 percent of total garment export earnings (Kelegama and Wijayasiri, 2004).

Sri Lanka's garment industry is heavily export-oriented. It is estimated that nearly 95 percent of industrial production is exported and the local market plays only a very minor role (UNIDO, 2000). Given that the industry has been heavily dependent on the quota system from the initial take-off, most enterprises have therefore been oriented towards job processing for overseas customers.

14.4 Contribution of Garment Industry to the Sri Lankan Economy

Contribution to Export Earnings

The rapid expansion of the garments export sector is demonstrated by the fact that the rate of export earnings growth of this sector recorded during the period 1980-90 was exceptionally high at over 20 percent per annum, given that the industry for the most part was starting from a very low base (Table 14.1). In the 1990s, export earnings growth decelerated somewhat, but still remained well above that recorded for total export earnings.

Table 14.1: Garment Industry in Sri Lanka: Selected Indicators					
			1980-1990	**1990-2000**	**2000-2004**
GDP Growth	%	4.4	5.3	3.9	
Export Growth	%	7.5	12.6	5.2	
Garments Export Growth	%	19.6	18.0	4.5	
		1980	**1990**	**2000**	**2004**
Garments/Total Exports	%	10.4	32.8	49.1	46.0
Garments/Manufacturing	%	30.3	58.5	63.3	58.8
Establishments in Garments	No	142	678	891	1061
Cumulative FDI in Garments	US$mn	36	108	158	158
Employment by Garments Industry	'000	102	250	227	330
Source: Central Bank of Sri Lanka, Annual Report, various issues; Kelegama and Wijayasiri (2004)					

As a result, there has also been a marked change in the composition of Sri Lanka's exports. The share of the traditional tree crop sector in total export earnings has continued to decline, while that of industrial exports has been rising. The share of exports of the industrial sector, which accounted for just 15 percent of total export earnings in 1978, had come to account for more than 75 percent of total exports by the mid-1990s. Garment exports had come to account for more than half of Sri Lanka's export earnings by the mid-1990s (having accounted for a negligible share of less than four percent at the beginning of the liberalisation period).

Garments Industry as a Source of FDI

FDI has the advantage of introducing management skills and access to foreign markets. The rapid expansion of East Asian garment exporters operating from Sri Lanka – with already established foreign markets – was a key contributor to the expanding role of FDI-related manufactured exports from the country. At the commencement of economic reforms in 1977, the manufacturing sector was host to a total of 70 foreign firms. This total increased significantly in the post-reform period with much of the expansion originating in the garment industry. The early surge of FDI came primarily from the traditional East Asian garment producing countries; FDI inflows into the industry were predominantly from Hong Kong and South Korea. In fact, it has been estimated that foreign investors own nearly 50 percent of total garments factories and account for 90 percent of total textiles and garments exports from Sri Lanka (USITC, 2004)[1].

Employment Generation in the Garments Industry

One of the key positive impacts of the emergence of the export-oriented garment industry in Sri Lanka was that it was to provide an important source of employment, particularly for the rural economy. In fact, it has emerged as the largest industrial employer in Sri Lanka. The industrial sector accounts for about 20 percent of total employment in the country with manufacturing taking the largest share of 16 percent. Direct employment in the garments industry – estimated at around 330,000 – accounts for around 30 percent of total manufacturing employment in the country. It is estimated that the

largest employers are the large manufacturers accounting for just over 51 percent of the total employed, while the small and medium factories account for the remaining 16 and 33 percent, respectively (SLAEA, 2002).

As with other comparable countries engaged in the garments under similar conditions, the work force is overwhelmingly dominated by female labour. However, while nearly 90 percent of the work force in the garment industry was female the overwhelming majority are to be found in the less skilled categories.

Employment in the garment industry has been found to be an important source of rural income in the post-liberalisation period (Dunham and Edwards, 1997)[2]. Most critically, the garments industry provided employment opportunities for young, unskilled females who were previously for the most part not considered to be part of the labour force (i.e. actively not seeking or available for employment). There is clear indication that employment opportunities in the garment industry from the early 1980s have had a significant impact on patterns of female employment in Sri Lanka. In total, the female labour force participation rate increased substantially from 25.8 percent in 1980 to 39.5 percent by 1990 (Rodrigo, 2001).

Field interviews suggest that the decision of most of females to seek employment in export garment industry had been largely induced by their lack of awareness of alternative employment opportunities available outside the industry. None of them, except a negligible proportion of the females interviewed, had been actively seeking employment outside the industry prior to entering the workforce of the garment industry (even though they are of the view that the number of job opportunities that are available and better suited to their qualifications is extremely limited). Therefore, the larger number of employment opportunities in the garment industry that emerged after 1977 is not the only fact that has encouraged them to seek employment in that industry; lack of awareness and poor career guidance that they had received have also played a part in their decision to be employed in the export garment sector.

In most factories, wages are relatively low and accompanied by poor incentive payment structures that are not based on productivity levels. Nevertheless, wages are set always above the minimum standards and according to the labour legislations in the country. It was mentioned in the study by Jayaweera (2004) that more than 90 percent received cash benefits which is above the poverty line. However, as wages are low, longer working hours and overtime work are required to maintain a decent living. As such, many workers have found it difficult to maintain healthy lives and have often been subject to occupational health hazards.

Despite the benefits of employment opportunities created by the garment industry, there have also been some adverse socio-economic problems for the work force. Working conditions, particularly in some of the SMEs have been subject to criticism (Kelegama and Epaarachchi, 2004). Living conditions, too, have come up for criticism where available accommodation for workers has been found to be of poor quality (CENWOR, 2001).

Furthermore, it is said that even though the industry provided significant employment opportunities for females in the labour force, opportunities for upward mobilisation of

labour, particularly at machine operator level is extremely limited or almost non-existent. Even though low-skilled workers are provided short-term training programmes and large factories provide salary increments, it was obvious that female career development has been trapped at low level employment categories whereas male workers have more opportunities for upward mobility and access to upper or middle level employment categories (Jayaweera, 2005).

14.5 MFA Phase-out and Future Challenges for the Garment Industry

The garment industry in Sri Lanka is characterised by both product and market concentration, making it more vulnerable to the pressures of heightened global competition in a quota-free environment. The majority of Sri Lanka's total export earnings from garments is concentrated in casual wear for women and men. The vast majority of its quota exports is standardised low or medium priced items, requiring relatively low technology and based on low priced labour where market entry is easiest (Weerakoon and Wijayasiri, 2000). Sri Lanka was subject to quotas under approximately 50 categories in the US market, and four categories in relation to the EU. Nearly 90 percent of total garment exports to the US consisted of quota items by the late 1990s.

In the case of total garment exports to the EU, however, only around 25 percent were quota items. For total garment exports, it is estimated that approximately 65 percent of the total volume of garment exports were quota items in the late 1990s. With its overwhelming dependence on quota exports, Sri Lanka's ability to maintain and expand on its market share in a quota-free environment, competing with large-scale, low cost suppliers, is subject to concern.

Sri Lanka's garment industry was provided quota free entry to the EU with effect from 2001, but still continued to face an average duty of 12 percent. In 2004, Sri Lanka became eligible for the labour incentive of the GSP scheme of the EU, which provided 40 percent duty concession for RMGs. However, it has been argued that the utilisation of the GSP scheme has been limited due to the existing RoO restrictions in the EU even with the use of South Asian Association for Regional Cooperation (SAARC) country inputs in the production process under the Regional Cumulative Criteria. As a result, Sri Lanka has been able to use only 32 percent of GSP quota for 'apparel knitted and crocheted' (Chapter No 61) and 11 percent for 'apparel not knitted and crocheted' (Chapter 62) in 2002 (Kelegama, 2005). Therefore, Sri Lanka is pursuing the idea of gaining Super Regional Cumulative Criteria for the GSP scheme to include SAARC and the Association of Southeast Asian Nations (ASEAN).

In a study by Kelegama and Epaarachchi (2004), it was mentioned that 50 percent of the industry would be forced to closed down under the phasing out of MFA given the industry's heavy dependence of garment exports on quota-based items (60 percent of total) and the production of the larger majority of SMEs (80 percent) are not based on demand driven supply mechanism. Also, highlighting the likely impacts of removal of quota system, the study further mentioned that there might be some unemployment in the short run whereas some unemployed will be absorbed into the remaining establishments in the industry in the medium and long run.

It was evident from the discussions with a range of garment manufacturers that the larger firms in the industry have resources to improve their competitiveness and face the challenge of exposure to MFA phase-out situation as they are financially steady and equipped with skilled man power to shape their industry to meet global trends. Most believe that the removal of quotas is a challenge as well as an opportunity for the local garment industry to keep up with external markets and obtain benefits from international linkages. In contrast, the small and medium scale garment manufacturers who have not been able to create direct supply links with overseas buyers during the last couple of decades have become increasingly vulnerable largely due to their small scale production, low profit margins and limited financial viability. As highlighted by some of the big exporters, the one and only option that small industries have is to rely on to merge with large companies or to be sub-contractors for large companies for their survival in the industry.

One of the major constraints highlighted by almost all stakeholders in the field interviews is the scarcity of skilled labour. Small and medium scale industries are particularly vulnerable to shortage of skilled labour, where the provision of training programmes for new entrants is an additional cost to them in a highly competitive environment. In addition, high labour turnover and absenteeism are yet other issues attributed by many stakeholders to recent downfall of productivity in the industry on the whole. Young female workers have a tendency to leave the industry after a short period of time largely due to long working hours, harsh working conditions and schedules, uncomfortable and low quality living arrangements.

The problem of product concentration is compounded by market concentration. Sri Lanka's major market for garment exports is the US. From exporting nearly 55 percent of all garment exports to the US in 1980, the ratio had increased to nearly 65 percent by the late 1980s[3]. The other major market is Europe, which continued to account for nearly a quarter of Sri Lanka's total apparel exports for much of the 1980s, increasing its share to over 30 percent the same period (Weerakoon and Wijayasiri, 2000).

The lack of a fabric base is also seen as a potential weakening factor in Sri Lanka's competitive position *vis-à-vis* its main competitors in Asia. It is estimated that 80-90 percent of fabrics and 70-90 percent of other accessories required for the garment export industry are imported (Kelegama and Foley, 1999). Since fabrics amount to 65-70 percent of the value of finished products, the lack of backward linkages from the garment industry continues to be a source of concern regarding the future competitiveness of the industry. Improving backward linkages is largely inhibited by the fact that Sri Lanka does not produce the raw materials – such as cotton and raw materials to make synthetic fibres – used in the production of fabric and some accessories.

It was apparent from field interviews that almost all the garment exporters prefer local purchases than imported raw materials if they are in line with the quality standards required by the garment industry and available at competitive prices. As some of the leading garment exporters interviewed in the survey mentioned, development of backward linkages has been poor largely due to the high cost of investments required to set up a domestic raw material base in a relatively small domestic market.

Sri Lanka is thus at a disadvantage *vis-à-vis* competitors, such as China and India which are well supported by backward integrated industries. Besides, high import dependence on raw materials has also resulted in longer lead time, which in turn, adversely affects the competitiveness of the industry. Capital costs in fabric production are significantly higher than in garment production – constraining the extent to which comparative advantage in low labour costs can be translated into a competitive advantage in terms of output price – and placing domestic entrepreneurs at a disadvantage.

Other more serious constraints faced by most garment manufacturers is the increasing cost resulting from poor infrastructure, in particular telecommunication, power, water and road networks. Manufacturing firms in the industry are not currently provided any concessions for electricity and water, which constitute significant magnitude of the total cost. The problem is particularly severe for factories operating outside and far away from Colombo. As revealed by many stakeholders, costs associated with infrastructure have limited the potential of small and medium scale industries to earn an attractive return on investment and enhance competitiveness. Discussions with manufacturers found that garment industries operating within the premises of FTZs are also not provided with such infrastructure facilities at concessionary rates.

Furthermore, limited access to finance in terms of medium to long term loans, short-term financing and other banking facilities has impeded the ability of some of small scale manufactures to expand their operations or establishment of new ventures. Yet, lack of access to finance is not a major constraint attributed by most of the manufacturing firms for loss of competitiveness and limited capacity of their scales of production and expressed satisfaction with the existing provisions of financial arrangements in the country.

According to the available data as well as stakeholder's interviews, the garment industry in Sri Lanka is not faced with the issue of technological up-gradation as the industry on the whole has managed to invest in the latest technologies which are equivalent to those used by other competitors in the region. Also, Sri Lanka has created a reputation for its supply of good quality garments, reliability of supply and relatively low prices of products. As such, an educated and literate work force will contribute enormously to the future success of the industry.

Therefore, the need is to invest in training and human resource development rather than on physical capital to enhance productivity of the sector. The competitiveness of the industry to face the challenge of removal of MFA has been largely affected by low level of skills and productivity of the workers. Scarcity of skilled workers such as pattern workers, technologists, fabric technicians is a major weakness of the industry. Therefore, it has been suggested by the industry leaders that Sri Lankan export garment industry needs to focus on development of specific products categories and customers, which are critical in order to survive in the world export market (JAAF, 2005).

One common complaint made by almost all stakeholders interviewed was the sluggish manner of public sector institutions related to export and import trade in Sri Lanka. As

mentioned, direct cost associated with wide spread bureaucratic practices such as rent seeking activities practiced in key government institutions and indirect cost related to long delays, long procedural requirements, etc., have adversely affected the competitiveness of the sector, in particular the small sector entrepreneurs, who are not equipped with professionals to handle trade procedures and formalities related to international trade in Sri Lanka.

It is fairly obvious that in order to compete in the post-MFA phase, Sri Lanka's garment manufacturing industry needs to urgently address the issue of restructuring its operations to survive in the new trading environment. There is a degree of justifiable optimism that the larger manufacturing firms in the industry, which have by and large established direct links with overseas buyers, will be in a position to compete successfully in a quota-free environment. Much of the concern regarding the future of the industry is largely a reflection of the perceived weaknesses of the majority of small sized firms operating in a quota 'protected' environment. Their ability to compete with large producers from countries such as China and India are highly questionable.

Moreover, garment factories that received special treatment for establishing manufacturing units in rural areas will face considerable difficulties as quotas are withdrawn. In a highly competitive environment, access to ports and other infrastructure will become even more critical and factories located in rural areas will be disadvantaged.

14.6 Conclusion

The garment industry in Sri Lanka experienced a rapid expansion after 1977 largely to the country's adoption of economic liberalisation with the primary focus on encouraging export-led industries. The expansion of the industry was also assisted by the prevailing global trade environment in T&C under the MFA which provided guaranteed markets in the form of quota. As a result, Sri Lanka became an attractive destination for investments from quota hoping foreign manufacturers, particularly from East Asia. The rapid take-off of the industry, which was primarily triggered by external factors, was further facilitated by the conductive domestic policy environment which took place after 1977 with progressive tariff liberalisation, removal of foreign exchange controls, removal of QRs, incentives granted to attract FDI and other institutional arrangements.

Decentralisation of manufacturing firms, which were more concentrated in the Western Province during the first decade of liberalisation, has been gaining increasing attention since the early 1990s with the policy of rural industrialisation. Subsequently, the garment industry today has become the single largest industrial employer in Sri Lanka and a significant contributor to foreign exchange earnings. As such, the industry has had considerable implications for the domestic economy through its direct impact on employment, export earnings, FDI as well as indirect impact on infrastructure development. One of the key impacts of the rapid expansion of the garment industry was the generation of employment opportunities for a large number of the labour force in Sri Lanka, in particular for young unskilled female unemployed, providing a survival strategy against income risk.

The majority of female workers attached to the export garment industry is mainly unskilled and belong to low income segment of the country and therefore, the industry has made significant improvements in their living standards as well as that of their dependents. Yet, despite the beneficial impacts of employment generation, the garment industry has also brought some adverse socio-economic problems for the work force in the form of harsh working conditions, poor living styles, occupational health hazards and low or non existent up-ward movement in career development.

The phasing out of quotas in 2005 is likely to hold significant implications for the industry. Despite divergences in views amongst garment sector stakeholders, it is generally accepted that the export garment industry on the whole will suffer with phasing out of MFA, with the SMEs in particular being more vulnerable to increased exposure to international competition. Even though the industry is basically equipped with necessary resources to cope with the challenge, the competitive strength of the export garment industry remains limited mainly due to the low productivity inherent in the industry as a result of several constraints faced by the industry in recent times such as severe shortage of labour at both skilled and unskilled levels, low garment factory standardisation, low investments in technology, poor infrastructure facilities outside the Western Province, etc.

Thus, restructuring and re-organisation of the industry will be critical if the garment industry is to maintain its vital role in the Sri Lankan economy, both as a source of export earnings and more critically as an important source of industrial sector employment.

References

CENWOR (2001), "Impact of Macroeconomic Reforms on Women in Sri Lanka: Garment and Textile Industries", Study Series No. 20, Centre for Women's Research, Colombo

Dunham, D, and C Edwards (1997), "Rural Poverty and an Agrarian Crisis in Sri Lanka, 1985-95: Making Sense of the Picture", Poverty and Social Welfare Series No. 1, Institute of Policy Studies, Colombo

Joint Apparel Association Forum (2002), "5 Year Strategy for the Sri Lankan Apparel Industry", JAAF: Colombo

Jayaweera, S (2004, "Continuity and Change: Women Workers in Garment and Textile Industries in Sri Lanka", *http://reseau.crdi.ca/en/ev-58039-201-1-DO_TOPIC.html*

Kelegama, S and R Epaarachchi (2004), "Labour Productivity and Job Quality in the Garment Industry" in S Kelegama (ed.), *Ready-Made Garment Industry in Sri Lanka: Facing the Global Challenge*, Institute of Policy Studies, Colombo

Kelegama, S, and J Wijayasiri (2004), "Overview of the Garments Industry in Sri Lanka" in S.Kelegama (ed.), *Ready-Made Garment Industry in Sri Lanka: Facing the Global Challenge*, Institute of Policy Studies, Colombo

Kelegama, S, and F Foley (1999), "Impediments to Promoting Backward Linkages from the Garment Industry in Sri Lanka", World Development, Vol. 27, No. 8

Kelegama, S (2005), "Impact of the MFA Expiry on Sri Lanka", *South Asia after the Quota System: Impact of the MFA Phase-out*, Institute of Policy Studies: Colombo

People's Forum for Development Alternatives (1998), *Garment Factory Women Workers*, Centre for Society and Religion: Colombo

Rodrigo, C (2001), "Labour Market Developments: Sri Lanka Country Profile in the 1990s", Background paper for a workshop on *Towards and Employment Strategy Framework in Sri Lanka* mimeo

Weerakoon, D and J Wijayasiri (2000), "WTO and the Textile and Garment Sector: Implications for Sri Lanka", South Asia Economic Journal, Vol. 1, No. 1

UNIDO (2000), "Master Plan Study on Industrialization and Investment Promotion in Sri Lanka: Apparel Industry", Integrated Industrial Development Support Programme, Ministry of Industries, Colombo

USITC (2004), "Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the US Market", United States International Trade Commission

Endnotes

1 However, this figure is subject to debate. According to the Sri Lanka Apparel Exporters Association (SLAEA), local industrialists are estimated to own about 85 percent of garment factories (Kelegama and Wijayasiri, 2004)

2 In addition to income generated by migrant employment overseas, particularly in the Middle East and employment in the armed forces subsequent to the escalation of Sri Lanka's internal conflict from 1983

3 In terms of Sri Lanka's total exports, the US accounts for nearly 40 percent of all exports, while the EU absorbs a further 20 percent

15 CHAPTER The Textile Industry in Sri Lanka

– Dushni Weerakoon and Jayanthi Thennakoon

15.1 Introduction

The economy wise liberalisation efforts initiated in the late 1970s in Sri Lanka marked a radical departure from a tightly controlled inward looking economy to a market-oriented outward looking economy with an explicit focus on manufacturing export-oriented growth. The growth momentum of the textile and garment (T&G) sector, which emerged as the driving force of growth in the industrial sector after 1977 came primarily from the export garment sub-sector and not from the textile sector. During the pre-liberalisation era, the domestic textile industry was essentially an import substitution industry confined to a few large scale textile mills run by the government. The industry was highly protected during up to 1977 with imports of fabrics under restriction while importation and distribution of raw materials were also tightly controlled. Yet, as in the case of many other import substitution industries, the textile industry did not make much progress during this policy regime.

The protection offered to the industry was continued to a large extent even after 1977 and until about the 1990s. During this period, textile firms still survived largely because of some degree of protection that continued to be offered by the state. Nevertheless, the domestic textile industry in Sri Lanka was among the most adversely affected by the liberalised trade reforms. The purpose of this case study is to examine the implications of trade policy reforms in Sri Lanka on the growth and structure of domestic textile industry while analysing the major constraints of the industry.

15.2 Structure of the Industry: Pre-reform

Sri Lanka's adoption of import substitution industrialisation policies from the 1960s had a significant impact on the structure and composition of the country's emerging domestic textile industry. The domestic textile industry, as many others, was set up as an import substitution industry primarily to provide a relief to continuing balance of payment (BoP) pressures that persisted in Sri Lanka during the 1950s. Such a policy strategy was adopted as a means of reducing dependence on imports and meeting the domestic requirement for textiles. As such, the industry was offered a wide range of incentives through the 1960s including tax exemptions, tax rebates on plants and machinery, depreciation allowances, concessionary rates of duties on equipments and raw materials, loans, technical assistance, protection of domestic industries through import controls, tariff adjustment policies and government purchases.

There was an outright ban on the import of fabrics, while the government maintained sole control over the import and distribution of raw materials for textiles. In the 1960s, all importers of textiles were required to purchase a certain percentage of locally produced handloom textiles under the Industrial Policy Act of 1949 (de Silva et al., 1996)[1] while cotton yarn was supplied to weavers at a subsidised price through the Weaving Supplies Corporation (Osmani, 1987).

The public sector dominated the spinning, weaving and finishing sector which comprised of three categories; mills, power looms and handlooms. By the time of liberalisation, there were five large textile mills operated under the National Textile Cooperation, contributing to most of the output in the spinning sector. The state-owned power looms, private and cooperative power looms and handloom centres under the Department of Textile Industries and the Department of Small Industries were operating in the weaving sector.

The structure of the local textile industry further shows that prior to liberalisation, most of the textile units in the private sector belonged to the small scale and cottage category with less than 50 employees. Within the small sector in Sri Lanka, the textile sector came second in order of value of production at the time of liberalisation and small textile units accounted for nearly one-fifth of all small scale industrial units in Sri Lanka, irrespective of their product category (Osmani, 1987).

Employment in the sector was mainly a state-created phenomenon (Gunathilake, 1997). Nevertheless, textile products were manufactured widely as a rural cottage industry given that the industry as a whole – and handlooms in particular – is labour-intensive and requires easily acquirable skills. Therefore, apart from the state as the major employer, a large cottage industry in handloom weaving also provided employment for over 50,000 workers, mainly women, in the rural informal sector during the import substitution era (Perera, 2000). As the industry operated under a highly protective market environment, employment in the handloom industry increased rapidly during the import substitution era (Osmani, 1987).

In terms of the gender impact of the textile industry, as in many other developing countries, the textile industry in Sri Lanka also provided large numbers of employment opportunities to the female workforce in the country during the pre-liberalisation era. It is estimated that the total workforce in the textile sector had increased by 176 percent between 1963 and 1971 while the female work force in the industry had increased by 173 percent over the same period, indicating the dominance of female labour in the industry (Perera, 2000).

15.3 Policy Reforms Post-1977 and Performance of the Textile Industry

The liberalisation effort that took place in 1977 included policy measures aimed at encouraging export manufacturing growth such as the liberalisation of import trade and exchange payments, removal of price controls, rationalisation of State involvement in industries and promotion of private sector involvement. The prevailing structure of the domestic textile industry made it particularly vulnerable to the opening up of trade given the decades of State protection that the industry had continued to enjoy. As was expected, the policy reforms brought significant implications for the local textile industry

and the reforms were followed by a sudden decline in textile output reflecting the inability of the industry to face the new global challenge of free markets.

The trade and tariff reforms, which were introduced as key element of trade liberalisation efforts, comprised of revisions to the existing import tariff structure aimed at reducing import controls and duty rates. The government announced the liberalisation of imports through the 1977 budget and the degree of tariff protection offered to local industries was gradually removed, forcing the local textile industry to compete with low priced imports. Meanwhile, government intervention in the supply of raw materials and the marketing of finished products in the sector was withdrawn while the subsidy of cotton yarn was also abolished.

As a result of progressive liberalisation of import duties on fibre, yarn and fabrics, abolition of public sector involvement in production, allocation of resources and pricing as well as the rationalisation programme for SOEs, the domestic textile sector suffered severe adverse effects. The larger public sector textile mills encountered serious financial difficulties in the open economic environment after 1977. In addition, import liberalisation resulted in a considerable quantity of imported textiles coming into the local market allowing consumers a choice of textiles; for example, textile imports increased nearly fivefold from 20 million meters to 96 million meters a year immediately after 1977 (Osmani, 1987). The local textile industry, therefore, faced severe market difficulties both in terms of supply and demand. As a result, despite the attempts made to regulate the imports of finished textiles through direct government involvement in import trade, the output of large textile mills tended to stagnate in the post-liberalisation era.

The output of government-owned textile mills declined significantly during the first five years of liberalisation from Sri Lankan Rs 25.9 million to 9.9 million (US$0.24mn-0.09mn) between 1978 and 1983 (Athukorala, 1986). According to the estimates of the Department of Census and Statistics of Sri Lanka[2], it was obvious that the textile industry reported a sharp downturn immediately in the aftermath of 1977, partly reflecting the impact of import liberalisation and the process of rationalisation. Yet, the industry has remained fairly stable since the mid-1980s. The impact is said to have been severe in the rural informal sector, which comprised mostly of small-scale industrial units.

While the domestic textile industry, on the whole, was the most adversely affected by import liberalisation, the handloom sector in particular – operating for the most part in the unorganised sector – was a weak force in terms of its ability to lobby the government. As a result, many firms went out of business. According to the Central Bank Industrial Survey of 1978, a year after the liberalisation of imports, out of 1300 firms in this sector on its mailing list, 200 firms informed the closing down of business (Athukorala, 1986). Estimates prepared by the Ministry of Textiles on the unorganised handloom textile sector suggest that out of about 110,000 handlooms which existed in the country prior to liberalisation, about 30,000 had ceased to function by 1980 (Athukorala, 1986). Studies by Gunathilake (1997) and Osmani (1987) suggest that downsizing of the local handloom industry was inevitable, even with the state protection provided, due to labour attrition and falling demand. Therefore, the capacity of the handloom sector to generate employment opportunities and export earnings was extremely limited. At present,

handloom weaving centres attached to textile cooperative societies and institutions in the state sector survive simply because these societies and the Department of Textiles purchase yarn and distribute it to weaving centres for production purposes.

It was expected at the inception of economic liberalisation in Sri Lanka that small firms would contribute to exported industrialisation by being subcontractors to large exporting firms (Kelegama, 1993). However, small and medium scale textile producers were the most affected and benefited little from the expansion of some of the leading sectors in the economy such as garments. Most of the small scale enterprises were not capable of establishing linkages with large scale firms. Even though there were large numbers of private and public sector institutions that had been established to promote linkages between large and small scale manufacturers, many small scale firms were not even aware of the existence of such services. In many cases, the crucial constraint faced by small textile producers was the scarcity of working capital and as a result, small textile suppliers failed to meet the required specifications and delivery schedules.

Moreover, small establishments were not in a position to take advantages of liberalised imports of raw materials as they had to depend on intermediaries for their supply of raw materials due to their small scale of production and small volumes of purchases, but large scale textile producers benefited relatively more from liberalised imports of raw materials. In addition, limited production capacity has constrained the ability of those small and rural establishments to compete with low priced imported finished goods. Rural small scale industries did not benefit from the network of financial resource mobilisation developed after liberalisation. As such, the most adverse effects of liberalisation could be seen in textile units in the rural informal sector (Osmani, 1987).

Parts of the mechanised sector were also adversely affected and were unable to compete with imports to service the rapidly expanding garments sub-sector which exhibited an import content estimated at over 70 percent of the value of output. Sri Lanka requires around 800 million metres of fabric for both domestic and export markets. Even though the export garment industry in Sri Lanka requires fabric raw materials by a larger amount, the domestic textile industry, consisting of the handloom and power loom sectors, is not well equipped to meet that demand for fabrics. Some raw materials are not manufactured in Sri Lanka in sufficient quantities and less than 10 percent of the fabric required by the export sector can be met by local textile manufacturers. Therefore, the Sri Lankan garment industry is highly dependent on imported fabrics for its production purposes.

In addition, though some finished textiles are produced in Sri Lanka in small quantities, it is also characterised by high import dependence. According to available data[3], domestic production of yarn in terms of volume has increased by 16 million kg between 1990 and1998 while the import volumes have increased by nearly two times (29 million kg) the increase of volume of domestic production. The data further demonstrates that the volume of annual imported fabrics and yarn was continually greater than the annual domestic production of fabrics in each year throughout the last decade. The domestic textile industry in Sri Lanka is geared primarily towards production for the domestic market. Yet, the growth in fabric demand in the domestic market is also very minimal at about 2.5 percent, worsening production capacity further (Gunathilake, 1997).

Realising that the capacity constraints in the domestic textile industry cannot be met solely by local capital investments, the government offered various policy incentives and concessions for foreign investors to establish new textile mills at the end of the 1980s. A number of fiscal incentives primarily aimed at foreign owned enterprises or joint ventures for domestic fabric production were announced in 1990. These included incentives such as exemption from corporate income tax, concessionary rate of income tax, exemptions from Exchange Control Act, facility of opening foreign currency accounts, duty free imports of plant and machinery, etc. However, despite heavy lobbying and advertising efforts made by the government, the reception was poor mainly because foreign investors were more interested in producing for the high end of fabric production and were not interested in producing for the low end of the market where there was a greater demand in Sri Lanka (Kelegama, 1993).

Since the textile industry in the pre-liberalisation era operated within a protective market environment and the industry was one of the hardest hit in the wake of import liberalisation, there was a significant lobby by the domestic producers, in particular, the SOEs and various other interest groups to continue with government support even in the post-liberalisation era. Given continued high unemployment in rural areas after 1977 and other socio-economic problems related to rural-to-urban migration with respect to employment in the export garment factories, the government reverted its attention back to the domestic textile industry. Envisioning the potential capacity of the small and medium scale industries to generate employment opportunities and thereby reduce rural poverty in Sri Lanka, the government began to re-focus on the industry.

Tariffs on imports of textiles were subsequently revised upwards in an attempt to halt the downward trend – although they were subject to fluctuations over the period (Perera, 1997). As a result, effective rates of protection for textile manufacturing started to creep up from 0.95 in 1979, to 1.81 in 1983 and further to 2.27 by 1988 (Gunathilake, 1997). In late 1989, a surcharge of five percent was introduced on all items under five percent import duty. In 1991, a 35 percent duty was applied only to expensive fabrics while the specific duties of Sri Lankan Rs 20 or 30 per square metre was used for all other non expensive fabrics. Since non-expensive fabrics constitute the bulk of imports, the duty paid by most fabric importers was almost 97 percent of the cost of fabric (Kelegama, 1993).

By 1993, although raw fibre (either synthetic or cotton) was not subject to any custom tariff, yarn was subject to a 20 percent tariff rate. The existence of such a non-transparent duty structure caused many problems. The tariff structure was thus further revised in mid-1993. The new duty structure was intended to protect the local fabric industry while it was expected that the introduction of a new duty rate of 100 percent[4] on textile fabrics would not have any major impact on the garment exporters as the duty increase by 3 percent was minimal, while it also ensured a more transparent duty structure (Kelegama, 1993). Backward integration was one argument that was put forward to justify the protection offered to the domestic textile industry while the negative employment implications of closing down of larger number of textile industries scattered throughout the country were also used to justify the continuation of the protection given to the sector (Perera, 1997). However, largely as a result of and in recognition of

increasing competition facing the domestic garment industry, a decision was taken to completely liberalise the import of textiles through the budget of 1997.

Even though the immediate impact of trade liberalisation on the textile industry was extremely negative, the production capacity of the industry has been increasing since the 1990s. The recovery is partly because the garment industry has started to substitute locally produced inputs for imported raw materials to some extent. The domestic handloom industry enjoyed a relative boom during the period 1989-94 with the announcement made by the government enforcing state-owned offices to use handloom materials for their office uses. However, it was a state-created phenomenon and the sales of hand-woven materials started to decline once the enforcement of that law was withdrawn. Supporting the idea of direct or indirect state trading activities, it was revealed in the field interviews by some of the stakeholders who belonged to the state sector that state intervention is essential to uplift the industry. In contrast, the large private sector is of the view that competitiveness is the crucial determinant of the future of the industry.

The improved export performance in handloom and textiles in the 1990s has come primarily from the large scale private sector. Handloom centres under the patronage of the state sector have not achieved the same export success as private sector companies specialising in handloom textiles. As revealed by many of the stakeholders in the field interviews, production in the private sector had also stagnated in the immediate aftermath of liberalisation. However, they had commenced and expanded their business with the incentives offered under the new policy package of liberalisation and it was apparent that those producers had resources to cope with inconsistencies in state policies and inadequate infrastructure.

15.4 Linkages to Poverty: Post-Reform Impact on Employment

It is evident according to the labour force statistics that macroeconomic reforms accompanied by liberal trade policy reforms initiated in Sri Lanka since 1977 have had adverse consequences for the poor through their direct impacts on the employment. With the structural reforms after 1977, the impact on employment was quite significant in the domestic textile industry. Unlike in the export-oriented garment industry, the largest concentration of workers employed in the domestic textile industry was found in rural areas in Sri Lanka and scattered throughout the country. Even in the 1990s, nearly 76 percent of total handloom workers were found in areas other than the Western Province with the single largest concentration of workers at nearly 31 percent found in the Eastern Province alone (Gunathilake, 1997). Thus, the micro impact of closing down of those firms had greater implications for the rural poor in the country.

The extremely severe impact on employment in the domestic textile industry can be mainly attributed to two strands of policies. First, the rural and small scale sector, which had depended largely on subsidised inputs collapsed with the withdrawal of producer subsidies and de-control of prices. Second, privatisation resulted in the closing down of textile centres which were under the patronage of the state sector prior to liberalisation, providing a large number of employment opportunities for the workforce in the country.

According to the estimates of a survey carried out by the Industrial Development Board in 1980 between 1977 and 1979, employment in approved industries had increased by seven percent while that in unapproved industries where the rural poor were more concentrated in, had declined by 16 percent. It indicates that the rapidly expanding manufacturing sector was not growing fast enough to absorb the labour displaced by contracting industries of the economy. The impact was particularly adverse for small individual units, which were not able to respond to the new incentives offered under the 1977 policy package. One apparent example was the handloom sector. The corresponding employment losses in this sector have been massive. Estimates suggest that in the 1970s, handlooms employed some 150,000 people. In the 1990s, total employment in this sector was put at less than 25,000 (Ministry of Handloom and Textiles, 1991). In fact, the loss of employment in this sector during 1977-80 was estimated at 40,000.

Table 15.1 shows the changes in the number and pattern of employment in the textile industry during the last two decades. As was mentioned previously, even though the textile industry experienced a sharp decline in the number of employees attached to the industry during the first five years of liberalisation, it is evident from the Industrial Census data that after 1983, employment in the local textile industry has remained fairly stable during the last two decades – although at a much lower level as compared to the pre-liberalisatan period. Unfortunately, comparable data for small scale establishments with less than five persons engaged is not available to make a firm conclusion that employment in the small scale sector has remained stable in recent years.

Table 15.1: Employment in Textile Industry

Employees[a]	**1983**	**1993**	**1996**	**2000**
Spinning, Weaving and Finishing	50663	41491	40762	33542
Made up Textile Goods	5394	3183	3023	3270
Knitting Mills	3703	15665	16873	19755
Carpets and Rugs	2017	2133	5512	7729
Cordage, Rope & Twine	4326	1963	7191	7843
Textile nec	77	327	130	360
Total	66180	64760	73491	72499

Notes: [a] Number of employees in establishments with 5 or more persons engaged
Source: Department of Census and Statistics of Sri Lanka, Annual Survey of Industries, various years

As discussed earlier, rationalisation of SOEs which started with the structural adjustment programme (SAP) of 1978 had significant implications for employment in the textile industry and thereby the living standards of the rural poor. Privatisation of state-owned textile mills affected both male and female employees in the sector. According to a study by Jayaweera (2004), among the establishments sold to the private sector there were considerably large number of smaller power looms distributed throughout the country. Textile centres that had provided employment opportunities primarily for women (nearly 60 percent of the total employed) had closed down; textile establishments

which provided employment primarily to men (nearly 60 percent of the total employed) was privatised (Jayaweera, 2004). Even though those workers had been given consolidated pensions and some compensation packages, the majority of the workforce of these establishments had been in their economically productive working years at the time of their retrenchment. In addition, the displaced workers were plunged to a macroeconomic environment where the incidence of unemployment and costs of living was very high. Thus, almost all the workers surveyed in the study had been of the view that the income and pension they were given was not enough to meet the cost of living while the quality of life had deteriorated and they faced an uncertain future mainly because they had no alterative sources of income (Jayaweera, 2004).

Furthermore, employment implications of liberalisation and subsequent welfare effects were particularly severe for females given that the textile industry had employed a large female workforce of the country. Handloom weaving, for example, is traditionally dominated by women equipped with traditional labour skills and basic or no education. Unlike in the earlier period, where the industry performed under a tightly protected regulatory environment and produced only for the non-competitive domestic market, the profile of employment in terms of skills that were required by the industry changed after 1977 with the exposure of the traditional textile sector to competition.

The newly recruited women workers after 1977 required educational qualifications at secondary level (Perera, 2000). Also, the newly recruited textile sector workforce was provided a more formalised training in order to capture the skills required by the industry to face increased competition. However, despite the notable efforts made to restructure the employment structure of the industry in order to adopt required technology, the industry experienced a rapid decline in its workforce after 1977 as mentioned previously. As the Census of Industries carried out in 1981 indicates, the corresponding decline in female employment in the textile sector dropped by 41 percent between 1971 and 1981 (Perera, 2000).

The gender composition of the workforce in the textile industry has thus changed over the last several decades. The share of female employment has declined from 77 to 51 percent between 1963 and 2001. Nearly half of the workforce in 2001 was male while the corresponding share was less than one-fourth of the total workforces before the 1970s[5]. This partly reflects the magnitude of new employment opportunities generated, particularly for females in the export-oriented garment sector.

The experience of the garment and textile sub-sectors has been vastly different. From 1981 to 1993, the textile sector experienced a drop in female employment by 15 percent, whereas the export garment sector recorded a substantial increase in its employment level. Even though the skills of textile production can be easily acquired, textile centres faced a shortage of women labourers even at operative levels while this was even more severe in the handloom sector where it has been found that young women shied away from working on handlooms (Perera, 2000). Competition from the garment industry was one of the major factors that affected employment in the domestic textile industry. Even though the export garment industry did not directly absorb textile workers due to the structural mismatch of employment in these two sectors in terms of age, skills and manpower levels, it absorbed potential workers for the domestic textile industry

providing the young unemployed in the labour force with relatively more attractive opportunities. As more attractive and less arduous employment opportunities were emerging in the export industrial sector, the textile and handloom sectors did not have the potential to create large scale employment opportunities.

However, female labour is still vital for the domestic textile industry even today. It was apparent from the field interviews that most of the female handloom workers still remain in this occupation as the primary means of livelihood mainly because of their lack of access to alternative employment opportunities available outside the industry. Some females are still engaged in weaving because they wish to increase the family income and at the same time combine their income earning activities with domestic responsibilities and child care, while some are employed in this occupation due to the flexible working schedules and hours offered allowing them to engage in household economic activities such as domestic agriculture.

A large majority of employees interviewed are married and over 40 years of age and not in their economically productive working ages. Their prospects for finding alternative employment are slim – traditional labour skills and attitudes are likely to make them less attractive to be hired for better jobs. They belong to low income families and most of these females are working on a part time basis. In addition, all the handloom weavers, irrespective of the sector that they belong to, i.e. state, cooperative or private are paid for their products on a piece rate basis. Individual weavers and workers attached to cooperative societies are particularly vulnerable to income insecurity as their wages are paid once their products are sold in cooperative shops.

As pointed out by many stakeholders, the irregular and unstable nature of the payment system associated with loss making production is a major reason discouraging the younger generation from entering into the labour force of the handloom sector as weavers. Most females prefer to work in large scale garment factories due to the attractive nature of the garment industry with relatively higher level of social and economic status. Unattractive working conditions and environment have further worsened the situation. However, as revealed by some of the weavers interviewed, unlike employment opportunities available in the garment industry, the relative freedom and flexible working arrangements, less stressful working environment that can be enjoyed in the textile industry can attract a young generation if the industry was to become a profit making industry. Thus, severe constraints currently faced by the textile industry such as problems of raw materials, poor technology in production etc., should be successfully addressed in order to make the industry profitable and subsequently change the perception of social attitude towards the industry.

Working conditions, regulations and salaries also vary within and across states, cooperative and private sectors. Weavers attached to the state sector are entitled to Employees' Trust Fund (ETF) and Employees' Provident Fund (EPF) as means of long term savings, while the Department of Textile is currently planning a pension scheme for workers in the state sector. However, the situation is severe for workers in cooperative and small private sector, as the production and sales of these sectors – which directly determine the income status of workers – has been in decline for several decades. Their income is, on the other hand, not assured through income insurance schemes such as

pensions or ETF and EPF schemes. On the contrary, the income status of large private sector employees is considerably higher than those of their counterparts in the state and cooperative sector. Workers attached to large scale private sector entities, which are not entitled to any pension schemes, have been compensated by being paid higher salaries to keep them with those establishments.

While it is generally accepted that the economy wide reforms had adverse impacts on the employment of the textile industry on the whole, it is also evident that the structural changes occurred both within and across sectors after 1977 have had differential impacts on traditional and new workers in employment during pre- and post-liberalisation eras. It is mainly because of the differences in skills that they have. The traditional workers, who had been working in the sector since the early 1970s had been more vulnerable to the burden of adjustments immediately after 1977 and even at present, they have found it difficult to face the challenges of globalisation and readjust accordingly due to less attractive nature of their labour skills. New workers who joined the workforce after 1977 on the other hand, have a better bargaining power and become relatively more flexible in moving across different labour markets.

These trends in changes in employment and consequent decline in income have resulted in significant changes in living standards of direct and indirect employees of the industry as well as those of their dependents. Female workers in low-income families have been particularly vulnerable to the burden of income deterioration accompanied with trade reforms as well as related macroeconomic changes in the economy. As such, welfare losses and the social cost of policy reforms and related changes in the economy after 1977 seem to be considerably high in case of the domestic textile industry.

15.5 Non-trade Reform Related Constraints in the Textile Industry

The collapse of small scale and traditional industries in Sri Lanka, which were protected during the import substitution era and could not survive in an open economic environment after 1977, reflects the inability of these industries to keep pace with competition. Even though the sharp decline in production of the domestic textile industry can mainly be attributed to trade and trade-related reforms, it was obvious that low productivity, slow progress in technological developments, lack of fund and high cost of capital, shortage of labour, lack of backward integration have also played a part and adversely affected the industry. Thus, a host of other factors besides trade policy reforms – some related the protected status it enjoyed under import substitution – peculiar to the industry contributed towards its inability to survive effectively in the post-liberal policy environment.

15.6 Conclusion

The impact of trade liberalisation on poverty with respect to the textile industry could be seen through two channels; impact on many small scale and rural textile establishments distributed throughout the country as well as the impact on large textile mills which provided a considerable number of employment opportunities for the country's labour force. The curtailment of formal employment opportunities in the organised sector caused workers to be employed in unstable wage employments with non-standard working conditions, which carried lower levels of social security. Besides, almost all the workers who were employed in small industries as well as in large public

sector mills belonged to low income segments in the country who did not have other sources of income to survive and were not equipped with dynamic working skills to adjust to new employment opportunities emerging in the rapidly expanding export oriented garment industry. Decline in income persisting for nearly three decades has, therefore, caused continuous deterioration of quality of life and they have not been able so far to readjust their employment skills to benefit from opportunities available in an export economy. They were also more vulnerable to other macro economic factors of the economy such as high inflation and rising cost of living, which have worsened their situation further.

With the textile sector including the handloom sub-sector providing an income source for a substantial number of females in the labour force prior to liberalisation, a decline in income in the rural and informal sector after 1977 had adverse impact on living standards and welfare of those households engaged in this industry. Poorer females who lacked access to alternative employment opportunities were particularly vulnerable to decline in their income. They have found it more difficult to survive and thereby escape from poverty.

A sharp decline in production and subsequent downfall of the industry after 1977 can also be attributed to several other reasons, which included non trade-related constraints faced by the industry such as low productivity, severe capital constraints, issues related to supply of raw materials, slow progress in technological developments, shortage of labour, drop in local-demand etc. These demand and supply-side limitations have worsened the situation of downturn reflecting the inability of domestic textile industry to survive in a highly competitive open market environment and thereby negatively affecting the workers who relied on it for their survival.

References

Athukorala, P (1986), "The Impact of the 1977 Policy Reforms on Domestic Industry", *Upanathi*, Journal of the Sri Lanka Association of Economists, Vol. 1, No. 1

Gunathilake, R (1997), "The Problems and Prospects of Sri Lanka's Handloom Industry", IPS Research Studies, Industrialisation Series No 6

Jayaweera, S (2004), "Continuity and Change: Women Workers in Garment and Textile Industries in Sri Lanka" *http://reseau.crdi.ca/en/ev-58039-201-1-DO_TOPIC.html*

Kelegama, Saman (1993), "The Development of Backward Linkages from the Garments Industry in Sri Lanka", A Study conducted for the Ceylon National chamber of Industries, Unpublished

Osmani, S R (1987), "The Impact of Economic Liberalization on the Small-Scale and Rural Industries in Sri Lanka" in Rizwanul Islam (ed), *Rural Industrialisation and Employment in Asia*, New Delhi: International Labour Organisation (ILO)

Perera, Myrtle (2000), "The Impact of Structural Adjustments on women Workers in the Formal Textile and Garment Sector in Sri Lanka", *Structural Adjustment, Gender and Employment: The Sri Lankan Experience*, Geneva: ILO

Perera, R (1997), A Note on the Textile Industry of Sri Lanka conducted for the Institute of Policy Studies of Sri Lanka: Unpublished

Endnotes

1 Cited in Gunathilake (1997)

2 However, comparable statistics and census data are not available for the years before 1983 in regular intervals as it has been taken twenty years to survey the industry in 1983 after the Industrial Census of 1963

3 Central Bank of Sri Lanka, *Socio Economic Statistics*, various years

4 Earlier it was 35 percent or SLRs. 30 square metre for synthetic and 35 percent or Sri Lankan Rs 20 per square metre for cotton

5 Department of Census and Statistics of Sri Lanka, *Annual Survey of Industries*, various years; and Perera (2000)

16 CHAPTER

Shrimp farming in Ben Tre province of Vietnam

– Le Anh Vu, Ngo Huong

16.1 Introduction

The fishery export has seen impressive growth in Vietnam in recent years. The sector's output volume comprises 3.3 million tonnes, with 1.36 million tonnes coming from aquaculture. In 2005, the sector contributed to 21 percent of the 'agriculture-forestry – aquaculture' GDP and to more than four percent of the country's GDP. The fishery export in that year achieved the highest value in five recent years, amounting to more than US$2.65bn, despite the difficulties emerging from stringent international trade regulations. It is estimated that the export value will reach US$4.5-5bn by 2010. The sector offers employment opportunities for a high number of the coastal population, contributing to changes in the agricultural and rural economic structure and promoting poverty reduction.

This chapter aims at defining the impact of trade liberalisation on shrimp farming in the Southern province of Ben Tre, whose shrimp farming has developed rapidly in recent years. It takes into consideration both positive and negative impacts of liberalisation on those directly involved in shrimp farming, those whose main income is dependent on the farming and those involved in related activities, such as employees working for shrimp pond owners, co-operatives, companies or related-service suppliers. Trade liberalisation creates impacts on all these groups, but in various levels from social groups, from the rich to the poor, from the Vietnamese to other ethnic groups, and from males to females.

16.2 Shrimp Farming in Ben Tre province

Potentials and natural advantages for aquaculture development, especially for tiger prawn farming are available in Ben Tre. Besides tidal flats, canals and integrated aquacultural with agricultural, forestry cultivation areas, the province consists of 50,000 ha of aquaculture with a majority of shrimp raising activities, including 12,000 ha of fresh water farming mainly in the North West districts, equivalent to 24 percent of the total farming area. In the remaining 38,000 ha, i.e. 76 percent, brackish and sea water farming is carried out in the coastal districts such as Binh Dai, Thanh Phu and Ba Tri.

Despite many years of development and favourable natural conditions for aquaculture, shrimp raising in Ben Tre has become the economic spearhead only recently. There is a continuous increase in both area and volume of shrimp farming. The raised shrimp volume forms the major part of total fishery volume, and has quality advantages over the caught products.

Shrimp breeding constitutes a significant component of the provincial GDP and economic growth rate and provides employment and income generation for thousands of labourers, thereby reducing the rural employment pressure. In many coastal rural areas of Ben Tre, the model is of much interest due to its economic effectiveness. Through shrimp breeding, many households made their way out of poverty and are now able to afford to build permanent houses, purchase valuable assets like vehicles, television sets, and cassette players. In 2003, 15,186 workers were involved in shrimp farming in Ben Tre; in 2005, this number had risen to 17,480. Moreover, hundreds of others are service suppliers of feed, breed and other materials or hired by shrimp pond owners. Shrimp feeding related workers are mainly found in coastal districts of provincial big shrimp farming area as Binh Dai, Ba Tri and Thanh Phu.

Various shrimp breeding models suit to coastal land ecological conditions and farmers' interests, including extensive brackish water sea shrimp farming, sea shrimp farming in ponds, extensive canal with breed raising, extensive sea shrimp feeding, intensive and semi-intensive tiger prawn model, integrated tiger prawn-rice cultivating, shrimp-rice integration and giant river prawn. Among the above models, intensive and semi-intensive tiger prawn farming are rising rapidly with products of strong competitiveness.

16.3 Positive impacts of Liberalisation

Most of the shrimp growers in Ben Tre were earlier rice farmers and gardeners. In the past, rice cultivation was the main means of income for many farm households. In the early 1990s – during the very commence of renovation and opening policy – Ben Tre farmers and fishermen lived in difficult economic conditions with strings of rice monoculture and limited income sources, which kept them in poverty and prevented them from economic breakthroughs. With the renovation and opening policy, the local economy of Ben Tre has been affected by trade liberalisation, with rice farmers, especially the poor farmers in tidal land areas being affected most.

Agriculture, the key livelihood that generated jobs and income for poor farmers, faced obstacles, as the main products (rice and fruits) grown in saltilised and aluminised land failed to compete with products from other highly subsidised economies. Trade liberalisation promoted an agricultural structure transition in Bent Tre, to break the rice monoculture economy, and pushing towards centralised and specialised commodity production. Paddy field, low effective saline and uncultivated areas were narrowed and converted into aquaculture, shrimp ponds of households, co-operatives and enterprises.

The total provincial shifted area was 6,904 ha, 5,358 ha and 5,398 ha in 2003, 2004 and 2005 respectively. Trade liberalisation encouraged farmers to move into shrimp feeding in the past few years. In Dai Hoa Loc commune (of Binh Dai district) 1,256 ha rice-farming land is reduced to only 30 ha. It is also released by folks of hamlet 6 (Thanh Phuoc commune) that 95 percent of communal rice growing land is now used for shrimp raising due to the latter's higher economic effectiveness. While one rice crop can make about Vietnamese Dong 3 million (US$189) profits per ha, the number of shrimp farming can reach Vietnamese Dong 100-150 million (US$6,278-9,417) in case of no risk. The palpable change can be noticed from shrimp farming trade liberalisation, according to the chairman of Thanh Phuoc commune (Binh Dai district).

Trade liberalisation has paved the way for deeper integration of the Ben Tre economy into the global one, but it has also created certain impacts. Ben Tre farmers are now moving from a familiar and historical economy of self-supply and small-scale agriculture into shrimp farming for export, to an up-scaled good suppliers and an element of international labour allocation. This is a comprehensive and profound change. Their old backward production customs and techniques are now replaced by advanced knowledge of production.

It is acknowledged that shrimp production for export fetches much higher income than rice farming. After some years of investing in the sector, Thanh Phuoc is now the richest commune of the district. Commune farmers' income has seen a sharp increase in income with Vietnamese Dong 8 million (US$502) per capita in 2005 and obtained an unprecedented low poverty rate of 0.5 percent of total communal households, i.e. 11 percent. Dai Hoa Loc commune, adjacent to Thanh Phuoc commune, by shrimp feeding, also enjoyed fast poverty reduction rate with 13.99 percent of 268 poor households under the new poverty line now due to shrimp farming.

Trade liberalisation along with a stimulation of social investment resulted in raised capital, fully mobilised sources, mass investment in pond cultivation for shrimp, developed shrimp-related services and export processing and more added jobs. In 2004, the investment by the people of Ben Tre alone was Vietnamese Dong 1170 billion (US$73mn), including Vietnamese Dong 827 billion (US$52mn) of self-finance and Vietnamese Dong 343 billion (US$21.5mn) from bank loans. Increased investment is the motivating cause for widespread development of the sector with mass cultivation of shrimp ponds in paddy fields, salinas and uncultivated areas, resulting in higher demand of workers involved, which is helping in deriving rural employment restructure. The labour force can be classified into professional and unprofessional workers, directly feeding workers and mangers, service suppliers and other supporters etc.

Hired workers are mainly the poor as they lack capital, land, and knowledge for their livelihoods. They often work for owners, co-operatives, enterprises, hatcheries, and material suppliers with hard works as pond dredging, environmental improvement, shrimp caring and so on. It often takes four months for one shrimp crop from breed releasing to harvesting while employees spend about six to eight months of work and receive a monthly salary of Vietnamese Dong 700,000-800,000 (US$45-50). There are often one to three hired workers in every poor household in Dai Hoa Loc anh Thanh Phuoc communes to enable to afford their essential needs. Despite strenuousness in work, the payment could help many households in being free of poverty. Some workers who had to leave the homeland for employment in Ho Chi Minh City, Dong Nai, Binh Duong, Vung Tau – Ba Ria now can get jobs right in their own hamlets. Therefore, this can help limiting pressure of social service and infrastructure overload for urban and industrial areas.

Some poor households, encouraged by the profits of the sector, have invested in farming with loans, coupled with learnt experiences and are now poverty-free and better off. Thewners now possess better experiences in organising dozens of hectares of shrimp farming farmsteads in rural areas.

Trade liberalisation promotes production and social infrastructure improvement in hamlets and villages. Transportation, irrigation, power supply, hatcheries systems have invested dozens of Vietnamese Dong billion in shrimp farming areas. The province financed Vietnamese Dong 7,114 billion (US$447mn) for irrigation systems, Vietnamese Dong 1,499 billion (US$94mn) for hatchery building in 2004 and an estimated Vietnamese Dong 9.1 billion (US$571,345) and Vietnamese Dong 1.5 billion (US$94,177) respectively in 2005. Billions of Vietnamese Dong has been invested in equipment purchasing, hatchery building by enterprises, co-operatives and farmers.

Under strict requirements by customers and international trade regulations, shrimp farmers are to apply advanced technologies in production to ensure product quality and food safety, in order to meet the market demand. It is admitted that awareness and application of new technologies in the whole shrimp feeding process – from pond cultivation, environmental protection, breed selection to caring, post-harvest preserving techniques – remarkably improve production and business capacity. Backward cultivation customs are now replaced by advanced production and business methods on the basis of more clearly renewed economic concepts. Linkages between shrimp farmers and processing units, breed centres and other service suppliers, and between production and business have been set up and developed in rural areas.

16.4 Negative impacts of Liberalisation

The structure of agriculture, forestry and fishery in Ben Tre has been changed due to trade liberalisation. The programme of agriculture, forestry and fishery restructure has been implemented for market adaptation and trade liberalisation. Aquaculture is considered the provincial economic spearhead in the restructure process. The recent sharp increase of aquaculture, however, has created livelihoods disorder among the farmers in Ben Tre. Out of the thousands of farmers in the commune, the poor are the most disadvantaged in seeking new livelihood opportunities to adapt to the changed situation of strong and unequal competition.

The lack of capital, techniques, and management capacity and information access has increased the poor's failure risk much more than that of the rich. Under the technical requirements in shrimp farming, there should be three crossing ponds, including one for shrimp, one for deposition and the rest for waste treatment. However, limited land and capital lead the poor to have only one pond for shrimp. The rich can afford an excavator, while the poor dig the ponds manually. As a result, the pond is shallow, with unsteady edges and can be easily polluted by wastewater from a canal. The ponds with inability to get regular dredging, or right treatment for environment, create negative impacts on the shrimp growth process. Polluted environment is one reason for mass death of shrimp in the poor's ponds. The rich farmers can consult fishery engineers in case of technical problems of environmental treatment, breed selection, feed and diseases and thereby limit the risks. The poor fail to afford these engineers but expect support from fishery extension agencies, which is rather limited.

The factor of the selected shrimp breed is decisive for farmers' success. The breed quality depends on many stages of production, quarantine, conservation and transportation. Breed service, in recent years, has been widely developed in the province with active participation from various economic backgrounds. Its quality, however, is

depending on the traders' attitude and a responsibility to the community since the market is under their control. Some measures have been applied, such as breed examining, quality certificate, to gain control on the market and prevention of low quality breed into farming areas. But some low breeds can be out of control from the local fisheries and authority agencies, which are in the cultivating areas. It is usual for the poor to buy these breeds due to their limited knowledge or little capital makes them buy on deferred payment with enclosed risks. Many farmers buy the low-quality breed due to a lack of information. Almost all poor households are unable to reach central provinces for breed procurement, so they get it through traders for higher price and receive lower quality reed.

Unfair competition leads the poor to suffer a great loss, resulting from their small scaled, unfocused production and weak linkage to the market. The poor's ponds are often of less than one hectare while those of the rich are dozens of hectares with much higher productivity. Hard access to market information, especially output market, makes the poor sell their products to traders rather than to fishery processors as the rich do. Many stakeholders suffer from shrimp price changes, including exporters and producers, but it is the poor who suffer the most. When the price goes down, the poor are forced to sell their output to traders for low prices as their shrimps are comparatively small and weak, and affected by the polluted environment.

At the time of the mass harvest, the same situation arises again, as all households try to sell their products to limit their loan interest, mass death of shrimps occur due to over-long keeping. Prolonged farming duration at increased cost but at an unchanged profit leads to an even greater loss. Many poor households have to sell all products to traders with losses touching millions of Vietnamese Dong. The rich farmers have significant advantages over the poor in the shrimp market. They are able to directly contact processing units without go-betweens and get higher prices. Processing factories are also more likely to procure the bigger volumes of the rich farmers, the shrimps can be directly collected, and the quality of the shrimps ensured as compared to often damaged shrimps collected from the smaller ponds of the poor.

The rich farmers' products are also more competitive in terms of dimension, thanks to standard technologies. Market information access is of higher value to the rich, because they are the ones who can afford to have media such as Internet, TV, and newspaper. In Tra Vinh, for example, many pond owners have Internet installed; some others have visited successful models in central provinces and abroad as well.

The decline of shrimp prices has many causes, ranging from complications in export with shrimp cases sued to strict requirements set by foreign partners. Being obliged to sign in "bond" fund, the Vietnamese fishery export processors are to spend a large investment in fund signing and extended input cost from the loans burdens enterprises, leading to a reduction of their profits. Some enterprises signed the fund worth millions of US$ and try to embroil farmers to share the financial burden.

Reduced shrimp prices affect farmers significantly and pull many of them into poverty again. Households with main income from shrimp farming or nearly poor households are very sensitive to abnormal changes of shrimp price and input price (machine oil,

transportation, power, breed, etc.). Increased input cost translates directly into reduced income for the poor. In fact, the average income of shrimp farmers has decreased by half compared to the early period. Households with dead shrimp harvests would suffer the biggest losses and thrown back into poverty, whereas households with diversified income sources and little dependence on shrimp would be affected less in case of lower shrimp prices. However, almost all households in the surveyed districts do mainly engage in shrimp farming and their main income from shrimp plays a decisive role in their total income.

Many signals show environmental pollution risks with unpredictable consequences for shrimp farming. There are also indicators that shrimp farming does create harmful effects on ecological sustainability, disordering the poor's livelihoods and increasing the poverty rate. It is considered that the polluted environment and low quality breed cause shrimp diseases resulting in mass death. Reduced shrimp farming effectiveness and emerging environmental issues are threatening the sector's sustainability. Environmental risks ultimately diminish the trade benefits of the poor.

The poor confront disadvantages not only in the form of a reduced output price and higher input costs, but also due to environmental issues. A profound understanding, capital and techniques for environmental treatment are required. But as the poor fail to obtain all the three conditions, their low environmental cost does not provide them with an equally good environment as that of the rich farmers. The problem is a lack of awareness of the poor farmers, but it is impossible for them to improve their situation with their limited capital sources and techniques. They have been suffering great environmental consequences. Many shrimp ponds remained uncultivated for two years after the financial loss and farmers are still unable to grow rice on this land. Many experts believe that it will take several years until rice can be cultivated on this land again.

Trade liberalisation has created a shrimp feeding "storm" in Ben Tre, but it has also missed means of other income sources. Gardening used to be a widespread source of income for the poor and contributed to their earnings, but now it is not of interest due to their exclusive concentration on shrimp. Successful gardening has also become more difficult now due to low productivity of fruit trees on saltilised and aluminised land from sea water diversion canal to shrimp ponds. At the moment, gardening rarely contributes at all to farmers' income. This has created a high instability of the poor households' income, including unsustainability of shrimp farming.

A few women have their own shrimp ponds but many involve in related works. In general, it can be said that the employment opportunities for women have improved. They participate in shrimp pond managing, shrimp caring, input and output market accessing and training courses held by aquaculture extension agencies and other companies. Women are now more self-confident within the family and in public decision making with improved economic management and social communication capacity through training. However, it seems that women are more burdened with housework when men are busy to shrimp ponds, having to shoulder more responsibility in the households for caring for family and children than men.

While the rich can hire workers for farming, the poor women have to work on the shrimp farms themselves. Women in poor households with small shrimp ponds must be responsible for all works as their husbands have shifted to distant places for better wages. In this respect, women in shrimp farming areas enjoy fewer opportunities to get more knowledge and involve in social activities.

There is no proof of child labour in Ben Tre. Though children are now enjoying better living standards and schooling due to improved household income, those in poor households face multiple challenges. Farmers who have faced consecutive losses in shrimp farming, were forced to cut their children' schooling expenses of extra lessons, books, notebooks and other materials. Due to their parents' debt predicament, some children have been affected psychologically and are in stark disagreement with them.

16.5 Conclusion

Trade liberalisation and economic integration have created impacts on the Ben Tre economic restructure with a logical change of farmers from rice into shrimp cultivation. Both the rich and the poor invest in shrimp but with different motivation, conditions and benefits from trade liberalisation and economic integration. Some of the poor are voluntarily shifting towards shrimp farming for higher profits, but some others are compelled to carry out farming even at the cost of low productivity of rice and face consecutive losses in growing rice in saltilised and aluminised lands, which have been affected from other households' seawater diversion canals.

Shrimp farming, in the context of trade liberalisation and economic integration, benefit farmers in many ways, but with unfair distribution among various shrimp farming groups. It seems that the poor receive fewer employment and income opportunities than the rich. The sector, despite its positive impacts on the livelihoods of the poor, also faces many challenges due to trade liberalisation. The poor shrimp farmers are confronting the greatest and long-term risks of re-impoverishment and environmental pollution. In case of environmental protection, measures have failed to be fully implemented, and shrimp farming can lead to a lack of livelihood options for the poor. Despite the recent developments in favour of high incomes and employment generation, shrimp farming implies price instability and unsustainable development. When Vietnam becomes a member of the WTO, the sector will face greater challenges from strict trade regulations and trade inequality.

Some measures supporting shrimp farmers need to be taken to minimise the negative impacts of trade liberalisation and market changes. Besides general measures, the poor should obtain some support like infrastructure, promotion of fishery extension and technology transfer, market access and better community management.

References

Oxfam (2008), "VIETNAM: Climate Change, Adaptation and Poor People"

www.mdec.vn

17 CHAPTER Leather Footwear and Garment Industries in Vietnam

– Ngo Van Hooi, Nguyen thi Tong

17.1 Introduction

Vietnam's consistently high levels of growth in manufacturing in recent years have contributed significantly to reducing poverty as well as increasing foreign exchange revenues. The garment and footwear industries have played a prominent role in this process; they are the two manufacturing sectors with the largest market share and also are among the sectors experiencing the highest growth. Any major impacts (positive or negative) to the manufacturing sector as a result of trade liberalisation will have major implications for the large numbers of low waged, unskilled, female and migrant workers who represent a large proportion of the total workers in the sector.

That this group of workers were very recently lifted out of poverty by the opportunity of waged labour in the garment and footwear sectors is also significant, since it increases the likelihood that downwards pressure on wages and/or productivity will cause them and their family members to return to their previous poverty levels. This chapter examines the links between trade and poverty through development in the context of the leather footwear and garment industries in Vietnam.

17.2 Overview of Leather Footwear and Garment Industries in Vietnam

Garments and footwear industries in Vietnam constitute the largest export manufacturing sectors (Table 17.1). Over the last three years, both sectors have experienced consistently high growth rates. In the first five months of 2006, the combined market share of both sectors stood at 16 percent of total exports. In the same period, the garments and footwear sectors grew by an enormous 31.1 and 21.1 percent respectively. The labour force is also growing rapidly in both sectors.

These sectors employ a significant amount of the waged labor force (Table 17.2) and in this way have played an important role in reducing unemployment, and therefore poverty. Research in the garment sector has shown that the work is relatively unstable, with significant amount of workers experiencing periods without work, whilst periods with work tend to involve long hours – 11 hours per day in many cases (Kabeer and Van Anh 2006). The extended working times characteristic of the garment (and footwear) sector are far longer than in other manufacturing sectors, and does not comply with the eight-hour day stipulated by Vietnam's labour code. The nature and conditions of work for employees in the garment and footwear industries in Vietnam are in sharp contrast to the widely held view that the most stable route out of poverty is by means of regular wage income (Sender Cramer and Oya 2005).

Table 17.1. Export Structure and Growth					
	Value (US$mn)	Share		Growth	
	2005	2004	2005	2004	2005
Total Export earnings	32442	100	100	31.4	22.4
Crude oil	7373	21.4	22.7	48.4	30.1
Non-oil	25068	78.6	77.3	27.4	20.3
Rice	1407	3.6	4.3	31.9	48.2
Other agriculture	2557	8	7.9	39	20.2
Seafood	2739	9.1	8.4	9.2	14.1
Coal	669	1.3	2.1	92.6	88.4
Garments	4838	16.5	14.9	19	10.3
Footwear	3040	10.2	9.4	18.7	13
Electronics and computers	1427	4.1	4.4	60	32.7
Handicrafts	569	1.6	1.8	16.1	9.2
Wood products	1563	4.3	4.8	100.9	37.2
Other	6259	19.9	19.3	27	20.5
Source: General Department of Customs, Vietnam					

Table 17.2 Number of Workers by sector			
	2003	2004	2005
Footwear	450,000	500,000	580,000
Garments		2,000,000	2,100,000
Source: Leather Footwear Association and Garment Association, and Ministry of Finance			

The garment and leather footwear sectors employ a large number of relatively low paid, unskilled and young women. The vast majority of these workers in both sectors are migrants. These features of the workforce are significant and essential to assessing the implications of further trade liberalisation in this sector.

The fact that the majority of workers in both garments and footwear are female is significant for several reasons. Firstly, data from the 1997-98 Vietnam Living Standards Survey (VLSS) shows that in terms of wage labour, women's earnings are considerably lower than men's, causing a 'crowding in' affect for women in lower value added work (Kabeer and Van Anh 2006). This gendered wage differential has both positive and negative implications. The demand for labour from this group in the garments and footwear sectors has lifted a large number of rural women and their dependents out of poverty (Thoburn and Jones 2005). At the same time, due to the fact that this category of workers was previously below the poverty line, the likelihood that they will return to poverty in the event of external shocks or structural changes to the industry is considerable.

The increased level of vulnerability of workers in garments and footwear is due to the combination of factors mentioned above. Firstly, the fact that they are migrants means that their real wages are substantially lower than those of their counterparts who have permanent resident status. It has been shown that migrant workers in Vietnam do not have the same rights as permanent residents. Their non-resident status means that the user fees they incur when accessing healthcare or education are higher (Dang Nguyen Anh 2004). Research into both garment and footwear sectors indicates that there is a high number of migrant workers with non-resident status (Kabeer and Van Anh 2006, ActionAid 2006).

The second reason why migrants are more vulnerable to poverty is that they tend to be the only source or main source of income for several other family members in the rural areas. ActionAid research found that the mean number of family members being supported by remittances was three. A typical worker was found to send between 30 and 40 percent of his or her wage in remittances, which caused a major strain on the workers' ability to adequately feed themselves. The fact that the garment and footwear sectors employ predominantly migrant workers means that these employees are more susceptible to poverty if their employment is threatened. Any external shocks which cause a sharp decline in productivity, resulting in firms shedding workers may lead to increased poverty levels since the workforce tends to be highly vulnerable.

At present, there are significant numbers of state owned enterprises (SOEs) and private firms active in the sector. However, macroeconomic commitments under bilateral and multilateral agreements mean increased privatisation and also increased FDI. There has been a recent increase of private firms in the market, particularly from FDI, and this trend is set to continue. The government is committed to increasing capital flows into the country from both FDI and Foreign Portfolio Investment (FPI), and the success of the garment and footwear industries could be a major pull factor for foreign firms.

The number of enterprises in the two sectors has risen in the past several years. In 2002, 1,792 enterprises were in operation in the two sectors; 1,622 for garments and 350 for footwear. This amounted to three percent of the country's total existing enterprises and 12 percent of the industrial ones. By 2004, the number increased to about 2000 garment and 380 footwear enterprises. There was also an increase in household enterprises and small workshops in these sectors, though accurate data is not available.

Recent research has shown that SOEs tend to be larger than private sector firms (Kabeer and Van Anh 2006; Jenkins 2005). The implication is that SOEs would be better placed to deal with short-term price fluctuations and are less likely to shed workers. There is some evidence that supports this; in the study of the garment sector by Kabeer and Anh, workers in SOEs were less likely to experience periods without work and SOE workers also received higher maximum monthly payments. It would appear that the conditions in SOEs are marginally better than those in the private sector.

However, with increased trade liberalisation there are a number of macroeconomic implications, which may reduce the competitiveness of these sectors. The wage elasticity is high, which means workers are highly vulnerable to price increases and demand

shocks. The two likely structural changes that are normally experienced with liberalisation of trade are increased privatisation and increased FDI activity.

The private sector in the Vietnamese garment and footwear industries is characterised by smaller firms than SOEs (Kabeer and Van Anh, 2006). Smaller firms by nature are less able to mitigate short run external shocks associated with input price fluctuations, or increased import duties imposed as a result of anti-dumping claims. This is empirically supported empirically by the recent impact of EU anti-dumping case in the footwear industry (ActionAid, 2006), where it was found that private sector firms either shed more workers or reduced working time more than the SOEs, which tend to be larger and in a stronger position to deal with sudden falls in orders and price increases.

Other research has shown that FDI in Vietnam tends to be more capital intensive, which means there is less demand in these firms for unskilled cheap female labour (Jenkins 2005). Thus, the implication is that with increased trade liberalisation and the increased FDI inflows that come with it the demand for unskilled labour of this type will fall.

17.3 Firms' Capacity to Deal with Increasingly Liberalised Markets

Our research of 10 enterprises across Vietnam in the garment and footwear sectors found that in general, firms felt that the challenges outweighed the opportunities associated with further trade liberalisation and the accession to the WTO. The opportunities, as perceived by the firms are: (i) increased investment from material and accessories importers and producers via FDI; (ii) favourable conditions from government policies in production and export promotion; (iii) increased demand of footwear and garments due to increased living standards; (iv) quota removal to EU market and increased quota to US market will increase market share; (v) greater autonomy of firms, less government interference in decision making; and (vi) increased capacity of production and market awareness.

On the other hand, the challenges include: (i) lower competitiveness than neighbouring countries (China); (ii) lack of capacity for value chain participation, (i.e. marketing, design, sales); (iii) lack of direct communication with customers; (iv) increased prices of power, water, wages and obligations for improving working conditions; (v) lack of training among workers; (vi) increased labour competition; and (vii) low labour retention rates.

It should be noted that the position of SMEs in dealing with the impact of trade liberalisation is quite different to other firm structures. An extensive survey of SMEs carried out in 2004 found that SMEs were severely under-represented in export sectors (Kokko 2004).

The survey found that only three percent of the SMEs under review were involved in export markets. Further findings show that SMEs tend to be uninformed and unconnected to international markets and that there is a huge scope for government policy to provide information on foreign market opportunities and export infrastructure. Thus, if the government wishes SMEs to play a prominent role in economic growth, particularly in a liberalised market, there is a need for strategic policies to enable these firms to access markets, compete and meet necessary international requirements and

regulations. Since fostering the development of SMEs has been posited as a way to reduce poverty in Vietnam, these findings have particular significance. It seems that without significant state support, the SME sector may not be able to adequately meet the challenges of trade liberalisation.

17.4 Likely Sources of External Shocks

Both the garments and footwear sectors tend to have highly concentrated shares in a small number of foreign markets, with one single major concentration of shares (EU for footwear and US for garments). This adds to the vulnerability of the sectors to external shocks. It also has implications for competitiveness. A more diversified export structure or a more equal share of the major destination markets such as is found in the seafood sector would reduce risks significantly. Furthermore, the two markets where Vietnamese footwear and garments are most prominent (EU and US) are also associated with a higher incidence of protectionism, in the form of anti-dumping legislation that is biased towards outside producers (Nguyen Thi Thanh 2006).

Anti-dumping Investigations

In the absence of other trade barriers, anti-dumping is a mechanism that can be used to protect domestic markets, and is increasingly used by the US and the EU (Nguyen Thi Thang 2006). If a country's export prices are considered to be lower than domestic prices, then a case for anti-dumping may be brought. Since Vietnam's largest export markets are the US and the EU, there is reasonable ground to expect an increase in anti-dumping claims from those WTO members in particular, as Vietnamese markets are further liberalised. Another aspect that makes Vietnam more susceptible to anti-dumping claims is the fact that it must retain its Non-Market Economy (NME) status under the accession agreement. The NME status means that a 'surrogate' market economy country can be chosen in order to assess the price levels and determine whether dumping is in fact occurring. This system has been shown to be inherently flawed, and allows the investigating country to significantly bias the results of the investigation (Nguyen Thi Thang 2006). It has also been shown that the decisions of anti-dumping claims, particularly in the EU and US are often politically motivated rather than technically determined *(ibid)*.

The recent anti-dumping case brought against Vietnam's footwear industry is a case in point. The surrogate country mechanism was applied and Brazil was the surrogate country. Since the cost of labour and materials in Brazil are considerably higher than in Vietnam, the decision was arguably biased against Vietnam (ActionAid 2006). Furthermore, the adverse impact of the anti-dumping case in the footwear industry has been severe.

The research by ActionAid, which covered five percent of the total footwear industry, found that: (i) orders have fallen considerably since the lawsuit, increasingly so in the first quarter of 2006 (by 50-60 percent for several firms studied); (ii) firms involved in processing for foreign partners have lost the most orders, and in some cases their partners have found alternative suppliers in Cambodia, Indonesia and Thailand; (iii) firms have narrowed production as a result and many are operating at 60-70 percent of their capacity; (iv) firms have been forced to divert resources to covering legal costs associated with the proceeding; (v) 76 percent of firms studied suffered a drop in

income of between 15 and 60 percent; and (vi) firms have made large sections of their workforce redundant, and/or significantly reduced working time (in some cases 30-50 percent of workers were temporarily laid off).

The labour force in the footwear industry is again comprised of largely low-skilled, young, rural migrants, whose remittances often support several other family members. The increased linkages to the rural unemployed and underemployed in this industry mean that the knock-on effects are severe. The loss of earnings of one worker will likely have a severe impact on other rural poor. Case studies detailed in the ActionAid study reaffirm this point and reveal that migrant workers tend to come from extremely poor families. The resulting unemployment and underemployment caused by the anti-dumping import duty rates imposed by the EU, is exacerbating poverty for both workers and the family members who depend on their incomes. ActionAid found high levels of undernourishment and malnutrition among employees in firms affected by the EU anti-dumping case. A significant amount of workers had poor health and could not afford to access health care. Many employees were finding it increasingly difficult to pay school fees for their children and were sending them back to the rural areas as a result.

It is clear from the 2006 case of anti-dumping in the footwear industry brought by the EU that the impact of such external shocks causes many workers and their families to fall into poverty. Since private sector firms are less able to mitigate the effects of such shocks, it can be expected that increased privatisation will serve to exacerbate this. It is also significant that private firms in this sector tend to be considerably smaller than SOEs. These factors, combined with the high number of low skilled low wage employees characteristic of the sector, means that Vietnam is particularly vulnerable to such external shocks.

Other Issues Relating to Bilateral Agreements

Under the bilateral trade agreement between the US and Vietnam, for the first year of Vietnam's WTO membership, the US reserves the right to re-impose quotas on Vietnam through the use of a special enforcement mechanism. If the US is not satisfied that Vietnam has eliminated all perceived subsidies in the textile and apparel sector then quotas will be re-imposed (World Bank CG document 2006).

Value Chain Integration

The increased participation and linkages to global value chains that increased trade liberalisation brings, has further implications for vulnerability of workers and the likelihood that they will return to below the poverty line. It has been shown that increased competition puts downward pressure on prices and therefore wages. Changes in working conditions that increase labour flexibility and intensity of work will have an adverse effect on workers livelihoods. In Vietnam's garment sector, SOEs managed to upgrade within the value chain, thereby mitigating these adverse effects to workers (Jenkins 2005). However, it is uncertain whether private sector or foreign firms entering the market will be able or willing to make the same adjustments.

The garments and footwear produced in Vietnam tend to be highly price elastic. This too weakens the firms' ability to compete internationally whilst retaining labour-intensive production techniques using unskilled labour. Shifting to the production of goods

which are more price inelastic tends to be associated with a shift to capital intensive technology. However, Seguino argues that a shift to labour intensive and more price inelastic exports can be achieved with strong state policies that support such a shift (Seguino 2005). This support includes: improving access to marketing and distribution networks; increasing technological capacity; supporting smaller firms in particular; and introducing fair labour practices which has been shown to be a major draw factor for large TNCs concerned with their reputation among their customer base (Cambodia is an example of this policy's success). Government policies to attract FDI flows can also have a strong influence on the export structure, in the form of certain tax benefits being offered in certain types of preferred production.

17.5 Conclusion

In order to meet the challenges of increased trade liberalisation that comes with Vietnam's accession to the WTO, the garment and footwear industries will need extensive government support. The firms need support to enable the development of a competitive private sector that is capable of mitigating short run shocks and increased competitiveness from other countries in the region, and to raise awareness within the SME sector and develop its capacity to integrate in global value chains. On the other hand, the workers need support to increase their skill level whilst increasing technical capacity, to eradicate inequality and discrimination in accessing services for migrant workers, to increase social safety nets for family dependents in rural areas, and to reverse gender wage gaps.

The increase in foreign capital inflows in the form of FDI, which is projected as a result of favourable macroeconomic environment with further trade liberalisation needs to be managed strategically in order to ensure that the FDI sector does not crowd out the SME sector, or in other words the more capital intensive sector does not crowd out the labour-intensive one.

The high costs associated with meeting the extensive international requirements, regulations and standards are also an important issue that should not be underestimated as a major constraint to weaker firms, i.e. private sector generally and SMEs in particular. The state has an important role in supporting and educating firms in order to meet these standards which will allow them greater access to larger international markets.

If these aforementioned supports are provided, then Vietnam's garment sector may be able to benefit considerably from the increased market access and integration into global value chains that are brought about by increased trade liberalisation.

References

ActionAid (2006), "Impact of Anti-dumping Proceeding by EC on Vietnam Footwear Industry"

Jenkins, R (2005), "Globalization, Production and Poverty", UN WIDER Research Paper 2005/40

Kabeer, N and Tran Thi Van, A (2006), "Globalization, Gender and Work in the context of Transition: The Case of Vietnam", UNDP Policy Dialogue Paper, Hanoi

Kokko, A and Sojoholm, F (2004), "The Internationalization of Vietnamese SMEs", Working Paper, Stockholm school of Economics

Nguyen Thi Thang, N (2006), "Discretionary Rules: Anti-dumping and Non Market Economy Status in Vietnam", UNDP Policy Discussion Paper, Hanoi

Seguino, S (2005), "The Macroeconomic Role of Hierarchy in Market Economies: The Case of Asia", Paper presented at the Third Roundtable Meeting of the 20 year review of Doi Moi, Vietnam Academy of Social Sciences, Hanoi

World Bank (2006), "Taking Stock: An Update of Vietnam's Economic Developments and Reforms", Mid year Consultative Group Meeting, Vietnam

18 CHAPTER The Cotton Textiles Industry in Kenya

– *Gloria Otieno*

18.1 Introduction

Trade liberalisation in the cotton textiles sub-sector in Kenya has evolved through different processes since independence in 1963. The cotton textile sub-sector was well established and grew tremendously in the era of import substitution in the 1960s and 1970s, when cotton and lint production was at its peak. However, due to import liberalisation in the 1980s and 1990s, there was an influx of imported textiles and garments – both used and new, which led to low demand for locally produced cotton products. This led to sector wide effects, which saw a reduction in cotton and lint production as well as local textiles and garments manufacturing, and closure of several key industries in the sub-sector. It is estimated that about 70,000 jobs were lost by the year 1999 and many poor farmers lost their livelihoods.

The introduction of AGOA in 2000 in the US provided an opportunity for the revival of the sub-sector. However, the country was not able to take advantage of this opportunity and instead foreign firms moved in and invested in the EPZs and took advantage of the DFQF exports to the US. This development led to considerable employment generation in the EPZs, however, the local cotton production did not increase to provide sufficient raw materials for the industries in the EPZ. This further led to more imports of raw materials. Hence, the industry as a whole has not been able to substantially benefit from AGOA.

18.2 Cotton Textiles and Apparel Industry in Kenya

Cotton is one of the cash crops grown by the small-scale farmers in Kenya. Its present contribution to GDP is relatively small[1] (less than two percent). However, it is viewed as an important crop in terms of poverty reduction and rural development (CBS, 2002). Kenya participates in all parts of the cotton-textile chain: cotton and lint production, yarn, fabric and apparel manufacturing.

The Kenyan cotton textiles and apparel industry has undergone many major transformations since independence. Kenya's cotton production originated in the early 20th century and was expanded throughout the 1960 to low rainfall areas of the country and some irrigation perimeters. After independence in 1963, the Cotton Lint and Seed Marketing Board (CL&SMB) established in 1955 became the sole body responsible for marketing cotton, the government through CL&SMB introduced controls and protective measures in the sector such as setting producer prices, restricting imports, providing free seed to farmers and supporting cooperatives. These were aimed at strengthening the sub-sector and hence the cotton production increased to over 70,000 bales of lint

annually. In the early 1980s, the textile and apparel industry became the country's most important manufacturing activity (EU, 2003) employing over 200,000 and over 30 percent of labour force in the national manufacturing sector at the time (CGD, 2005). During this period, there was much support from donor-assisted programmes[2] and government and there was little if no competition from imports, hence the expansion (Ikiara and Ndirangu, 2003).

The sector declined substantially in the 1990s at the height of trade liberalisation – both cotton production and the textile garments industry suffered due to continued synthetic competition, diminishing world prices, introduction of cheap imports of second hand clothes and diminished cotton profitability aggravated by inefficiencies in the production system and supply-side constraints (EU, 2003). The decline in cotton production in the last two decades has also coincided with increase in poverty levels in areas designated as major cotton belts. The gradual cotton decline has also affected other parts of the chain industry including ginners, textile mills and manufacturers.

Value Chain – Structure and Production

The value chain of the cotton and textiles industry in Kenya is relatively diverse and can be divided broadly into six main categories: (i) cotton growing farmers; (ii) ginning; (iii) textile mills – spinning, weaving and yarning; (iv) textile and garment manufacturing; (v) traders – second hand and new clothes; and (vi) consumers.

The chain begins with the farmers who produce cottonseed, which is the raw material for lint production. The cottonseed is then ginned into lint and seed, whereas seed is used for oil production, lint is then converted into yarn, which is spun into thread. Thread is then taken to the weaving stage to produce fabric. Most of the spinners operate weaving stations, while some operate integrated textile milling plants, which involve weaving, dyeing, stitching and apparel manufacture. The chain also consists of producers mostly in the EPZs producing exclusively for exports and micro and small garment producers who produce mainly for local consumption. The market chain is then divided into traders of imported new clothes and second hand clothes and traders of domestically produced goods. Last in the chain are the consumers who are the most valuable as they are the ones who consume the final product and will therefore determine what the industry produces.

Cotton Production

Cotton is produced largely under rain-fed conditions by individual growers on landholdings averaging about one hectare. It is mainly grown in parts of Coast, Eastern, Nyanza, Rift Valley and Western Provinces, which are the worst hit in terms of poverty. Since the crop does well in low rainfall areas, it has the potential to reduce poverty in Kenya's semi-arid lands. There is a high correlation between cotton growing areas and poverty; the poorest districts tend to have the highest potential for cotton growing.

Currently, cotton production and area coverage is very low compared to the potential area suitable for its cultivation. The crop is largely grown on smallholdings on areas less than a hectare. The areas with the highest potential, i.e. Western, Coast and Nyanza are the hardest hit in terms of poverty; for instance Homa-Bay district which has 77 percent individuals living on less that a dollar a day has a potential of 13,000

hectares as compared to the current coverage of 574 hectares, if production was to be expanded it might have an impact on poverty levels. It also emerges that Eastern province has the highest coverage in terms of area under production despite the fact that farmers are not utilising their maximum potential of 40,000 hectares; yields are however generally higher as compared to other areas and hence, the value of cotton is the highest in Eastern province. However, poverty levels are still high in these areas.

Cotton production is faced by constraints ranging from low yields, high cost of production and low and declining prices. The average yield at the time was 572 kg/ha of seed cotton, which is relatively low, compared to 1200 kg/ha calculated as the potential yield once all principles of production are adhered to (Ikiara and Ndirangu, 2003). According to their study, low productivity was attributed to low producer prices; high costs of inputs, poor seed quality and weather conditions. The study further computed production costs and found that Kenyan farmers are operating at a negative gross margin of about Kenyan Shilling 3.80[3] (US$0.047). Low and declining prices are attributed to declining world prices, which fell by 60 percent between 1950 and 1998 and continue to fall.

Ginning

Ginneries are a focal point in the cotton industry and their location, efficiency and organisation are critical to it. Before the liberalisation of the industry, all the ginneries were owned, operated and regulated by the government. Today, there are about 24 privately owned ginneries with a capacity of about 140,000 bales and a capacity to employ some 1,000 people. Only about 10 ginneries are operational (EPZA, 2005). The country-wide capacity utilisation is about 33 percent; the ginneries are hence operating well below capacity (EPZA, 2005). The ginneries in Kenya are able to produce only 20,000 bales of lint annually, yet they have a capacity to produce 140,000.

In a study by Ikiara and Ndirangu (2003), ginneries faced constraints ranging from high cost and unreliability of electricity, poor and fluctuating world prices, outdated technology and inadequate supplies of seed cotton from farmers which resulted in low capacity utilisation and high costs of production. The operating environment for ginneries was also characterised by regulatory failure and a lack of government support.

Apparel, Yarn and Fabric Manufacture

The garment and textile industry in Kenya dates from the colonial period. As early as 1954, the industry had a total of 74 enterprises employing 2,477 workers (Kinyanjui, 1992). Until recently, the garment industry was one of the most important manufacturing activities in Kenya. The industry grew rapidly in the immediate post-independence period. It thrived because of the protection offered to firms under the import substitution strategy. It also grew because of government investment in the industry.

Privately owned garment firms evolved and thrived in the import substitution era. Garment firms, like manufacturing in general, benefited from the protectionist policies that lasted until the mid 1980s. Like other manufacturing sectors more generally, the garment and textile industry failed to create strong vertical and horizontal linkages with other sectors, which, left them vulnerable when the protectionist policies were

abandoned (McCormick, 1995). Furthermore, by the late 1980s, the failure of the Kenyan cotton industry and the move towards greater use of synthetic fibres put textile producers at the mercy of fluctuating global markets. Effective rates of protection ranging from 72 to 93 percent, however, allowed the firms to compete in the domestic market, despite their inefficient cost structure as compared to firms operating in international markets.

Currently, there are about 50 registered textile mills with a capacity to process 120,000 bales of cotton lint annually; however actual volume processed is about 55,000 bales which means that most mills are operating below capacity and about 40,000 bales are imported. Kenya is also home to some 120 medium-sized garment manufacturers, part of which operates in the EPZs and has provided employment directly to some 37,000 people (EPZA, 2005).

Before the decline of the textile industry in the 1990s, there were about 110 registered large-scale garment manufacturers. The garment-manufacturing sector had a combined capacity to process fabric and garments equivalent of 85 percent of local demand (EPZA, 2005). Growth in the sub-sector declined so much that by 1997, the share of the two industries in total wage employment in the manufacturing sector had declined from 18.6 percent in 1985 to a low of 14.7 percent in 1997 (Ikiara & Ndirangu, 2003). Some of the largest integrated textile mills in the country were shut down during this period. Other factors that led to this decline included the failure of the country's cotton growing sector to provide enough raw materials to the textile mills, increasing use of synthetic fibres, and a worsening of the operating environment manifested by high cost of inputs and electricity, poor infrastructure and the influx of cheap imports including second hand clothes, which employs close to 500,000 Kenyans (EU, 2003).

Even though the overall effects of the downturn of the industry as a result of liberalisation have not been systematically quantified, it is estimated that the effects have included the following (McCormick and Kinyanjui, 2005): (i) Closure of a large number of factories and mills, which has led to a massive loss of employment estimated at over 70,000 jobs; (ii) loss of government revenue due to closures; (iii) loss of investor confidence; (iv) most of the workers who lost their jobs in the textile industries have started informal activities such as trade in small enterprises, some of which are engaged in sale of imported clothes and second-hand clothing and shoe; and (v) in some towns like Eldoret, Thika and Kisumu where there was a concentration of textile activities, there has been shrinkage of the local economy, with other business activities equally impacted negatively.

The implementation of AGOA spurred the revitalisation of Kenya's textile and apparel sector, creating alternative employment opportunities. The EPZs in Kenya have attracted investment in apparel production for exports to the US hence creating employment opportunities for about 39,000 people (EPZA, 2005).

Micro and Small Garment Producers

Micro and small garment producers are an important element of the cotton-textile value chain. In Nairobi alone, they have grown substantially from an estimated 2,421 garment producers and retailers in the year 1989 to about 6,323 in the year 2000. Most of this

increase has occurred in retailing rather than in production (Mc'Cormick and Kinyanjui, 2002). The growth is attributed to retrenchments in the formal sector and the collapse of many medium and large textile firms, which released workers and created a niche for the smaller enterprises (Kegode, 2003). Moreover, it is very easy to enter this sector because the capital required is a relatively low, training services are readily available and affordable and operational costs are low as well. In 2002, the total number of small-scale garment producers in the country was estimated at 135,562, employing about 230,956 workers (Table 18.1).

Table 18.1: Employment in the Cotton Textiles Industry in Kenya (2002)

Activity	Total worker fabrics	No of enterprises
Ginneries	298	24
Spinning, weaving and finished textiles	1423	860
Knitting and crocheting	9776	5191
Weaving and apparel	54,256	41,372
Textile, soft finishing clothing	53,329	22,916
Ready –made garments	7,913	5,097
Second-hand garments	103,931	60,102
Totals	230,956	135,562

Source: Kegode, (2003)

18.3 Trade in Textiles and Garments

Traders of New Clothes

Trade in textile and garments in Kenya has evolved over the past few years, from a series of retail chains (such as Deacons & Njiris) and non-indigenous Kenyan traders who enjoyed monopoly in the 1970s and 1980s to a market dominated by imports of both new and used/second-hand clothing (McCormick et al, 2002). Liberalisation of the market in the 1990s saw an influx of cheap imports, which has literally overtaken the domestic market. This has been further exacerbated by the culture of 'exhibitions' – where imported new clothes from Dubai, Singapore, Thailand and Turkey are sold. Moreover, the second-hand clothing industry now has a strong footing in virtually all corners of the country. These developments drastically reduced the demand for Kenya-made garments.

Second-Hand Clothes Trade in Kenya

The second-hand clothes market is one of the most successful in Kenya; over the years, import liberalisation saw an influx of second-hand clothes into the Kenyan market at an alarming rate. The industry is said to offer employment – both direct and indirect to about 5 million people in both rural and urban areas (Field, 2004). With highly skewed income distribution where 56.8 percent of the workforce lives below the poverty line (Economic Survey, 2004), the second-hand clothes sub-sector employs a large number of people given the sizeable market it serves. The entire marketing chain from importing, wholesaling and retailing involves poorer Kenyans. Given the low

capital requirements and informal nature of the retail level, unemployed school leavers and even college graduates are engaged in selling used clothing. A jobless and unskilled person can start a *Mitumba* (second-hand clothes) trading business with as little as US$25.

It is estimated that Kenya imports over Kenyan Shilling 47 million (US$771,002) worth of second-hand clothing annually. Traders of second-hand clothes make an average of Kenyan Shilling 6,720 (US$96) per month, which is double the monthly income received by a machinist in a garment factory in the EPZ who receives an average of Kenyan Shilling 4,752 (US$65.3). Thus it is perceived by most as a profitable business (Bahadur et al, 2004).

18.4 Market Conditions – Consumption and Exports

Local Market

Local manufacturers supply about 45 percent of the Kenyan textile market requirements while imported new and used clothes account for about 37 percent of the market. Demand for textile products in the country is estimated to be growing at 3.8 percent per annum. While the demand is increasing, there is a huge influx of imported garments in the country of the following categories (EPZA, 2005).

As such over the past ten years of liberalisation of the Kenyan textile market, imports of textile goods in Kenya increased mainly on account of: (i) reduced local production of textile goods, and, (ii) increased demand for cheaper textile goods. The total share of imported textiles and apparels was 54.7 percent as compared to 45.3 percent of locally manufactured goods in the domestic market.

Table 18.2: Market Share of Domestic Textiles and Apparel in Kenya (2004)

Item	Market Share (in percent)
Imported fabric	17.5
Imported new clothes	20.8
Imported used clothes	16.4
Local manufactured items	45.3
Total	100

Source: Ministry of Trade and Industry (2004)

International Market

The main exports in the textiles sector are textile yarn, fabrics and apparels; only a small percentage of cotton is exported in raw form. Textiles exports from Kenya enjoy preferential access under a number of arrangements.

Regional Agreements – EAC and COMESA

The East African Community (EAC) is the regional inter-governmental organisation between Kenya, Uganda and Tanzania. It has a combined population of 90 million people with a GDP of US$25bn. A customs union (CU) was established and made effective from January 01, 2005 with a common external Tariff at 0, 10, and 25 percent for

raw materials, semi-processed goods and finished products respectively. The textiles and apparel exports to the two partner countries (EPZA, 2005) for the year 2003 was Kenyan Shilling 904.85 million (US$14.8mn).

The Common Market for Eastern and Southern Africa (COMESA) consists of 20 member states with a total population of 385 million[4]; thus it forms a major market for both internal and external trading. It was established in 1993 with the main focus of formation of a large economic and trading unit that is capable of overcoming some of the barriers that are faced by individual states. By the year 2000, all internal trade tariffs and barriers had been removed. COMESA is thus one of Kenya's most important Free Trade Areas (FTAs) and constitutes about 73 percent of total export to Africa, most of which are finished products (Economic Survey, 2003). Kenya's apparel and textile exports to COMESA for the year 2003 totalled over US$550mn. The most important markets are Uganda and Tanzania, each making up one third of the exports, followed by the Democratic Republic of Congo, making up for 16 percent of exports in the year 2003.

The African Growth and Opportunity Act (AGOA)

The AGOA was promulgated in the US, aimed significantly to liberalise trade between the US and 37 designated SSA countries of which Kenya is one of them. The Act originally covered the eight-year period from October 2000 to September 2008, but amendments signed into law by US President George Bush in July 2004 further extend AGOA to 2015. At the same time, a special dispensation relating to apparel was extended by three years to 2007 (AGOA).

The effect of AGOA arrangement on the development of the Kenya's economy has been felt positively since the Act was put in place about four years ago, with the country's exports to the US market growing 42 percent to stand at Kenyan Shilling 14.7 billion (US$184mn) in 2003. There has also been job creation with a majority of the 2000 workers employed being women.

However, the opportunity provided by AGOA and the Kenyan government has largely attracted foreign investors, mainly from Pakistan, Sri Lanka, Korea, India, and China. On July 30, 2001 the East African, published an article "Jobs for Kenyans, Thanks to AGOA" in which it was reported that senior officials of Kenya's Ministry of Trade and Industry were visiting foreign countries (Sri Lanka, Korea, US, etc.) to solicit investors in Kenya's EPZs.

The local entrepreneurs are therefore not in a position to compete with the better-financed foreign firms. Herein lies the contradiction of some of the AGOA objectives, particularly as it relates to economic growth and development of the beneficiary countries. While the foreign firms provide employment, the ultimate objectives of poverty alleviation and improving the standards of living of the local population may never be achieved. In situations like this, the benefits of AGOA have largely accrued to the foreign investors. These firms enjoy insurance cover provided by the Export-Import Bank, tax holidays, DFQF entry of their products into the US market. This is a 360° degree protection against all risks that a business could encounter for foreign investors.

18.5 Stakeholder Perceptions on Liberalisation

Import liberalisation is an aspect, in which all stakeholders interviewed are aware of none of the stakeholders were consulted before the implementation of any of the reforms associated with trade liberalisation. At least 90 percent of all the stakeholders thought that trade liberalisation was done abruptly and without provision of safety nets and hence the government should be held responsible for the reforms and its aftereffects. The majority of stakeholders (72 percent) feels that trade liberalisation has negatively impacted the sub-sector. Most consumers and second-hand clothes traders feel that they have benefited from trade liberalisation in the sub sector because cheaper goods have been availed.

Farmers on Liberalisation and Effects

The perception survey results indicate that at least 89.1 percent of all farmers were fully aware of the reforms when they took place but did not have control of the effects that followed; most farmers therefore experienced a negative impact during the period that followed liberalisation; among the effects of liberalisation were reduced productivity; reduced incomes; reduced number of employees and reduced support services[5]; when farmers were asked to cite the aspects of liberalisation that had these negative effects; import liberalisation featured as the most prominent aspect followed by the abolition of state-owned corporations and the abolition of cooperatives.

Ginners on Liberalisation and Effects

Due to the abolition of cooperative societies in the 1990s, the relationship between ginners and farmers became weak, and hence issues like setting prices and payment of farmers on time became problematic. This could have ultimately contributed to farmers reluctance to continue growing cotton altogether and leading to low supplies to ginneries.

Ginners therefore feel that there should be an apex body in place to oversee regulatory issues in the sector as well as issues like prices and farmer-ginner relationships. Moreover, the costs for electricity and related taxes should be reduced and credits or incentives to install new technologies be provided. Some ginners also feel that cheap imports should be regulated either by increasing taxes or by abolishing them altogether.

Textile and Garments Producers' Perceptions

About 83 percent of firms interviewed therefore feel that liberalisation has negatively impacted the sub-sector; 35 percent of firms interviewed felt that import liberalisation should be allowed albeit regulated, 30 percent felt that liberalisation had negatively impacted their businesses due to increased competition from cheap imports and 10 percent felt that it had increased poverty; only 5 percent felt that liberalisation had positively impacted their business. However, the general feeling was that the country had liberalised without prior preparation, safety nets or adequate time for adjustment.

Traders' Perceptions

The profile of traders interviewed included: traders of both used and second-hand clothes, which included non-indigenous Kenyan traders who have been in the market long before liberalisation, each group of traders had a different opinion on liberalisation:

whereas the non-indigenous Kenyan traders felt that liberalisation had negatively impacted their businesses due to competition from cheap imports, the traders of imported clothing both new and used felt that liberalisation has positively impacted their operations in terms of creating employment and incomes and hence helped to reduce poverty.

Consumers' Perceptions

Most of the consumers interviewed saw liberalisation as a positive aspect since it has provided cheap and affordable clothing of relatively good quality, consumers expressed concern that should *"Mitumba"* be abolished then they would face difficulties in affording new clothes, unless the government would do something to provide employment and improve incomes and living conditions of the population, second-hand clothing would still continue to thrive.

18.6 Conclusion

From the study it emerges that not all the negative effects in the industry were a result of trade liberalisation. Trade liberalisation had both positive and negative effects on the sub-sector. Cheap imports have led to the closure of some of the uncompetitive industries and loss of employment and livelihoods. This phenomenon in turn affected the lower parts of the chain such as ginneries and farmers, leading to a loss of incomes and livelihoods to the poorest segments in the value chain. On the other hand, cheap imports have led to an availability of affordable clothing to consumers as the well as the generation of incomes for a segment of traders involved in these activities.

The Kenyan government has identified cotton-textiles as a strategic sub sector, which if well established can lead to substantial poverty reduction. However, results from the survey indicate that there are various constraints experienced by all major sections of the value chain; farmers have to deal with low producer prices and are virtually operating at negative gross margins while ginners have to contend with outdated technology and high costs of production. Competition from cheap imports, especially the second-hand clothes were also seen as a major factor affecting both textile and garment industries.

Therefore, in order to improve the sub-sector, the country must deal with inefficient and uncompetitive production of raw cotton and uncompetitiveness of the textile and garment industry through the use of modern technology and lowering costs of inputs such as electricity, infrastructure should be improved. Further, imports must be regulated especially the second-hand clothes and efforts must be made to develop an integrated value chain for consumption of locally produced goods.

References

Bahadur A, Keon M and Mthembu N (2004), "Developing a Strategic Response to the Trade in Used Clothing in Africa", A Report by the Civil Society Research and Support Collective (CSRSC)

CBS (2002), "Statistical Abstract", Central Bureau of Statistics, Ministry of Finance and Planning, Nairobi

Export Processing Zones Authority (2005), "Kenya's Apparel and Textile Industry 2005", *Kenya's Investors Guide*

European Union (2003), "Assessment of the International Competitiveness and Value Adding Opportunities in the Kenyan Cotton Industry", *The European Union's Programme for Kenya Project No. Quince/14/2003/KE*

Field S (2004), "The Second-Hand Clothing Trade in Kenya: Who are the Main Beneficiaries?" *Presentation to the Bureau of Recycling, London, October 2004*

Ikiara, M M and Ndirangu, L K (2003), "Developing a Revival Strategy for the Kenyan Cotton Textile Industry: A Value Approach", Kenya Institute for Public Policy Research and Analysis, Nairobi, Working Paper No. 08/2003

Kegode, P (2003), "Report on Cotton-Textile Supply Chain in Kenya", *Regional Agricultural Trade Expansion Support Programme (RATES), Nairobi*

Kinyanjui M N (1992), "Small and Medium-sized Manufacturing Enterprises in Central Kenya: Structure, Role and Location", *unpublished PhD Thesis, University of Cambridge*

McCormick D and Kinyanjui M (2002), "E-Commerce in the Garments Industry in Kenya: Usage and Obstacles", I*nstitute of Development Studies Report for E-commerce for Developing countries: Building an Evidence Base for Impact Assessment, IDS University of Nairobi*

McCormick D and Kinyanjui M (2005), "Implications of Liberalization of Markets for Non-Agricultural Sectors", *Discussion Paper, Institute for Development Studies, University of Nairobi*

Endnotes

1 GDP contribution of cotton is relatively small when compared to other export crops like tea, horticulture and coffee whose contribution stands at 28, 16 and 6 percent respectively (CBS, 2002)

2 Assistance programmes included USAID's Small Holder Credit Scheme, the New seasonal credit Scheme, DANIDA's Farm Input Supply scheme (FISS), the EU's Machakos Integrated Development Programme and the World Bank's Cotton processing and Marketing Project (Ikiara and Ndirangu, 2003)

3 Computed cost of production in 2001 was averagely Kenyan Shilling 23.80/kg seed cotton whereas the average price of seed cotton was Kenyan Shilling 20.60/kg (Ikiara & Ndirangu, 2003)

4 Member countries are Angola, Burundi, Comoros, D.R. Congo, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe

5 Support services in terms of extension, credit provision, marketing and provision of inputs reduced in the period following liberalisation

19 CHAPTER The Telecommunications Sub-sector in Kenya

– *Gloria Otieno and Eric M Aligula*

19.1 Introduction

Trade liberalisation in the Kenyan Telecommunications sub-sector began earnestly in 1997 when the government embarked on progressive liberalisation and privatisation within the sub-sector. Before the liberalisation of the sub-sector, services were delivered within a monopolistic public sector structure, e.g. the Kenya Posts and Telecommunications Corporation (KP&TC); which combined regulatory and operational responsibilities (UNCTAD, 2005). The sector was at the time plagued by inefficiencies, poor coverage and low network coverage. The liberalisation of the sub-sector through the 1997 Communications Act led to splitting of the KP&TC into Postal Corporation of Kenya, Telkom Kenya and the Communications Commission of Kenya, which is the regulating agency. Further reforms in the sub-sector were a result of Kenya fulfilling its obligations under the WTO framework.

These have led to the development of the ICT policy, which entails reviewing of the policy framework for investment, competition and growth including obligation of investors to universal access as stipulated in the WTO reference paper on Basic Telecommunications. This study is intended to discuss the effects of telecommunication liberalisation on poverty in terms of employment generation, increase of FDI, access to services and increase of opportunities due to access to information.

19.2 Telecommunications and Poverty in Kenya

Poverty Situation in Kenya

Available statistics in Kenya shows that the level of poverty has been on the increase. It is currently estimated that 56 percent of the Kenyan population live below the poverty line, up from 48 percent in 1992 and 52 percent in 1997. The increase in poverty has resulted in decreased food security, inadequate access to basic social amenities such as health and education, unemployment, escalating insecurity, lawlessness and general economic decay (GoK, 2002). Currently, it is estimated that 56 percent of Kenyans are living below the poverty line.

According to the Poverty Reduction Strategy Paper (PRSP) for Kenya, the poor tend to be clustered into certain social categories such as: the landless; people with disabilities; female headed households; households headed with people without formal education; pastoralists in drought prone districts; unskilled and semi-skilled casual laborers; AIDS orphans; street children and beggars; unpaid family workers; large households; single mothers and fathers; subsistence farmers; urban slum dwellers; and unemployed youth (GoK 2002). An examination of these social profiles indicates that gender, education and

occupation are important proximate determinants of poverty. Gender-related poverty varies by marital status, but women in general are more likely to be poor than men. This is largely due to their lack of rights and control over productive resources and their lack of legal protection. Low levels of asset ownership, poor access to credit and the limiting social norms mean that women are highly concentrated in agriculture. The majority of subsistence farmers are women (69 percent), and this is the livelihood group whose members are most likely to be poor in Kenya (Omiti et al, 2002).

Poverty in Kenya has been associated with a number of factors. These, according to the PRSP, include: lack of or slow economic growth; income inequality and unequal access to productive resources; natural shocks such as drought, floods and fire; inadequate spread and access to basic social services especially education and health; poor implementation of development programmes; lack of effective social policies and mechanics; and diseases such as TB and HIV/AIDS (GoK 2002).

Poverty in Kenya is largely rural, with rural households being twice as likely as the urban population to be poor or very poor. But urban poverty is increasing alarmingly in terms of both incidence and severity. Aggregate figures broken down only into rural and urban categories conceal the sharp regional disparities in poverty incidence that exist in Kenya. These are closely associated with rainfall and agro-ecological potential, and poverty is higher in arid and semi-arid parts the country. The provinces with the highest incidence of poverty in 1997 were Nyanza (63 percent) and Coast (62 percent). Central Province had the lowest incidence at 31 percent (Ministry of Finance and Planning, 2000). Coast province has seen the most significant rise in poverty (44 percent in 1992, 56 percent in 1994 and 62 percent in 1997).

Poverty alleviation interventions have tended to focus exclusively on empowering disadvantaged individuals through creation of employment, provision of opportunities for income generation and through provision of services to improve lives of poor and disadvantaged groups. Access to communications services has been seen as a major move in improving lives of poor disadvantaged groups all over the world. Access to information is at the heart of all human activity, and as previously discussed, telecommunication services can help in poverty alleviation through provision of information for markets, provision of income generating opportunities and provision of employment. These issues will be discussed within the Kenyan context in a later sub section of this study.

19.3 Liberalisation and Regulation of Telecommunication Services

Policy, Legal and Regulatory Frameworks

The history of the legal framework for the Kenyan telecommunications sector started with the East Africa Posts and Telecommunications Corporation (EAP&TC) Act of 1967, which mandated a regional public body (i.e. EAP&TC) to deliver postal and telecommunication services in East Africa. There was very limited trade in and value addition of telecommunications then. With the breakup of the EAC in 1977, the KP&TC Act Cap 411 of 1977 was enacted so that a new corporation (KP&TC) could continue offering the same services in Kenya. The services were thus delivered within a

monopolistic public sector structure, which combined regulatory and operational responsibilities in the same institution (UNCTAD 2005).

Kenya's telecommunication sector has only recently begun the process of liberalisation, privatisation and regulation. Reforms in the sector were introduced in a small way in 1990 when the government relaxed the control of non-strategic functions in the telecommunication sector, in particular the liberalisation of vending of customer terminal equipment. In 1991, market access and ownership requirements were relaxed, as was the liberalisation of supply, installation and maintenance of internal telephone wiring and customer premises. Then, in 1992, KP&TC introduced cellular services (Kane, 2003).

In the year 1998, the Kenya Communications Act split the former KP&TC into 3 bodies: The Postal Corporation of Kenya; Telkom Kenya and the Communications Commission of Kenya (CCK). Under the Act, CCK discharges functions in the area of licensing, price regulation, type of approval equipment, interconnection between operators and fulfillment of universal obligations for instance at the WTO level.

Telkom Kenya, on the other hand, took over all telecommunications functions of the former KP&TC. Telkom was given a monopoly till June 2004. It holds and operates licenses for local telephone services, international gateway services, global mobile communication by satellite, VSAT services, Internet node and backbone services, value added services, customer premises equipment vending and internal and external wiring services. With regard to local telephone, long distance and international telephone service and the country's internet backbone, Telkom Kenya was given monopoly until June 2004 (Kane, 2003). Up to date there is no second landline operator and thus Telkom Kenya still enjoys the monopoly.

Further reforms in the sub-sector have led to the development of the ICT Policy, which entails reviewing the policy framework for investment, competition and growth of the industry in order to facilitate commercial decision-making. In addition, the draft policy encourages all investors to participate in the provision of universal service/access; attract more private sector resources and develop public/private sector partnerships; develop a sector with efficiency, credibility, commercial integrity and good corporate governance; provide quality and sustainable service with pluralism of choice to consumers; and keep abreast with and participate in ICTs both regionally and internationally.

Privatisation of Telkom Kenya

Another major policy reform was the decision to privatise Telkom Kenya through the sale of 49 percent of its equity to a strategic investor, who was expected to invest in the modernisation of the network in 2003. However, the price offered by the highest bidder was so low that the government held back. Deeper reforms have to be undertaken to rationalise the bloated work force; restructure the company's balance sheet to make it profitable; form a subsidiary to run the Internet business; and roll out a fixed wireless service due to rampant vandalism of cables. The privatisation of Telkom Kenya was to be guided by the Privatisation Bill of 2003, which has adequate safeguard provisions to ensure orderly privatisation of strategic parastatals. As indicated earlier, privatisation

is among the best practices in the provision of telecommunications services, and it should be addressed expeditiously (UNCTAD, 2005).

Competition

Competition is another best practice in telecommunications service provision. In 1991, telecommunications was de-monopolised when KP&TC allowed private firms to sell telecommunication equipment. It has been suggested that the impetus for de-monopolisation was due to the recognition by KP&TC that they could not supply these goods. Two important concomitant policies facilitated the entry of private firms into the telecommunications equipment sector. One was the reduction in tariffs on equipment. The second was the relaxation of foreign currency exchange regulations (CIDCM, 1999). Both changes were critical for the entry of private actors, as most telecommunications equipment is imported.

The Kenyan Government has however fallen behind schedule on a number of commitments intended to liberalise the telecommunications sector further, which include licensing of a second national fixed telephony operator by the end of the fiscal year 2004-05 and a third mobile operator by December 2003. In addition, the four Internet gateway service providers that were to be licensed during the same period and the VSAT services that were to be completely liberalised were not (CCK, 2006). CCK has, however, tendered a Second National Operator (SNO) and retains the right to issue more licenses and/or regulate price and other conditions for fixed telephony services until competition in the sub-sector is adequate.

Liberalisation of the international Internet highway has already facilitated licensing of additional service providers. By February 2005, four more companies (Kenya Data Network, Jamii Telcoms, Harum International and Alldean Satellite Networks) had been licensed for provision of Internet backbone and VSAT services (UNCTAD, 2005). Further, as reported in the Business Week magazine of Daily Nation of February 01, 2005, there is a concerted effort in "…Making Universal Telecommunications Access a reality" with regard to availability and accessibility either through MNCs, SMEs, and the government in under-serviced areas.

These developments are expected to introduce competition in the local bandwidth market and create opportunities for cheaper connectivity, which is essential for rapid development of electronic commerce and other data communications. Additional competition in the telecommunication sector will be created through further commitments within the General Agreement on Trade in Services (GATS) multilateral trade framework (UNCTAD, 2005).

19.4 Expansion and Growth of the Sub-sector Services

Increase in Licensed Telecommunications Operators

Due to the liberalisation of the sub-sector, Kenya's telecommunication services have experienced tremendous growth over the past few years. The development of the telecommunications sector since the year 2000 has been marked by a dramatic increase in the subscriber base of the mobile services and a stagnation of the subscriber base of fixed line services.

The mobile network is now over 10 times that of the fixed network. This can be explained by the large capital investment, estimated at US$500mn, undertaken by the two mobile services providers in the country. Furthermore, the country has experienced tremendous growth in local investments in the sub-sector as is evidenced by the number of licensed operators (see Table 19.1). By 2001, for instance, CCK and Telkom Kenya records show that there were 235 registered equipment companies, 72 ISPs, 1000 cyber cafés, and a sizeable number of professionals providing consultancy and support services. By 2004, many more operators had been licensed in different market segments.

The liberalisation of the sub-sector has led to major investments in the mobile phone service providers. Safaricom is owned by Telkom Kenya (60 percent) and Vodafone, UK (40 percent) while Celtel is owned by local Sameer Investments Group and Vivendi International. These two companies have in turn provided direct employment to about 2000 people and indirectly to millions of Kenyans.

Table 19.1: Licensed Telecommunications Operators in Kenya

Type of Operator/Service	Licensed Operators
Fixed line operators	Telkom Kenya Limited, a national operator Bell Western Limited, a regional operator
Mobile operators	Safaricom Limited Kencell Communications Limited Licensing of 3rd mobile operator not yet completed
Internet backbone operators	Telkom Kenya Limited 10 were gazetted on September 03, 2004, for licensing
Public data network operators	Six operators, including Telkom Kenya Limited
ISPs	78 licensed, but less than half are operational
Internet exchange point providers	Two
Local loop operators	Four licensed two were gazetted on September 03, 2004, for licensing
GMPCS service providers	One was gazetted on September 03, 2004, for licensing
VAS-premium service providers	17 One were gazetted on September 03, 2004, for licensing
National commercial VSAT operators	Telkom Kenya Limited Alidean Satellite Network (Kenya) Limited. two were gazetted on September 03, 2004, for licensing
Postal operators	Postal Corporation of Kenya (PCK)
Private courier operators	74
Broadcasting	12 TV broadcasters

Source: CCK (2006)

Liberalisation of the sector since 1997 has seen over 12 foreign firms authorised to invest in the telecommunications and ICT-related areas. Two firms have been authorised to invest in computer related services, five authorised to provide telecommunication services, two firms to supply telecommunications equipment and the rest in the sale of mobile phones and accessories.

Fixed Telephony Services

Telkom Kenya is still the only provider of fixed telephony services in the country to date, although the five-year exclusivity period granted to the company ended in June 2004 and a SNO has been tendered. Not surprising therefore, there has been very poor growth in fixed line connectivity and access despite liberalisation. This is mainly due to monopoly of the service provider (UNCTAD, 2005). Thus, the number of subscribers to the fixed telephony network grew from 291,706 in June 1999 to 328,356 in June 2003, but this had dropped to 290,000 by June 2004.

By June 2004, the number of fixed telephony subscribers amounted to only about 48 percent of the target set by CCK. The demand for fixed telephone lines remains high; however, with the number of people on the waiting list standing at 116,544 in 1999 and 107,266 in June 2004. The most outstanding achievement in the area of fixed telephony since the early 1980s has been the expansion of public telephone service, with the number of public telephone booths increasing from 588 in 1981 to about 10,000 in 2004 (Economic Surveys – various).

Expansion of fixed telephone services has also been remarkable especially in the rural areas where accessibility has improved. Comparing tele-density per province *vis-à-vis* the poverty situations in each region, it is evident that the provinces with the highest poverty have the lowest tele-density. Coast, Nyanza, North Eastern, and Western have the highest poverty rates and the lowest tele-density, the value is higher for Coast province because of Mombasa town which is considered an urban area hence it has more line connections. North Eastern province has the lowest number of line connections; this could be in part due to poor infrastructure in the region. It is hence noticeable that main line connections have not been able to adequately serve the poor in rural Kenya.

Cellular Telephony Services

The KP&TC introduced cellular or mobile telephone services into the country in 1992, through the analogue system known as the Extended Total Access Communication System (ETACS) that was commercially launched in 1993. At that time, the services were so expensive that it was only a few rich people who could afford them. The cost of owning a mobile handset was as high as Kenyan Shilling 250,000 (US$4,165). Not surprisingly, therefore, only 20,000 lines were developed over the 1993-99 period. With the restructuring of the sector in 1998-99 that allowed competition and private sector participation in the sub-sector, the mobile services sector turned into a duopoly with two service providers – Safaricom and Celtel. The two companies were licensed in 1999, since the new ICT policy aimed to obligate service providers to universal service (CCK, 2006).

Both Safaricom and Celtel Kenya have realised tremendous growth in subscriber rollout over the last five years, which saw their combined subscriber base reach about 3.4 million by December 2004 and according to the Economic Survey of 2006, mobile service subscribers are now 5.6 million up from the previous year's 4.3 million registering a growth rate of 56.1 percent.

Internet Services

An NGO, the African Regional Centre for Computing, and a small private company, Africa Online, introduced Internet services in Kenya in 1993. Africa Online has since grown into one of the largest corporate entities in SSA countries. The business environment for non-public sector providers was very hostile then. The size of the Internet services market in the country, which amounted to only 250,000 users a few years ago, had grown to 500,000 by 2001 and 1.3 million by December 2003, currently it is estimated to be over 2 million users (ITC, 2006).

Despite increasing liberalisation, ISPs still face considerable problems including high tariffs and poor service reliability, as they are dependent on Telkom Kenya for the Internet backbone services. Not surprisingly, therefore, less than half of the 78 ISPs that had been licensed in 2004 are operational. Besides the ISPs, there are over 1000 cyber cafés countrywide providing Internet services to many people, at increasingly affordable rates, in both rural and urban areas. This has been facilitated by the Post Office Protocols (POPs) established by JAMBONET in several parts of the county. JAMBONET has also pioneered the provision of free net service connections to people with Personal Computers (PCs) and modems, the major beneficiaries being households and SMEs required to pay only for phone time. However, CCK discontinued this service in 2004 when ISPs complained that JAMBONET, the only supplier of Internet backbone services at the time, was giving them unfair competition in retail Internet services (CCK, 2005).

The scope of Internet connectivity may be constrained by inadequate infrastructure and the lags involved in setting up of fixed line infrastructure. Similarly, connectivity within the region is poor because of lack of high capacity optic fibre on the East African Coast.

Satellite Communications

Satellite communication technology has been in use in East Africa for international gateway links. This is likely to increase with domestic link VSAT stations, as the technologies offer quick and cost effective solutions for establishing links to and from remote areas where the provision of terrestrial infrastructure would be cumbersome, costly and time consuming. In the case of Kenya, VSAT facilities have been employed to establish external gateways even in urban areas because of the poor quality of services provided by Telkom and JAMBONet. However, the licensing procedures have been very restrictive, requiring approval of CCK in consultation with Telkom/JAMBONet (UNCTAD, 2005).

The majority of those benefiting from VSAT connectivity have been commercial entities and embassies transacting businesses internationally. Several applications for authority to offer direct connection via VSAT have not been approved yet. Indeed, while a liberal

and pro-competitive stance has been taken with respect to Internet and other telecommunication services, independent international gateway operators are permitted on a case-by-case basis (UNCTAD, 2005).

19.5 Access to Services and Information

Accessibility seeks to measure physical access to services; the urban areas have access to all types of services with highest rates of penetration. Infrastructure, connectivity and access in Kenya, as measured by the fixed telephone exchange capacity and the number of connections; tele-density; the numbers of Internet hosts and users, and PCs; and the number of cellular telephony providers, have improved significantly over the years in response to the changing policy and regulatory environment

Tele-density stands at about 0.16 fixed lines per 100 people in the rural areas and about four lines per 100 people in the urban areas. The national telephone penetration factor, that is the percentage of households/offices with a telephone, stands at about 4.2 percent but varies widely from 0.1 percent in the very remote districts to 27.7 percent in Nairobi. However, most of the telephones in the urban areas are located in offices rather than in households (UNCTAD, 2006). Thus, in spite of the adoption of Universal Access/Service policies and explosion of telephony services occasioned by the advent of liberalisation, privatisation and introduction of the mobile services, the rural sector coverage still remains deficient.

Recent developments in improving telecommunications infrastructure have seen Telkom Kenya introduce a fibre optics cable running from Nairobi to Mombasa. The programme is worth Kenyan Shilling 14.7 billion (US$200mn) and scheduled to run from Mombasa to Nairobi covering 500 km and Nairobi to the northern corridor. This programme is to ensure the expansion of Internet bandwidth, tele-density and implement rural telecommunications programme covering all districts (*Daily Nation*, June 12, 2006). The long distance optic cable has capacity of STM 16 operating at 2.5 gigabytes per second, this will see an improvement of efficiency reliability and speed of both voice and data services.

19.6 Cost and Affordability

The connection fees for Celtel, for example, have declined by 44 percent, from Kenyan Shilling 1,490 to 990 (US$24.8-16.4) currently. The price of calls has remained more or less constant; however, partly because of introduction of an excise tax of 10 percent on airtime in 2002, the cost of local fixed telephony services has gone up significantly while those of distance calls have fallen. The cost of international calls dropped much more especially due to the introduction of VoIP. Thus, depending on the destination of the calls, data from Telkom Kenya shows that prices fell by 55-73 percent from US$2.00-3.30 per minute in 2000 to US$0.90 in 2005. Affordability of fixed telephony services in Kenya has, moreover, improved from 12.1 percent in 2000 to 7.6 percent by 2003 due to increasing competition (UNCTAD, 2005).

Close to 80 percent of telephony use among Kenyans is now mobile, and less than 10 percent is fixed telephony (CCK/IDRC, 2004). On an average, Kenyans spend Kenyan

Shilling 600 (US$.9.9) per month on mobile telephony compared with only 110 on fixed telephony, 419 on email, 362 on Internet, and 55 on post mail (CCK/IDRC, 2004).

The tariffs for Internet connectivity, even the backbone services that have so far been supplied by Telkom Kenya alone, have also fallen drastically following reforms, which subsequently led to competition, thereby improving affordability. The international connectivity charges have not changed much in the last five years; because of the monopoly of Telkom Kenya. This situation is likely to change, with considerable benefits to consumers in the form of reduced cost and improved quality, should there be a second service supplier. The rapid growth in the number of ISPs has improved the quality of service and reduced its cost tremendously. While the cost of Internet services was as high as Kenyan Shilling 5-10 (US$0.06-0.12) per minute in 1998-2000, for instance, this has fallen to Kenyan Shilling 0.50-1.00 (US$0.006-0.01) currently, which has improved access to many low-income families.

19.7 Employment and Wages in the Sub-sector

The liberalisation of the sub-sector and subsequent entry of new players in the market have led to major benefits in terms of employment. Records of the two mobile companies (e.g. Safaricom and Celtel) show that they have directly created a little over 1000 new jobs. The figures for indirect employment are difficult to calculate but are evidently substantial. These jobs are in dealership distributions and agency business; many outlets that retail telecommunication products and services like telephone handsets and related accessories, airtime, support services, computer assembly, and repair/ maintenance services for hardware and software.

The overall net employment impact of reforms in the telecommunications sector is not easy to judge, as Telkom Kenya is expected to retrench 11,000-14,000 employees. It is almost certain that the net impact will be positive; however, as the potential for more jobs in the sector is greater especially with opportunities arising for participation of micro-entrepreneurs.

19.8 Participation of SMEs and the Community Phones[1] Programme

The participation of SMEs in the non-Telkom exclusive services increased substantially after liberalisation. This has specifically occurred in the area of cyber cafes and community phones. It is estimated that there are over 1000 cyber cafes in Kenya today – all run by small and medium entrepreneurs, providing both incomes and employment to a considerably large number of Kenyans. There are also a number of other traders engaged in sale of mobile phone handsets, mobile phone accessories and airtime who have gained meaningful employment and incomes through liberalisation and subsequent growth of the telecommunications sub-sector.

On the other hand, the community-based mobile telecommunication services are provided by both Celtel and Safaricom Service providers locally known as *Simu yetu* and *Simu ya Jamii.* These initiatives have provided easy access to cheap and affordable communication to the lower income bracket that does not own mobile phones. Furthermore, the initiatives have provided incomes to many poor Micro-entrepreneurs who have benefited from programmes such as K-Rep's and Safaricom's "Micro-lend"

initiative targeting credit to micro entrepreneurs who wish to operate community phones. Estimates from the Nairobi City Council indicate that there are about 10,000 such operators in the city alone. Others are also spread in the rural areas and other towns such as Kisumu, Mombasa and Nakuru.

Community phones have also helped to achieve some of the universal access goals through improved accessibility of communication and information services in rural areas that do not have infrastructure to support expansion of fixed line telephony. Cases have also emerged where the disabled who would otherwise be destitute have benefited from specially designed community mobile phones through a pilot project entitled "Community Telephone Business for Paraplegics" for the Kenyan Paraplegic Organisation (KPO) sponsored by the Safaricom foundation.

19.9 Telecommunications and Trade in Kenya

Growth of the telecommunications sub-sector has created demand for telecommunications infrastructure, machinery and mobile handsets. This has led to increased imports especially of mobile phone handsets and related accessories especially from countries such as Dubai, Finland, UK and China, though the value is not documented, this has led to increased trade in the sub-sector. Kenya is therefore a net importer of telecommunications equipment, apparatus and accessories. In 2002, for instance, the country's imports of these equipments (KRA, 2003) was valued at Kenyan Shilling 9.63 billion (US$160.4mn) as compared to exports valued at only Kenyan Shilling 27 million (US$449,842).

In the case of telecommunication services, Kenya's exports are very small. In 2000, for example, the country exported communication services worth US$22mn or 2.2 percent of the total services exports of that year. The main reason for that are the many years under which the sector was constrained by a restrictive regulatory environment. This environment hampered the sector's ability to develop its export potential. Even though recent episodes of liberalisation and privatisation have made significant improvement in telecommunications capacity, there is still weak domestic supply-side capacity, especially due to an underdeveloped basic infrastructure. Lack of an optic fibre network infrastructure in the East African coast also continues to hamper Kenya's ability to exploit its export potential (UNCTAD, 2006).

On the other hand, improved telecommunications services have also led to increased information access for traders-both importers and exporters of goods. The internet has also allowed some firms to market their products and even buy and sell through the internet, such has been seen in the textile industries operating in the EPZ who are listed on the internet and have their products listed for potential buyers to contact them. Other initiatives involve programmes that help farmers in getting information for markets and prices of produce. Telecommunications has therefore proved as a vital tool for traders and producers to access vital information, which has subsequently led to increased trade, this is specifically important for micro and small enterprises and poor farmers.

19.10 Stakeholder Perceptions on Liberalisation and its Effects

Major stakeholders interviewed included the CCK, which is the National Regulatory Agency; major Service providers; Telkom Kenya, Safaricom and Celtel. Other stakeholders included: (1) major Internet service providers; (2) cyber cafes; (3) community mobile phones; and (4) consumers of the services drawn from lower middle and upper income brackets.

Stakeholders felt that accessibility to services had improved tremendously after liberalisation. In terms of employment creation 54.5 percent felt that liberalisation had positively impacted employment creation and 45.5 percent felt that the effect was very positive. Safaricom alone has created direct employment to about 1000 Kenyans and indirectly to over 20,000 people through their retailer outlets and community phones. This has a direct impact on poverty, since community phones are mostly operated by micro-entrepreneurs, majority of whom are poor. Liberalisation of the sector has led to increased investments especially FDI.

Diffusion of skills and technology within the sub-sector has also improved since liberalisation, and this has been mainly in the area of computer technology, online courses and telecommunications operations. With regard to cost and affordability of services, at least seven out of 16 respondents felt that that the costs were very high, while another 9 felt that the costs were just high. Only two respondents felt that telecommunication services were affordable. Constraints faced by players in the industry included high operating costs- electricity and fuel; and poor infrastructure (both road and telecommunication infrastructure) impeding access to rural areas. Unreliability and poor quality service was also cited as a major constraint especially in internet services, slow speed and constant interruptions related to network problems. Access to services in rural areas is also a major concern among stakeholders.

19.11 Conclusion

Kenya has gone through a series of reforms in the telecommunications sub-sector since the year 1997. What used to be a monopolistic public sector driven service has been gradually transformed into a competitive and growth oriented sector driven by private sector and foreign capital, this was mainly done through the splitting of the once monopolised KP&TC into the Postal corporations, Telkom Kenya and creating of a regulating agency – the CCK which has ensured competition and fair play within the sub-sector. The introduction of the ICT policy, if well implemented, will lead to further reforms in the Kenyan telecommunication service industry which will obligate major suppliers with universal access. This will enhance further service provision in the rural areas where the poor are mostly concentrated.

References

Communications Commission of Kenya, (2006), "Telecommunications: Licensed Operators and Service Providers", CCK, 2006 available at: *http://www.cck.go.ke/licensed_operators_and_service_providers/*

CCK/IDRC (2004), "Universal Access (2004)", Consultancy Report prepared by Total Information Management and Information Management and Development Consultants, Sponsored by communications Commission of Kenya and International Development Research Centre

GoK (2002), "Economic Survey", Government Printer, Nairobi

ITU (2006), "World Telecommunications Development Report", ITU 2006 available at *http://www.itu.int/ITU-D/ict/publications/world/*

Kane S (2003), "Telecom Reform and Poverty Alleviation in Kenya", LINK Center Graduate School of Public and Development Management University of Witwatersrand, South Africa

Kenya Revenue Authority (2003), "Imports Exports Database", KRA Nairobi

Omiti J, Owino W, & Otieno W O (2002), "Poverty Reduction Efforts in Kenya: Institutions, Capacity and Policy", IPAR Discussion Paper No. 033/2002

UNCTAD (2005), "Investment Policy Review: Kenya", Unedited Advance Copy, February 2005, United Nations

Endnote

1 The Community Phone is locally known as *Simu ya Jamii* and *Simu Yetu*

20 CHAPTER The Clothing Industry in South Africa

– *Christi Van Der Westhuizen*

20.1 Introduction

Historically, the South African clothing industry benefited from the protection afforded by high tariffs in the era of the National Party's import-substitution policies. The sector, which is geographically concentrated in the Western Cape and KwaZulu-Natal provinces, was well established by the second half of the 20th century and produced predominantly for the domestic market. The development of the industry in KwaZulu-Natal occurred in the wake of the previous government's racial industrial development policies which attracted Asian manufacturers to the 'homeland' border areas.

From the 1980s onwards, the clothing sector has increasingly been exposed to international competition, a process which was significantly accelerated when South Africa acceded to the WTO's ATC in 1994. The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) signalled the incorporation of the T&C industries into the world trade regime. In compliance with the ATC, WTO member states had to phase down tariffs by January 01, 2005, ending the MFA which held sway over the industries since the 1970s.

Despite the above-stated policy aims, trade liberalisation may detrimentally impact on income distribution through 'exposing previously protected domestic industries to greater foreign competition, causing income and employment losses' (Culpeper 2005: 11). The case of the clothing industry in South Africa provides an illustration of such an outcome, as the liberalisation of trade in South Africa precipitated the decline of the clothing industry and resultant employment loss. While other economic factors also contributed to its deterioration, it is accepted that global exposure has placed the industry in a 'difficult period', necessitating restructuring (DTI 2005). Restructuring has involved the contraction of the formal sector of the industry, the shedding of jobs and the informalisation of the industry (Altman 1993; ESSET 2003; USITC 2004).

This chapter provides a case study of the clothing sector and examines how the industry has adjusted to the challenges of global competition. It explores the adjustment options which remain to be pursued to prepare for and benefit from global exposure, and what the reasons may be for failure in this regard, including the failure of manufacturers to reorient their operations towards exporting and utilising AGOA preferences. The chapter explains the relevant factors in those cases where firms have continued producing in spite of increased competition, and examines the policies and actions undertaken by the government *vis-à-vis* the sector, including the exploration of alternatives to

liberalisation and the preparation of the sector's employers and clothing workers for increased competition and its consequences. Besides, it looks at alternative strategies *vis-à-vis* liberalisation and amelioration of the negative effects of liberalisation on the clothing industry.

20.2 The State of the Industry

The clothing sector's decline has been associated with import penetration due to the liberalisation of trade, which commenced under the National Party in the 1980s and increased pace during the 1990s (Altman 1993; ESSET 2003; USITC 2004). Historical factors influencing its decline include: (i) the industry's insulation due to apartheid sanctions and protective tariffs; (ii) comparatively concentrated production and ownership[1] structures, causing inefficiencies because of high overheads; (iii) the predominance of family-run businesses which are operated conservatively, do not seek to maximise growth, and are not pursuing novel production and management methods. Related hereto are the low levels of capital investment; (iv) the lack of pursuance of strategies apart from labour cost flexibility, such as marketing, operational change, and skills development; and (v) labour relations marked by an 'apartheid mentality' (Altman 1993: ii; 26; 33; ESSET 2003: 15; DTI 2005).

The industry continued its decline throughout the 1990s and the first half decade of the 2000s. The share of the clothing-textile and leather industry in GDP has declined from 3.72 percent in 2000 to 2.83 percent in 2005. Table 20.1 shows the different hourly wage rates in South Africa compared with its main competitors in the global clothing market in 2002. While the formal sector rate is double that of the average rate in China and more than three times that of India, the minimum hourly rate in 'non-metro' areas is less than the average hourly rate in China but double the rate for an entry-level worker in some parts of China.

This minimum hourly rate is paid at factories in rural KwaZulu Natal and elsewhere where wage payments are lower than urban rates, as per the BC approved rates. Lower wages in rural areas correspond with the lower skills levels of workers producing lower-value garments aimed at the mass market. Historically, manufacturers in these areas have been Asian, and apparel from these areas has frequently been exported. Conversely, producers in the Cape Town area, who are geographically closer to the buyers (retailers) and fashion designers, have focussed on higher-value fashion items which require more skill, hence workers are more skilled and their wages are higher.

Employment levels in the industry have fluctuated in the past 16 years since liberalisation commenced. Table 20.2 below shows the drop in employment in the wake of the National Party's liberalisation policy of 1989, the Structural Adjustment Programme (SAP). Table 20.2 shows employment at a higher level in 1997 than in 1992, and then a trend of steady decline from 1997 onwards. However, this official data does not reflect the reported number of jobs lost. These figures also differ from that emerging from firms registered with the education and training authority of the sector, which is a total of 124037 in 2005.

Table 20.1: Comparison between Hourly Wage Rates for 2002 in Clothing Industry	
South Africa 'non-metro' minimum wage*	US$0,51[2]
South Africa informal sector urban rate*	US$1,09[3]
South Africa**	US$1.38
China**	US$0.68
India**	Us$0.38
Bangladesh**	US$0,40
Kenya**	US$0.38
Mauritius**	US$1.25
China Entry-level clothing factory worker***	US$0,25
Note and Source: ** No social security benefits payable. Source: Van der Westhuizen 2005; SACTWU 2002* ***Amounts include social security benefits. Source: US International Trade Commission 2004* *Source: Washington Post* (20/6/02)	

This number represents employees working for organised employers, which did not include informal employers at the time of the formation of the Sector Education and Training Authorities (SETA) at the end of 2004. Barnes (2005: 4) calculated total employment in the clothing sector as 158879 by using the formal vs. informal clothing sector employment figures in the September 2003 Labour Force Survey and the formal employment figures of Statistics South Africa. While fluctuations in employment, under-registration of workers, and increasing informalisation explain why figures still seem too high, these problems may only be resolved by more accurate data collection.

Table 20.2: Employment in the Clothing Industry 1987-1992	
Year	**Number of Employed Persons**
1987	131326
1988	134163
1989	127750
1990	120524
1991	114300
1992	107028
1997	126901
1998	116740
1999	123902
2000	121615
2001	117281
2002	117417
2003	114932
2004	113922
Source: South African Standardised Industry Database, Quantech (2004)	

20.3 Reactive Restructuring of the Clothing Industry after 1994

South Africa commenced the liberalisation of the clothing sector in compliance with the WTO's ATC, deciding unilaterally to halve *ad valorem* tariffs over a shorter period than required – 7 instead of 12 years – to a maximum of 40 percent by 2004. Consequently, clothing imports into the South African market escalated rapidly. With China being the most competitive exporter of clothing in the world market, the vast bulk of clothing imports came from the Asian giant, with the value of clothing imports surpassing that of exports for the first time in 1998.

In the wake of a significantly stronger South African currency, import growth showed the most dramatic increase between 2002 and 2005. Units from China jumped from 85 million in 2001 to 123 million in 2002 (45 percent); to 215 million in 2003 (75 percent); to 335 million in 2004 (56 percent – *SARS. Customs figures quoted in Clothing Trade Council of South Africa 2005*). Manufacturers contend that China's success in the South African clothing market can at least partially be ascribed to an 'unequal [international] playing field' (Interviews 4; 8; 11).

Benefits that accrue to Chinese producers are a fixed exchange rate undervaluing the Chinese currency by up to 40 percent (only changed in the second half of 2005); lower labour costs in the absence of a human rights regime; non-performing loans at a 1,5 percent interest rate; export incentives; state-subsidised infrastructure; production by SOEs which sometimes run at a loss; and possible input subsidisation in the Chinese textile industry (CloTrade 2005; Lande *et al*, 2005). Chinese officials have however denied these claims and insist that China's competitiveness is the result of its 'market economy' policies (*Sunday Times*, October 09, 2005). Apart from multilateral agreements, South Africa has also renegotiated bilateral agreements with Southern African states such as Malawi, Zimbabwe and Mozambique, allowing the importation of clothing at below Most Favoured Nation (MFN) duty rates (Bennett 2003).

The dumping of illegal goods on the South African market through undervaluing or not declaring goods has been a significant contributing factor to the industry's woes. Indications are that large quantities of goods have entered the country from the Far East and the Southern African Development Community (SADC) without duties being charged (Bennett 2003). Difficulties have been encountered in rooting out the problem because of corruption and a lack of capacity and resources in the customs administration (Bennett 2003).

Interviews with the stakeholders reveal that cheap imports caused a price deflation within the industry, a phenomenon witnessed across the world in the apparel market as garment prices have declined by 15 percent over the past five years. As elsewhere, it forced adjustments in the South African industry, especially by manufacturers, as buyers now had the choice of imported goods at lower prices, and manufacturers were therefore competing with such goods, as well as goods from the rural areas and 'cut, make and trims'(CMTs). However, instead of systematically planned restructuring of the industry to meet the demands of domestic realities, *inter alia* a large unemployed workforce with low skill levels, the industry was forced to restructure in a reactive, disorganised manner. The result was therefore unsurprising: large-scale job losses and

the contraction of a labour-intensive industry which could have been a generator of jobs.

20.4 Export of Clothing

The South African clothing industry is comparatively unusual, as it supplies both the domestic and foreign markets. In the wake of South Africa's policy decision to join the global regime on clothing and thereby expose the local market to foreign competition, some manufacturers sought to reorient themselves to produce for the export market. In the clothing and textile sectors combined, 30 percent were supplying foreign markets in 2005, compared with 10 percent in 1994 (*Business Report*, February 02, 2005).

Overall export performance has been below expectation (Kaplan 2003), especially when South Africa is compared with other AGOA participants. South African exports have fallen substantially since 2003, while exports from other AGOA signatories have continuously been rising. While the year-to-date figures for 2004 and 2005 are lower for AGOA exports overall – possibly reflecting the end of the MFA – South Africa's figure for 2005 is almost 50 percent less than that for 2004.

Exploring the reasons for the disappointing export performance brings one to the first broad observation that differences between the economic environments in South Africa and its trading partners influence exporters more than producers for the domestic market. These differentials include lower inflation and lower overhead costs, such as electricity, transport in trading partners, while municipal rates in South Africa have been escalating.

The statistical evidence shows, first, the impact of the weaker Rand in boosting exports, and then the impact of the stronger rand in reducing exports. Manufacturers interviewed in this study were adamant that competing in the international market is impossible without a weaker currency and government support. Those manufacturers that managed to retain their export market in the face of a strong currency, were able to do so because of one of the following three factors: long-standing relationships forged over several years (House of Monatic; Seardel; Allwear; Tern Sportswear); or a strongly interconnected relationship with an overseas customer where fabric supply to the manufacturer is part of the deal (Lolita Clothing); or being vertically integrated with a textile manufacturer (Standard Textile Company and Tern Sportswear). This raises two issues: the destabilising effect of government indecision on business planning, and the demand for a ready and reliable supply of textiles.

Access to textiles is a highly limiting factor cited by a number of respondents. Competitiveness in the world market demands ready access to a reliable supply of a variety of quality textiles. The capriciousness of consumer demand, driven as it is by marketing, makes this even more important. However, textile supply in SSA is known as sub-quality, unreliable and suffering from insufficient volumes, long time lags and limited variety. In South Africa, the chronic underinvestment in the textile industry has led to a 1998 estimation that R3 billion to R10 billion (US$373mn-1.2bn) over 5-10 years may be necessary to modernise and add capacity in spinning, weaving, finishing, dyeing and printing (USITC 2005).

The reality of poor textile supply also explains South Africa's disappointing uptake of AGOA preferences. The AGOA triple-transformation rule – entailing that both fabric and yarn should be sourced from either the US or signatory states – has prejudiced South Africa and Mauritius, which do not enjoy lesser developed status under AGOA like Lesotho and Kenya. This RoO would be less of an obstacle for a country with a high level of vertical integration of its clothing industry (Gibbon 2002). In the interviews, exporters argued strongly that the government should encourage the US to change the highly constraining RoO in AGOA. This is after the Mauritius EPZ Association made a submission in 2004 to the US House of Representatives, asking for a special dispensation to access third country textiles, a request which was granted. Namibia and Botswana received a similar concession in 2002. Lastly, AGOA is a unilateral endeavour from the US, put in place through legislation and subject to being revoked or unrenewable. Thus, it exacerbates the conditions of uncertainty currently prevailing in the industry.

Reorientation towards export markets was partly enabled by the government's Duty Credit Certificate Scheme (DCCS), an incentive programme launched in 1993 and aimed at boosting manufacturers' export production through providing customs duty rebates on imported inputs to such manufacturers. A second, lesser known scheme carried over from the pre-1994 era is the so-called '470.03' rebate provisions for export manufacturing. Companies importing yarn, fibre or fabric to be converted into apparel for export purposes, can do so duty-free. Exporters utilising the 470.03 may not use the DCCS. Other government initiatives include the Competitiveness Fund, which was hampered by late implementation; and low interest loans for capital upgrade, which was primarily aimed at the textile sector.

Government policy influences the environment and the kind of clothing industry found in South Africa today, and government's stance on policy intervention becomes a factor in itself. The accelerated implementation of the WTO ATC sparked consequences, which the government appears unable to deal with. While manufacturers accept that the DCCS has to be amended because it conflicts with WTO rules, the lack of a decision by the government has further contributed to the destabilisation of the industry.

20.5 The Social Fall-out of Clothing Trade Liberalisation

Many clothing workers in developing countries would not have an income in the formal sector were it not for the clothing industry (Nordas 2003). Some trade theorists posit that workers retrenched from uncompetitive industries will experience a short period of frictional unemployment before undergoing training and accessing new employment opportunities. However, developing countries frequently suffer low investment levels which result in sub-optimal job creation, as evidenced in South Africa with its capital formation level of only 16 percent of GDP. Therefore, restructuring has been associated with growing unemployment, and re-employment levels in the clothing industry have been low, as can be seen in the Table 20.3 (ESSET 2003).

Several respondents in this study emphasised the labour intensive nature of the clothing industry and its social function in absorbing relatively low-skilled labour which is otherwise currently not being absorbed in the South African economy. Page (2004) notes that ameliorating the negative consequences of trade policy through social

Table 20.3: Re-employment Rates for Workers Retrenched between September 1997-2000		
	No of workers	**Percent re-employed (in percent)**
Re-employed	13 163	30,9
Not re-employed	29 383	69,1
Total	42 546	100
Source: ESSET (2003)		

policy and administrative targeting is complex, which accords more importance to the analysis of first round effects of changes in the trade regime. Whether such considerations have played a role in the policy decision to liberalise clothing trade is unclear.

When identifying those more exposed to trade-related shocks, vulnerability by livelihood group, socio-cultural identity and geographic location should be investigated (Page 2004). Clothing workers fall into the livelihood groups 'urban industrial workers' and 'rural industrial workers', categories characterised by low entry barriers (e.g. skills), low wages and high levels of drudgery (Page 2004). Some 86 percent of the workers in the South African clothing industry are women, which fits the world-wide trend. Women are regarded as particularly 'suitable' workers for the clothing industry because of their perceived capacity for long periods of physical immobility, patience, dexterity and for their 'docility' (Benería and Roldán, 1987). Labour flexibility is associated with the international increase of female labour, and is a gender, race and class construct, as black and working class women predominate in unregulated, low-wage, low-skill, low-status jobs (Van der Westhuizen 2005). In South Africa, clothing workers are geographically and racially differentiated, with black women predominating in the industry in the rural areas of KwaZulu Natal, and coloured women predominating in the industry in the urban areas of the Western Cape. Therefore, poor women of colour absorb the social costs of liberalisation, as shown in the case of the clothing industry in South Africa over the past 15 years.

Livelihood strategies for retrenched clothing workers are limited by the dearth of economic opportunities in communities which are already under stress and under-resourced. First, prior to employment loss, these workers were low wage earners who increasingly found themselves to be the sole breadwinners as jobs in other sectors were lost. This meant that after these workers lost employment, such households have been pushed into poverty. Second, these workers cannot find alternative employment due to limited economic diversification and the low rate of job creation and, hence, labour absorption in South Africa. The limited employment opportunities in Mitchell's Plain outside Cape Town, for example, cause clothing workers to arrange employment for family members at the clothing factories where they are employed, with the result that a factory closure can cause a household to lose all its breadwinners in one foul swoop (Van der Westhuizen and Deedat 2003).

Moreover, women's employment loss can be devastating in poor communities, as the effects are felt beyond the individual worker who loses her job. Studies in developing countries have shown women to be essential for the sustenance of livelihoods in poor families (Momsen 2001: 1, 2; Page 2004: 8). In South Africa, the lack of economic opportunities for the poor majority means that livelihood options are reduced to begging for food from neighbours, creating a snowball effect in which whole communities have to absorb the impact of job losses in the clothing sector (Van der Westhuizen and Deedat 2003). Studies have shown differential effects on family members, with women and children bearing the brunt of employment loss. Unequal power relations in the home ensure that the employed male partner's standard of living is frequently not affected by the female partner's job loss, while the women and the children bear the consequences of her job loss (ESSET 2003).

Respondents in this study indicated that clothing workers in metropolitan areas support at least four dependants, while those in non-metropolitan areas support at least six dependants. In Newcastle, unemployment stands at 60 percent, which explains the higher number of dependents per worker. Other studies have found higher numbers of dependants of clothing workers in urban areas. The rate of absenteeism in the clothing industry, which is notoriously high (seven percent), is ascribed to the social problems with which these women have to cope, including being the sole breadwinner, alcoholism, drug abuse, domestic violence, gang violence and women's continuing role as the caregiver within the household.

A study published in 2003 found that retrenchment led to a 'significant and sustained decline in household income, severely constraining the ability of households to maintain expenditure on healthcare, education and food' (ESSET 2003). In all, 68 percent of households reported the reduction of income spent on food as a result of job loss, since budgets left little room for reallocation of other expenses. In 34 percent of households, someone went without food because of lack of money; in 25 percent of households, a child went without food because of lack of money. Some 76 percent of households reported being affected by the loss of health insurance. Loss of health insurance had a destructive multiplier effect, as the workers' family members were frequently reliant on the workers' sick funds for access to health care.

Some 60 percent of interviewees were supported by another employed person in the household, and 27 percent were supported by people outside the household (ESSET, 2003). While urban and rural workers frequently access the available social security support mechanism – the child support grant – social security as provided by government is inadequate to buffer the shock, leading to respondents in the study reporting reduced access to healthcare and a decrease in food consumption. Poor nutrition, heath and education undermine families' attempts to prevent a further slide into poverty (ESSET 2003).

In another study (Van der Westhuizen and Deedat 2003) more than half of the respondents were the sole breadwinners in their homes before retrenchment. Respondents reported children being denied access to education because the parent was unable to pay school fees. Confirming the findings in the ESSET study, unemployed clothing workers were forced to make trade-offs between different needs, having to

choose between purchasing food, paying for transport to look for a job, or pay-as-you-go electricity.

Respondents frequently find themselves in a spiral of debt, as they borrow money to cover basic needs. Another coping strategy is the pooling of resources, as retrenched workers move in with employed family members, or send their children to live with employed family members. These strategies illuminate the pressure that families are placed under, and the resultant social fragmentation (Van der Westhuizen and Deedat 2003). Finally, opportunities for re-employment are frequently limited to CMTs, with the concomitant problems of non-payment, underpayment, inconsistent payment, lack of social insurance, long hours and unhealthy working conditions.

20.6 Conclusion

The survival of the South African clothing industry hangs in the balance, which should be of concern, given its labour-intensiveness and potential for job creation. While liberalisation has for the moment been halted as the government, the industry and labour focus on rejuvenation strategies, further international pressure looms. The WTO negotiations on Non-Agricultural Market Access (NAMA) include eliminating tariff peaks in order to level tariff structures internationally, which may affect apparel in particular, given that it is one of the categories of goods with the highest tariffs in South Africa. This pressure is set to increase further, as the US and EU have indicated their willingness to altogether scrap their tariffs on apparel by 2015.

Short-term options to protect the industry include activating safeguards in terms of China's accession protocol to the WTO until 2008, while other limited safeguard measures are available until 2013. The plan by ex-minister of trade and industry Alec Erwin and Southern African Clothing and Textile Workers Union (SACTWU) general secretary Ebrahim Patel to 'save the industry', included using WTO safeguard regulations to stem Chinese dumping. However, China has adopted a resistant approach in bilateral trade negotiations with South Africa.

Turning to production, the Department of Trade and Industry and SACTWU regard production for international niche markets in value-added apparel as the future for the industry, while large producers maintain that mass production for the international market is within the reach of the industry, provided certain changes were effected. While a compelling argument is made for mass production, it does not exclude production for niche markets. Some respondents argued that the changes in South Africa's clothing industry mirror those in southern Europe where the industry is also contracting. CMTs could play an important role here, as flexible production units which can cope with quick turn-around times and short runs. However, CMTs have to be regulated to avoid the abuses detailed above, and should receive government support. In particular, CMTs require business skills, seed capital, and access to credit.

Another option is regional integration. No country in the SADC is competitive at every production stage of the textile and clothing supply chain. The production and value-adding steps in this supply chain require 'different resource investments in capital, skills and capacity building…and different markets have different competitive requirements for price, response time, product quality, the variety of products, and

order delivery size' (Chemonics International, 2004). SADC is a net exporter of cotton of about 145 000 tons per annum which, if utilised in the sub-region, would go a long way in supplying fabric for AGOA exports (Chemonics International, 2004).

Taking regional integration to another level, some industry players in South Africa believe that Africa could in the medium term become the next low-cost world producer of clothing, as Asian countries diversify away from the industry. In Japan, Taiwan, Korea, Hong Kong, and Singapore, clothing manufacturing served as a stepping stone industry toward export-oriented economic development. SSA could accept that it cannot presently compete with China when it comes to the production of textiles. Instead, through adopting a regional approach, SSA could be the next large producer of apparel for the global market. Textiles could be sourced from China to overcome the obstacle of textile shortage, while investments should be poured into developing a regional textile production capacity. This is, however, a medium to long-term vision, and as such requires concerted regional industrial policy.

References

Altman, M (1993), 'Tinker, Tailor, Tailor's Son, Developing the SA Clothing Industry", Report submitted to the Industry Strategy Project, April

Benería, L and M Roldán (1987), "The Crossroads of Class and Gender. Industrial Homework, Subcontracting, and Household Dynamics in Mexico City", Chicago, University of Chicago Press

Bennett, M (2003), "Organizing in the Informal Economy: A Case study of the Clothing Industry in South Africa", Small Enterprise Development (SEED) Working Paper No 37, Geneva, International Labour Organisation

Culpeper, R (2005) "Approaches to Globalisation and Inequality within the International System", Overarching Concerns Programme Paper No 6, Geneva, UN Research Institute for Social Development, October

DTI (2005), "Clothing, Textile and Footwear Sector", Submission to the Parliamentary Portfolio Committee on Trade and Industry, October 2005 also available at: *www.thedti.gov.za*

ESSET (2003), "The Impact of Trade Liberalisation on Workers in the South African Textile Industry", Research Report, January

Gibbon, P (2002) "South Africa and the Global Commodity Chain for Clothing: Export Performance and Constraints", Copenhagen, Centre for Development Research, March 25

Kaplan, D (2003) "Manufacturing Performance and Policy in South Africa — A Review", Paper prepared for the TIPS/DPRU Forum 2003, September

Momsen J H (2001), "Women and Development in the Third World", London and New York, Routledge

Page, S (2004), "Trade and Poverty Linkages Study", Paper prepared for Africa Trade and Poverty Programme, Department for International Development, UK

US International Trade Commission (2004), "Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the US Market", Publication no. 3671, August 2005 also available at: *http://63.173.254.11/pub3671/main.html* .

Van der Westhuizen, C (2005) "Women and Work Restructuring in the Clothing Industry", in Webster, E, and Von Holdt, K (eds.) *Beyond the Apartheid Workplace: Studies in Transition*, Scottsville, University of KwaZulu-Natal Press

Van der Westhuizen, C., and Deedat, H., 2003. 'The socio-economic impact of trade liberalisation and employment loss on women in the South African clothing industry: A Cape Town case study'. Cape Town: Economic Justice Network of the Fellowship of Christian Councils in South Africa (FOCCISA). Unpublished report.

Endnotes

1 Meaning a small number of large companies is responsible for a high percentage of production, while cross-ownership abounds

2 Minimum wage for machinist in 2002 = R211.16 per week. Calculated with the end-2002 Rand/Dollar exchange rate of R9 to the dollar

3 During peak season. Excludes possible overtime payment

21 CHAPTER

The Tourism Industry in South Africa

– *Brendan Vickers*

21.1 Introduction

South Africa is a popular tourism destination, with arrivals growing from 640,000 in 1994 to almost 8.4 million in 2006. Tourism is South Africa's fastest growing industry and contributes between seven to eight percent of GDP, which includes indirect effects. Tourism employs an estimated three percent of South Africa's workforce. Given the country's high unemployment rate — 23 percent in September 2007 — tourism is regarded as potentially the largest provider of jobs and earner of foreign exchange. It is projected that in 2010, when South Africa hosts the FIFA Soccer World Cup, the tourism economy will employ more than 1,2 million people (directly and indirectly). Tourism in South Africa supports more than 6,500 accommodation establishments.

One of the fastest growing segments of tourism in South Africa is ecological tourism (ecotourism), which includes nature photography, bird-watching, botanical studies, snorkelling, hiking and mountaineering. Authenticity tourism is also becoming increasingly popular, with tourists wanting to experience South Africa in the many rural villages and townships across the country, where conditions of poverty and underdevelopment persist. Business tourism, which includes conference tourism, is also an important growth segment, but not close to leisure tourism's contribution and potential. Business tourism injects some R20bn (US$2.47bn) annually into the South African economy, sustains almost 260,000 jobs, and annually pays an estimated R6bn (US$0.7bn) in salaries and R4bn (US$0.49bn) in taxes (GCIS 2004). This paper provides an analysis of this sector and its impact on trade, development and poverty in South Africa.

21.2 The Global Tourism Industry: Present and Future Trends

The global tourism industry has grown spectacularly since the end of the Second World War. One indicator is the exponential rise in international tourist arrivals: these have grown from a mere 25 million in 1950, to a record 806 million in 2005. The receipts generated by these arrivals have even outgrown the world economy as a whole, reaching US$682 billion in 2005 – and depending on the year, this trade volume equals or exceeds that of oil exports, food products, or even that of cars and transport equipment. These receipts are not unimportant for low and middle income countries, and may often dwarf official aid flows to these nations. For instance, in 41 of the 50 poorest countries in the world, tourism constitutes over 5 percent of GDP or 10 percent of exports (Ashley and Mitchell 2005).

The *Tourism 2020 Vision* study published by the World Tourism Organisation (UNWTO) forecasts that by 2020 there will be close to 1.6 billion international tourist arrivals worldwide. These international tourists will spend over $2tn per annum. It is argued that successful destinations stand to reap unparalleled economic benefits in terms of jobs, investment, and growth. By 2020, the top three destination regions in terms of total tourist arrivals will be Europe (717 million tourists), East Asia and the Pacific (397 million), and the Americas (282 million). These are followed by Africa, the Middle East and South Asia. East Asia and the Pacific, South Asia, the Middle East and Africa are forecast to register tourism growth rates of over 5 percent per year, higher than the world average of 4.1 percent. The more mature regions — namely Europe and the Americas — will grow lower than this average. Europe will maintain the highest share of world arrivals, although this will decline sharply from a relative high of 60 percent in 1995, to 46 percent in 2020. On the other hand, Africa will increase its share of the world tourism market from 3.6 percent in 1995, to at least 5 percent in 2020. South Africa is already a visible global player in this highly competitive market, and is proactively being positioned and branded as a world-class destination.

21.3 The Linkage between Tourism and Poverty Reduction

With annual tourist arrivals in developing countries growing rapidly and sanguine growth prospects for the future, the potential contribution of this sector to economic growth, poverty reduction, and improved livelihoods has gained renewed attention among governments and international development agencies. The Canary Island Declaration on Tourism in March 2001 concluded that for a large majority of LDCs, of which 30 are African, tourism development could be an avenue to increase participation in the global economy, to alleviate poverty, and to achieve socio-economic progress.

This was confirmed by the 2005 UN Summit that reviewed the Millennium Development Goals (MDGs), at which the UNWTO — together with United Nations Children's Fund (UNICEF), United Nations Development Programme (UNDP), UNCTAD, and a broad range of private sector and NGO organisations — highlighted tourism as one of the most effective tools for sustainable growth in the world's poorest countries, and as a key instrument to achieve the MDGs. Thus, it is not surprising that the UNWTO announced a host of programmes for 2007, and declared that this should be a critical year to consolidate tourism as a key agent in the fight against poverty and as a primary tool for sustainable development.

More specifically in the African context, the UNECA has also pointed to tourism as a viable option for pro-poor growth in a continent ravaged by poverty, insecurity, and underdevelopment. The New Economic Partnership for Africa's Development (NEPAD) similarly places great faith in the potential of the tourism sector to help address the continent's myriad developmental challenges. In this regard, a NEPAD Tourism Action Plan has been developed. It provides a more detailed framework of policy interventions at the national and sub-regional levels to create an enabling policy and regulatory environment for tourism development and expansion; tourism marketing; research and development; investment in tourism infrastructure and products; and importantly, human resource development and quality assurance. There is now even interest in promoting 'peace through tourism', with several conferences on this topic convened in African and other capitals, and the launch of transfrontier 'peace parks' in Southern Africa.

Thus far, the salutary potential of the tourism sector for reducing poverty remains largely untapped and inadequately analysed, particularly in Africa. While some countries with very limited tourism potential have emphasised tourism in their PRSPs — such as Malawi, Mozambique and Zambia — others with strong existing tourism industries virtually ignore the role of this sector (ODI, 2006).

Given the contested nature of the tourism industry and its impact on local communities, whether good or bad, it is important that governments, development partners, and civil society subject this sector to closer critical scrutiny. While earnings from tourism may appear impressive as a contribution to foreign exchange, it is the impact of this sector — both direct and indirect — on local livelihoods and communities that is paramount if this sector is to positively contribute towards local economic development.

Some would argue that international tourism in developing countries, as an elitist and highly seasonal enterprise, inevitably has negative effects on local communities: displacement of the poor, increased local costs, loss of access to resources, sexual exploitation (including prostitution), and social and cultural disruption. Moreover, tourism is an outward-oriented, private sector-led industry, and the large international companies that generally characterise this sector may have little or no interest in social upliftment and poverty reduction. And with current technological development, it is possible that tourism earnings remain outside the destination country due to large leakages (e.g. imported skilled labour and luxury products, repatriation of profits by international companies, the considerable role of marketing, transport, and other services based in the originating country). Thus, without the appropriate interventions to ensure the development of pro-poor tourism, the above unfavourable conditions may well transpire.

In sum, tourism has generally been viewed as an engine for economic growth, rather than as a mechanism for delivering both directly and indirectly on poverty reduction. The UNWTO has therefore been at the forefront of the debate to mainstream tourism into national development plans and PRSPs. It argues strongly that tourism, one of the most dynamic economic activities of our time, can play a significant role in catalysing balanced sustainable development and generate benefits for the poor. To this end, the UNWTO has established a Sustainable Tourism – Eliminating Poverty (ST-EP) Programme to enhance the development performance of tourism.

There are, then, various ways of addressing poverty and its socioeconomic discontents through the development of a dynamic tourism sector in developing countries (Ashley, Boyd and Goodwin, 2000; Gerosa, 2003; Luvanga and Shitundu, 2003; ODI, 2006). First, existing tourism enterprises — whether large or small, or located in urban or rural areas — can directly provide jobs for poor communities and the unemployed. Second, tourism provides labour-intensive and small-scale opportunities for the poor to directly supply goods and services, produced by locals, to tourists and tourism enterprises. In South Africa, the labour intensity of tourism measures 0.84, compared to manufacturing: 0.58; all non-agricultural: 0.54; and agriculture: 9.70[1] .

Third, with relatively low barriers to market entry, the poor can establish their own tourism enterprises, whether micro, small and medium sized enterprises (MSMEs) or community-based enterprises. Fourth, the proceeds from a tax or levy on tourism income

or profits can be used to benefit poverty reduction programmes. Fifth, poor communities can benefit from investment in infrastructure stimulated by the tourism industry (e.g. roads, piped water, sanitation, electricity and telecommunications). Finally, tourism is an important opportunity to diversify local economies: it can develop in poor and marginal areas with few other export and diversification options.

21.4 Tourism as an Engine for Pro-Poor Growth in Africa

Significantly, Africa is the world's regional leader in terms of tourism growth (albeit from a low base), with Sub-Saharan Africa (SSA) — pulled by South Africa, Kenya, Mozambique, Swaziland and Seychelles — leading the performance. At the same time, in North Africa, the two main destinations, Morocco and Tunisia, have experienced somewhat different growth paces. Tourism is also one of the fastest growing industries in the SADC region, with immense untapped potential for further development. The Overseas Development Institute (ODI) identifies four reasons why tourism is a potential engine for pro-poor growth in Africa.

First, whilst Africa contributes little to global tourism figures, tourism is significant for the continent's economies. By 2003, tourism accounted for over 11 percent of total African exports (Ashley and Mitchell, 2005). In addition, Africa attracts four percent of global international arrivals. This indicates that the tourism sector and its potential pro-poor benefits are disproportionately important for Africa, compared to other continents.

Although two-thirds of international tourism receipts in Africa are concentrated in several key countries — namely South Africa, Egypt, Morocco, Tunisia and Mauritius — the tourism sector is important to a broader spectrum of African countries too. Tourism constitutes over 10 percent of total exports in more than half of African countries for which there is available data. In some countries, such as Mali and The Gambia, small annual international arrival figures of 70,000 visitors — that is less than 200 tourists a day — are still significant, with tourism respectively contributing 10.1 and 30.5 percent of total exports for these two countries (Ashley and Mitchell, 2005).

Second, the tourism sector in Africa is rapidly developing, and becoming increasingly competitive and sophisticated. Whereas tourism represented two percent of African exports of goods and services in 1980, this figure has today multiplied by almost six times. Moreover, this sector is remarkably free of the price supports seen in agriculture and tariffs on manufactures.

Third, there are good long-term prospects for the tourism sector. Indeed, the continent's comparative advantage in wilderness and wildlife are likely to increase in value as such assets become scarcer globally. West Africa is also benefiting from increasing interest in the Black 'Holocaust' resulting from the North Atlantic Slave Trade. Meanwhile, South-South tourism is increasing in Africa as elsewhere in the developing world. Tourism is, for instance, a key sector of the IBSA initiative between India, Brazil, and South Africa.

Finally, there are cases where countries have successfully graduated from Least Developed Country status by effectively harnessing a strong tourism sector – as evidenced by the Maldives, and Mauritius and Botswana in the case of Africa.

21.5 Tourism Sector in South Africa

Prior to South Africa's first democratic elections in 1994, the country's tourism sector was plagued by a host of constraints that limited its potential to play a more meaningful role in the development of the economy. These constraints included: (i) lack of inclusive and effective national, provincial and local structures for the development, management and promotion of the tourism sector; (ii) inadequate or non-existent ground transportation, especially in the rural areas; (iii) lack of infrastructure in rural areas that compounded perceptions that the safety of tourists could not be guaranteed; (iv) poor consumer-oriented service; (v) poor involvement of local communities and previously neglected groups in the tourism industry, mainly as a result of government policies; (vi) lack of market access – local communities did not have access to the lucrative tourism industry; and (vii) the potential of domestic tourism was largely suppressed due to the segregated access to tourism products that prevailed then (DEAT 1996).

Since 1994, the government has recognised the role of the tourism sector as a key catalyst for economic growth and development. For this reason, it has embarked upon various initiatives to develop this industry in a sustainable and responsible manner, and to maximise its real potential in light of the country's rich, diverse and attractive tourism attributes. In addition, there is now considerable local activity and emphasis upon tourism-led local economic development planning across large cities, smaller localities and rural areas (Rogerson 2006).

Accordingly, the government now explicitly targets, and seeks to promote, tourism as a high potential growth and export sector. This has been welcomed by all constituencies. The Accelerated and Shared Growth Initiative for South Africa (ASGISA) points to the positive role of tourism in poverty reduction and social upliftment, and support for this targeted sector is now being fast-tracked. Tourism is thus viewed as a key conduit to improve the livelihoods of many poor communities that reside in the underdeveloped 'second economy', as well as supporting the further global integration of the industrialised, modern and wealthy 'first economy'. With the necessary policy interventions and the looming 2010 Soccer World Cup in mind, the government seeks to raise the contribution of tourism to GDP from 8 percent to 12 percent, and create 400,000 new jobs by 2014.

Principles Governing Tourism Development

The 1996 White Paper on the *Development and Promotion of Tourism in South Africa* set out the government's initial vision and objectives for the tourism industry, in line with the social equity imperatives of the progressive Reconstruction and Development Programme (adopted in 1994, but succeeded in 1996 by the more conservative Growth, Employment and Redistribution strategy). It recognised that tourism had largely been a missed opportunity for South Africa in the past, but could provide an '…engine of growth, capable of dynamising and rejuvenating other sectors of the economy'. Its approach to the development of responsible and sustainable tourism turned on several key principles, including the following: (i) tourism should be private sector-driven, although the government should facilitate tourism development by ensuring an enabling environment; (ii) tourism growth and development should be based on 'effective community development'; (iii) 'sustainable environmental practices' should direct

tourism development; (iv) cooperation between stakeholders nationally and within the Southern African region should steer targets and programmes; and (v) tourism should be a means to economically empower 'previously neglected communities', and in particular women.

The 1996 White Paper was supplemented in 2002 with the adoption of the government's *Responsible Tourism Guidelines*. Based on the triple bottom line of sustainable development (economic, environmental and social sustainability), the document provided the private sector with guidelines for practising responsible tourism and providing opportunities to local communities. The principles adopted included the following: (i) establishing partnerships and joint ventures in which communities had a significant stake, and enjoyed meaningful participation and equity; (ii) buying and using locally made goods and services within a 50 km radius (with the target of this increasing by 20 percent over three years); and (iii) recruiting and employing staff as far as possible from local communities (i.e. within 20 km of the enterprise).

Tourism-based Poverty Reduction Programmes in South Africa

Given the importance attached to the tourism sector as a conduit for economic development, the government and its parastatal enterprises have embarked on various initiatives to more meaningfully involve the poor and historically disadvantaged individuals in tourism development. These initiatives include at least three programmes, briefly outlined below (Spenceley & Seif 2003; GCIS 2004).

First, the Poverty Relief Programme, supervised by the Department of Environmental Affairs and Tourism, promotes the development of community-owned tourism products and the establishment of tourism infrastructure, including roads.

Second, information centres and tourism signage. This programme aims to create long-term sustainable work opportunities by encouraging and supporting communities to provide better services either directly to tourists or tourism businesses.

Finally, the Tourism Enterprise Programme (TEP), launched in 2000, provides advice and expertise to new entrants into the tourism commercial sector. By February 2004, a public-private partnership with the TEP had created more than 10,000 jobs and provided assistance to a total of 1,731 tourism enterprises – of which about 1,200 were Black Economic Empowerment (BEE) companies.

It is also worth noting that the commercialisation of national and provincial parks, and the development of World Heritage Sites, is governed by public-private partnership (PPP) legislation. The PPP tourism toolkit makes social and environmental deliverables a requirement for the awarding of tourism operational rights to private sector concessionaires. This has had the result of facilitating a number of community, private and public deals in nature conservation areas, with varying degrees of success.

Tourism human resources and skills development takes place through different levels, including the full introduction of Travel, Tourism and Hospitality studies as a subject in schools, and the provision of leanerships ('apprenticeships') through the Tourism and Hospitality Education and Training Authority (THETA). South Africa now has about

127,000 learners in more than 680 high schools countrywide who are studying tourism – up from only 55,000 in 2003 (Van Schalkwyk 2004). In addition, the objective of the THETA learnership programme is to train 5,000 unemployed people within four years, as well as upgrade the skills of 10,000 people already working in the hospitality industry.

The Performance of Tourism in the South African Economy

In the period since 1990, tourism to South Africa has grown spectacularly, confirming its credentials as a preferred global destination. With a small domestic market and less than 1 million annual foreign arrivals in the two decades prior to 1990, South Africa has grown to a destination that welcomed 8.4 million foreign tourist arrivals in 2006 – 13 percent growth on 2005. In addition, the number of international airlines servicing South Africa increased from 53 in 1994, to 64 in 2003, with many more flights now scheduled (GCIS 2004). Even after the September 11 terrorist attacks in the United States, when the global tourism market shrank, tourism to South Africa still increased spectacularly. The initial growth spurt in arrivals has since stabilised, but with sanguine growth prospects (particularly in light of the country hosting the 2010 FIFA Soccer World Cup, from which several tourism-oriented Southern African countries are also likely to benefit). South Africa currently captures 0.9 percent of the world tourism market, with considerable potential to raise this even higher. Some tourism stakeholders even argue that the country should aim for two percent of the world market by 2014, which means 13 million tourists per annum (and considerable job creation).

Domestic tourism is the mainstay of the South African tourism system. This market was valued at R21 billion (US$2.18bn) for 2005, for total domestic direct spend. South Africa has also successfully branded itself as a preferred destination for business tourism. The latter stimulates many static and dynamic economic activities, including: (i) the generation of revenue for the economy; (ii) formal and informal sector job creation; (iii) training and improved skills for volunteers during international conferences and parallel events; (iv) the development of SMMEs; (v) promoting empowerment through public procurement and tendering for logistical services (e.g. travel, accommodation and tour arrangements); (vi) new or improved fixed investment (e.g., infrastructure development); and (vii) imaging, branding and marketing of South Africa to a global audience to: boost foreign investment and trade, attract foreign students to world-class South African universities, and promote tourism.

South Africa has also sought to develop international best practice for large scale events. For instance, the country developed a *Greening the WSSD Initiative*, which was the first attempt to organise a major UN Summit in an environmentally-friendly way using environmental best practice. A key objective of the Initiative has been to create a model for hosting international conferences and events in an environmentally sustainable manner in developing countries and countries in transition. However, hosting these events can be administratively arduous for the South African government, particularly as there is no uniform national policy for the planning, management and execution of these conference logistics (i.e. each department follows its own particular policy and approach). Table 21.1 lists these hallmark events and conferences hosted by South Africa.

Table 21.1: Hallmark Events and Conferences held in South Africa	
Conferences	Year
UNCTAD IX Summit	1996
Non-Aligned Movement Summit	1998
Commonwealth Heads of Government meeting	1999
World AIDS Conference	2000
World Conference Against Racism	2001
African Union Summit	2002
World Summit on Sustainable Development (WSSD)	2002
Major Sporting Events	
Rugby World Cup	1995
Africa Cup of Nations: Soccer	1996
Athletics World Cup	1998
All Africa Games	1999
Cricket World Cup	2003
FIFA Soccer World Cup	2010

Unlike other tradable industrial products, tourism is a services-oriented activity, with various components and linkages into the economy. Its impact on trade, development and poverty is thus complex, and difficult to precisely measure. However, tourism is now often referred to as the 'new gold' of the South African economy as the total foreign direct spend of tourists has overtaken gold foreign exchange earnings, for long the mainstay of the country's 'minerals-energy' economy. The contribution of the tourism sector to GDP is between seven and eight percent, or around R100 billion. This reflects the broader structural shift in the South African economy towards services industries. Nonetheless, the tourism sector has outperformed all other sectors in terms of both GDP and job creation (SAT 2004).

However, while tourism is performing well relative to other priority sectors and is creating jobs and value, transformation levels are poor. In other words, tourism is still predominantly white-owned and white-managed. This is further complicated by an estimated 90 percent of tourism businesses in South Africa falling into the category of SMMEs. Many are also family-owned and managed. The government thus actively seeks to increase the access of groups previously excluded, not only from tourism production, but also consumption, and of enlarging the developmental impact of tourism. Transformation is also a key competitiveness issue, since foreign tourists wish to interact with an integrated and authentic destination. For these reasons, in 2004 the government adopted a Tourism BEE Charter and Scorecard, which comprises a set of quantitative measurements to assess the degree to which firms have complied with the requirements of transformation and gauge their BEE status over a ten year period.

Key BEE targets are that by 2014: (i) more than one-third (36 percent) of all firms should directly or indirectly be owned by black people; (ii) blacks should comprise 60 percent of executive management boards; (iii) at least three-quarters of firm's staff is comprised of black people, and that 45 percent of this should be women; (iv) 75 percent of expenditure

on skills development should be targeted towards black employees; (v) 50 percent of expenditure on procurement should be on companies that are BEE compliant; (vi) 1 percent of revenue should be spent to facilitate enterprise development by black-owned SMMEs (e.g. twinning initiatives); and (vii) 1 percent of money spent on social and industry-specific developments (e.g. 'corporate citizenship' spending on education or community projects) should be aimed at developing local black tourism.

The South African hospitality and travel intermediary markets have been significantly affected by global trends. The presence of multinational firms in the South African hotel sector has grown dramatically. At the same time, the number of travel consortiums — conglomerates of tour operators and travel agencies who operate under one marketing brand — has grown in South Africa. For instance, tourism expansion has seen the number of inbound tour operators grow from 460 in 1999, to more than 800 by 2004. At the same time, however, six firms dominate the market, accounting for 60-70 percent of revenue generated. Notwithstanding increased competition and oft-occurring 'price wars' from larger producers (which can be detrimental to some small or medium-sized tourism firms), smaller producers have continued to benefit from recent tourism growth by focusing on specialised or niche market segments (Cornelissen 2005).

Strong regional and social variation occurs in the distribution of tourism impact across South Africa's nine provinces. Despite international tourism growth, three provinces capture 74 percent of foreign tourist spend: Gauteng (31.1 percent), the Western Cape (28.2 percent) and KwaZulu-Natal (14.8 percent). A similar situation pertains with domestic tourism, where KwaZulu-Natal, Gauteng and the Eastern Cape attract 60 percent of local movement (GCIS 2004). If tourism is to impact significantly on poverty and unemployment, then it must develop in areas beyond the traditional tourism routes and nodes currently used – specifically beyond the three metropolitan areas of Cape Town, Gauteng and Durban.

The South African government is engaged in a process of deregulating both domestic and international aviation. This started in 1990, when competitors to South African Airways (SAA) were allowed to operate in the domestic market. By the end of the 1990s, a new fleet of low-cost airlines also introduced greater price competition to the market. However, the government is often criticised for operating a restrictive aviation regime, which limits foreign airline access into the South African market. This is to ostensibly protect the market for SAA. It should be stressed that aviation – particularly for long haul destinations like South Africa – can be the primary driver or barrier to growth. Therefore, in 2006, the South African government approved an Airlift Strategy in order to address these issues. There is now a process in place to allow for the managed liberalisation of Bilateral Air Service Agreements between countries. The approach is one that prioritises tourism as well as trade, in the consideration of liberalisation. This may potentially lead to a more flexible, responsive and competitive aviation environment for tourism.

21.6 Conclusion

While far more research and analysis is required, the evidence thus far generally appears to suggest that the growth in the tourism export and trade sector has had a positive impact on the South African economy, and in many cases on local economic development.

However, significant challenges persist, inter alia: the transformation of the sector; the geographic distribution of tourism benefits; seasonality in domestic and foreign arrivals; risk management of unpredictable events (including exchange rate volatility); and the sustainability and competitiveness of the sector. Nonetheless, the success achieved since the early 1990s in developing pro-poor tourism in South Africa sets a solid foundation for its future growth and expansion, in line with the ASGISA targets of increasing the contribution of tourism to 12 percent of GDP, and creating 400,000 new jobs by 2014.

References

Cornelissen, S (2005), "The Global Tourism System. Governance, Development and Lessons from South Africa", Aldershot: Ashgate

GCIS (2004), "South Africa Yearbook 2004/2005", Pretoria, GCIS

Luvanga, N and Shitundu, J (2003), "The Role of Tourism in Poverty Alleviation in Tanzania", Research on Poverty Alleviation (REPOA), Report No. 03.4

ODI (2006), "Can Tourism Help Reduce Poverty in Africa?", ODI Briefing Paper, March

SAT (2004), "Gearing up to be Globally Competitive: Tourism Growth Strategy 2005-2007"

Van Schalkwyk, M (2004), "Responsible Tourism: Engaging Local Communities", in Bowes, B, Lundy, G and S Pennington (eds) *South Africa 2014*. Pietermaritzburg, Interpak Books

Endnote

1 A labour intensive sector such as agriculture contributes more to employment than output – so has a ratio of > 1.0, the lower the ratio, the lower the labour intensity of the activity.

22 CHAPTER The Fisheries Industry in Tanzania

– *Josaphat Kweka, Justin Musa and George Kabelwa*

22.1 Introduction

International fish trade has grown rapidly in the last two decades as a consequence of trade liberalisation. Exports have risen from US$15bn in 1980 to US$56bn in 2001. At the same time, the share of developing countries in this trade has risen from 40 to 50 percent and net receipt from under US$4bn to US$18bn respectively (Bostock et al 2004). Although the sector has not been sufficiently mainstreamed in poverty reduction strategies in Africa (see Thorne *et al* 2004), the sector is considered to be a significant contributor to poverty reduction since it is a notable source of food security, income and livelihood.

The linkage between trade and poverty in the fishery sector is ambiguous for two reasons. First, increased export trade of fish may decrease the supply for local consumption (hence compromising the food security role of the sector). Second, although fisheries can be a source of livelihood in many fishery-endowed poor countries, the benefit of fish export to the poor is not automatic and may depend on specific policies of a particular country or how the poor are positioned in the supply chain. It is a therefore cause for concern that, in their study of 29 African countries, Thorne et al (2004) found out that only in three countries, namely Ghana, Guinea and Senegal, fisheries, had the sector been sufficiently mainstreamed in the poverty reduction strategies.

This chapter examines the linkage between trade and poverty in the Tanzanian fishery sector focusing on both the policy framework and the supply chain analysis. The overall objective is to examine how the poor who are at the bottom of the value chain (production process) gain from the sector's increased exports trade and explore factors, which may constrain the poor from gaining (more) from the fishery trade.

22.2 Overview of the Fisheries Sector in Tanzania

The fisheries sector has a significant contribution in poverty reduction endeavours. The sector contributes about 10 percent of the GDP (United Republic of Tanzania, 2006). Its contribution in the growth of GDP for the last five years has been between 1.6 and 3.1 percent respectively (Government of Tanzania, 2006). Foreign exchange earnings have been shooting up in recent years. For example, foreign exchange earning from fish sales rose from US$61.8mn in 1996 to US$92.2mn in 2004 (United Republic of Tanzania, 2005). One third of the Tanzanian population derive its protein from fish. Almost 50 percent of the Tanzanian population live below the poverty line of one US$ per day.

This section of the population depends to a large extent on fish for their protein intake, as they cannot afford other protein-rich foods.

The fisheries sector is one of the significant sources of employment in the country. It is estimated that 80,000 fishers are employed full time in the fisheries sector (United Republic of Tanzania, 2006). Also, others derive their livelihood from fisheries-related activities such as animal feeds industries and boat building.

There has been a persistent increase in the contribution of fish exports to total exports. The share of fish exports rose from 7.5 percent in 1997 to 13.5 percent in 2003. The contribution of non-traditional exports has been growing from year to year during the last decade and the fish exports are the third greatest contributor in this category after minerals and tourism. The average contribution of fish exports was about 11.6 percent of total exports while minerals contributed an average of about 21.1 percent between 1995 and 2003.

22.3 Policy Framework in the Fishery Sector

The National Fisheries Policy of 1997 is aimed at regulating, promoting and developing the exploitation of fisheries resources as sustainable as possible in order to provide food, employment, income and foreign exchange. The major objectives of the fisheries policy are to increase the production of fisheries, increase employment and the foreign exchange earnings. Clearly, the impressive performance of the fishery sector has partly been a result of the policy, which encouraged the development of industrial processing in Lake Victoria. However, it should be noted that effectiveness of the fisheries policy is dependent on the focus and implementation of policies on related sub-sectors such as environment and trade.

The objectives of the National Environmental Policy 1997 specific to the fisheries sector are highly coherent with those of the Fisheries policy. These include: (i) utilisation of fisheries in a sustainable manner by using appropriate fishing gear and processing methods; (ii) control of destructive fishing and processing methods by regulation and support; (iii) promotion of alternative fishing methods to avoid deforestation to fish smoking; (iv) conservation of fish stocks with a view of maximising maximum yield; (v) control of the introduction of non-indigenous species; (vi) reduction of post-harvest losses through improved processing and preservation techniques; (vii) protection of fragile ecosystems and endangered species through proper fishing management, mitigation of coastal/waterways degradation and control of industrial pollution; and (viii) integration of fish farming methods and other environmental methods of farming to enhance productivity.

Other relevant national policies governing the fishery sector in Tanzania include the National Investment Policy 1997 (NIP), the Fisheries Master Plan 2002 (FMP), The National Trade Policy (NTP) 2003 and the National Strategy for Growth and Poverty Reduction (NSGRP) 2005. The NIP, through the Tanzania Investment Centre, has acted to lure investment both foreign and domestic to the industry. The FMP aims at developing a feasible integrated development strategy that will stimulate sustainable economic growth in the fisheries sector. The benefits of FMP are directed at artisanal

fisheries groups, small-scale traders, fish processors and their communities. One of the strategies of NTP is to enhance the contribution of non-traditional (including fishery) export in the growth of the economy.

The NSGRP which is the second round of the PRSP, was to be implemented in July 2005 and focuses on growth as a means to reduce poverty. Although the fishery sector was not mainstreamed in the first poverty reduction strategy, its contribution to growth makes it an important sector for poverty reduction in the context of the NSGRP.

22.4 Key Outcomes of Liberalisation

22.4.1 Employment and Earnings in the Fisheries Sector

The fish trade has helped to boost employment hence contributing to poverty reduction. As can be seen from Table 22.1, the number of fishers increased consistently from 75,621 in 1995 to 119,856 in 2003, while the number of boats increased from 22,464 in 1995 to 36,776 in 2003[1] .

Table 22.1: Number of People Employed in the Freshwater Fisheries Sector 1995-2003

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of Fishers	**75,621**	**75,621**	**75,621**	**78,672**	**81,572**	**92,529**	**101,195**	**119,856**	**119,856**
Fresh water	50,029	50,029	50,029	50,029	56,088	75,042	75,042	95,547	95,547
Marine	25,592	25,592	25,592	28,643	25,484	17,487	26,153	24,309	24,309
Number of boats	**22,464**	**22,976**	**22,976**	**22,268**	**22,268**	**30,171**	**29,941**	**36,776**	**36,776**
Fresh water	18,696	18,696	18,696	18,696	18,696	25,014	25,014	31,849	31,849
Marine	3,768	4,280	4,280	3,572	3,572	5,157	4,927	4,927	4,927

Source: World Bank (2005) and Economic Survey 2004

Another area where fisheries contribute to employment is the production of fishing gear (boats, fishnet etc). For example, the production of fishnet has doubled from 24 tonnes in 1999 to 41 tonnes in 2003. The number of fish processing factories has increased from none in 1995 to 24 in 2005. These factories (especially around the Lake Victoria) provide employment to local people (fish agents, factory workers). Both skilled and semi-skilled workers are employed in fish processing factories. It is estimated that 600 semi-skilled people are employed per factory. Hawkers, mostly women, benefit from fish trade by dealing with punk from the factories. In the fishing camps, women are engaged in the preparation of meals for fishermen in addition to fish hawking.

Kulindwa (2001) estimated the fisheries employment multiplier[2] at 1.56 with backward linkages of 1.37 and forward linkage of 0.18 (World Bank 2005). Applying this multiplier to 2003 data we can estimate the total employment contribution by the fisheries at 239,712.

Output Prices

The fisheries sector in Tanzania has undergone substantial change during the last decade. The Government has worked hand in hand with the private sector in a bid to ensure smooth running of fish market. In its part, the Government has established two modern fish markets, one in Mwanza to cater for the Lake Victoria Zone and another (the Magogoni fish market) in Dar-es-Salaam to cater for the Marine Zone. In fact, in Dar-es-Salaam the fish market is considered to be the largest in Eastern and Southern Africa.

The trade liberalisation process, which started in the mid-1980s and heightened during the 1990s, has had a substantial impact on the fisheries sub-sector. The number of fish processing factories has risen from none in 1995 to 27 in 2005 (United Republic of Tanzania, 2005). Around 11 of these industries are located along the Indian Ocean while 14 are in the lake Victoria Zone. As a result, fish output has also increased tremendously although output per fisherman seems to be declining due to the increase in number of fishermen**.** The output of fish rose from 331,466.90 tonnes in 1993 to 362,510.0 tonnes in 2004.

Subsequent to trade liberalisation, the fish prices are determined by market forces. In fact, the prices fluctuate widely, since the fishing activities are seasonal. During the rainy season, the fish market becomes over-supplied and the prices drop. Notwithstanding the seasonal nature of the business, there is some improvement in the prices of fish now compared to the last 10 years (even after taking inflation into account). In 1995, fishers used to supply to factories/agents at a price of Tanzanian Shilling 500 per kg compared to Tanzanian Shilling 1200 per kg in 2004. Apparently, this increase is a reflection of the rise in export prices (although not at equal proportions).

22.5 Perceived Obstacles in Fish Export Trade

Despite the impressive achievements of the fisheries sub sector in Tanzania, there remain some impediments hindering full exploitation of the international fish trade opportunities. In this study, various stakeholders interviewed were asked to identify key obstacles faced in improving their performance in fish export trade (or benefiting there from). Largely, the constraints mentioned are of two types: the common structural constraints on one hand; and fishery-specific obstacles on the other hand.

The common structural constraints include poor infrastructure and inadequately provided and costly utilities (electricity, water, telephone). Such problems affect the efficiency and increase the cost of production – thereby adding to the transaction costs; and hence lowering value addition in the fish export. Local fish suppliers raised a complaint regarding the poor state of railway and road transport. Given the perishable nature of fish products, lack of reliable transport can lead to frequent losses on the part of traders.

Despite these seemingly common (and economy-wide) constraints, there are sector-specific obstacles that affect fish export and value addition processes. The biggest obstacle among fish processors is fish export royalty, which affects the relative competitiveness of Tanzanian fish exporters compared to Kenyan or Ugandan counterparts who have no royalty. However, officials from Fishery department emphasise

the usefulness of the Royalty in financing fishery research and developing the fishery infrastructure hence sustainability of the sector. Nevertheless, the three East African states are in a process of harmonising the taxes in the fisheries sector, whereby the fish processors/exporters will be subjected to level playing field.

Another obstacle to the development of a robust fisheries sector in Tanzania is lack of access to modern technology. Two problems can be inferred from this state of affairs. Firstly, the observation particularly in marine fisheries (Silva 2006, Berach 2003), that the type of fishing gear used by artisanal fishers can have a serious impact on the environment and consequently on the sustainability of the fisheries sector. Secondly, fish processors lack the technological capacity for increasing value addition by producing fish and related products (e.g. samosa, fish-leather products, fish meal etc.) other than row products (fillets). Such industries would have added more return to the investors, create more jobs and tax revenue.

22.6 Factors Influencing the Trade-Development-Poverty Linkages in the Fisheries Sector

Industrial Organisation Issues

One of the key issues underlying the impact of fish export on poverty is not about price transmission, but rather about biased industrial organisation. On one hand, fish processors/exporters are highly organised through the Tanzania Fish Processors Association. Fishermen, on the other hand, are highly disorganised. They lack associations which could have assisted them in price negotiations or provide a forum for coordinating their concerns. Some organisations, however, have emerged in recent years (e.g. TAFU, WAWADA, MUWADA), but these are relatively infant and incapacitated. As a result of a lack of collective bargaining, fishermen and agents often complain of unfair prices from factory owners. It is the factory owners who set prices while the fishermen and agents are prices takers.

Clearly, this means that the price transmission is partial and market forces are less than fully functioning, thus limiting the extent in which fishermen and agents (who are at the lower end of the value chain) can benefit from fish export trade.

Fish Quality, Environment and Food Security

Fish exports from East Africa have had two bans from the EU market. The first ban occurred in January 1997 and was due to the outbreak of cholera in East Africa. The ban was triggered by unhygienic fish handling in the landing sites and markets; hence substandard fish processing in the factories (Mitullah 1999). The second ban was attributed to fish poisoning (Musonda and Kessy 2001). Consequently, the EU sent a mission to investigate the whole fish supply chain in East Africa. The mission recommended the establishment of competent authority in each country exporting fish to the EU that would be responsible for approving all fish processing.

Following the recommendation of the EU mission, the Government of Tanzania appointed the Department of Fisheries (DoF) under MNRT as the competent authority. As a result of the collaborative efforts between the DoF and other stakeholders in the sector, the fish ban was lifted in November 2000. The DoF not only oversees the adherences to

standards in the fisheries sector but also undertakes regular monitoring and control inspection of landing sites and fishing camps to make sure that fishers are adhering to fish handling standards. Quality control officers of the fish processing factories make regular inspection of fish processing plants to ensure that quality standards are adhered to. Fish processors also train fishers and fish agents regarding hygienic methods of handling fish.

In addition to these efforts by public and private sector, the success of environmental standards at landing sites can be attributed to community-based fisheries management. Embracing the concept of community management, the government has, through the Department of Fisheries, coordinated the community-based fisheries management. During the period from 1995-2004, about 500 Beach Management Units (BMUs) have been established. The BMUs function as part of the local Governments, but are manned by fisheries department via its field offices. Under the BMUs initiative, fishing communities in land sites and the community at large do self-policing to stop environment degrading activities such as fish poisoning. However, the BMUs are only operational in the Lake Victoria area. Plans are underway to spread them to all the fishing communities in Tanzania.

PPP/Stakeholder Collaboration

The lifting of the fish ban can be attributed to improved quality and adherence to international quality standards. To meet the international standards, different stakeholders were involved. In the first place, collaborative efforts of different stakeholders (both private and public) were used to stop fish poisoning. Secondly, fish processing factories established modern laboratories for testing fish quality. Thirdly, the fisheries department has a quality control section that is to make sure fish exports adhere to internal hygienic standards (quality auditing).

The Fisheries Department inspects factories and landing sites regularly to make sure quality standards are being adhered to and take appropriate measures where there are irregularities. Fish processing factories train agents about modern hygienic ways of handling fish before allowing them to engage in this activity. Fisheries department personnel have regular programs to train fishers on hygienic ways of handling fish. The fisheries department makes sure that fish processors have a Tanzania Bureau of Standards (TBS) and EU certificate before they are allowed to export fish products.

The Fisheries Department and fish processors work hand in hand to make sure no harmful chemicals are used in fish processing factories except chlorine, which is used for treating water for factory use. The government negotiated with the EU on behalf of the processors, thereby auguring their efforts. In order to tackle the problem of fish quality in a more sustainable manner, the Government of Tanzania has established two fish quality control laboratories, one at Nyegezi in Mwanza and another one in Dar-es-Salaam.

Food Security and Sustainability of the Fisheries Sector

There is an observation from stakeholders that the harvesting of fish resources in Tanzania is not sustainable. Several empirical studies indicate that the resources are not being harvested according to the principle of maximum sustainable yield (Wilson

1993, Berachi 2002, Berachi 2003, Bulayi 2001, Kulindwa and et al 2004, Silva 2005). This allegation is evident from the table below. The table indicates that Catch per unit effort (CUPUE) is falling over time. The CUPUE for the inland fisheries is falling faster than that of marine fisheries indicating serious depletion risk for inland fisheries due to higher Nile Perch exports.

The surge in fish exports may also pose a risk to food security as supply for local consumption seems to fall putting upward pressure on prices. A study by Abila (2001) in the Kenyan side of the Lake Victoria found out that increased exposure of the fisheries sector to international trade not only leads to a shrinkage of the local supply chain, but is also a threat to food security in the fishing community. The increased number of fish processing factories also increases demand pressure hence rise in prices that may affect the price for local consumers.

It is worth noting that some measures have already been taken to address the environmental problems in the fishing communities. One such measure is the establishment of BMUs by the Lake Victoria Environmental Management Programme (LVEMP) funded by the World Bank. As noted earlier, BMUs aim at fostering community participation in the management of fisheries resources. As of now, the BMUs are only operational in the Lake Victoria zone, but plans are under way to spread it to the other fishing communities in the country. Currently, there are about 500 BMUs countrywide as compared to none in 1995.

Gender Involvement in Fish Trade

Generally, women's involvement in the fisheries activities is much lower than that of men, and concentrated on the lower end of the value chain (see for example Medard et al 2001, Chando 2002) Nevertheless, women have benefited significantly from the liberalised fish trade. All stakeholders contacted in this study are of the view that trade liberalisation has had positive impact on the life of women. Women are not involved in direct fishing activities, for it is considered male activity given its risky nature.

This study finds that women are involved in several activities directly or indirectly connected to the fish trade or fishery activities. These include support activities (cooking for fishermen etc) and hawking at landing sites, in addition to selling some processed or by-products to local consumers. Women are key suppliers of labour in the fish processing factories. On average, women comprise about half of the total labour force in these factories. Women are also key beneficiaries of fish processing by-product, buying punks from the factories and sell the same to chicken feed manufacturers.

Another activity where women are highly involved is fish smoking and frying. Fish smoking and frying are activities, which are mainly done by women. After having processed the fish, women sell it to local markets for local consumption, including fish wholesalers who transport fish to various parts of Tanzania. Another activity in which women are highly involved is seaweed farming. Seaweed farming is practiced mainly in Tanzania mainland coast and the isles of Zanzibar and Pemba. In Zanzibar, seaweed farming forms a significant part of exports.

22.7 Conclusion

This study has sought to explore the linkages between trade, development and poverty reduction in Tanzania using the case of the fisheries sector. From the economic point of view, the fisheries sector can be considered a 'winner' of trade liberalisation. This success is exemplified by increased contribution of the sector to total exports and Government revenue. It is also evidenced by improved livelihood of grassroots workers due to increased employment opportunities (both direct and indirect) and increased prices of fish products. Questions however arise whether the fishery sector can be used as a showcase by government in enhancing the impact of trade liberalisation. In addition, how this should be done is a question. Is it through the EU partnership, Donor Support (e.g., World Bank), or Regional Integration Arrangements?

The study has also found out that trade-development-poverty linkages are possible. But these linkages are effective only when other underlying issues are addressed. For example, the paper has observed that the contribution of the fisheries sector to poverty reduction has been hampered by an ill-functioning markets. Consequently, grassroots workers are not able to take full advantage of the opportunities arising from increased exposure of the sector to international trade.

Furthermore, there is the problem of unsustainable fisheries management. Evidence indicates that fisheries resources in Tanzania are not harvested according to the principle of maximum sustainable yield and this has been exacerbated by increased exposure of the sector to international trade (Kulindwa et al 2004, World Bank 2005, Silva 2006). The fisheries resources in Tanzania are currently exploited, using the principle of open access as opposed to community based management principle as suggested from research findings (Bulayi 2001, Berachi 2003, Lokina 2005). Consequently, food security and long-term sustainability of the fisheries sector is threatened.

References

Abila, Richard O (2004), "Fish Trade and Food Security: Are they Reconcilable on Lake Victoria?", United Nations Food and Agricultural Organisation (FAO), Rome, *www.fao.org*

Berachi, Isaac G (2003), "Bioeconomic Analysis of Artisanal Marine Fisheries of Tanzania (Mainland)", A Masters Degree Thesis Submitted to the Department of Economics, Norwegian College of Fishery Science, University of Tromso, Norway *www.nfh.uit.no/dok/IFM/Thesis*

Bostock, C, P Greenhalgh and U Kleih (2004), "Policy Research – Implications of Liberalisation of Fish Trade for Developing Countries", Natural Resources Institute (NRI), University of Greenwich, UK *www.nri.org/projects/fishtrade*

Bulayi, Magese Emmanuel (2001), "Community Based Cooperative Fisheries Management for Lake Victoria Fisheries in Tanzania", A Research Paper Submitted to University of Iceland for the Award of the Degree of MSC Fisheries, United Nations University (UNUS) *www.unuftp.is/project*

Chando, Catherine Msigwa (2002), "Gender Roles in Fisheries Planning and Projects: The Case study of Coast Region in Tanzania", Norwegian College of Fishery Studies,

University of Tromso, Thesis submitted for the award of MSc Degree http://www.nfh.uit.no/dok/IFM/thesis/chando2002.pdf

Kulindwa, Kassim A A (2001), "Contribution of Lake Victoria Fisheries to National Economy", A Report Submitted to LVEMP, Fisheries Research Component, Socio-economic Sub-component

Kulindwa, Kassim A A, Eric Odada, Daniel O Olago, Michieni Ntiba and Shem Wandiga (2004), "Mitigating Environmental Problems in Lake Victoria, East Africa: Causal Chain and Policy Options", Ambio Vol 33 No 2 February 2004 *www.ambio.kva.se*

Lokina, Razack Bakari (2005), "Efficiency, Risk and Regulation Compliance: Applications to Lake Victoria Fisheries", A PhD Thesis Submitted to the University of Göteborg, Department of Economics, April 2005 *http://www.handels.gu.se/epc/archive/00004188/01/Lokina_titel.pdf*

Medard M F Sobo, T Ngatunga and S Chirwa (2001), "Women Involvement in Fisheries in Lake Victoria", World Fish Centre, Penang, Malaysia *www.worldfishcenter.org*

Mitullah, Winnie V (1999), "Lake Victoria Nile Perch Cluster", IDS WP87, Institute of Development Studies (IDS), UK, *www.ids.ac.uk/bookshop/wp.htm*

Musonda, Flora Mndeme and W Mbowe (2001), "The Impact of Implementing SPS and TBT Agreements: The Case of Fish Exports to the EU by Tanzania", Economic and Social Research Foundation (ESRF)

Silva, Patricia (2006), "Exploring the linkages between Poverty, Marine Protected Areas Management and the Use of Destructive Fishing Gear in Tanzania", World Bank Research Paper 3831, World Bank, Washington DC *www.worldBank.or*

Thorpe, Andy Chris Reid, Raymon van Anrooy, Cecile Brugere (2004), "African Poverty Reduction Strategy Programmes and the Fisheries Sector: Current Situation and Opportunities", *African Development Review* 2004 Vol 16 p328 *http://www.blackwell-synergy.com/doi/abs/10.1111/j.1017-6772.2004.00094.x*

URT (2005), "The Economic Survey 2004", President's Office-Planning and Privatisation, Dar-es-Salaam

URT (2006), Official website of Department of Fisheries

Wilson, Douglas (1993), "Fisheries Management on Lake Victoria", A Paper Presented at the Annual Meeting of the African Studies Association 4-7 Dec 1993, Ecopolicy Center, Rutgers University, New Brunswick, New Jersey, US

World Bank (2005), "Study on Growth and Environment Links for Preparation of Country Economic Memorandum (CEM)", World Bank, Washington DC

Endnotes

1 Note that these statistics do not include fish for own consumption. Kulindwa (2001) estimates that the contribution of fish for own consumption to total fish production is about 10 percent (see World Bank, 2005)

2 The employment multiplier is calculated as total employment due to fish business divided by those directly employed as fishers

23 CHAPTER The Cotton and Textile Sectors in Tanzania

– *George Kabelwa and Josaphat Kweka*

23.1 Introduction

Tanzania embarked on major reforms towards a market oriented economy since the mid-1980s as a result of the SAPs supported by the World Bank and the International Monetary Fund (IMF). As part of these reforms, the country adopted a liberal trade regime. Measures to liberalise trade included, among others, withdrawing the role of the government in production and commercial activities in favour of the private sector, rationalising import tariffs, dismantling import restrictions, introducing a foreign-exchange market, and improving incentives for export performance. Currently, Tanzania's trade liberalisation is shaped by several multilateral and regional trade agreements associated with bodies such as the WTO, the SADC, and the EAC.

The objective of this study is to analyse how the distributional impact of trade liberalisation has affected the cotton and textile sectors in Tanzania. The study looks at the impact of international trade as a combined outcome of three forces, namely: (i) the structural effects such as trade barriers, infrastructure, and institutional factors; (ii) the labour demand effects; and (iii) the labour supply effects.

23.2 Impact of Trade Liberalisation on the Cotton and Textile Sectors

The performance of the cotton and textile sectors has had significant implications on poverty reduction. Cotton, which was introduced by the German Settlers around 1904, contributes about 15 percent of foreign exchange earnings and is the second largest export item after coffee. About 40 percent of the country's population depends on cotton for their livelihood. The textile sub-sector on the other hand was deliberately established in the early 1970s by the government as part of the industrialisation efforts. Through the textile sub-sector, the government intended to generate more employment, add value to the cotton-based exports and develop products that could be substituted for textile imports (Ladha, 2000). The textile sector grew from four textile mills between 1961 and 1968 to 35 mills by 1980s. The total investment in the sector exceeded US$500mn during the 1980s and consequently, the textile sector became the largest employer in the country employing about 37,000 people. The third contributor to the government revenue has been various taxes and the largest exporter of manufactured goods.

Trade liberalisation and reforms in the cotton sub-sector involved three steps. First, the cooperative movement reform, which began in 1991 when the government crafted a new Cooperative Society Act (Kahkonen and Leathers, 1997). With this Act, the cooperative unions had to conform to the international cooperative principles. That is, primary societies were to be formed by farmers, who would then control the cooperative

unions through their elected representatives. Second, the gradual relaxation of price controls by the government starting from 1991-92. That is, in 1991-92 the government announced only an indicative price for cotton, and during 1992-93, cooperative unions were given the freedom to determine their own producer prices. Third, before 1994, the cotton sector was highly monopolised. Two institutions, the cooperative unions and the Tanzania Cotton Marketing Board (TCMB) handled all the marketing and processing of cotton. From 1994, this monopoly was abolished and TCMB, which was renamed the Tanzania Cotton Lint and Seed Board (TCLSB), had a new role of enforcing marketing regulations. In addition, all price controls were removed and private traders were allowed to set their own producer prices. Note that the Cotton Industry Act of 2001 provided for the formation of the new Board called the Tanzania Cotton Board (TCB), which replaced the TCLSB.

The impact of trade liberalisation and reforms can be found on the production, marketing, pricing and processing of cotton. Since the beginning of trade liberalisation and reforms, cotton production has fluctuated a lot. The main reasons for the fluctuating trend include a lack of cotton inputs and bad weather in the major cotton growing areas. Also, in the absence of additional production incentives in the form of attractive support services, fluctuations in Tanzania have been much more heavily influenced by the world price of lint (Maro and Paulton, 2002).

One important objective of the reform programme was to increase the profitability of cash crops by introducing multiple channels for marketing and allowing farmers to receive a higher share of the proceeds from export sales (Kanaan, 2000). As a result, there emerged many marketing channels available to the cotton farmers. A cotton farmer now has many options for selling his cotton: (i) take the seed cotton to a local cooperative depot of the primary cooperative society and sell it to a cooperative union; (ii) sell the seed cotton at the farm gate or at a nearby buying station to a private trader who assembles cotton from several farmers and then transports it to a private ginnery; (iii) transport and sell the seed cotton directly to a private ginnery; or (iv) sell the seed cotton to TCLSB (Kahkonen and Leathers, 1997).

The movements of cotton prices in the post-trade liberalisation era have also been unfavourable to the farmers. Since the beginning of trade liberalisation in the early 1990s, the trend in producer price has remained stable despite the rising costs of essential inputs. This implies that over time, the profitability of the cotton production to the farmers has been declining, especially in real terms. It is hard to determine whether this can be attributed directly to liberalisation; however, as external world market conditions have changed substantially over the same time period.

The conclusion that one reaches when analysing whether producer prices have improved relative to the export price is dependent on whether one looks at the absolute gap between the two prices in shillings or at the producer price as a percentage of the export price. When measured as the difference in shillings, the gap between the producer prices and export prices has been widening. On the other hand, of one considers the producer price as a percentage of the export price, then the producers seems to have been receiving fairer prices since liberalisation.

Regardless of what one thinks about the changes since liberalisation however, it is widely agreed upon that factors such as inability to access marketing information are holding down producers prices from what they could be in a more efficient market. Smallholders need exposure to competitive markets and must be organised collectively in cooperatives or farmers associations in order to have the bargaining power necessary to obtain a good price. Therefore, some recommendations have been made for the farmers either to start their own associations or to auction their cotton at market places known as *gulios*.

Another impact of trade liberalisation involved the entry of the private processing firms. These private firms recorded a large influx at the beginning of the liberalisation process in 1995, which reduced the remaining cooperatives to a minor role. It is suggested that the high entry might be explained by either donor assistance for ginnery rehabilitation, unduly optimistic expectations of world price trends around the time of liberalisation and undue optimism about the possibility of raising smallholder production levels (Lundbaek, 2002).

However, strong competition during seed cotton purchase had negative impacts on both seed cotton and lint quality and on the possibility of delivering inputs to producers on credit (Gibbon, 1999). The few firms that have tried to invest in extension provision have also found that most of the benefits are captured at harvest time by ''free-riding'' competitors. Thus, after an initial post-liberalisation increase, coinciding with the high world lint prices of the mid-1990s, seed cotton production plummeted during 1997–99 (after a stagnation in prices). In response, the TCB convened the first annual stakeholders' conference in 1999 to chart a way forward for the cotton sub-sector. This was followed by TCB-led interventions in seed and pesticide provision and quality control. Production levels have now begun to recover, despite adverse world prices (Poulton et al, 2003).

In the textile sub-sector, as the pre-liberalisation government protection and subsidies came to an end because of trade liberalisation and reforms, the textile sub-sector inevitably collapsed, leading to massive labour redundancies and unprecedented idle capacities. The textile sub-sector could not survive international competition in the new market-oriented economy because of poor management; high operating costs such as high power tariff as well as unfavorable taxation policies; high level of foreign debts and currency devaluation; poor and outdated technology; unfair competition from substandard imports as well as high degree of tax evasion by importers; and negative export incentives (RATES, 2003). Consequently, in 1996 for example, only two industries were operating out of 35 textile mills.

The textile sub-sector is currently at the revival stage after commendable efforts by the government to revive the sub-sector partly through the privatisation and investment policies. Most of the new industries are engaged in the production of printed fabrics for the local and regional market, although there are some which have succeeded in exporting yarn and finished garments to Europe (Ladha, 2000). It is reported that over 80 percent of Tanzanian lint is exported directly to regional and international markets with less than 20 percent being utilised by the local textile mills – a long way from the

national target of utilisation of up to 60 percent. Many textile manufacturers are planning to absorb the targeted extra volume of cotton exported by ginneries through increasing production, installing quality machines and looking for bigger markets.

As noted before, the current Tanzania's trade opportunities under liberalisation are largely shaped by several multilateral and regional trade agreements under the WTO, SADC, and EAC. Tanzania has received a lot of trade opportunities, especially in the export of her textile products, under these settings. None of these opportunities, however, have been utilised efficiently, mainly due to the lack of capacity such as modern technology in order to meet the required quality standards of the products.

As regards the European market, the Cotonou Agreement signed between the EU and the African, Caribbean, and Pacific (ACP) group has the objective of enabling the ACP member states including Tanzania to enter into Economic Partnership Agreements (EPAs) with the EU either individually or collectively, taking into consideration the integration process already in existence. This arrangement also opens potential markets for Tanzanian cotton.

It should be noted however, that with the end of the MFA on January 01, 2005, there are new challenges to textile and apparel trade globally and particularly to developing countries like Tanzania. Analysis of the US market in apparel categories shows that China boosted its market share in apparel and textile trade from 9 percent in 2001 to 65 percent as of March 2004 (GAFTT, 2004). This implies that the prospects of Tanzania to take more advantage of the US market are in jeopardy. In addition, the cheap textiles and clothing imports from China that are flooding Tanzania's domestic market, can seriously injure the clothing and textile sub-sector and result in loss of precious productive capacity, factory closures and retrenchments.

With the end of MFA in mind, the Tanzanian government has attempted to make several efforts to take advantage of the regional market. As a result of these efforts, recently the country was given preferential trade opportunity to enlarge her market for clothing and textiles in the Southern African Customs Union (SACU) region under the relaxed RoO. Apart from Tanzania, other SADC members that receive this preferential trade opportunity include Malawi, Mozambique and Zambia. In addition, in June 2005, Tanzania, together with other 14 countries from the three regional blocs of SADC, EAC and the COMESA, participated in the formation of the African Cotton and Textile Industry Federation (ACTIF).

The aim of the ACTIF is to be a nationally, regionally, and internationally recognised trade body established by the cotton, textile and apparel sectors that provides effective regional representation at international forums. ACTIF is dedicated to the specific concerns of the industry and promotes improved competitiveness in both the regional and the global markets. ACTIF is currently working on modalities for undertaking its obligations.

23.3 International Trade and Labour Market in Cotton and Textile Sectors in Tanzania

Overview of the Labour Market in Tanzania

In Tanzania, both cotton and textile manufacturing have employed large amounts of labour. Cotton has been one of the main cash crops for more than 400,000 small-scale farmers, most of whom live in the most populous regions of Mwanza, Singida, Kagera, Kigoma and Shinyanga (USAID, 2004). During the 1980s, the textile sub-sector was the largest employer in the country, employing about 37,000 people. The employment effects of the liberalisation of the cotton and textile sector in Tanzania are therefore very important for poverty reduction.

It is important to note that in Tanzania wages are low and unemployment is prevalent. For example, the unemployment rate has increased by about one and a half percentage points over the 10 year period to 2.3 million (1.3 million women and 1.0 men), equivalent to 12.9 percent of the labour force by 2000-01 (United RT, 2005b). According to the Integrated Labour Force Survey (2000-01), employment-to-population ratio (the proportion of the target population that is employed) was 76 percent nationally. The ratio was lower in urban areas (58 percent) than in rural areas (81 percent). Unemployment was worse among the youth, including the educated youth. As regards wages, the legal minimum wage for employment in the formal sector of about Tanzanian Shilling 48,000 (US$53) per month, even when supplemented with various benefits such as housing, transport allowances and food subsidies has not always been sufficient to provide a decent standard of living for a worker and family, and workers depended on their extended family or on a second or third job[1]. It is to be noted, however, that formal salary/wage employment constitutes a small proportion of total employment in Tanzania.

Labour unions are also very weak in Tanzania. There are two labour unions in Tanzania, both of which date back to the socialist times where all firms were legally obligated to register a branch. Although the union laws, like most labour legislation have not been changed for over 20 years, union activity has been very low, as the unions are struggling to find their place in the new economy. Although still a legal requirement, some firms continue to operate without union registration without any problems. Others that have union registration generally do not encounter any significant problems and find the union organisations to be quite helpful in assisting in labour issues. General strikes and labour unrest in Tanzania are almost non-existent and there have been very few cases in the post-privatisation area.

There is also a membership organisation called the Association of Tanzanian Employers (ATE) which most companies are members of and assist in dialoguing with the government and unions on various labour issues and legislation (Ladha, 2000). Note that the first phase of Labour Law Reform – addressing employment relations, collective labour relations, dispute resolutions, and labour market institutions was approved by Parliament in April 2004.

Structural Effects of Trade Liberalisation

One of the structural effects of trade liberalisation in Tanzania has been a significant shift in export structure from the dependence of traditional exports such as coffee, cotton, tea, and tobacco towards non-traditional exports such as minerals, manufactured

and fish and fish products. For example, cotton exports initially increased from US$74.6mn in 1990 to US$130.4mn in 1997, but declined to US$47.2mn in 2004. Though it could be possible that some of this decline is due to switching to other crops, the decline in traditional agricultural crop exports, in light of the fact that agriculture generates 70 percent of employment and that 90 percent of the poor reside in rural areas, is a concern when considering the employment effects of trade liberalisation.

It is important to note that before trade liberalisation, the government policies were in favour of traditional exporters. Exporters of non-traditional exports during the pre-liberalisation period had to surrender most of their foreign exchange earnings and to cope with a cumbersome and non-transparent system of export permits compared to those of traditional exports. Since the mid 1980s, restrictions of the exports of non-traditional crops were relaxed, as exporters were allowed to retain an increasing share of their export proceeds to finance their import requirements (Kanaan, 2000).

A shift of employment from the formal sector to the informal sector is another important structural effect. While trade liberalisation has often had a negative effect on urban wage employment, as former import-substituting industries and export processing industries become unable to compete, trade liberalisation is often associated with a booming informal sector (UNCTAD, 2004). In Tanzania, the informal sector is now the largest sector employing 55 percent of total persons in employment, followed by the private (including formal) sector taking 29 percent and the rest in the remaining sectors. Informal sector employment has expanded and more households in urban and rural areas are undertaking informal sector activities.

A final important structural effect is the institutional effect, which involves the shift from investment driven by the public sector to the one driven by the private sector. This was associated with an increase in the number of private buyers from 10 during the 1993-94 season to 26 in the 2003-04 season. In addition, private companies have installed 22 ginneries increasing the number from 33 in 1994 to around 60 in 2002.

Labour Demand Effects

The analysis of labour demand effects focuses on the textile industries, the cotton processing industries (ginneries), and the medium-scale farmers because the nature of their operations requires labour input. Evidence available in the formal statistical sources shows that in the textile sector, trade liberalisation in Tanzania has been associated with a marked decrease in formal employment. Wage employment in the textile sector decreased from an average of 26.6 percent of the total manufacturing employment between 1991 and 1994 down to an average of 13.1 percent between 2001 and 2004. This trend, however, does not necessarily reflect the decline in the demand for labour but probably reflects the collapse of the textile sector which came with trade liberalisation. However, one striking feature of the trend in wage employment is the change in pattern between permanent employment and temporary employment. While the share of permanent employment declined from an average of 98.2 percent between 1991 and 1994 to an average of 10.1 percent between 2001 and 2004, the temporary employment share increased from an average of 1.8 to 89.9 percent in the respective periods.

As it was argued before that the decrease in employment may reflect the closing down of textile companies rather than the decrease in demand for labour. This study attempts to estimate the change in the demand for labour in the textile sub-sector by making use of the employment elasticity. Employment elasticity measures the percentage employment growth resulting from unit percentage output growth. One study on Tanzania's manufacturing sector by Wangwe *et al* (2000) came out with an estimate of about 0.55 for the output-employment relationship in the post-adjustment period (i.e. 1988-1998). In this study, two sub-periods, i.e. 1991-94 and 2001-04 will be compared. According to our estimates, employment elasticity in the textile manufacturing sector declined drastically from 3.2 in the 1991/94 down to 0.05 in 2001-04. This implies textile industries during the post-liberalisation period have become less labour intensive.

Most companies (especially those that have very seasonal labour demand) tend to employ a part of their workers on temporary or casual contracts in order to avoid the high taxes and to enable them to have flexibility during slow periods. The law demands that "casual" labour be employed on a daily basis. It is very common for companies to engage workers on short-term contracts (up to 3 months). However, the law further states that if a worker is engaged consecutively for more than 3 months or if a worker works more than 288 days within 12 calendar months of joining, then the worker is considered to be a permanent employee. Permanent workers can be terminated by giving one month's written notice or cash in lieu of notice. Terminating workers is usually not a problem provided that the correct procedures are followed. Workers are also entitled to holiday pay of 28 days for every year worked (Ladha, 2000).

At the bottom of the cotton chain are the cotton farmers. Employment data on cotton farming is very difficult to obtain. However, many cotton farmers are engaged in seasonal employment and own just small-size farms. Only medium-sized farms of around 40 hectares exist and there are virtually no large-scale farms. The owners of the medium-scale farms are involved in the demand for labour as cotton farming is a very tedious undertaking. Labour is associated with such activities as ploughing, weeding and harvesting. Most large farmers use tractors, which they hire at the rate of about Tanzanian Shilling 30,000 (US$24.6) per hectare for ploughing. Other charges include harvesting, which costs Tanzanian Shilling 10,000 (US$8.2) per hectare and harvesting which costs Tanzanian Shilling 200 (US Cent 16) per *debe*[2] . The medium-scale farmers usually hire local dance group members for weedings as well as harvesting.

Labour Supply Effects

The main determinant of labour supply in the cotton and textile sector in Tanzania is wage or non-wage labour income. People decide whether to supply their labour in wage employment depending mainly on wages offered relative to the income they receive in the non-wage employment. It is to be noted however, that cotton growing activities are seasonal. Therefore, after the cotton growing season ends, many people become unemployed and would prefer to supply their labour to the cotton processing or textile industries in the form of wage employment.

Wages depend on the national minimum wage scale. Workers' salaries differ depending on education and experience. The trend in labour income in the textile sub-sector shows a decline relative to other manufacturing sectors despite the absolute increase.

Note that most textile industries employ about 1200 permanent and casual workers, out of which 30 to 40 percent are permanent employees.

In the cotton processing industries (i.e. the cotton ginneries), wages also depend on the level of education and experience. The average wages in the surveyed companies for engineers, shift in-charges, and technicians averaged about Tanzanian Shilling 380,000 (US$350), 120,000 (US$100) and 90,000 (US$80) per month respectively, while the average wage for casual labour stood at about Tanzanian Shilling 1,100 (US$1.5) per 8-hour shift. Women, who constitute the poorest section of the population in the cotton growing regions, are normally employed as casual labourers (usually constitute about 25 percent of casual labour) and due to the low wages they do not benefit from wage employment.

As regards non-wage employment, most of the smallholder cotton farmers supply their labour in either farm or off-farm informal activities. In the farm activities, earnings depend on both the production and transaction costs on one hand and the export price on the other. In relation to the cost of production, cotton farmers have been profitable as they have been able to retain more than a half of the producer price. In 2004 for example, the producer price was Tanzanian Shilling 300 (US Cent 24.6) and the cost of production was estimated at Tanzanian Shilling 170 (US Cent 14). Transaction costs have also decreased because of trade liberalisation. Unlike during the pre-liberalisation period, nowadays farmers are paid instantly as purchasing on credit is not allowed. In addition, the removal of agricultural price controls and the liberalisation of marketing arrangements significantly shifted agricultural income from marketing boards to the small farmers. The producer's share of the export price has increased, though the gap between the two in nominal shillings terms has widened. Increases in the producers share are beneficial to labour supply and production and should be supported by policies supporting organisations of farmers and the establishment of central markets.

The other important determinant of labour supply in Tanzania is land ownership (Mduma and Wobst, 2005). Land is very limited in the cotton growing regions and many farmers own small-sized farms. Therefore, due to the need to smoothen their labour income, many smallholder cotton farmers encounter two key options: either to increase productivity, or use some of their time in off-farm activities. Productivity remains extremely low in Tanzania partly due to the lack of credit financing for input procurement following the collapse of transactions previously handled by the Regional Co-operative Unions. Because of low productivity in the cotton farms, many cotton farmers have resorted to increasing the quantity of their cotton at the expense of the quality of cotton by taking advantages of the weaknesses in the liberal market system.

A cotton farmer has an option of being engaged in off-farm activities. Note that the movement of labour from agriculture (to off-farm employment and urban areas) is one of the stylized facts of economic development. There has been slow but significant labour mobility in the cotton growing areas. Some surveyed stakeholders argue that the dependency on cotton for livelihood is now diminishing. Therefore, many cotton farmers now undertake other activities. Some of the other activities that they undertake include paddy farming, livestock husbandry on cattle, goats, sheep, and small businesses such as watch repair, etc.

According to Mduma and Wobst, (2005), there have been some policy conflicts in relation to promoting the on-farm activities and the off-farm ones in Tanzania. For example, while the National Employment Policy (URT, 1998) encourages the development of rural off-farm employment, the Ministry of Agriculture in its Agricultural Sector Development Strategy (ASDS) considers off-farm employment as a competitor for limited rural labour supply. The ministry further argues that rural-urban migration reduces the agricultural labour force (URT, 2001)

23.4 Complimentary and Compensatory Policies to Trade Liberalisation in the Cotton and Textile Sector

Complimentary Policies

Trade liberalisation and reforms cannot succeed in promoting growth in isolation from other policies and reforms. Complementary policies enhance the flexibility of markets, which reduces the costs of adjustment and facilitate the creation of markets that will benefit the poor. Therefore, despite the trade liberalisation and reforms in the cotton and textile sector, other policy improvements are required in order for the sector to reap the full benefits of trade liberalisation. The degree to which developing countries and poor groups within them gain or lose from liberalisation depends crucially upon a range of policies with regard to service delivery, infrastructure provision and the regulation of financial markets (Conway, 2004). According to Winters (2002), the key complimentary policies include infrastructure support, development of markets, fiscal incentives and the removal of rigidities in the labour market. The shortage in the implementation of these policies has also affected the cotton and textile sector in Tanzania.

In the National Strategy of Growth and Poverty Reduction (NSGPR), the government has designed important policies to ensure the development of markets for the agriculture sector as well as the rural sectors. Some of these policies include increasing training and awareness creation on safe utilisation and storage of agro-chemicals (including agriculture and livestock inputs, e.g. cattle dips), and the use of integrated pest control, eco-agricultural techniques, and traditional knowledge; improving human resources capacity and efficiency in agricultural services delivery; strengthening the capacity for timely control of crop pests and disease outbreaks; improving the access to support services with particular focus on research and extension meeting the needs of farmers; and increasing communication and collaboration in delivery of extension services.

As regards the market for micro-credits, the government's policy is to increase access to rural micro-financial services for subsistence farmers, particularly targeting the youth and women promote off-farm activities with particular focus on supporting the establishment of agro-processing SMEs, the promotion of community-based savings and credit schemes such as Savings and Credit Cooperative Societies (SACCOS) and revolving funds.

Fiscal incentives are also very important if trade is to work for the poor. There have been a number of fiscal incentives for investment in the textile industry, such as tax holiday on importation of textile machinery, spare parts and chemicals for the newly revived textile mills. In a bid to boost the performance of the textile sector, the Government of Tanzania has also established the EPZs, which provide very steep tax

breaks to exporting firms which are located inside these zones. The main hindrances faced by the textile sector to benefit from this initiative include the failure to export, infrastructural problems and cost factors to compete with the world market.

Rigidities in the labour market can also make it difficult for the poor to move into other occupations, take advantage of new market opportunities and minimise the costs of trade liberalisation. Conversely, worker training and other forms of assistance can also help the poor who lose jobs in sectors that suffer from trade liberalisation to find jobs in sectors that benefit from it. In the rural households, it is encouraging to note that households have been diversifying their economic activities. Although income from agriculture is dominant, some 40 percent of rural household income originates from off-farm employment. Opportunities for expanding and diversifying rural incomes from natural resources are not realised in part due to bureaucratic and legal hurdles.

The proportion of rural households who derive incomes from more than three sources is 65 percent. The trend is already towards increasing employment in non-farm activities in the rural areas. However, the process is happening too slowly and without coordination and support. This trend can be reinforced through more deliberate policy interventions. On- and off-farm earnings need support from both a strong agricultural sector and other rural sectors including forestry, wildlife, fisheries and tourism (URT, 2005b).

Compensatory Policies

In Tanzania, the NSGRP clearly identifies some intervention measures for people who have been affected by trade liberalisation in terms of retraining and assistance in finding new employment. However, these interventions are general and not specific to the cotton and textile sector. In addition, due to inadequacy of budgetary resources, the government has targeted only the most vulnerable groups of population for social safety nets. These vulnerable groups include among other, children, orphans, people with disabilities, the elderly, people living with HIV/AIDS and women.

There have been some specific measures to deal with employment problems resulting from trade liberalisation both in the rural and urban areas. It should be noted that trade liberalisation in the cotton and textile sector has reallocated labour from rural agriculture activities to rural off-farm activities or, through labour migration, to urban petty-trading activities. In addition, in urban areas many people who lost jobs as a result of trade liberalisation and reforms formed SMEs, both formal and informal. Most of petty traders in urban areas are youth aged 20 to 29 years. It is estimated that 92 percent of these have primary level education but no formal skills training.

Those who formed SMEs in urban areas and those who joined smaller-scale non-farm activities in rural areas both require policy attention. They all lack adequate finance and technical and managerial skills, infrastructure, market information and contacts to external markets. Small businesses also face unfriendly and variable administrative impediments to business licensing. A credible, enabling policy environment is needed to enable the informal businesses to formalise their enterprises and improve their entrepreneurship skills. This requires a change in attitudes of the bureaucracy toward private sector development.

23.5 Conclusion

The study finds that the cotton and textile sector has become less labour intensive, probably as a result of the rising labour costs, decreasing cost of capital, and possibly also increasing availability of skilled labour in Tanzania. With the presence of weak labour unions, labour insecurities have grown as employers have increased their preference to short-term contract and casual labour. While there has been massive unemployment in the cotton and textile industry, new jobs in the informal sector have been created partly as a result of cheap textile imports. Wage employment in the cotton and textile processing industries has not been rewarding, as wages have remained rather constant. In the non-wage employment, and cotton farming in particular, the incomes received by farmers have not increased. In order to improve their incomes, farmers have been trying to increase the sales of their cotton by resorting to more quantity and less quality.

However, relative to the export price, farmers have been receiving fairer prices of their cotton, despite the fact that they still lack adequate information about world cotton price movements. The study also finds that complimentary policies on infrastructural development, fiscal support, credit markets development, and human capacity building are important if trade is to produce better results on poverty reduction in the sector.

Tanzania has designed very good policies in order to make the cotton and textile sector a success. Almost all the policies focusing on poverty reduction are in place. However, there have been many problems in terms of implementation. These problems include policy prioritisation, decisions on the pace of policy implementation and policy conflicts. Some of the policy implementations are undertaken at a very slower pace. This problem however could also be a result of the slower pace characterising the international trade negotiations as the country tries to harmonise its policies. Policy conflicts have also been identified as key sources of the ineffective implementation of policies.

References

Conway, T (2004), "Trade Liberalization and Poverty Reduction", *Doha Development Agenda Impacts on Trade and Poverty*, Overseas Development Institute (ODI), October 2004

GAFTT (2004), Official Website of Global Alliance for Fair Textile Trade *www.fairtextiletrade.org*

Gibbon, P (1999), "Free Competition without Sustainable Development? Tanzanian Cotton Sector Liberalization 1994/95 to 1997/98", Journal of Development Studies, 36(1), 128-150.

Kahkonen, S, and H Leathers (1997), "Is There Life After Liberalization: Transaction Costs Analysis of Maize and Cotton Marketing in Zambia and Tanzania", Prepared for US Agency for International Development, December, 1997

Kanaan, O (2000), "Tanzania's Experience with Trade Liberalization", Finance and Development, June 2000

Ladha, H (2000), "Profile of Tanzania Textile Sector", Prepared for UNIDO, October, 2000

Lundbaek, J (2002), "Privatization of the Cotton Sector in Uganda: Market Failure and Institutional Mechanisms to Overcome It", Department of Economics and Natural Resources, Copenhagen, Royal Veterinary and Agricultural University

Maro, W, and C. Paulton (2002), "Competition and Coordination in Cotton Market System in Southern and Eastern Africa", System Overview Report for Tanzania, Department for International Development (DFID), September, 2002

Mduma, J K, and P Wobst, (2005), "Determinants of Rural Labor Market Participation in Tanzania", African Studies Quarterly, Vol. 8, Issue 2, Spring 2005

Poulton, C, Gibbon, P, Hanyani-Mlambo, B, Maro, W, Larsen, M N Osorio, A, Tschirley, D, and B Zulu (2003), "Competition and Coordination in Liberalized African Cotton Market Systems", Department for International Development (DFID)

RATES (2003), "Cotton – Textile – Apparel: Value Chain Report Tanzania", Regional Agricultural Trade Expansion Support, 2003

UNCTAD (2004), "The Least Developed Countries Report – Linking International Trade with Poverty Reduction", New York, United Nations

URT (1998), "National Employment Policy", Ministry of Labour and Youth Development (MLYD), The United Republic of Tanzania, Dar es Salaam

URT (2001), "Agriculture Sector Development Strategy", Ministry of Agriculture, The United Republic of Tanzania, Dar es Salaam

URT, (2005b), "National Strategy for Growth and Reduction of Poverty", The United Republic of Tanzania, Vice President's Office, Dar es Salaam, April 2005

USAID (2004), "Tanzania Agricultural Sector Assessment", Dar es Salaam, Tanzania

Wangwe, S M, Hobbs, G T and H G Lawuo (2000), "Investment for Poverty Reducing Employment in Tanzania: The Conceptual Context", Tanzania Political Economy Series 3

Endnotes

1 Country Reports on Human Rights Practices - 2003 Released by the Bureau of Democracy, Human Rights, and Labor February 25, 2004

2 One "*debe*" is equivalent to a 20 litre bucket of water

24 CHAPTER The Dairy Sector in Uganda

– *Geoffrey Bakunda*

24.1 Introduction

The dairy sector is one of the sectors that had been under government control for sometime with the Uganda Dairy Corporation (UDC) dominating most of the buying of milk from farmers. The UDC had a network of milk collection and bulking centres scattered all over the country and has been responsible for both setting the price of milk. The price set by the UDC acted as the reference price on which other minor players pegged their prices. The period considered post liberalisation is when independent and formal organisations came up to challenge the UDC as regards the price and other market dynamics such as time of payment and hence these organisations started buying milk in large quantities competing with the UDC. They set up Milk Collecting Centres (MCCs) and established more formal channels for buying milk.

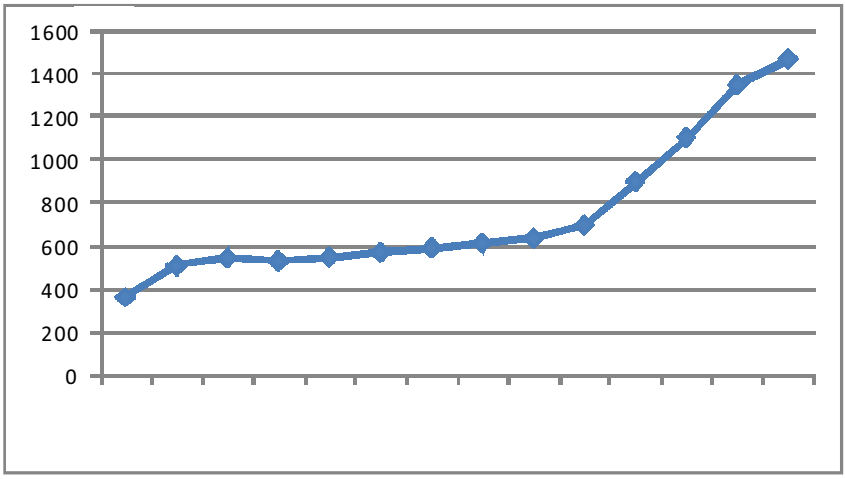
The first major private operators entered the dairy sector in 1992, following the government economic and market liberalisation policies. Five operators were licensed to set up milk processing plants and this marked the beginning of a competitive era in the sector. However, legal and institutional development lagged behind the operation of market forces and the Dairy Industry Act was enacted in 1998, while the Dairy Development Authority (DDA) was mandated to regulate the sector established in the year 2000. In addition, largely due to the lack of sufficient funds, the DDA has not been able to perform its roles, including, the promotion of market research in dairy produce and the improvement in quality and promotion of private enterprise in production among the others. The purpose of this chapter is to explore the trade-development-poverty linkage in the context of the dairy sector in Uganda.

24.2 Impact of Liberalisation on Household Production and Productivity

Increase in Milk Production

Over the period 1995-2005, milk production in the districts surveyed (Ntungamo,Mbarara, Bushenyi, Ibanda) increased tremendously, doubling in most cases. Most farmers reported increases in milk output from 20 to 60 litres and by corresponding magnitudes. In order to respond to positive market signals immediately following liberalisation, farmers invested in acquiring more exotic breeds of animals that could afford them higher yields with the same piece of land. A common observation of the farmers was that “it is changing from local breeds to cross breeds”. Some farmers sold off their indigenous herds outright while others cross bred their indigenous herds with exotic breeds to improve the quality of the herds while maintaining the disease-resistant qualities of the indigenous animals. Additional evidence from dairy farmers in Ntungamo district suggests that the increase in output was deliberately planned by the farmers to take advantage of positive market signals.

Figure 24.1: Milk Output During the Period before and after Liberalisation (Million Litres)



The average annual growth rate in milk production between 1991 and 1997 was 9.2 percent, while the average annual growth rate in milk output in the period 1998 to 2004 was 15.7 percent. The difference in the two growth rates is statistically significant, suggesting that the opening up of the markets for milk and milk byproducts indeed had a positive impact on milk production at both the farm level and the national level. However, it is important to note that despite the general increase in milk output, field evidence points out that there was no corresponding expansion of the processing and marketing sub-sectors (Mbabazi, 2003) to absorb the massive upsurge in milk output. This was particularly the case in the Ankole region, but also in other milk producing areas. This created a gap in demand that was compounded by the closure of most of the milk processing factories that had been established in Mbarara.

Increase in Input Costs and Reduction in Extension Services

Although there was a modest increase in farm level productivity arising from the use of improved herds, increased use of acaricides, planting of improved pastures, a general improvement in farm management methods, and further improvement in farm productivity was hampered by uncontrolled increases in input costs. The prices of farm inputs such as acaricides, farm equipment and others increased considerably, limiting their usage. Most agricultural inputs including fertilisers are imported. However, previously, agricultural input imports were handled by Uganda Farm Supplies Ltd, a wholly government-owned company that supplied inputs at affordable prices.

The liberalisation of agricultural input imports and their distribution meant that the farmers had to purchase inputs at market prices as all forms of subsidies by the UDC were removed. Not only did it create uncertainty of access for farmers, it meant that farmers could only access inputs at higher market prices. Farmers have not been cushioned against market forces in connection to imported farm inputs. Field evidence shows that the prices of imported inputs have sharply risen under liberalisation. For

instance, field estimates show that the cost of fertilisers, drugs and acaricides have risen by more that 60 percent on average over the last five years. In some cases, the prices have more than doubled.

Apart from the rise in input costs, the farmers reported that they were not getting enough inputs and they lacked access to extension services. In fact, almost a total absence of extension services worsened the situation. Under liberalisation, all veterinary services were privatised and under the government Plan for Modernisation of Agriculture (PMA), this is likely to continue. While prior to liberalisation, the government used to offer training to dairy farmers, after liberalisation, much of this training has been left to non-governmental organisations (NGOs) and community based organisations (CBOs), which do not operate everywhere. Where the CBOs do not operate, extension services are non-existent.

The absence of extension services and the high cost of inputs has forced many dairy farmers to resort to the use of generic drugs as opposed to branded ones which, more often, are not only less effective but also less cost-effective. The costs of veterinary services are simply unaffordable to the ordinary farmers. Farmer evidence suggests that the increase in costs exceeded the increase in productivity, and subsequently eroded the farmers' investment in better breeds.

Increased Farm Level Losses of Milk

While there was a general increase in farm output for milk, there was no corresponding increase in purchases farmers' milk. Liberalisation of the dairy sector appears to have failed to address the fundamental issue of creating more market outlets for excess supplies during the wet season. Milk production has consistently exceeded its demand and the farmers have over the last decade (since 1997) suffered increased farm level losses of milk due to inadequate demand, especially during the wet seasons. Knowledge of excess milk at farms made the farmers more vulnerable to exploitation by both the formal and informal milk traders.

24.3 Impact of Liberalisation on Marketing and Distribution Channels

Weakening of the Regulatory Regime

The regulatory regime is reported to have deteriorated following the liberalisation of the dairy sector in the mid-1990s. Regulation of the sector is weak. The DDA was created in 2000 to undertake regulatory and developmental functions in the sector in accordance with the DDA Act of 1998. However, while a legal framework was put in place, this was not followed by sufficient enforcement machinery and infrastructure. It was reported that the activities of the DDA seemed to focus on the Dairy Corporation Ltd (DCL) largely neglecting the activities of the private players, particularly the informal ones.

It is apparent that a liberalised regime that has not been accompanied by an appropriate institutional framework and regulatory reforms has created "confusion" in the sector leaving the weakest members of the sector, the farmers, prone to exploitation and without protection or support.

Reduced Guarantee of Markets for Milk

After opening up the buying, processing and distribution of milk and its products in the Ugandan economy, a key result that occurred was that farmers were no longer guaranteed selling their milk. It was no longer guaranteed that all the milk produced would be sold. Prior to liberalisation, the UDC, which enjoyed near monopoly conditions, was mandated not only to purchase milk countrywide, but also to guarantee fair prices to dairy farmers. Following liberalisation and the creation of DCL, which was to compete alongside other private buyers and at market prices, the obligation to purchase farmers' milk ceased forthwith. DCL has the option either to buy or not to buy, depending on whether it served its commercial interests. Competition between DCL and the private sector increased the demand for milk soon after liberalisation and farmers not only reaped higher prices but also were able to sell all their milk produced. The situation was temporary and lasted for about one year, during which time new investors were also entering the market. However, the positive market signals had attracted many small and medium farmers to increase production.

Due to the 'new competition', DCL could neither guarantee regular purchases from farmers which quite often reduced the volumes purchased nor the prices farmers were paid for their milk. At the same time, the private buyers operated purely on a commercial basis; they had not established milk buying centres and their purchases from farmers were more sporadic than under the UDC regime. Increased production combined with DCLs inability to sustain large purchases of milk soon created conditions where farmers could not sell all their milk. Since 2000, farmers have had no guaranteed market for milk. DCL, like the other private buyers only buy when it suits them and at prices set by themselves. This has been exacerbated by the general deterioration of the milk cooling and collecting infrastructure, which has neither been expanded nor improved upon. The sum total of all this has been that liberalisation reduced the guarantee of markets previously enjoyed by the farmers.

There was no regulatory mechanism for the new players who entered the dairy sector as buyers and traders of milk. The absence of a regulator in the procurement and milk buying exposed the farmers to unscrupulous buyers who cheated the farmers by taking their milk and never paying for it.

Increased Importance of Micro Markets

There has been increased reliance on micro-markets since the liberalisation of the dairy sector. After the opening up of the dairy sector to other players, dairy farmers found themselves having to rely more on local micro markets for essential sales of milk and mitigation of prices. Under the liberalised regime, prices often plummet during the wet seasons (March-June) and (September-November) for about seven months each year which negatively affect farmers' incomes. Increasingly, the local micro-markets (small towns and villages without milk) within the milk producing locality offer better prices and payment terms to the small dairy farmer as compared to the DCL, which is supposed to market milk and milk by products nation wide. The farmers are paid a slightly higher price in cash as opposed to the relatively lower DCL price which is normally paid 2-3 months after delivery and which is often the price offered by the other licensed buyers.

Some of the observations from farmers are discussed in the following section. For the smaller farmers, these local micro-markets have presented a niche opportunity that should be exploited to address their market concerns and improve their income problems. Some have opted not to sell their milk to commercial traders but locally. The increased reliance on micro-markets pointed to the increasing failure in the formal marketing system to not only offer a fair price but also to harness farmers' production capacity adequately.

Expansion of the Informal Distribution Channels and Network

The enactment of the DDA Act in 1997 and the dismantling of the UDC into the DCL and the establishment of the DDA to regulate and promote the growth of the sector resulted in a phenomenal growth of the informal sector in the distribution chain of milk and dairy products. According to current estimates, about 80 percent of all milk produced is sold through the informal sector (Land O Lakes, 2003). While informal traders have generally improved access to milk by increasing the distribution intensity especially in urban markets, this informal sector has distorted the key market parameters, including quality, prices, distribution, and packaging and several other problems have arisen out of their participation in the sector.

On the whole, the emergence of a large informal network has made milk marketing in Uganda difficult to coordinate and regulate. At the worst, they have not only been discouraged from making organised investment in the sector, but also led to the collapse of the few processing plants that were established soon after liberalisation. This has been mainly through selling adulterated milk, making it difficult to procure economic quantities, and 'killing' demand for processed milk by selling milk at artificially low prices to consumers.

Breakdown of the Quality Control Systems

The end of the UDC monopoly as the only commercial buyer of milk in the milk belt led to a complete breakdown of the quality control systems. UDC hitherto was running and enforcing quality control. Following the liberalisation of the sector, many private traders joined the commercial milk buying and selling without the necessary knowledge, technical expertise, professional competence and integrity to handle milk for human consumption. As a result, there has been an increase in milk adulteration, and the subsequent drop in the quality of milk. Field evidence suggests that the DDA as a regulator of the sectors seems to put emphasis on the DCL bound deliveries neglecting the informal sector, which are the biggest adulterators of milk. Subsequently, the DDA which is the regulatory authority that came with the liberalisation regime has proven ineffective with its limited coverage which excludes the informal sector that currently constitutes 80 percent of the dairy industry in Uganda.

Collapse of Cooperatives from the Milk Supply and Distribution Chain

Since the 1960s, cooperatives were quasi-government, as the cooperative movement was seen as an instrument of control and a mechanism through which the rural surplus could be extracted for the benefit of the urban dwellers while at the same time improving the incomes and quality of life of the rural communities (Mbabazi, 2005). Following liberalisation, most of these quasi-government cooperatives were dismantled, leaving the farmers in disarray, especially with regard to milk marketing. Generally, liberalisation

has been accompanied by increased vulnerability of farmers in remote areas and increased hardship in marketing their dairy output. However, field evidence shows some genuine efforts of reviving cooperatives by the farmers, independent of the government system within the milk-producing region. This was true in the areas visited in Ntungamo and Ibanda districts as is also true in Bushenyi. In areas where such farmer cooperatives have been reestablished, such as Ibanda Milk Producers Association (IMPA) and Ntungamo Dairy Farmers' Cooperative Society (NDAFCO), farmers have started reaping more stable prices and more regular payments.

Loss of Export Markets

Liberalisation resulted in failure to maintain export markets hitherto enjoyed prior to liberalisation. Uganda has lost rather than gained export markets of milk. Due to the decline in milk quality arising from weak or no enforcement of quality standards, poor monitoring by the DDA, limited sensitisation of farmers and the profit maximising informal marketing networks who adulterate milk to maximise volumes, and in general a deteriorating infrastructure, most of the milk exported during the period 2000 to 2002 was of erratic quality. There has been lack of consistency in the quality of milk, and nobody seemed responsible or accountable. This failure in quality control was a big factor in the loss of the export market to Rwanda. The Rwanda government banned the imports of fresh or pasteurised milk from Uganda in 2002 partly to "protect" its consumers.

Rwanda is a good market given its proximity to the South Western Uganda region which is the largest milk-producing belt in Uganda. Apart from the loss of markets for fresh and pasteurised milk, exports of ultra heat treated (UHT) milk to neighbouring countries either ceased or declined considerably partly due to inconsistencies in quality that was shunned by the market. The DCL, which was a newly formed government company from the former UDC and required to operate purely on commercial basis, could not cope up with the liberalised era in which there was no government support.

Consolidation of DCL's Role as the Dominant Commercial Buyer

Far from creating a competitive market for milk, with the failure and collapse of other milk processors, liberalisation has instead consolidated the DCL's dominant position as a quasi monopoly, the largest commercial buyer of raw milk with devastating results for dairy farmers. Whenever, it is felt that the DCL is out of the market, the milk market completely fails, private buyers then cut the prices they are willing to offer farmers and quite frequently deliberately default on paying the farmers for their milk supplies. It is clear that although liberalisation was meant to enhance competition and create vibrant market conditions for the stakeholders particularly the farmers, market failure has been experienced season after season. The competitive conditions envisaged have not been created and farmers and other private investors (formal private sector) have made losses and closed down. Those which are operating are doing this far below installed capacity.

24.5 Impact on Prices and Price Stability

Decline in the Real Prices for Milk

Following the dissolution of UDC and the opening up of the dairy sector to competition, there has been a decline in the real prices, particularly the farm gate for milk. Liberalisation

of the dairy sector reduced farmers to price takers. The prevailing situation is that the milk buyers including the DCL and the private buyers determine the farm gate price for milk without consideration for the farmers' cost of inputs and production.

The real price of milk has fallen so low that at its highest, the price of milk is lower than the price of local brew called in the local dialect as "*tonto*" in Ntungamo, where a litre of milk is cheaper than a half litre of mineral water! The sharp fall in prices has not only exacerbated farmers losses but is a major source of frustration when they compare with other less worth while activities like local brewing that do not contribute to national welfare. The price decline has been worse when the cost of inputs is factored into the equation. The situation has been made worse by the relative increase in production, which, considering the perishable nature of their product makes them even more vulnerable. At the current prices farmers can barely recover their production costs, which reduce family income and welfare.

Increased Fluctuations of Farm Gate Prices

Apart from the decline in real prices, the collapse of the cooperative movement following the liberalisation of the sector has increased the price fluctuations suffered by the farmers. Hitherto, with UDC as the sole buyer working together with the farmers' cooperatives, a buffer system was developed whose proceeds used to cushion the farmers from price drops, especially during the flush seasons. Presently, the farmers receive low prices even during the dry seasons and are offered "almost nothing" for their raw milk during the flush season, when more than half the milk yield is poured away for lack of market. Price fluctuations are worsened by the activities of vendors. In Ntungamo and Ibanda districts, the daily prices offered by vendors and other private milk traders varies widely and sometimes changes more than six times in one season.

To many farmers, these fluctuations are very frustrating because without predictable incomes they cannot plan for acquisition of inputs and other farm improvements. However, in the last two years, the newly formed farmers' cooperatives are beginning to address the problem of fluctuating prices. For instance BUDICO, a dairy farmer cooperative society in Bushenyi district signed contracts with major buyers which helped to guarantee its members a price of Ugandan Shilling 300 (US$0.17) a litre for the whole year round in 2004.

24.6 Impact on Technology Adoption

There has been an improvement in the dairy herds in all the dairy districts surveyed. In the districts of Ntungamo, Ibanda and Kamwengye, dairy farmers undertook measures to improve farm productivity with available land resources. Following the liberalisation of the sector, there was a spur in demand and better prices brought about by increased competition. Farmers were encouraged to increase output to respond to the positive market signals. Five new private milk processing factories were established in Mbarara in the late 1990s and farmers knew that the best way to increase output and make more money was to introduce exotic animals especially of the Friesian type whose output of milk is more than three times the output of local breeds. In the counties of Ngoma and Kajara, in Ntungamo over the last decade dairy farmers have become more settled and modernised with fewer of them being pastoral with improvements in their herds, improved pastures and they have fenced off their farms. This is reflected in their increased yields of milk.

However, the level to which the farmers would have utilised better veterinary services and inputs has been limited by the prohibitive cost of both the inputs and services. Liberalisation led to the withdrawal of subsidised veterinary services, which the government used to offer at a minimal cost. These services are beyond the reach of most dairy farmers in the outlying areas. With competitive pricing for veterinary services, most vets moved to urban centres, especially to Kampala and Mbarara where they can either handle multiple clients who can afford their services or supplement their incomes with alternative businesses especially running animal drug stores. Rural dairy farmers in South Western Uganda have suffered the brunt of this policy.

24.7 Impact on Wages and Employment

Reduction in Farm Employment

The number of people employed in the dairy sector in general and on dairy farms in particular has reduced despite the increase in production. The liberalisation era has seen an improvement in herds, with increasing numbers of farmers phasing out their indigenous animals and introducing high grade cross breeds. Farmers have fenced off their farms with improved pastures and abandoned the practice of having roaming herds. Traditional pastoral practices were more labour-intensive than the modern approaches recently adopted. Consequently, the number of people employed as farm hands and herdsmen has decreased.

Nominal Wages Increased but Real Wages Remained Stable

The nominal wages for farm workers seem to have marginally increased, but the real incomes of these farm workers over the last 10 years appear to be stable. This has been largely due to the increase in the inflation levels in the country and the relative fall in the purchasing power of the local currency. Farm workers and workers in the milk supply chain have continued to demand for higher wages, as they witness no improvement in welfare, in spite of the 'increase' in the wages. While this has been happening, the dairy farmers themselves have not realised increased income to cover the increase in wages. Currently, a situation persists where farmers find that labour costs are going up while workers find that the increase in wages has not positively affected their welfare.

All in all, it is apparent that since liberalisation, the dairy sector has become less labour-intensive. Employment elasticity has declined negatively affecting employment generation. It is clear that while liberalisation should have positively impacted on wages for labour, wages increased only nominally and improvement in real wages has been affected by distortions and inadequacies in the milk supply and processing chains that have left large quantities of milk unsold. Because milk prices also have remained low and declining, increase in real wages could not be realised in an overall inflationary environment.

24.8 Impact on Risk and Vulnerability

There has been an increase in the loss of milk by farmers due to low and unpredictable sales. The supply of raw milk in the last 10 years has outstripped its demand leaving the farmers with big volumes of unsold milk. Hitherto, with production substantially low, the dairy corporation, in collaboration with farmers' cooperative societies, operated

bulking and collecting centres and could virtually buy all the milk produced. The increase in production, following the liberalisation of the sector, has not been followed with commensurate investment in new cooling, collecting and bulking centres.

Even when farmers sell their milk, they are increasingly losing proceeds from their milk sales due to non-payment and high default rates by private milk buyers. In the pre-liberalisation era, the likelihood of such losses was limited, when the UDC was the principal player in the market. Currently, the proliferation of private milk buyers has increased the default rates. Because most of the milk from farmers (about 80 percent) is bought by these private buyers, the extent of the risk of losing milk incomes by the dairy farmers is higher than before.

Liberalisation has not addressed the problems related to the price spiral which the dairy sector suffers owing to seasonal price fluctuations. Prices fluctuate widely between the dry and wet seasons when prices are high and low respectively. Unlike in the pre-liberalisation days when the UDC, then mandated by government to buy milk, provided price guarantees and ensured stable prices, today farmers face a higher risk of loss of income from fluctuating and declining prices. The near monopoly role of the DCL coupled with its own inefficiencies as a commercial operator puts dairy farmers at a greater risk. Prices are completely unpredictable and frustratingly on a steady declining trend as there appears to be no concrete measures from the government to ensure farmers are paid a fair price for their milk, let alone buy all of it. The risk of income loss has therefore increased.

24.9 Liberalisation and Changes in the Milk Supply Chain

The milk supply chain in the pre-liberalisation era had farmers selling their milk to the UDC through their cooperatives. The UDC would process the milk and sell it to consumers through distributors and retailers. Liberalisation led to the dismantling of the UDC and the farmer cooperatives, the DCL was formed and new investors were encouraged to compete with the DCL as processors and distributors of milk. These changes apart from changing the character of the milk supply chain, affected the various players in the chain differently.

Farmers' Cooperatives

Liberalisation led to the collapse of dairy farmers' cooperatives. Before liberalisation, the government encouraged the development of organised farmers' cooperatives, which solely worked for the benefit of their members. Furthermore, before liberalisation government policy required dairy farmers to sell their milk produce through their cooperatives to the UDC although there were a few licensed milk traders who sold milk mainly to institutional customers. Dairy farmers would access farm inputs from Uganda Farm Supplies, a fully government-owned parastatal at subsidised rates, which in turn, compelled farmers to sell their milk through cooperatives to the UDC. Farmers' cooperatives used to own milk collecting and cooling centers, undertook the bulking of milk from numerous small dairy farmers, negotiated better prices with the UDC and guaranteed credit to their members from the Uganda Farm Supplies Ltd. The policy of encouraging organised farmers' cooperatives was abandoned in the wake of liberalisation.

The opening up of the dairy market and the dismantling of the UDC meant that milk could be bought from farmers without going through farmers' cooperatives. As a result, farmers' cooperatives collapsed. All the benefits that used to accrue from cooperatives to their members ceased. Dairy farmers were therefore exposed to unregulated and unlicensed milk vendors who cheated them through extremely low prices and defaulting on payment for the milk. The farmers' cooperatives used to cushion the farmers from the seasonal price fluctuation but the milk traders currently take advantage of these fluctuations to cheat the farmers instead. The demise of the Uganda Farm Supplies Ltd following liberalisation has made farm inputs too costly for the dairy farmers. Field evidence suggests that dairy farmers are trying to reorganise themselves into farmers' groups such as IMPA and NDAFCO in Ibanda and Ntungamo districts respectively. However, their effectiveness as marketing channels for milk is still low because of inadequate resources. The collapse of organised farmers' cooperatives has had the effect of disenfranchising the farmers in the milk supply chain.

Milk Traders

The pre-liberalisation supply chain was strictly regulated and controlled and the few traders allowed to trade in raw milk outside the processed milk supply chain had to be licensed. This regime was completely phased out with the new dispensation after liberalisation. The market was opened up for any player wishing to trade in milk both raw and processed. Under the regulated framework of the pre-liberalisation era, the licensed traders could only buy milk at government fixed prices, which were often higher than the market prices, and the liberalised market has allowed traders to buy milk at market prices, which are lower than the previous prices.

The post liberalisation era is characterised by increased volumes of milk, which the traders can now buy at lower prices with a positive effect on their margins. The end of the UDC monopoly and its direct procurement of milk from the farmers have reduced competition for milk at this level of the supply chain to the advantage of the milk traders and to the farmers' detriment.

Distributors

There has been a proliferation of milk processors with liberalisation. This has increased the number of suppliers of processed milk and other dairy products from one to six processors including the Dairy Corporation Ltd, Alpha Dairies, Paramount Dairies, Jesa Dairies etc. These processors deal in a wide variety of products, which has improved supply terms to the distributors due to increased competition. In addition, the distributors have a wider range of products to offer their customers. The entry of new players in the milk processing business and the increasing competition has resulted in the introduction of more value added products previously not locally available including yogurt, cheese and butter.

However, liberalisation introduced a *laissez faire* atmosphere in the sector. The sector is hardly restricting the opening up of the market to unscrupulous unlicensed milk vendors trading in unprocessed milk with all its risks. The sale of unprocessed milk was restricted in the pre-liberalisation era and all traders in raw milk were licensed. Competition from these unlicensed milk traders selling raw milk has reduced the market

share for processed milk from 80 percent before 1995 to 20 percent by 2005. Moreover, this has introduced a new phenomenon of milk adulteration, which did not exist before liberalisation. On the whole, field evidence suggests that distributors of processed milk are worse off than their counterparts in other regulated sectors.

Consumers

Liberalisation has increased a variety of locally produced dairy products available in the super markets at affordable prices. These products were not available locally before liberalisation, they had to be imported and therefore, they were scarce and very expensive. The prices of processed milk have considerably increased in the last ten years. Prices of processed pasteurised milk have on average increased by 100 percent from Ugandan Shilling 600 (US$0.35) per litre in 1995 to Ugandan Shilling.1, 200 (US$0.71) in 2005 though sometimes prices drop to Ugandan Shilling.1,000 (US$0.59) in the wet season. As a result, despite the risks associated with unprocessed milk, it is cheaper to buy raw milk than processed milk. In addition, both processed and raw milk are adulterated with water, which reduces the quality of milk substantially.

24.10 Conclusion

The case study of the dairy sector in Uganda suggests that liberalisation has contributed to the deepening of rural poverty. The welfare and real incomes of most rural farming households are generally lower than before. Although liberalisation opened new opportunities to the private sector, the incompetence of the private sector only resulted in the expansion of trade at the informal level and only limited expansion of the formal marketing of agricultural output in the two sub-sectors. Market efficiency has gone down and increasing portions of agricultural output have remained unsold. The liberalised market regime has failed to effectively link the producers to both local and export markets. Neither has liberalisation been accompanied by the requisite regulatory and promotional capabilities of the institutions created to do so. Consequently, there have remained gaps in regulation, promotion and supportive infrastructure, which have not enabled the liberalised markets to function properly.

References

Mbabazi, P (2005), "Supply Chain and Liberalisation of the Milk Industry in Uganda", Fountain Publishers, Kampala

Dairy Development Authority (2003), "Dairy Development Authority Annual Report 2001/2002", Kampala, Uganda

Land'o Lakes Uganda (2003), "Report on the Dairy Sector in Uganda", Kampala, Uganda

25 CHAPTER The Maize Sector in Uganda

– *Geoffrey Bakunda*

25.1 Introduction

Maize is an important crop that is virtually grown in all parts of Uganda. Presently, it is one of the most important cereal crops widely grown and a major part of the diet of both rural and urban communities as well as institutions in Uganda. The crop occupies a strategic position in the country's food security alongside bananas, cassava and sweet potatoes. Maize also provides farm households and helps produce buyers, processors, exporters and transporters with income. It is therefore an important crop from both the food security and income generation points of view. The maize sub-sector is estimated to provide a living for about 2.5-3.0 million households, about 1,000 traders/agents and over 20 exporters. Maize has recently become a major export crop in the regional markets, rising from about US$6mn in 1990 to an estimated US$11.8mn in 2000 and US$10.4mn in 2001. It is probably on these premises that the government, the development partners and the private sector attach great importance to the promotion of maize. The purpose of this chapter is to explore the trade-development-poverty linkage in the context of the maize sector in Uganda.

25.2 Overview of the Maize Sector in Uganda

As with other commodities in Uganda, maize production is carried out by two groups of farmers – the predominant small-scale and the emerging medium/large scale commercial farmers. Typically, small-scale and medium-scale farmers have holdings of between 0.2-0.8ha and 0.8-2.0ha under maize respectively. In Uganda, maize production is generally characterised by low yields regardless of farm size that results in high unit costs and leads to low returns. Yield levels for maize range between 1.0 and 1.8 metric tonne /ha, i.e. 4 to 7 bags (100 kg) per acre and unit costs are as high as Ugandan Shilling 120-170 per kg.

Maize producers and traders in Uganda are faced with high production and distribution costs that compress their margins at the farm gate. At the same time, grain mills within Uganda and more generally within the region operate below full capacity because they cannot purchase adequate local supplies of maize. This circumstance drives up their unit operating costs and compresses their margins as well. The problems that farmers, merchandises and millers face are complex and systemic. The markets in which all three participants operate are thin and susceptible to large price swings. It is certainly true that physical bottlenecks exist to the operation of efficient supply chains, such as the absence of secure storage facilities, distribution/ transport technologies and shortage of rural electric power.

As far as demand for maize is concerned, prices are key determinants of marketing and its competitiveness. Due to the very volatile prices, maize export performance has tended to be erratic, with low prices working backwards, which in turn reduce production and export incentives. Around the early 1980s, the Government of Uganda identified five major food crops, namely: maize, beans, groundnuts, sesame and soybeans, as non-traditional agricultural exports (NTAEs). The parastatal Produce Marketing Board (PMB) was mandated to procure and market these commodities. The primary objective of PMB was to procure, store, grade and sell food to deficit areas, thereby ensuring food security. Any surplus was then to be sold outside the country. Marketing under the PMB-controlled era was, however, characterised by several flaws including diversion of crop finance, lack of prompt payment and inability to reach the rural farmers. Following these and other related shortcomings, the government decided in the early 1990s to open up the marketing of agricultural produce to competition. The objective was to improve efficiency, restore price incentives and consequently generate producer confidence. Under the liberalised marketing system, farmers are generally paid cash for their produce. However, government sets no price and hence the price paid to the farmer is that offered by the buyer.

Even after the liberalisation of the economy and diversification of the export base, trading in food staples (such as maize, beans, millet and sorghum) has mainly been confined internally or to the neighbouring countries. Most of the major grain traders look at food aid agencies, notably the World Food Programme (WFP) as the main export avenue. Even across the Kenyan border, where most of Uganda's grains have found their way, very little formal exports have been recorded. The high domestic production costs, coupled with high transportation costs and other transaction bottlenecks, effectively meant that Uganda could not be competitive beyond the neighbouring states.

With a total regional consumption of approximately 20 million metric tonnes, Uganda can only offer 0.5 percent into this market. Uganda has not been able to penetrate the regional market due to lack of organised commercial exports of maize and other grains. As such, Uganda has been considered an unreliable supplier of quality grains and a supplier of last resort. This image was based on the lack of vibrant commercial sector participation and the fact that grain production is from approximately 2.0-2.5 million scattered farming families who produced at a subsistence level, with unreliable commercial surpluses. The under-capitalisation and poor liquidity of the grain-trading sector has further exacerbated the problem. This situation has been made worse by the reluctance of the banks to provide loans to either the productive or the speculative sectors of agriculture. The whole grain-trading sector is basically dependent on the value of property held in Kampala by the active grain traders, which is hardly a base for agricultural modernisation.

In order to unlock the full potential that improved farm to market linkages afford, small holders must embrace new business models, be reorganised into more commercially-oriented businesses and integrate their farm level production into more sophisticated supply chains that can effectively link them to potential customers throughout the region. Uganda does have a comparative advantage within the region for export of agricultural products because of good rainfall patterns (which allows for two crop

seasons a year) and good soils. However, tapping into such regional markets requires the supply of products of the right volumes and quality, an efficient and effective private sector performance as well as prices that can generate farmer production incentives.

However, institutional or "software" obstacles pose an even greater obstacle. Lack of standardised maize grading and classification standards throughout the region increases the risk of completing transactions across borders. Also, the lack of institutions for proving third party assurances of maize quality (based on regionally harmonised standards), tradability and collateral hamper grain-marketing efforts and increase trading risks to merchandisers. Finally, limited market depth and limited "tradability" of local maize on regional or international commodity exchanges causes local markets to be less liquid and more volatile than they need be. With the retreat of government from active intervention in Uganda's maize marketing and distribution systems, both the quality and the supply of maize have declined. Still, maize remains by default the most potentially valuable staple crop that Ugandan farm producers can grow. It offers farmers the flexibility in storing their wealth and some measure of liquidity. Thus, it can be dried or stored, fed to livestock, consumed, or sold for cash.

25.3 Impact of Liberalisation on Household Production and Productivity

Increase in Household Production of Maize

Household production of maize has increased over the last 10 years due to an expansion in acreage. Most maize-farming households in the key maize growing districts expanded their acreage which in most cases doubled their output. Most farmers on average doubled their acreage from a range of 1-5 acres to a range of 10-20 acres. In Kamwenge and Iganga districts which were surveyed, most of the maize farmers happened to own land above 10 acres which facilitated expansion of acreage to respond to the positive market signals that followed the liberalisation of the sector. In most of the maize growing regions, expansion in acreage has been facilitated by the adoption of improved technology which in almost all the cases involved the use of ox-ploughs in land preparation, planting, weeding and other farm related activities.

Farm Productivity Increased due to Adoption of New Technology

Farm productivity has almost doubled with the adoption of better and more efficient farm technologies, especially the introduction of the ox-plough. In the past decade, farmers used a hand hoe and various other rudimentary methods on their farms which greatly hindered their productivity. But today a growing number of farmers in the key maize growing districts have adopted the use of ox-ploughs for tilling and planting on their farms making it efficient and fast because production can go on the whole day unlike the using of hand hoes where humans get tired.

Furthermore, in the pre-liberalisation era, farmers produced much less than they do presently, because of that all there produce was sold in a short time. With the help of the Produce Marketing Board, there was no need to hold the harvested maize for long. PMB took maize produce to its various collecting stores and the farmers did not need storage facilities. But today because of the tremendous increase in production, which is not matched with market availability and market assurance, this has led to the need

of having storage facilities as an individual farmer. This has marked the increased investment in farm storage facilities in the maize growing areas. Most farmers agreed that they have storage facilities and the stores were holding their produce from the previous season. However, it should be noted that the adoption of more efficient technologies was occasioned by the increasing cost of farm labour and the decline in soil fertility requiring increasing usage of fertilisers.

25.4 Impact on Marketing and Distribution Channels

Loss of Guaranteed Market and Sales for Maize

The dissolution of the Produce Marketing Board, which previously guaranteed both market and price for maize, has resulted in the loss of a relatively more guaranteed market for maize. The collapse of the PMB has resulted in a multiplicity of small resource constrained buyers offering very low prices.

Furthermore, field evidence shows that the external liberalisation of the maize sector opened the regional market for exports of maize from Uganda. Indeed, exports of maize grain and maize floor increased since 1995. However, the limited capacity of the produce buyers has excluded the maize producers from the expansion of the demand for maize within the East and Central African region achieved in the last 10 years. While there are two seasons of maize in Uganda, most of the East African regions have one season of maize as a result of the widespread drought in the sub-region. WFP procurement from Uganda has increased from 20, 000 metric tonnes in 1995 to about 60, 000 metric tonnes by 2003 (Maize Study, 2003).

The political instability in Zimbabwe has contributed to the WFP's increase in sourcing maize from Uganda. The WFP is the largest commercial buyer of grain in East Africa with annual expenditure of up to U$200mn per annum. Because of increased uncertainty in the market for maize and to mitigate losses of maize output, some of the able farmers have been forced to invest in improved farm storage facilities to ensure their output can be safely stored even up to the next season. During the field visits, which was approaching the harvesting season, most farmers in Kamwenge and Iganga still had unsold maize in their farm stores. Not only does this add inventory costs to farmers, but the smaller farmers with poor farm storage facilities loose a substantial portion of their unsold produce.

Increased Uncertainty in the Distribution

The end to railway transportation for the maize crop from Kamwenge and the shift to the more costly and more cumbersome road transport for the crop have increased the uncertainty in the distribution network of maize. Multiplicity of small buyers offering very low prices and yet they cannot purchase all maize produce for distribution to other areas has also led to the uncertainty in the distribution. Most of the produce buyers who entered the sector at the demise of the PMB were speculators, without a long-term commitment to the sector and as a result have not invested in storage infrastructure. Given the seasonal nature of the maize sector, such capacity would have provided the capacity to stabilise prices during scarcity times. This lack of investment in the upstream part of the maize supply chain explains the on-farm investment in

storage facilities. PMB was the only purchasing organisation that maintained storage facilities that are no longer available to the sector.

25.5 Impact on Prices and Price Stability

Decline in Nominal and Real Prices

There has been a tremendous decline in the price of maize. Comparing the past 10 years and the present, the change in price is almost unbearable by most farmers. The prices of maize have continued to decline in nominal and real terms and with speculators taking over the market in the wake of the collapse of the PMB, there is increased price instability from season to season. The low price has resulted into intense frustration for the farmers and majority of the farmers are planning to give up farming because they do not see a future in maize production. Not only has the price of maize continued to decline but also the relative price of maize.

The price of other commodities has tremendously increased as compared to the price of maize. As a result farmers find it difficult availing themselves with basic and essential needs in their households. This continued decline in the relative price of maize aggravates poverty at household levels and affects the well-being of the farmers and their families. The farmers in anticipation of better prices in a subsequent season have taken to the habit of hoarding their crop. This trend of market imperfections is partly a result of the fact that the private buyers of maize are not committed to the trade. Unlike the days of the PMB, when the board had persistent role of buying farmers' produce, the private buyers are simply "snap buyers" attracted by events in the market with no intention of creating a permanent market but one from which they would benefit.

Maize Prices Became More Unstable and Unpredictable

Prices of maize, particularly farm gate prices have not only declined, but the decline has been accompanied by increasing fluctuation and instability. Prices not only change widely between seasons but there are wide intra-season variations. Because most of the produce buyers who entered the sector at the demise of the PMB were mainly speculators, without a long term commitment to the sector, little has been done to provide for stabilisation of seasonal prices to farmers. As a result, little has been done to invest in storage infrastructure upstream the supply chain. Given the seasonal nature of the maize sector, such infrastructure would have provided the capacity to stabilise prices during scarcity times. This lack of investment in the upstream part of the maize supply chain explains the on-farm investment in storage facilities. PMB was the only purchasing organisation that maintained storage facilities which are no longer available to the sector.

25.6 Impact on Technology Adoption

In an effort to increase farm output and take advantage of the surge in demand and increased incomes soon after liberalisation of the sector, a big proportion of maize farmers adopted improved farming technologies on their farms. The number of men employed has reduced tremendously in these farms because it is more efficient and economical to use ox-ploughs than employ many people. The use of ox-ploughs in particular has contributed to the doubling of maize output in Kamwenge district since 1995. This is also true in some parts of the districts of Iganga, Bugiri and Kapchorwa in

eastern Uganda. Apart from the use of improved tools, better farming methods have also been adopted. In most places, farmers have tried to use various other methods to help the land regain its fertility like crop rotation, mulching, use of manure, but the majority has adopted the use of fertilisers to improve their productivity, although they complain about the price.

Costs of agricultural inputs like fertilisers, labour, the ox-ploughs, seeds etc., have gone up during the liberalisation era. This substantially increases the cost of maintenance and reduces farm profitability. The adoption of improved technology has not been accompanied by the establishment of appropriate repair and maintenance facilities to support the effective usage of that technology. The increased cost of inputs has been due to the failure by the government to establish effective agricultural support and regulatory institutions while fully liberalising the agricultural inputs markets. Given that almost 100 percent of Uganda's agricultural inputs are imported, the costs were bound to rise in line with changing market forces.

25.7 Impact on Risk and vulnerability

Reduced Risk of Non-payment

Before liberalisation, there was a high risk of non-payment. The PMB, the only government mandated agency to purchase maize from farmers at the time, used to take maize grain from farmers but never paid in time. The lack of prompt payment by the PMB began to hinder the farmers' development. In the post liberalisation era, the situation changed tremendously since farmers were paid cash on delivery, which reduced the risk of non-payment. According to farmers in Kamwenge and Iganga, liberalisation has brought about a reduction in poor payment, which has improved farmers' development.

Increased Risk of Loss of Maize Grain in Storage

The lack of a guaranteed market and poor storage facilities for the produced maize has led to a loss of the maize as a result of getting infested by pests while in stores for a long time. Majority of farmers in the survey districts, particularly in Kamwenge district, had maize in storage without buyers and without any expectations of getting market. In the pre-liberalisation era, farmers were however assured of marketing by the PMB.

Increased Exposure to External Shocks

Prior to liberalisation, the government's policy on maize was to maximise food security and as such there was a ban on maize exports. The sector was therefore protected from the volatility that characterises the international commodity markets. Following liberalisation, the export ban was lifted and the sector has been increasingly exposed to the demand and supply conditions especially in the regional market. Maize is the most traded item in the EAC and COMESA by volume.

Although imported maize grain and processed maize were not on the list of banned imports prior to liberalisation, the opening up of the maize market to international market has increased the volume and variety of flour imports of maize grain and processed maize flour. There is an increasing interest from foreign investors, especially the big players in the regional market in Uganda's milling sector. East Africa's biggest

milling business, UNGA Millers, a Kenya based company, has since bought Uganda's second largest miller, Lira Millers.

25.8 Impact on Wages and Employment

The level of employment in the maize sub-sector has generally gone down. The average number of workers employed in most farms has been reduced. Most of the small farms that initially employed about five workers have reduced them to only two, while the medium sized ones which employed about ten or more workers have also reduced them by about 60 percent on average.

It is evident that the adoption of improved technology following liberalisation has reduced the level of employment in the maize sub-sector. The terms of employment have also changed. Most workers used to be employed on a monthly basis, earning a salary. With liberalisation, workers are paid for each working day. All employment is now on contract labour basis. While these terms of employment appear to have been beneficial to farmers who have ensured that labour remains cost-effective, and higher levels of labour productivity are maintained, it has created income uncertainty for the workers.

Although the level of farm labour has generally declined, liberalisation of the maize sector and the subsequent collapse of the PMB led to the incursion of the private sector buyers into the buying and selling of maize, which increased the employment levels along the supply and distribution channels. The fact remains that the formal employment in the maize sector has reduced, giving way to informal employment. There has been an increase in the number of grain traders to fill the gap left by the dissolution of the PMB.

The wages in the maize sector have generally increased. The average worker used to earn about Ugandan Shilling 30,000 (US$17.96) per month. However, currently workers earn an average of Ugandan Shilling 60,000 (US$35.9) a month, i.e. Ugandan Shilling 2,000 (US$1.19) per day worked. Although the nominal wages have increased, the real wage measured by the purchasing power seems to have remained the same. This has been due to the increase in the rate of inflation in the country and the relative fall in the purchasing power of the local currency.

25.9 Liberalisation and Changes in the Maize Supply Chain

The maize supply chain in the pre-liberalisation period started with typically subsistence small farmers who sold their crop in small quantities at government fixed prices to the PMB through their farmer groups. The PMB would store, grade and sell maize to either the millers to eventually sell to the consumers in the domestic market or store the maize as strategic food reserves for future use. Liberalisation led to the dismantling of the PMB which has since been replaced by a consortium of large grain traders, the Uganda Grain Traders Ltd. (UGT). Maize trade was made open for anyone who is interested. Traders can now buy maize from farmers at market prices since the price controls have been phased out. Also the lifting of the ban on exporting maize has extended the supply chain beyond Uganda's borders.

Liberalisation opened up the market to all sorts of traders, destroying the market security farmers used to enjoy. Farmers are no longer sure of a market for their produce and the prices they receive are so low, worsened by a large number of middlemen along the supply chain. Before liberalisation, farmers used to buy subsidised inputs, specifically high yielding seeds and fertilizers from Uganda Farm Supplies Ltd, a government-owned company. The end of the subsidy and the demise of the Uganda Farm Supplies following liberalisation made these inputs too costly for the maize farmers. Field evidence suggests that most of the farmers have resorted to using farm retained seeds and have stopped using fertilisers which has resulted in a tremendous decline in their yields and crop acreage.

Liberalisation has weakened the role of the farmer groups in the maize supply chain. Before liberalisation, farmers groups (owned and run by the farmers themselves) used to have the exclusive role of aggregating the maize crop from the multitudes of small-holder farmers. They dried, sorted, grading and stored the maize before selling it to the PMB. Through this consolidation of functions, the farmer groups minimised the number of middlemen along the supply chain and in the process maximised the proceeds for their members.

The pre-liberalisation supply chain for maize was strictly controlled and the only traders allowed to trade in maize outside the official channel running between the farmers' groups and the PMB were local millers who produced maize flour for the consumption of the farmers and institutional consumers like schools, the forces, hospitals and prisons. This arrangement was completely dismantled after liberalisation. The post-liberalisation era is characterised by hordes of speculators posing as traders. This proliferation of middlemen only serves to reduce the farmers' incomes from maize.

Before liberalisation, the farmers' groups, which had exclusive rights to purchase maize from farmers, invested in post harvest equipment (drying, sorting, grading) and storage. Liberalisation meant that these facilities were sold off, and the new speculative entrants into the sector have not invested in any of these but their haulage trucks. Field findings indicate that despite their low incomes from maize most farmers have been compelled to invest in on farm storage to make up for the storage shortage in the sector and provide a safety net to hold their harvests in anticipation of better prices in the following seasons, as a result of the erosion of their market guarantee.

At the processing level, grain milling is the most widespread power-driven small-scale industry in Uganda, in both urban and rural areas. Maize mills account for more than 70 percent of all grain milling activity (PSFU, 2003). One of the most fundamental positive effects of liberalisation is the explosion of milling as a value addition activity in the rural maize economy. This has created an investment avenue to the farmers, and has diversified their agrarian dependence on farming. Besides, these mills have introduced a new dimension of paid employment for people living in the maize belt and providing processed maize flour to ordinary households and institutional customers. The proliferation of private millers using intermediate technology has reduced the cost of milling making it easier for farmers to add value to their produce at a minimal cost. The opening up of the market meant that it was easier for farmers to access maize mills because they are widespread in the maize belt. Field evidence indicates that prior to

liberalisation, farmers could only eat maize in its most rudimentary form as maize cobs, but with this new dispensation, rural maize farmers can partake maize flour at affordable prices.

Before liberalisation, PMB's role in the maize supply chain was to procure, grade, market and sell maize among other commodities. Thus the PMB had a fundamental role in the supply chain to store these maize stocks. The PMB fixed and enforced the minimum price for maize every season. Government's primary objective in establishing the PMB was to manage the country's strategic food reserves and ensure food security. The PMB, therefore, strictly enforced the government ban on exporting maize outside Uganda's borders; the PMB played the role of the regulator in the maize supply chain. The PMB was dissolved during liberalisation, and its assets including its warehouses, stores and food silos sold off to the private sector. The privatisation of the PMB's assets gave rise to new prominent players in the supply chain, the large grain traders and processors. Utilising the PMB's former facilities, they procure, sort, grade and to some extent store maize before sale.

Liberalisation opened up the maize sector to international markets and lifted the government ban on exporting maize and other grains. This policy reversal created a new export market opportunity for Uganda especially in Kenya. The vacuum resulting from dissolving the PMB and the need to take advantage of the export opportunity led the large grain traders and processors to form a private consortium of grain traders, the Uganda Grain Traders Ltd, (UGT), which has invested US$7.8mn in an ultra modern grain-handling complex fitted with a weighbridge with a holding capacity of 30,000 metric tonnes.

Liberalisation opened up the market to the World Food Programme (WFP), which could not be part of the market with government's ban on exporting maize during pre-liberalisation. The WFP is the biggest commercial player in the sector, with annual purchases of 120,000 metric tonnes of maize.

25.10 Conclusion

The foregoing field investigation suggests that liberalisation led to the destruction of farmers' cooperatives or groups. Most farming households were left as economic orphans with no form of support both in production and marketing. Also, liberalisation seems to have resulted in the decline of both the nominal and real incomes of the rural farming households, i.e. those directly engaged in primary production. Costs of production have been steadily on the increase, which has negatively reduced the profitability of farming activities for both large and small scale farmers.

Agricultural marketing structures and systems that assisted in transferring rural produce to organised markets were dismantled and never replaced effectively. The market structures that emerged after liberalisation were largely informal with the quality of the private sector inadequate to effectively replace the structures that operated before liberalisation.

During the post-liberalisation period, employment has gone down at farm level and seems to have increased in the informal trade sector. The number of people in informal

trade seems to have gone up although it was difficult to quantify. Wages have increased nominally, i.e. 2-3 times but their worth measured by the purchasing power seems to have remained static. Liberalisation seems to have encouraged the expansion of the informal sector in the maize sector. Informal traders seem to have taken advantage of liberalisation without effective regulation scenario to maximise their trading opportunities.

The biggest impact on incomes and welfare appears to have been on rural farming households. The welfare of rural farming households has significantly deteriorated. Liberalisation has deepened and worsened poverty among the farming households in the maize sector in Uganda. The consumers, however, seem to have benefited from liberalisation. The increase in maize milling activities has increased access to processed maize flour within affordable price ranges, which has improved the livelihoods and food security of both farmers and consumers.

References

DENIVA (2006), "Uganda: The Imports of Trade Liberalisation in the Dairy and Maize Sectors on Household Welfare"

"Identifying Improvement Opportunities and Diagnosing Prospects for Uganda's Maize Supply Chains", Draft Report submitted by Independent Consulting Group

26 CHAPTER The Agro-processing Sector in Zambia

– *Venkatesh Seshamani*

26.1 Introduction

Agro-processing involves turning primary agricultural products into other commodities for the market. In Zambia, the agro-processing sector comprises industries whose core activities include: (i) snack food production; (ii) fruit and vegetable drying; (iii) oil (from groundnuts, sunflower and seed cotton) and honey processing; (iv) cereal milling (maize, wheat, soya beans, etc; (v) peanut butter production; (vi) sugar processing; (vii) mushroom processing; (viii) dairy products; (ix) beef production; (x) fish farming and distribution; (xi) tea, tobacco and coffee processing; and (xii) poultry farming.

The agro-processing sector has generally enjoyed a reasonably good market in Zambia with a notably indigenous production structure in the sense that the industries use a significantly high quantity of local raw materials. In addition to its contribution to national income, agro-processing has the potential to increase income and access to food for the poor who largely depend on agriculture for their livelihood, by establishing small-scale processing businesses that can be carried out at homes and do not require huge investment. Thus, through this transmission mechanism, agro-processing can potentially reduce poverty in a sustainable manner. The purpose of this chapter is to explore the trade-development-poverty linkages in the agro-processing sector in Zambia.

26.2 Impact of Trade Liberalisation on the Agro-processing Sector

Respondents from the field investigation observed that the agro-processing sector recorded growth and expansion in recent years. This is particularly attributed to the deliberate efforts by government to support the agricultural sector, which is the key resource sector for the agro-processing industry. The agriculture sector has enjoyed a lot of support from the government in its deliberate effort to diversify the economy from the mining sector to other sectors deemed to have business potential. In this sense, farmers have been given a lot of security. The sector has grown in terms of the number of players and thus productivity has risen. As a result of competition, the agro-producers have been forced to increase the ranges of their products, which have been made possible through increased mechanisation of the processing plants. Thus, the sector has witnessed a facelift in terms of new technology that has led to significant reduction in the cost structures.

There has been an increase in the product range resulting from the companies' deliberate policy of diversification undertaken to counteract possible adverse impacts of trade liberalisation. Also, there has been an improvement in productivity on account of low costs incurred through a significant use of local raw materials. Turnover levels in general have been satisfactory since most firms have been able to withstand competition with

their foreign counterparts. In general, firms have been viable and profitable and not overly perturbed by competition. There has been an expansion in employment owing to diversification that has necessitated increased labour. There has been substantial recapitalisation, but this has occurred more on account of change of ownership through privatisation. Also, human resource development saw growth to some extent only in the highly technical operations that require highly technical staff.

26.3 Overall Impact of Trade Liberalisation

Among the most significant findings of the survey is that stakeholders' support for trade liberalisation in fact remains strong. All the people interviewed were in favour of trade liberalisation but were against the manner in which it was implemented in Zambia. They observed that trade liberalisation should have been implemented slowly and with extra caution to allow local industries to adapt to the liberalised environment.

The stakeholders also supported the idea that liberalisation should have been implemented over a period of time. Opening up to trade meant that Zambian industries had to make adjustments to deal with greater international competition. Thus, the government should have begun by building capacity in all the domestic firms, by way of re-evaluating the existing capital as a deliberate measure of the ability of the local industries to adapt to greater international competition that was necessitated by trade liberalsation. One of the strongest messages respondents voiced was that local industries were not prepared for competition necessitated by trade liberalisation, and thus needed support in terms of easier access to credit in order to enable them to restructure their operations to suit the new environment. The government overlooked the fact that the local industries required re-orientation to enable them to withstand competition that was brought about by trade liberalisation.

The local industries initially enjoyed lucrative domestic markets under a protected economy. Since the advent of the free market doctrine of trade liberalisation, which has seen the lifting of restrictions on imports, the domestic market has experienced an excessive supply of imported products that are sold cheaply due to their lower production cost structures as compared to those of our local products. This problem is exacerbated by Zambia's geographical position. Zambia is a landlocked country and thus, local industries do not have easy access to other foreign markets and if they do they incur huge inland transportation costs.

As a result of trade liberalisation, there has been a creation of more real and sustainable employment. In addition, there has been an increase in the total volume of economic activities amongst the local people, especially the poor who are engaged in various other activities due to ramification of other core economic activities into the informal sector.

The general view that the appreciation of the Zambian currency *'kwacha'* has had detrimental effects on the income levels of export-oriented businesses was also overwhelming. The respondents observed that while they realise that it has benefited some people, there is a need for the government to quickly look at the tradeoffs of the *kwacha* appreciation. There is technically very little that the gain in the strength of the kwacha has done to drive down the production costs to warrant any reduction in the

general price levels. This is especially so in the case of those industries with bulky inventories that takes a long period to consume. Besides, these are materials that were acquired at an old exchange rate and thus, it would not make any business sense to arbitrarily reduce the price just because of the current strength of the *kwacha*. The respondents were not only uncertain about the sustainability of the strength of the *kwacha* but also pointed out to the view that such fluctuations in the exchange rate tend to introduce speculations in the economy, a situation which may undermine business. They observed that the country needs to learn a few lessons which include the South African experience of the appreciation of the Rand on the local economy.

The respondents acknowledged the view that a number of industries were sacrificed in the process of liberalising but a few have also come on board. So what the government needs to realise is that most of these industries are still in their infancy and thus need protection to grow and become competitive. The respondents pointed to the need for government to promote effective PPP. In their opinion, government must realise that private-sector-led growth requires that there is coherence in policy and activities at all levels between the public and the private sector. To this end, the respondents were happy to note that the government is currently reviewing a policy document that will promote policy coherence and adequately take care of the needs of the private sector's development strategy.

The respondents also pointed out some institutional flaws such as the difficulties faced when VAT claims are due. The government has made a number of products including milk VAT exempt. This has been good on paper but not quite in practice. It has been extremely difficult to claim this VAT and this practice has simply introduced distortions in that this VAT is viewed as an added cost of production that is transferred to the consumers through inequitable pricing.

There was a hostile view pertaining to the current labour laws. There was consensus on the view that liberalisation was implemented in piecemeal in the sense that the labour market for instance, is still not liberalised. Trade unions still have a great influence in industrial relations and this situation has destroyed the general work culture in Zambia. Employers have developed an antagonistic attitude towards their employees because they are too protected by their Trade Unions.

Many of the respondents observed that the general situation in Zambia today is that most financial institutions are ready to avail credit to local investors, but the cost of borrowing as reflected by the high lending rates in excess of 40 percent per annum. This makes it prohibitive to borrow money for business. In this sense, credit would be said to be unavailable. The respondents also observed that this problem has been compounded by persistent high inflation rates, which further reduce the revenue bases of the individual industries and thus rendering them unable to service their existing debt obligations. In the long-term, these industries are unable to re-capitalise, and thus fail to match the current technology required to keep them competitive.

26.4 Conclusion

Trade liberalisation in Zambia aimed at creating a competitive and productive economy, which would be driven by private sector initiative with a view to enhance living standards

for Zambians. Contrary to these expectations the stakeholders' general view is that since the advent of trade liberalisation, the Zambian economy has been characterised by increased hardship among the poor, destruction of infrastructure and hence the environment. The number of firms that have been closed is higher than that of the ones that have come on board. Thus, the rate of unemployment has increased resulting in the general decline in the purchasing power of the people. The income gap between the rich and the poor has widened resulting in increased inequality and marginalisation of the poor. In sum, poverty has actually increased as opposed to the expected benefits of trade liberalisation.

However, notwithstanding the above shocks, since the advent of trade liberalisation, the Zambian economy has witnessed the emergency of small scale entrepreneurs who are mostly middlemen and those engaged in re-processing and thus providing some form of employment and income to the poor.

Zambia should take extra caution when signing any international trade protocols because most of her industries are in their infant state and thus cannot absorb the shocks of having to compete with giant foreign counterparts including some of those in the region. This implies that Zambia does not seem to have the supply side capacity to exploit the opportunities that would be given under any international agreement. Foreign products have led to the closure of a number of local industries and thus Zambia has had a good lesson from which to prevent further adverse impacts.

Thus, Zambia must re-assess the gains from some of the trade agreements that have already been signed under COMESA and SADC. The benefits have so far not been overwhelming;[1] hence the need to defer those agreements that have not yet come into effect such as the SADC trade protocols due to come into effect in 2008. For instance, Zambia should realise the danger of 100 percent removal of duty on wheat, under the SADC trade protocol. Once this agreement is implemented, Zambia's traditional market will be dominated by foreign industries from giant economies like South Africa. These international trade protocols have introduced unfair trade practices that have in turn killed local production, hence the need for a more strategic approach.

The business community in Zambia has also taken too long to adjust to the liberalised environment. This slow process of adjustment is largely attributable to government failure to provide the necessary direction like has been the case with a few sectors, which include among others the agricultural, the transport and the financial sectors. The financial sector for instance, had over the years remained widely underdeveloped, but has in the recent years improved and is able to harness local savings to support investment although the cost of borrowing is still high.

Reference

OECD (2008), " Trading Out of Poverty: How Aid for Trade Can Help

Endnote

1 As an example, Kenya does not pay duty on oil but Zambia pays 15 percent

27 CHAPTER The Textile Sector in Zambia

– *Venkatesh Seshamani*

27.1 Introduction

The textile sector is very critical to the Zambian economy not only in terms of its capacity to contribute to the country's export earning, but also in terms of employment creation that the government desires to achieve in order to reduce poverty. Historically the textile sector has had an outstanding record of export earnings in Zambia. For instance the textile sector was the largest exporting industry in 1996 among Non-Tradition Export (NTE) sectors, and has been second to Primary Agricultural Commodities in the ensuing years despite the declining trend after 1997. It has been among the top two NTE earners since 1994 following expanded investment especially in cotton spinning (see Export Board of Zambia, 2000). The purpose of this chapter is to explore the trade-development-poverty linkages in the context of the textile sector in Zambia.

27.2 Overview of the Zambian Textile Sector

Up until the onset of trade liberalisation, Zambia had a well-established T&C sector. But the sector which boasted of having over 140 companies in the 1980s and empowering over 25,000 Zambians through provision of jobs saw mass closures of garment factories and scaling down of operations especially of the textile sub-sector with the resultant employment levels dropping to below 2,500 (Chikoti *et al*, 2002). The Zambian textile sector comprised of highly mechanised parastatal and private companies in all the spheres of textile operations that were captured for this study sample. These include cotton growing, spinning, weaving, knitting and garment manufacture.

The country previously had a very good market for the whole range of products that the sector produced. Today, the textile sector is faced with serious challenges, which have led to a decline in productivity forcing a number of industries to close down. This gloomy situation has largely been attributed to trade liberalisation that removed restrictions both internally and externally and thus brought about competition, which many local industries seem to have not been ready for due to the inefficient manner in which they were run as they enjoyed protectionist policies from government.

The textile sector in Zambia, just like everywhere else, requires a number of raw materials amongst which cotton is major. Cotton growing in Zambia has been very successful, especially in recent years. Commercial cotton growing was previously dominated by LINTCO (Lint Company of Zambia). After the privatisation of LINTCO, many other commercial farmers switched their focus to other alternative crops like maize because cotton growing had become unviable. Today cotton production is highly dominated

by out-growers schemes, a principle that involves the mobilisation of local farmers who are supplied with some basic inputs as one incentive to keep them in business. Zambia produces a wide range of products, which include cotton lint, cotton yarn, poly/cotton yarn, acrylic yarn, cotton fabrics and cotton yarn fabrics.

Impact of Trade Liberalisation on the Textile Sector

In the wake of the general economic liberalisation measures implemented since the early nineteen nineties, there has been a steady erosion of purchasing power of the population, and as a result, domestic demand for most local products significantly reduced in the last well over 10 years of trade liberalisation. This problem has been compounded by dominance of the traditional foreign markets by countries with stronger economies. In the case of the textile sector, this meant that people could not afford to buy new clothes, a situation that led to the influx of imported fabrics, which in turn impeded local industrial production. For instance, *salaula* and other Chinese fabrics have greatly undermined the Zambian textile sector.[1] This situation has forced a number of industries that have survived closure to reduce their productivity and this has resulted in low capacity utilisation of the existing textile infrastructure leading to a substantial number of jobs loses.

There was a consensus among the respondents in this study that the Zambian textile sector previously produced a wider range of products than is the case today. Further, the textile industries that have survived the effects of trade liberalisation are those in cotton processing on account of an increase in cotton production in Zambia.

Respondents also alluded to the view that local industries do not enjoy the maximum benefit of close proximity to the suppliers of most raw materials including cotton, which is actually locally grown and ginned. The issue of import parity pricing in the case of local raw cotton supply came out prominently. It was observed that ever since the privatisation of LINTCO, local raw cotton is quoted based on Liverpool price index causing local industries to bear the cost, insurance and freight (CIF) costs, which includes the cotton price, shipping freight and insurance cost. This unfair trade practice tends to push up the cost of production, which is in turn translated into high prices of the final products that are expected to compete with similar foreign products from countries whose price of local cotton is either controlled by government or ex-factory.

Lack of political will on the part of government to assist the sector was also a sore point with many respondents. They observed that unlike the South African textile industries, for instance, that enjoy lower production costs, economies of scale and greater capacity utilisation, their Zambian counterpart firms do not enjoy these economic advantages since the Zambian Government does not provide any form of subsidy or direct cash incentive payments for exporters including those that utilise local raw materials.

While it is acknowledged that Zambia is a minor in as far as influencing international trade policies is concerned, there is a need to put in place some safeguard measures to compensate for some unfair trade practices like import parity pricing. They further observed that such stimulant measures are practiced by a number of stronger economies like US, China, and the EU to name a few, through the provision of subsidies.

27.3 Conclusion

The sector has witnessed a decrease in product range caused by competition from foreign products and a decline in people's purchasing power resulting from job losses. Apart from cotton growing, the sector has witnessed a significant decline in productivity owing to: (1) the dominance of the traditional markets and other foreign markets by the Asian tigers as a result of the removal of all quotas as per WTO agreements in 2004; (2) inability to recapitalise; and (3) high levels of indebtedness. Again, except for cotton growing, there has been a decline in turnover owing to reduced productivity and shrinkage of markets. Most of the firms were just breaking even with their revenue structures prominently characterised by huge debts arising from domestic borrowing for restructuring, low productivity and shrunk markets.

There has been a major downsizing of the labour force as a result of decline in productivity. All the firms surveyed have undergone substantial rehabilitations and mechanisation necessitated by competition brought about by trade liberalisation. Unfortunately, the bulk of this investment is currently under-utilised because these firms have had to reduce production as a result of the shrinkage of the domestic markets.

References

Chikoti, S and Mtonga (2002), "Country Paper on Textiles and Clothing in Zambia", Ministry of Commerce, Trade and Industry, Lusaka

Export Board of Zambia (2000), "Zambia Supply Survey on Textiles and Clothing", Lusaka

Endnote

1 Prior to trade liberalisation also there was an inflow of used clothing brought in by religious and charitable organisations for distribution on a non-profit basis to the poor. Subsequently, some private businesses too imported a whole range of used garments that could be bought by everyone. However, owing to restrictions imposed by import licensing and foreign exchange controls, the quantities of such imports were still small and did not pose any threat to the products sold by domestic textile firms

About the Editors

Selim Raihan is an Associate Professor in the Department of Economics at Dhaka University, and is the Executive Director of the South Asian Network on Economic Modelling (SANEM). His research works focus on issues related to international trade, macroeconomic policy and poverty. Some of his recent publications include *Export Diversification for Human Development in the Post-MFA Era; A Quantitative Assessment of WTO and Regional Trade Negotiation Outcomes for Bangladesh*; and *Dynamics of Trade Liberalisation: Analyses of Policies and Practices*. He has worked as a consultant for several organisations including, CUTS, ADB, UNDP, Commonwealth Secretariat, ILO, IFPRI, IDRC and World Bank.

Mohammad A. Razzaque is currently Economic Adviser at the Economic Affairs Division of the Commonwealth Secretariat, London, UK. His primary research interests lie in the area of applied trade policy analysis, and he has written extensively on trade issues. His most recent publications include three edited volumes: *Trade, Migration and Labour Mobility; Global Rice and Agricultural Trade Liberalisation: Poverty and Welfare Implications for South Asia;* and *Venturing into a Quota-free World: The Readymade Garment Industry of Bangladesh*. He has contributed to research projects initiated by, amongst others, ADB, CUTS, IDRC, ILO, UNCTAD, UNDP, UN-WIDER and World Bank.

ISBN 978-81-8257-119-8

CUTS Centre for International Trade, Economics & Environment
CUTS CITEE

CUTS Centre for International Trade, Economics & Environment
D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India
Ph: 91-141-228 2821, Fx: 91-141-228 2485
Email: citee@cuts.org, Website: www.cuts-citee.org