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**NEPAL'S CARPET INDUSTRY IN THE ERA OF  
GLOBALIZATION AND COMPETITION**

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## ACRONYMS

AAFLI	Asian-American Free Labour Institute
BCFED	British Columbia Federation of Labour
CBS	Central Bureau of Statistics
CCIA	Central Carpet Industries Association
CNN	Cable News Network
CSF	Critical Success Factors
CSR	Corporate Social Responsibility
CWIN	Child Workers in Nepal Concerned Centre
DOL	Department of Labor
EU	European Union
FDI	Foreign Direct Investment
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
GDP	Gross Domestic Product
GNP	Gross National Product
HMG/N	His Majesty's Government of Nepal
HS	Harmonized System
IDRC	International Development Research Centre
IDS	Institute of Development Studies
ILO	International Labour Organization
IMF	International Monetary Fund
INGOs	International Non-Governmental Organizations
ISIC	International Standard Industrial Classification of All Economic Activities
ITC	International Trade Centre
LDCs	Less Developed Countries
NCEA	Nepal Carpet Exporters Association
NBCCI	Nepal Britain Chambers of Commerce and Industry
NDF	Nepal Development Forum
NGOs	Non-Governmental Organizations
NICs	Newly Industrialized Countries
NPC	National Planning Commission

NPR	Nepalese Rupees
NRF	Nepal Rugmark Foundation
NSIC	National Standard Industrial Classification
OBM	Own Brand Manufacturing
ODM	Own Design Manufacturer
OEA	Original Equipment Assembling
OECD	Organization for Economic Cooperation and Development
OEM	Original Equipment Manufacturer
QPD	Quality, Price and Delivery
SATA	Swiss Agency for Technical Cooperation
SAWTEE	South Asia Watch on Trade, Economics and Environment
SITC	Standard Industrial Trade Classification
SMEs	Small and Medium Enterprises
STEP	<i>Stiftung für gerechte Bedingungen in Teppich-Herstellung</i>
TNCs	Transnational Corporations
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund
US	United States
WTO	World Trade Organization
WWW	Worldwide Web

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## INTRODUCTION

### 1.1 Background

It is argued that globalization has intensified economic, political, social and cultural relations across borders with uneven impacts for individuals, firms, regions and countries (Holm and Sorenson, 1995; Scholte, 2000; Kaplinsky and Morris, 2001). Due to their deepening integration into global markets, firms – especially in developing countries – are under increasing pressures. As Humphrey and Schmitz (2002: 1019) point out: “For producers to maintain or increase incomes in the face of these pressures, they must upgrade: either increase the skill content of their activities and/or move into market niches which have entry barriers and are therefore insulated to some extent from these pressures.” Successful industrialization depends on continuous upgrading on the part of firms and nations so that engaging in an activity leads to reaping of rents that can be excluded to competitors (Kaplinsky, 1998). Fostering and maintaining competitiveness have become indispensable in the process of economic development at local, regional or national levels (Blakely, 1989; Porter, 1991; Helmsing, 2000). Competition affects all – ‘old clusters’, giant corporations or economically powerful nation-states (Best, 1990; Porter, 1990; Knorringa, 1999). In the absence of upgrading as a response to competition and as experience also suggests, globalization adversely affects producers (especially in the developing world) specializing in highly competitive product markets leading to immiserizing growth (Kaplinsky and Morris, 2001; Kaplinsky et. al., 2002). Furthermore, despite liberalization, the global economy is governed by rules reflected in the rise of new international trade standards. Concerns about ethical, social and environmental aspects of production are now central to the global agenda on trade (Nadvi and Waltring in Schmitz ed. 2003). Such rules affect competitiveness in the ‘global commodity chain’, especially ‘buyer-driven chains’ characterized by ‘value chain governance’ in which ‘lead firms’ source production to firms in developing countries (Gereffi, 1994: 216; Humphrey and Schmitz, 2002: 1020). Global standards thus imply new forms of global governance in the world economy.

In the case of the hand-made woolen carpet industry in which many developing countries specialize in, such rules refer primarily to attempts at enforcing labour standards on suppliers by both 'lead firms' in the value chain and by other development actors because of increased global awareness of fair trade in recent years. The paper examines and analyzes the performance of the Nepalese carpet industry (especially its export sector) in the context of globalization, competitiveness, core labour standards, immiserizing growth and value chain analysis.

## **1.2 Statement of the problem**

Floor coverings – including hand-made woolen carpets – are among the various labour-intensive manufactures traded in the world today. A few developing countries specialize in the production and export of hand-made woolen carpet producers while industrialized nations form the main markets. For Nepal – a less developed country (LDC) with a Gross National Product (GNP) per capita \$ 250 in 2002 – carpet manufacturing is one of the primary sources of foreign exchange. The country is ranked as the 14<sup>th</sup> largest producer of carpets with a 1.1 per cent share of the world market.<sup>1</sup> For an economy characterized by a large primary sector in terms of the population who depend on agriculture, carpets contributed 22 per cent of non-agricultural Gross Domestic Product (GDP) in 2001.<sup>2</sup> At the end of the Nepal's Ninth Plan (1992-97) in 1997, the sector provided jobs to around a quarter of total manufacturing employment.<sup>3</sup> Carpets formed the leading export item for around a decade or so but its share has fallen from more than half of total exports to less than a quarter of total exports in 2002.<sup>4</sup>

## **1.3 Research questions**

The paper intends to find answers a few questions, which are outlined as follows:

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<sup>1</sup> Source: International Trade Centre, UNCTAD/WTO (<http://www.p-maps.org/pmaps/ppi.php>). This rank is for all categories of carpets. In case of hand-knotted carpets only with a total global value of USD 1, 926 millions, the country would be ranked the 6<sup>th</sup> largest producer.

<sup>2</sup> GDP from industry and services was 70.2% while 39.1 % of GDP arose from agriculture (World Bank, 2002: <http://www.worldbank.org>)

<sup>3</sup> Computed from HMG/N, Central Bureau of Statistics: *Statistical Pocketbook, Nepal 2002*.

<sup>4</sup> Cited in CCIA (<http://www.nepalcarpet.org>), World Bank and HMG/N (various years).

- How can the performance of the Nepalese carpet industry be explained in the context of globalization, competitiveness, core labour standards, immiserizing growth and value chain analysis?
- Once the leading export item, the share of carpets has dwindled considerably. What factors led to the decline? What does the data – both primary and secondary – reveal? How do some actors in the value chain – producers, buyers, trade bodies and consumer labelling organizations – view the issues?
- How has the Nepalese carpet industry responded to competitive pressures?
- What lessons can be derived from the Nepalese experience for small and medium enterprises (SMEs) in their export-oriented industrialization endeavour?

#### **1.4 Objectives and rationale**

The overall objective is to analyze the case of the Nepalese carpet industry in an era of globalization and competition. The study assumes relevance because of the following reasons:

- It addresses globalization of product markets for a country – Nepal – and for a product – hand-made woolen carpets – which have received little academic attention.
- It extends the standard literature on developing country product markets, value chain, upgrading and competitiveness and finds out whether the various theories and empirical evidence drawn by various researchers in other sectors also apply in this particular case.
- The study has valuable lessons for nations aspiring to industrialize as recommended by current policy consensus and while questioning the relevance of such policies for countries at different stages of development is also aware that alternatives need to be identified.

#### **1.5 Methodology and limitations**

A comprehensive review and discussion of the literature is undertaken along with analysis of data sources (both primary and secondary).

### *1.5.1 Review and survey of literature*

Multiple topics are covered in this research paper which is used to analyze the issues facing the Nepalese carpet industry. While the next chapter introduces, substantiates and examines the theoretical concepts, some are briefly stated here. The main topics include: 'globalization' (Ohmae, 1990; Waters, 1995; World Bank, 1996; Perraton, Goldblatt, Held and McGrew, 1997; Berner and Conyers, 1998; Busch, 2000; Scholte, 2000); 'competitiveness' (Best, 1990; Porter, 1990); 'child labour and core labour standards' (International Labour Organization, ILO); 'immiserizing growth' (Bhagwati, 1958; 1973 cited in Kindleberger and Lindert, 1978 and in Soderston and Reed, 1994); and 'value chain' analysis (Kaplinsky, 1998) including the 'global commodity chain' (Gereffi, 1994 and 2002) framework.

Using the above frameworks, what have previous researchers analyzed? Kaplinsky and Morris (2001) introduce value chain analysis. Kaplinsky et. al. (2002) analyzes globalization/value chain/immiserizing growth of products markets for the South African furniture cluster. The literature on industrial clusters, value chains, upgrading along with competition are manifold. Local economic development cases vis-à-vis learning and upgrading are analyzed by Barzely (1990, 1991) for white marble miners in Spain; by Guimaraes (1989) for shrimp cultivators in Bangladesh; and for shoe producers by Knorringa (1999) in India and by Knorringa and Schmitz (2000) for a few developing countries. Researchers from Institute of Development Studies (IDS) like Humphrey and Schmitz (2002) address the overall topic of insertion in global value chains and implications for upgrading with emphasis on buyer-driven chains. There is a vast literature linking trade and labour standards (Dasgupta, 2001; US Department of Labour, 2003; EU, 2003 and Rugmark, 2003). The debate continues in an analysis by Busse (2002) who shows how comparative advantage is affected by labour standards. Nadvi and Waltring (in Schmitz ed. 2003) bring out the implications of new rules – including product and process standards – in a globalizing world, which has implications for producers everywhere. Egan and Mody (1992), Lall (1991) and Keesing and Lall (1992) have contributed significantly to trade-related literature that precede mainstream value chain analysis and thus emerge as early proponents of the 'new competition' school of thought with their analysis of third world manufacturing exports and relationship between producers and lead firms engaged in quasi hierarchical relationships.

### 1.5.2 Data

#### (a) Secondary data

There are various sources of secondary data: publications by government, private sector, individual researchers, NGOs, INGOs and international agencies that were used by the author. Information was also accessed from the Worldwide Web (WWW) by the same agencies on topics concerned with either the Nepalese carpet industry or within the broader subject matter. The research paper makes use of the following secondary data sources:

- His Majesty's Government of Nepal (HMG/N) and its agencies like National Planning Commission (NPC), Central Bureau of Statistics (CBS), Ministries of Finance, Labour, Industry and Commerce
- Federation of Nepalese Chambers of Commerce and Industry (FNCCI)
- Central Carpet Industries Association (CCIA)
- Nepal Carpet Exporters Association (NCEA)
- Child Workers in Nepal Concerned Centre (CWIN)
- Nepal Rugmark Foundation (NRF)
- TransFair e.V./Rugmark International
- Care & Fair Nepal
- *Stiftung für gerechte Bedingungen in Teppich-Herstellung* (STEP) whose literal English translation of the German abbreviation is 'Foundation for Fair Conditions in Carpet Production and Trade'
- European Union (EU)
- The Bretton Woods institutions: The World Bank (WB) and International Monetary Fund (IMF)
- World Trade Organization (WTO)
- International Labour Organization (ILO)
- United Nations (UN) and its agencies: United Nations Conference on Trade and Development (UNCTAD), United Nations Development Programme (UNDP), and United Nations International Children's Emergency Fund (UNICEF)
- Government of the United States (US), Department of Labor

(b) Primary data

The need was felt to collect primary data that would enrich the research paper from many viewpoints. First, secondary data needed to be verified. Second, having primary data would provide views of actors in the carpet value chain and also enable the researcher to have a closer look at the core issues. The author obtained primary data mainly through questionnaire surveys sent to respondents via email. Two personal interviews with carpet importers were also conducted. The respondents included:

- Global buyers (including importers, wholesalers and retailers) of Nepalese carpets in Europe who are also participants of consumer labelling programmes like Rugmark, Care & Fair and STEP;
- Sellers (carpet exporters in Nepal who are licensees of Rugmark/Care & Fair/STEP);
- Carpet trade association (the CCIA in Nepal) and
- Fair trade bodies; namely TransFair e. V. /Rugmark International and its office in Nepal: NRF.<sup>5</sup>

The response from both global buyers and suppliers is low: 5 global buyers in Europe and 4 suppliers in Nepal replied (representing a response rate of 45 per cent and 20 per cent). Only 5 out of 11 lead firms responded in Europe: 3 in Germany and 1 each in Belgium and Luxembourg. While many other respondents had shown their willingness to respond, they did not do so despite many attempts at contacting them. Language and communication barriers were faced with some non English-speaking European global buyers. In Nepal too, not many exporters showed a keen interest as the low number of responses attest. However, they include an interesting mix of actors. Two global buyers based in Germany were the first and third largest importers of Rugmark labelled Nepalese carpets during 2001/02 (NRF, 2003). Among other 3 respondents from Nepal are a former president of NRF (and presently general secretary of Rugmark International), an official from NRF and the executive secretary of CCIA. Diversity is

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<sup>5</sup> The Germany-based TransFair e. V./Rugmark is an internationally registered trademark and independent label which certifies those carpets that are produced without using illegal child labour. It has branches in three carpet producing nations in South Asia: India, Nepal and Pakistan. Germany, UK, US and Canada also have Rugmark offices. The two other well-known carpet labeling organizations are Care & Fair (also based in Germany) and the Switzerland-based STEP.



reflected among the exporting firms; two of them are in the small-scale category (with fixed assets of less than 10 million Nepalese rupees) whereas the remaining two are in the large-scale category (with fixed assets greater than 50 million Nepalese rupees). All exporters participate in either one of the three child labelling initiatives.

## **1.6 Organization of the paper**

This paper consists of five chapters and proceeds as follows. Chapter 1 (Introduction) provided a background to the study, statement of the problem, research questions, objectives, rationale and dwelt on methodological aspects. The analytical framework – consisting of various theoretical perspectives is carried out in Chapter 2 (Theoretical framework). Analysis is carried out in the next two chapters. Chapter 3 (Some aspects of the carpet industry: global and Nepal) highlights some features of the global carpet industry (including the hand-made woolen segment) as well as deals with the events and issues facing the Nepalese carpet industry. Chapter 4 (Findings and survey results) presents primary data from various actors in the carpet value chain, thus providing an even closer view of the core issues. The last chapter viz. Chapter 5 (Conclusions), while reflecting on theories, summarizes the main points and offers key conclusions.



## THEORETICAL FRAMEWORK

The present chapter examines the various concepts and theoretical approaches used in the study; their relevance arises in explaining the underlying issues that need to be addressed.

### 2.1 Globalization

The most significant development in the world economy during the past few decades has been the increasing internationalization – and, arguably, the increasing globalization – of economic activities.

(Chapman in Dicken ed. 1998: 1)

Economic globalization refers to the increasingly interconnected nature of global economic relations through world trade, the activities of transnational corporations (TNCs), international investment and financial markets, labour migration and so on.

(Berner and Conyers, 1998: 2)

In this age of ‘the borderless world’, people are increasingly aware that the constraints of geography on social and cultural arrangements are receding (Ohmae, 1990; Waters, 1995). Globalization is thus not only a buzzword but also the reality that is shaping the lives of all people today. It is also multi-dimensional in character and economic globalization is only one aspect of it; reflected in ‘new markets, new actors, new rules and norms which have arisen in terms of managing the scale of globalization’ (UNDP, 1999). Trade openness, liberalization and deregulation has led to the creation of new markets for both new goods and services. The current global economy is one wherein space and time constraints have been overcome and production and consumption occur through a global division of labour. The global product market caters to increasing and

ever-changing tastes of consumers with competition among producers to meet growing demand.

Besides the state, there are new actors mainly represented not only by market forces (represented by TNCs) but also by civil society actors like NGOs involved in traditional development activities and in many new areas. Both old and new actors enforce or attempt to enforce rules for member-states either belonging to the UN or to international organizations through conventions and treaties. Among the actors, the WTO aims to usher a regime of 'free trade' vis-à-vis a rule-based trading system whose membership now includes the majority of the world's nations. The policy consensus that emanates from global economic and financial institutions is one of neo-liberalism whose overriding belief is that 'free markets' and absence of state intervention promotes growth, maximizes equity and fosters efficiency (Scholte, 2000: 259).

In what ways have countries embraced globalization, especially economic globalization? The role played by the Bretton Woods institutions – the World Bank and the IMF – in pursuing economic liberalization (*laissez faire* denoted the prevalence of market oriented policies) – also called the 'Washington Consensus' (attributed to economist John Williamson who coined the term) is noteworthy. Broadly speaking, policy advice called for an end to the state's grip on the economy and recommending openness to international trade. 'State failure' also hastened the demise of the socialist states and economies, which were largely unsuccessful in promoting rapid growth with equity. In the case of many countries where the role of market forces in the economy was minimal, resource constraints began to appear. The public sector was unexposed to competition but prey to directly unproductive activities, which affected their efficiency, productivity and profitability. By the late 1980s, even bulwarks of state-sponsored development regimes like the erstwhile Soviet Union, China, India and the eastern European bloc started introducing measures to overcome state failure. Reforms removed decades of mismanagement of the economy at the hands of the state whereas now most economic regimes recognized the importance of integration and participation in the global economy to bring about dynamism and help attain growth and development targets. However, globalization – which involves both opportunities and risks – has not proved to be the panacea for removing economic ills as evidence suggests. Although globalization has intensified economic interdependence and created riches for some groups and

countries, it has been uneven for the majority with growing North-South gaps due to unequal access to opportunities that globalization brings (Scholte, 2000). In the event of producers failing to insert themselves properly in the global economy, welfare losses may occur whose the effects can be harmful, sudden and long lasting (Kaplinsky and Morris, 2001). As globalization opens up new possibilities – both opportunities (although not always equal opportunities) as well as risks – there will be both winners and losers. Realizing gains require economic agents – individual producers, firms, industries or countries – to make changes in the way they do things. Being ‘competitive’ could keep them on the centre-stage but being complacent is sure to marginalize them and relegate them to the ‘periphery’ with overall loss in welfare. In a nutshell, globalization requires firms and nations to be competitive.

## 2.2 Competitiveness

How is competitiveness related to globalization? Consider an oft-mentioned instance with regard to trade-friendly versus closed economic regimes. Many developing or transition economies of today that previously followed autarkic policies sheltered domestic producers from competition and hence were not globally integrated. However, today’s newly industrialized countries (NICs) – especially in East Asia – were able to benefit from integration into the world economy as their participation in global markets enabled them to allocate resources efficiently (the prices at which they traded were world prices that were market determined and not regulated). Instead of the inefficient public sector/import-substitution industrialization model prevalent in their developing country counterparts (catering primarily to the domestic market), these NICs also tapped in technology and were able to upgrade from low-wage labour intensive goods to high-wage capital intensive goods.<sup>6</sup> The ‘Asian miracle’ may be attributed to growing competitiveness on the part of east and Southeast Asian nations who were able to gain from globalization and pursue a high growth path.<sup>7</sup>

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<sup>6</sup> Kaplinsky and Morris (2001) point out that: “East Asian firms have made the transition from OEA (original equipment assembling production involving value added assembling under contract to a global buyer to OEM (original equipment manufacturing manufacturer that is making a product which will bear the buyer’s badge) to ODM (own design manufacturer) to OBM (own brand manufacturing).”

<sup>7</sup> Singapore, Malaysia, Thailand, Hong Kong (now China) and South Korea are considered to be the success stories of the ‘Asian miracle.’ A high correlation may be found with regard to participation in world trade and levels of economic growth.

Now that the state is no longer at the 'commanding heights of the economy', market forces and trade are considered to be 'engines of growth'. With the moves to usher 'free trade' and emergence of a single global market, competition in all economic aspects is fierce – whether in product or financial markets. Enhancing competitiveness at the domestic levels implies providing greater space to other actors in undertaking economic activities. Participation in world markets requires firms and nations to be increasingly competitive in terms of improving efficiency and innovation. Hence, in the words of the ILO: "the ability to generate, while being and remaining exposed to international competition, relatively high factor incomes and factor employment levels on a sustainable basis" may be taken as a simple definition of competitiveness. It denotes the ability (of individuals, households, firms, industries and nations) to compete in global markets as well as to withstand competition at home. With competitiveness, localities specialize in their own areas of expertise. What about the global dimensions of competitiveness (Kaplinsky, 1998: 13)? If the industries that are losing position to foreign rivals are the relatively productive ones in the economy, a nation's ability to sustain productivity growth is threatened and their competitiveness is eroded (Porter, 1990: 8).

The notion of competitiveness suggests that resource endowments cannot be a criterion in determining outcomes if they are not productively employed. Hence, comparative advantage cannot be considered the sole criterion by which the economic problems of 'what, how and for whom to produce' are based. This is due to the fact the geo-economy is constantly changing through changes in patterns of demand and nature of product, among others. As stressed by Porter (1990), nations must nurture 'competitive advantage' so that their possession of various assets and attributes at the level of firm/industry/sector/ gives them an advantage over rivals: such advantages lie in new ideas resulting in innovative approaches. Enhancing competitive advantage is the result of efforts at micro, meso and macro levels. There must be coordination between various actors and the interplay of factors like enabling factor conditions, demand conditions, related/ancillary industries and firm strategy/structure and rivalry. With the four critical embedded factors, enabling state policies facilitate the potential for the nation's products in both domestic and foreign markets. The presence of competitive advantage in international terms could be measured by a significant and sustained share of world

exports to a wide array of nations and/or foreign direct investment (FDI) reflecting skills and strengths created in the home nation.

It is thus held that complacency leads to erosion in competitiveness. Consider the dominance of the US and Europe for most consumer durable goods until the 1960s. Most brands of consumer goods (for e.g. cars) were produced in these two continents (North America and Europe). 'Fordism,' 'Taylorism,' mass production, division of labour, separation of ownership from workers and supply-driven production were hallmarks of production in the West. Since the 1970s, however, cars made in Japan (and later from South Korea) were able to successfully compete with American and European cars as they catered to a growing middle class in their respective countries but also created demand in other nations. Subsequently, Japanese firms have emerged as the leading players in the other segments of the consumer goods industry like electronics. When Best (1990) terms the situation of industrial decline in the UK and US coinciding with the rise of new industrial powers like Japan in the post war era as the 'new competition,' he drives home the point that even market leaders firmly ensconced in their areas of core competence cannot assume their position will remain so; they must not remain 'locked in' and continuous upgrading is essential as the geo-economy is constantly shifting. Competitiveness has implications that affect employment, incomes and production. New competitors are continuously attempting to catch up and overtake leaders in their areas of core competence. The situation has arisen mainly because business enterprises aided (by the state) improved their productive capability through both organization flexibility and a strategy of permanent innovation. The dimensions of the 'new competition' are: a collectively entrepreneurial firm; consultative coordination in the production (value) chain; competition and cooperation within the sector and a strategic industrial policy by the government (Best, 1990: 11-21). The 'new competition' requires flexibility in production processes, demand-driven production and networking, among others.

Competition is an inevitable process: it affects traditional small-scale producers as much as it does TNCs and nations. Insertion in global markets does not come *sans* competition. Studies have shown that producers with global linkages – whether shrimp cultivators in Bangladesh (Guimaraes, 1989), shoe producers in Agra, India (Knorringa, 1999), white marble miners in Macael (Barzelay: 1990, 1991) or surgical instrument manufacturers in Sialkot, Pakistan (Nadvi, 1999) – had little alternative but to respond to competitive

pressures by means of enhancing their competitiveness through upgrading and learning processes. Such pressures have heightened for developing countries in this era of globalization. While quality, price and delivery reliability (QPD) are the critical success factors (CSF) for being competitive, moving into higher value-added activities gives some firms or countries edges over competitors (Kaplinsky and Morris, 2001).

### **2.3 Core labour standards and trade**

Although globalization has intensified economic activities, it is widely considered to have led to inequalizing effects with respect to country, class, gender, race, urban/rural and age (Holm and Sorenson: 1995; Scholte, 2000). The experience of low-cost, labour intensive goods producing nations reveal such inequalizing effects. For countries that specialize in labour-intensive goods by drawing on additional labour reserves and non-observance of labour standards (by using forced and child labour), it is shown that increase in the endowment of unskilled labour enhances comparative advantage in labour-intensive goods (Busse, 2002: 1921-29).

There is also growing awareness of the need to tackle issues of global concern through a concerted and coordinated global effort. While the economic agenda is dominated by policies that 'let markets' work and 'get prices right', they do not always consider the social costs borne by society in the process of economic growth. Child labour is only a symptom of the vicious circle of poverty and is defined as labour performed by children under a minimum age.<sup>8</sup> Children have been found working in many activities in both the formal and informal sectors, often under exploitative conditions. In export-oriented sectors, child labour is rife in developing countries. By working, they have been forced to forego a decent childhood and are thus unable to have a secure future. Therefore, labour standards have been pushed at the centre of the new rules on international trade aided by government policies, consumer awareness and agendas of NGOs who demand the observance of core labour standards in the trade of 'credence goods'.<sup>9</sup> This has

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<sup>8</sup> The minimum age depends according to what each country has prescribed; ranging between 16 and 18. The ILO estimated that some 280 million children between the ages 5-14 were working (i.e. "economically active") in the developing world in 1995, out of which 120 million were working full-time (ILO, 2002: 15).

<sup>9</sup> In such goods, a core element of competition lies in consumer perceptions on ethical, social and environmental norms (Reardon, 2001 cited Nadvi and Waltring in Schmitz ed. 2003).



resulted in a rapid proliferation of global standards in these areas. Many of these standards have been influenced by multilateral initiatives and in the case of labour standards, by leading international institutions like the ILO (Nadvi and Schmitz in Schmitz ed. 2003). For child labourers who work in economic sectors, such interventions have intensified. As Nadvi and Waltring (2003: 1) remark: “There is heightened interest in global standards that are meant to address issues ranging from labour conditions, health and safety norms, quality management procedures to environmental and social concerns as various actors take a keen interest in these standards, notably consumers in advanced countries, INGOs, global buyers and producers and UN agencies.” To that list may be added national governments and supranational authorities like that represented by the US and the EU who claim that they are driven by concerns such as protecting the vulnerable (people of a particular age group or the environment).<sup>10</sup> The ILO Conventions provide the overall framework to promote social goals in the working of the global economy but the effort of international organizations like the UN, EU and the Organization for Economic Cooperation and Development (OECD) in trying to pursue the objectives of global social governance and corporate social responsibility (CSR) has gathered momentum in recent years.<sup>11</sup>

While adhering to the ILO’s conventions on child labour is universally accepted by member-states, the proposal to link the issue of child labour to global trade has intensified the debate between those who argue that such standards pose new forms of non-tariff barriers and those who view compliance as one path for developing countries to avert the pitfalls of globalization (this is relevant particularly in the case where developing country producers are locked into a relentless ‘race to the bottom’ strategy in which producers lower costs of production at the expense of workers’ welfare). It is argued that though trade liberalization is about freeing trade of the barriers that restrict market access – which has been implemented by developing countries as part of the

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<sup>10</sup> The EU defines the scope of fair trade as a means to ensure that producers, including employees, receive a share of the total profit commensurate with their input and to improve social conditions, particularly those of employees in the absence of developed structures for social services and worker representation. Governments of the economically advanced nations stress that their motive is based on the wider goal of fighting poverty, promoting economic and social development so that developing countries can be gradually integrated into the world economy (<http://europa.eu.int/scadplus/leg/en/lvb/r112508.htm>).

<sup>11</sup> The UN framed a Global Compact in 2000 on ‘corporate social responsibility’. Fair trade is one of the sectoral development policies of the EU. The OECD has framed Guidelines on Multinational Enterprises. They all agree on CSR as a cornerstone of sustainable development.

structural adjustment agenda – the developed countries have found new ways of protecting their markets. One such attempt is through the introduction of non-trade issues, like labour standards – especially the issue of child labour – into the trade agenda in order to counter competition against imports from low wage economies (Dasgupta, 2001). Those opposed to linking the issue of labour standards with trade point out that the West’s ‘moral argument’ case is selective in nature as child labour is among the many clauses dealing with core labour standards at the exclusion of enforcement of other conventions.<sup>12</sup> According to the WTO, many officials in developing countries argue that better working conditions and improved labour rights arise through economic growth suggesting that in the event of core labour standards becoming enforceable under WTO rules, any sanctions imposed against countries with lower labour standards would merely perpetuate poverty and delay improvements in workplace standards. Hence, the efforts to bring labour standards into the WTO represent an excuse for undermining comparative advantage of lower-wage developing countries ([http://www.wto.org/english/thewto\\_e/minist\\_e/min99\\_e/english/aat](http://www.wto.org/english/thewto_e/minist_e/min99_e/english/aat)).

Most member-states of the ILO by ratifying its conventions – (including 138 and 182) show their commitment – but still have a long way to go towards effective elimination of child labour. Governments, business and civil society have come together in initiatives against child labour especially in economic sectors where child labour is existent. In the carpet and garments industries, labelling has become one of the main channels to ensure that core labour standards related to children are being met. For example, NGOs foster sector specific codes and labels, and are implemented mainly through them and business partnerships with independent monitoring procedures and civil society participation (Nadvi and Waltring in Schmitz ed. 2003). The rise of consumer labelling initiatives like Rugmark, Care & Fair and STEP in the carpet sector requires adherence to core labour standards by not employing under-aged children and exploiting them.

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<sup>12</sup> Core labour standards are met if the 8 conventions of the ILO are met. The 8 conventions are outlined briefly. Convention 138 refers to the Minimum Age Convention (1973) whereas Convention 182 deals with the Worst Forms of Child Labour (1999). The other six ILO conventions are the following: Freedom of Association and the Right to Collective Organize Convention (1948); Right to Organize and Collective Bargaining Convention (1949); Forced Labour Convention (1930); Abolition of Forced Labour Convention (1957); Equal Remuneration Convention (1951); and Discrimination (Employment and Occupation) Convention (1958). The number of countries ratifying them are 139, 151, 160, 155, 156 and 154 (UNDP, 2003:250).

## 2.4 Immiserizing growth

Globalization offers the potential to raise economic growth rates significantly. But at the same time, it also exposes firms and economies to intense competitive pressures. Declining terms of trade can result, and in some cases this may lead to immiserizing growth, that is, an increase in economic activity which delivers lower standards of living. The result is growing unequalization, both between and within countries. These development pitfalls can be avoided if the productive sector develops the ability to withstand intensive competitive pressures that are associated with globalization.

(Kaplinsky, 1998: 2)

The paradox of globalization lies in that participation exposes producers to both opportunities as well as risks. In this context, it has been noticed that many developing economies that attempted to increase their growth potential through exports actually ended up being worse off than before. Firms, sectors and nations specialize in highly competitive markets where 'oversupply' causes prices to fall and where demand facing LDC exports tends to be price elastic. Although this phenomenon has long affected exports of primary products, those of manufactured goods have also experienced what is called 'immiserizing growth' (coined by economist Jagdish Bhagwati), which occurs as a result of the failure of individual firms, sectors and national economies to insert themselves appropriately into global markets (Bhagwati, 1958, 1963 cited in Kindleberger and Lindert ed. 1978). It is thus seen that LDC industrial growth, based on labour-intensive activities for the global market, does not provide the basis for sustained growth (Kaplinsky, 1998: 5).

What factors are responsible for immiserizing growth? In theory, growth requires increase in resources or increasing efficiency of existing resources. As most of the developing countries have surplus labour (mostly unskilled) and specialize in the production of labour-intensive good, by doing so there is increased economic activity, which creates employment and generates incomes. However, in the face of stagnant demand, suppliers are faced with falling prices for their product ultimately making the

growing and trading country worse off (Soderston and Reed, 1994: 68-69). As the good is also produced by other nations, any attempt at raising price leads to a decline in revenues. Depreciation or devaluation of national currencies make exports competitive but in the face of 'competitive devaluations' there is another 'race to the bottom' in which the value of exports become cheaper so that returns are falling. The World Bank's own study supports the empirical evidence for LDCs which have experienced declining prices for their manufactured exports relative to industrialized manufactured exports during the period 1975-95 (Wood, 1997 cited in Kaplinsky, 1998: 8).

The question therefore arises as to how the mode of insertion into the global economy should be managed to ensure that incomes are not reduced or further polarized? It is pointed out is that producers must 'upgrade' – by process, product and functional upgrading measures – where competition is absent or less severe and where new forms of rent shield producers from the possibility of immiserizing growth (Kaplinsky, 1998).

## **2.5 Value chain analysis**

Globalization has led to dispersal of economic activities especially in the sphere of production: "the world economy today is a 'global factory' in which the production of a single good commonly spans several countries, with each nation performing tasks in which it has a cost advantage" (Gereffi, 1994: 219). Hence, production is not location specific and activities can be coordinated by various actors in a production chain specializing in their own areas of comparative advantage and adding value at each stage of production. Therefore, the definition of a value chain as: "the full range of activities which are required to bring a product or service from conception, through the different sums of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use (Kaplinsky and Morris, 2001: 4) or as: "a trans-nationally linked sequence of functions in which each stage adds value to the process of production of goods and services (Gereffi, 1994: 7).<sup>13</sup> In fact, most products today are in one way or the other embedded in value chains.

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<sup>13</sup> The concept of 'global commodity chain' was introduced by Gereffi which are either 'buyer-driven chains' or 'producer-driven chains.' Producer-driven chains refer to those industries in which TNCs or other large integrated industrial enterprises play the central role in controlling production systems

As Kaplinsky and Morris (2001:8) point out, there are several aspects to be taken note of: “First, the several links in the value chain indicate activities which could be performed by actors who may not be located within a contiguous geographical territory. Second, each step in the chain reflects a growing division of labour and global dispersion of production in which systematic competitiveness becomes increasingly important. Third, efficiency in production is a necessary but not a sufficient condition for successfully engaging in production – by being a part of the value chain – for penetrating global markets.” Gereffi (1994) also speaks of production frontiers in which countries in ‘inner rings’ have higher higher-value added content as opposed to those at the periphery. Production costs also becomes cheaper as one moves towards the frontier. A dichotomy may be identified here if the chain has buyer-driven characteristics: developing country producers are specializing in labour-intensive goods (for example, in textiles or apparel) that are marketed by firms for consumption in industrialized markets or if some goods are sourced from TNCs to export-processing zones where production costs (of labour) are low. In either case, producers have to compete so that they are able to gain from insertion into the global economy. In most cases, developing country firms sell to ‘lead firms’ – importers, wholesalers and retailers – who due to their vicinity to world markets and closeness to global demands, standards and trends; exercise greater power in the relationship, described as ‘quasi-hierarchy’ (Humphrey and Schmitz, 2002: 1023). This is primarily done by the lead firm exercising a high degree of control over suppliers in the chain and also facilitating or hindering ‘upgrading’ for their suppliers in the developing world.

## **2.6 Conclusion**

This chapter examined the theoretical perspectives on globalization, competitiveness, core labour standards, immiserizing growth and value chain analysis. A link between the various concepts may be drawn.

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(including its backward and forward linkages). This is most characteristic of capital and technology-intensive industries like automobiles, computers, aircraft and electrical machinery. What distinguishes producer-driven production systems is that the control is exercised by the administrative headquarters of TNCs. Buyer-driven chains refer to those industries in which large retailers, brand name merchandisers and trading companies play the pivotal role in setting up decentralized production networks in a variety of exporting countries (Gereffi, 1994: 7). Examples of buyer-driven chains are apparels, textiles, shoes and carpets, among others. It is in the latter type of value chain in which lead firms or global buyers exercise greater control over suppliers.

Globalization of product markets has intensified competition for producers in most countries and sectors, particularly labour-intensive sectors (Knorringa and Schmitz, 2000: 177). For example, such competition has been depicted in previous studies like in the shoe industry in Brazil, China and India (Knorringa 1999; Knorringa and Schmitz, 2000); the furniture industry in South Africa (Kaplinsky et. al., 2002) and the surgical instrument cluster in Pakistan (Nadvi and Halder, 2002). However, the issue is also that some developing countries will find it difficult to compete effectively and will therefore be locked into processes of immiserizing growth (Kaplinsky et al., 2002: 1159). The above studies have pointed out to the importance of coordination among actors in the value chain, either through learning or upgrading for developing country producers. In order to survive (or to overcome immiserizing growth), upgrading is necessary; implying a multitude of tasks for the producers who have to adopt production processes that are more efficient and cost-effective; changes in the product itself (or moving up the value chain) and adhering to product standards to improve the quality of the product. Emerging standards on health, labour, environment and human rights also require firms to adopt best practices – so that production processes are consistent with those standards. With an understanding of the main trends, we now see how they have interacted in the product market for hand-made carpets especially in relation to the Nepalese carpet industry.

## CARPETS: SOME ASPECTS OF THE GLOBAL BUSINESS AND THE NEPALESE INDUSTRY

### 3.1 The global carpet industry: an overview

Carpets and other textile floor coverings – of which two broad types of carpets may be distinguished: machine-made and hand-made carpets – are categorized on the basis of various forms of industrial classification viz. Harmonized System (HS), International Standard Industrial Classification of All Economic Activities (ISIC) and Standard Industrial Trade Classification (SITC) codes.<sup>14</sup> HS lists as many as 22 types of carpets in the product group range 570110 to 570500 (<http://www.p-maps.org>). There are 13 sub-categories in the ISIC classification for the code 3214 (<http://www.unstats.un.org>). According to the SITC list, there are 6 sub-groups of carpets under the product code 659 (<http://www.unstats.un.org>).

As can be seen from table 1, at the three-digit SITC level (product group: 659 – Floor coverings etc.), the carpet industry had a total global export value of \$7.3 billion in 2001 (<http://www.intracen.org>). The major carpet exporters are the industrialized countries but this is only for machine-made category. As a labour intensive product, hand-made carpets are produced and exported from developing countries. The US and Germany are the two largest importing countries accounting for two-thirds of total global imports of hand-made woolen carpets.<sup>15</sup> During 1997-2001, the top 6 supplying countries to the US were India, Iran, Pakistan, China, Nepal and Turkey. Likewise; during the same period, the top 6 exporters to Germany included Iran, India, Nepal, Pakistan, Turkey and China. Entry of many producers implies that the carpet sector is becoming competitive. As a

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<sup>14</sup> The various categories of carpets are HS Code 570110 (Carpets of wool or fine animal hair, knotted); ISIC Code 3214 (Manufacture of carpets and rugs); and SITC Code 659 (Floor coverings etc.).

<sup>15</sup> For HS 570110 category and SITC 659, the main markets for hand-made carpets are United States, Germany, Italy, United Kingdom, France, Switzerland, Japan, Spain, Austria and Canada (Source: [http://www.p-maps.org/pmaps/productchampions\\_reporter.php?cu](http://www.p-maps.org/pmaps/productchampions_reporter.php?cu))

result, world prices are declining; total export value for SITC 659 fell from \$10.5 billion in 1997 to \$ 7.3 billion in 2001.

**Table 1: Global carpet trade - top 15 carpet exporting countries (US\$, 000)<sup>16</sup>**

Country	1997	1998	1999	2000	2001
Belgium	-	-	2,133,942	2,016,835	1,941,350
US	865,972	833,301	777,862	796,495	715,661
India	613,514	615,258	695,041	649,126	-
Iran	694,344	605,111	731,890	706,512	601,951
Netherlands	2,060,643	759,611	661,331	566,344	569,118
China	455,674	442,611	423,229	476,006	496,090
Germany	495,108	504,424	478,612	409,000	439,904
UK	471,693	404,836	384,041	375,233	353,251
Pakistan	197,202	209,190	243,762	282,021	265,187
Turkey	350,176	343,607	270,099	293,501	263,281
France	360,763	354,616	367,899	321,851	253,214
Canada	167,942	163,051	189,944	222,970	203,697
Nepal	155,700	128,929	146,269	146,356	110,200
Italy	129,326	136,943	128,460	122,657	125,393
Denmark	139,004	143,363	130,333	119,067	122,230
Total value	10, 546, 914	8, 935, 253	8, 953, 502	8,698,703	7,377, 779
Nepal's share in total (%)	1.47	1.44	1.63	1.68	1.49

Source: ITC, 'International Trade Statistics' (<http://www.intracen.org/tradsat/sitc3-3e/ep659.htm>) and World Bank, 'Nepal Development Forum Economic Update 2002' (<http://www.ndf2002.org>)

Note: (-) indicates non-availability of data

Despite recent falls in global prices, carpets and floor coverings are trade widely traded products. The industry organizes global fairs periodically such as the annual Domotex Fair in Hannover, Germany and at Atlanta in the US. In such events, the entire spectrum of carpets and floor coverings are exhibited: hand-made rugs and carpets, machine-made

<sup>16</sup> SITC Code 659: Floor coverings etc.



woven carpets, textile and flexible floor coverings etc. (cited in <http://www.domotex.de>).<sup>17</sup> Such exhibitions bring together manufactures, retailers, wholesalers, importers and consumers.

### *3.1.1 The hand-made carpet industry: features and issues*

The developing countries primarily specialize in hand-made woolen carpets: either hand-knotted or hand-woven which is characterized by labour-intensive production. Value of such category of carpets is estimated at \$ 1.926 billion in 2002.<sup>18</sup> Nearly all hand-made carpets are exported, with less than 10 per cent sold for domestic consumption.<sup>19</sup> Referring to table 1, the leading producers are India, Iran, China, Pakistan, Turkey and Nepal although the share of carpets in total exports varies country-wise.<sup>20</sup>

With so many competitors, what has been the experience for producing countries? It is observed that the annual growth of carpet imports into Europe has been declining since the past five years (see table 2). Consider the following figures published by the ITC (in the website <http://www.p-maps.org>):

- In the HS Code 570110 category, the value of world imports for the top 10 importing nations plummeted from \$1.6 billion in 1997 to \$1.3 billion in 2001 with imports experiencing an annual change in value (during 1997-2001) of -3.9 per cent.
- The annual growth rate in the importing nations has been negative in the nine out of the ten largest importing countries since 1997 (see Table 2). The import growth rates ranged from -13.22 per cent in Germany during 1997-2001 to -0.16 per cent in France during the same period resulting in the main supplying

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<sup>17</sup> Only recently – during November 4-6, 2003 – was the First World Conference on Handmade Carpets held in the Indian capital, New Delhi.

<sup>18</sup> The data was given in a news item of the Indian English daily – The Hindustan Times – in its website (<http://www.hindustantimes.com>) of November 4, 2003.

<sup>19</sup> According to the US Department of Labour, Bureau of International Labour Affairs (<http://www.dol.gov/ilab>)

<sup>20</sup> During 2001, the shares of carpets in exports of the main hand-made producing carpets were as follows: 0.2 per cent for China, 0.9 per cent for Turkey, 1.8 per cent for India, 2.6 per cent for Iran, 2.7 per cent for Pakistan and 22 per cent for Nepal (Source: ITC, UNCTAD/WTO in <http://www.p-maps.org>).

countries also to experience negative export growth figures in value. Only the top importer – the US – has not experienced negative annual growth figures.

- All the top exporters witnessed drastic shortfall in exports to Germany during 1997-2001. In value terms, these export growth figures were as follows: -10.51 per cent for Iran, -17.55 per cent for India, -13.55 per cent for Nepal, 2.29 per cent for Pakistan, -17.19 per cent for Turkey and -25.62 per cent for China.
- There were corresponding declines in quantity (measured as thousands of tons) supplied too. Iran, India, Nepal, Pakistan, Turkey and China exported 8,107 tons; 18,153 tons; 11,477 tons; 808 tons; 870 tons and 1,172 tons respectively to Germany in 1997. In 2002, the quantities of carpets imported by Germany from these nations were 6,678 tons; 11,423 tons; 6,123 tons; 1,111 tons; 530 tons and 338 tons.

**Table 2: Main carpet importing countries (value of imports of HS 570110 in \$, 000)**

Country	1997	1998	1999	2000	2001	Annual % growth (1997-2001)
US	301,775	387,421	440,666	557,542	510,925	15.57
Germany	612,105	561,268	467,771	403,094	364,917	-13.22
Italy	100,923	96,821	94,066	82,650	64,785	-9.03
UK	71,812	61,559	61,513	53,677	50,522	-7.79
France	41,202	42,171	43,600	39,008	43,959	-0.16
Switzerland	61,477	55,984	44,537	41,832	38,186	-12.31
Japan	58,769	38,637	34,511	36,036	32,800	-11.49
Spain	25,917	29,322	30,099	27,956	23,570	-2.20
Austria	47,622	35,155	33,006	27,808	23,502	-14.66
Canada	29,006	30,344	30,091	30,618	21,791	-3.96

Source: ITC, International Trade Statistics, ([www.p-maps.org/pmaps/productchampions\\_reporter.php?cu](http://www.p-maps.org/pmaps/productchampions_reporter.php?cu))

As hand-made carpet production is labour-intensive, there is a concentration of economies mainly competing on the basis of low costs (in the form of low wages). In all these countries, carpet making is a treasured and historic craft offering exciting contemporary design as well as traditional wares in hand-knotted, hand-woven and hand-

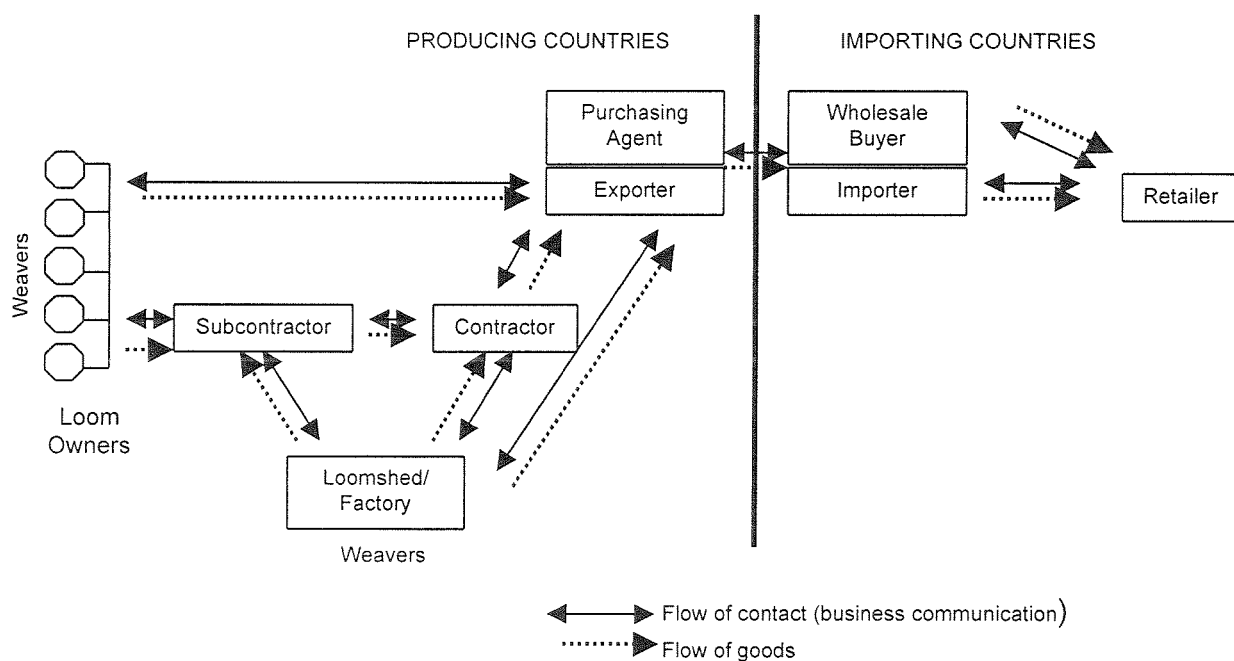
tufted rugs and other carpets (<http://www.domotex.de>). Craft involves both the uses of designs that reflect on culture as well as well as worker skill reflected in processing and quality.<sup>21</sup>

A chain of production and distribution exists among the supplying and buying nations. In the exporting nation, weavers who are employed by producers – either exporters themselves or who act as middlemen between owners and workers – weave the carpets. Exporters are linked to global buyers in the importing (and normally consuming) countries. In the value chain, several activities may occur within the exporting nation – from processing of raw materials to many tiers of the production process that is labour-intensive – but the country could depend wholly on a particular input (like raw materials) from outside. Buyers could be involved in one or multi-functions depending on whether they import, carry out wholesale or retail functions. Figure 1 illustrates the various tasks among producers and buyers in the global hand-made carpet commodity chain.

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<sup>21</sup> This depends on the amount of knots woven per square inch such 60, 80 or 150 knots. The higher the knots, the more processed is the hand-made carpet.

**Figure 1: Hand-knotted carpet chain of production and distribution**



Source: US Department of Labor, Bureau of International Labor Affairs ([http://www.dol.gov.ilab](http://www.dol.gov/ilab)), pp. 3

Figure 1 only presents a covert view of activities that actors in the value chain undertake as it depicts that both producing countries and importing countries are linked in a continuous flow of contact (business communication) and flow of goods. This trade relation links developing country firms to the global economy.

The sector is also characterized by fast-moving markets where suppliers have limited knowledge of market demands primarily because they are only concerned with production and export and do not undertake wholesale or retail functions: “The supplier’s limited knowledge of market demands may arise particularly in fast-moving markets characterized by innovation and product differentiation; this factor favours a quasi-hierarchical relationship because of the supplier’s limited competence and dependence on the buyers” (Humphrey and Schmitz, 2002: 1022). As the organizers of the carpet fair Domotex assert: “Responding flexibly and rapidly to changing market tastes, presenting new ideas in creative settings and offering professional after-sales service – this is what

members of the retail trade expect from today's floor covering manufacturers. Visiting trade professionals are consciously on the lookout for new sources of inspiration. Holistic concepts capable of wooing the consumer are in hot demand. Service and the ability to deliver are often more important than price" (<http://www.domotex.de>).

Can the factors on which producers participating in competitive product markets be identified? Most authors agree on some common elements based on their empirical research on buyer-seller links and manufactured exports from developing countries. The analysis here is adopted from Egan and Mody (1992), Lall (1991) and Keesing and Lall (1992). There is both consensus and recognition that producers must be able to supply at a 'competitive price' and that buyers demand 'quality goods' whose 'delivery' must be done when agreed upon. Although Egan and Mody (1992: 324) identify the 'inseparable triad' of price, quality and delivery (QPD) that buyers take in consideration in making purchasing decisions for their analysis of US imports of footwear and bicycles, these factors could be considered equally relevant from the viewpoint of any global buyer, including the hand-made carpet segment. These critical success factors (CSF) are corroborated by research findings of Keesing and Lall (1992) in the case of manufactured exports from East Asia in which exporters had to respond to competition by meeting price, quality and delivery standards (rapid delivery and a readiness to meet reorders). The authors also suggest that a country's trade arrangements providing easy access to imported inputs and free-trade regime for exporters (and preferably for local suppliers as well) are critical for manufactured exports (Keesing and Lall, 1992: 179). The hand-made carpet industry also displays characteristics of being 'design intensive' in which close and continuous information flows between design setters and manufactures is paramount (Lall, 1991: 141). Moreover, in the light of increasing emphasis on safety, labour and environmental standards, hand-made carpets could be said to constitute characteristics of 'credence goods'.<sup>22</sup> Since the last few years, the global hand-made carpet industry has been the focus of international attention as it was found that the sector (especially in Asia) has a high incidence of child labourers who were also reported to be subjected to what the ILO terms as 'worst forms of child labour.' With the advent of consumer labelling initiatives in the hand-made carpet industry since the early

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<sup>22</sup> The characteristics of such goods cannot be easily verified at the point of purchase. In the case of hand-made carpets, before the advent of labelling, consumers could not know whether child labour was used or not.

nineties; the lead firms in both Europe and North America – importers, wholesalers and retailers – are increasingly undertaking the dual function of also being licensees of the child labour initiatives like Care & Fair, Rugmark and STEP: which attempt at ensuring that carpet production does not involve children. The pressure for both suppliers and buyers to adhere to core labour standards in relation to child labour has come not only from consumer groups but also from NGOs, INGOs and official policies of states in which lead firms are themselves located.

## **3.2 The Nepalese carpet industry: an overview**

### *3.2.1 Background*

Since the middle of the 1950s, Nepal's attempt to industrialize first only through the planning mechanism and later by planning with liberalization has yet to deliver rapid growth with equity.<sup>23</sup> Due to its large primary sector, exports were composed mainly of food products and raw materials, which are gradually being replaced by manufactures. According to the World Bank (2002), the share of manufactures was raised from 24 per cent of exports in 1991 to 27 per cent of exports in 2002. During the past 15 years or so, the country has embraced economic liberalization and hence an open trade regime.<sup>24</sup> In the current era of globalization and competition, hand-made carpets thus represent Nepal's first foray into global product markets, which the country seeks to benefit from the viewpoint of its comparative advantage.

### *3.2.2 Growth*

As one of the few LDCs specializing in production of hand-made woolen carpets, Nepal was the 14<sup>th</sup> largest exporter of floor coverings but the 6<sup>th</sup> largest exporter in hand-made carpets during 2001. Nepal's share in world carpet exports is much lower compared to

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<sup>23</sup> Nepal was among the first 23 nations classified – on the basis of social and economic indicators – as a LDC by the World Bank in 1971. Three decades later (2001), living standards is still low, GNP per capita is the lowest in South Asia, poverty is widespread (42% of the population still live below the poverty line) and the country lies in the 'low human development' category.

<sup>24</sup> Trade in goods as a share of GDP reached 40% in 2001. Nepal's accession to the WTO occurred at the Ministerial Conference at Cancun, Mexico in August 2003.

that of India, Iran, China, Pakistan and Turkey but the significance lies in its being among the leading export commodities for the impoverished Himalayan kingdom.

Weaving is an age-old tradition especially in the mountainous regions of Nepal. However, the origin of hand-made carpets in the organized sector is relatively new, assuming its modern form only a couple of decades ago. The triggering event was the Chinese invasion of Tibet in 1959, which brought thousands of Tibetan refugees to Nepal. Credit goes to the Swiss Agency for Technical Assistance (SATA) which, through financial and technical support to the resettlement programmes for the refugees, initiated carpet weaving as a source of livelihood for them. In 1964, the first commercial shipment of woolen carpets was exported from Nepal (FNCCI, 2003). During the course of the three decades (1964-94), the industry has gained a foothold in global markets. Labour is the only domestic input to the value chain whereas the wool used to make the yarn is imported from New Zealand, Australia and China (from Tibet). The dyes and other chemicals that are used for carpet dyeing and washing are imported from Europe. Most of the cotton thread used as a base for carpet weaving and almost all of the machinery used during production (like carding of wool) have to be imported from India (Sitaula, cited in <http://www.panasia.org.sg/nepalnet/economics/carpets.htm>).

Production undergoes various processes like wool sorting and washing, carding, spinning, dyeing, carpet-knotting, trimming, washing and drying, final finishing and packing for export. The carpets contain a high degree of hand processing and qualities range from 60-150 knots per square inch. Although Buddhism has traditionally influenced the designs, in recent years manufacturers have also introduced modern design and colours with present day market tastes. The hallmark of carpets is the amalgamation of Nepalese and Tibetan cultures in design. Sizes range from 0.25 square metres to 56 square metres (CCIA, 2003).

Since 1991, Nepal's liberalization process has involved deregulation and greater role for the private sector.<sup>25</sup> New legislations like the Industrial Enterprise Act 1992 and Foreign

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<sup>25</sup> New economic policies encouraged private investment. The World Bank points out that Nepal's economic performance improved in the 1990s with per capita income growth increasing to more than 2.5%, as the economy responded to macroeconomic stability after the first round of liberalization (The World Bank, 2002).

Investment and Technology Transfer Act 1992 provided incentives in import duties and lowering income taxes. Policies like lowering of entry barriers resulted in the industry being led by the private sector.<sup>26</sup> It is also estimated that around 95 per cent of the carpet factories are concentrated in the capital and surrounding districts comprising Kathmandu Valley; where it emerged as a veritable source of low-wage employment for unskilled labourers migrating to the nation's only metropolis because of rural unemployment and acute economic dualism. However, it is reported that workers could not join labour unions because of the private sector nature of the industry and also because they could not afford straining relations with employers on whom dependence for eking out a living was overwhelming.<sup>27</sup>

The late 1980s and early 1990s thus witnessed a phase of uncontrolled growth of the industry in the capital Kathmandu where carpet factories sprung up in every locality. Such uncontrolled growth also put pressure on civic infrastructure. While some private carpet industries had been operating for years, the emergence of new ones may be seen in the light of growing demand for the good in global markets. Its classification as a cottage industry meant that it enabled small-scale producers to enter the sector. Table 3 highlights some statistics relating to carpets in relation to the manufacturing sector. It is worth noting that during 1994/95, the carpet sector accounted for a quarter share of employment, wages and value-added in the manufacturing sector.

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<sup>26</sup> The government's classification of industries – based on amount of fixed assets – makes the carpet sector a 'cottage industry' but expanding firms have moved to the category of medium and large enterprises. In 2000, the number of carpet firms registered with the Ministry of Industry and Commerce reached 1,238 whereas the CCIA had a membership of 377 at the beginning of 2002. While the CCIA is a trade representative body, Nepal Carpet Exporters Association (NCEA) is the forum of carpet exporters.

<sup>27</sup> The Foreign Investment Promotion Section, Ministry of Industry, Commerce and Supplies of HMG/N has listed industrial factor costs (<http://www.yomari.com/fips/factor/factor.html>). Carpet workers could be considered to be living close to the poverty line and receiving subsistence wages. Considering the monthly wage rate between NPR 2, 500 for unskilled labour and NPR 4, 000 for semi-skilled labour (factored by the S exchange rate of \$1 = NPR 75 during 2002), they earn between \$ 33.34 and \$ 53.34 per month.



**Table 3: Principal indicators for NSIC 3214: Manufacture of carpets and rugs, (1994/95)<sup>28</sup>**

Indicators	Quantity	% of total manufacturing sector
Establishments (in number)	719	16.02
Employees (in number)	56, 227	24.43
Wages and salaries (in '000 NPR)	1, 094, 190	26.04
Change in stock at the end of year (in '000 NPR)	216, 079	24.46
Census value added (in '000 NPR)	5, 350, 769	25.99

*Sources:* HMG/N, *Statistical Yearbook of Nepal 1997*, Central Bureau of Statistics, pp. 354 (Calculations for column 3 made by author)

The value of carpets has surged from negligible levels in the early 1970s to account for more than half the share of total exports by the mid-1990s (see Table 4).<sup>29</sup> During 1990 to 1994, the share of carpets in total exports expanded dramatically with production reaching a pinnacle in 1993/94 with the value of carpets tripling in three years. Indeed, the export of carpets worth NPR 9.5 billion (\$ 190 million) comprised half of all Nepal's exports of NPR 19.5 billion (\$ 380 million) for that fiscal year. Germany has remained Nepal's largest market for exports although exports to the US are also growing.<sup>30</sup>

<sup>28</sup> NSIC refers to National Standard Industrial Code.

<sup>29</sup> The share surged from 4.7 per cent of total exports in 1974/75 and peaked at 55 per cent of total exports in 1992/93. The corresponding increase in quantity was 10,000 square metres in 1972/73 to 33, 25, 123 square metres in 1993/94.

<sup>30</sup> In 2001/02, Germany's share in Nepal's carpet exports was 64% followed by the US, which imported 16% of Nepalese carpets. Reports reveal that the share of the German market was 80 per cent in 1993/94.

**Table 4: Quantity and value of carpets exported from Nepal (1972/73 to 2001/02)**

Fiscal year	Quantity (square metres)	Value, NPR (millions)	Value S (millions)	Share of exports (%)
1972/73	10, 000	2, 472	-	4.7
1982/83	1, 51, 000	1, 37, 756	-	-
1990/91	-	37, 02, 000	87.2	50.1
1991/92	-	71, 31, 000	166.1	52.0
1992/93	31, 26, 290	95, 25, 649	192.1	55.2
1993/94	33, 25, 123	95, 18, 055	190.0	49.3
1994/95	28, 96, 090	77, 03, 760	154.5	43.7
1995/96	26, 17, 645	80, 32, 233	147.9	40.4
1996/97	28, 91, 225	91, 44, 635	155.7	40.4
1997/98	24, 47, 050	85, 16, 344	137.0	35.59
1998/99	26, 04, 476	102, 87, 749	144.3	31.27
1999/2000	25, 09, 452	99, 65, 560	142.5	21.69
2000/01	22, 42, 693	82, 22, 667	110.2	17.9
2001/02	16, 93, 197	62, 77, 646	86.1	-

Sources: CCIA ([www.nepalcarpet.org](http://www.nepalcarpet.org)), The World Bank ([www.ndf.org](http://www.ndf.org)), HMG/N (1999, 2001 and 2003). (-) indicates non-availability of data

### 3.2.3 Decline

For two consecutive decades – 1981-91 and 1991-2001 – Nepal’s average annual growth of GDP per capita has remained at 2.4 per cent (World Bank, 2002 in <http://www.worldbank.org>). It has been observed that in such a situation of static output, the share of the predominant export item grows in relation to total exports. Similar to the experience of South African furniture exports, it can also be concluded that the Nepalese carpet industry became an increasingly effective participant in global markets “with external demand being the most dynamic component driving domestic production” (Kaplinsky et. al., 2002: 1170).

Since 1994/95, the sector experienced a slowdown in export growth to the main market Germany. It is reported that total exports that year declined by 34 per cent, orders were cancelled leaving a high amount of unsold stocks forcing eventual closure of several carpet units. The reasons for the sector to be in the throes of a crisis and weak performance suggest the interplay of multiple factors. Global buyers of hand-made base their purchasing decisions from suppliers based on three main criteria: the 'inseparable triad' of price, quality and delivery. In what criteria did Nepalese manufacturers fail to perform? Did the 'credence good' characteristics of Nepalese hand-made carpets contribute to its decline? For a sector with rapidly changing tastes and trends, a comparison of assessment by actors in the value chain (buyers in various importing nations) was undertaken. The following sets of evidence are relevant in explaining some of the possible explanations for declining exports.

The first set of evidence comes from lead firms based in Europe who were asked to identify the main reasons for the 1994/95 crisis in the Nepalese carpet industry. One importer felt that: "Nepalese carpets were not able to compete on price in global markets as competition was intense." An importer/wholesaler pointed out that: "intense domestic competition led to low quality exports." A retailer reconfirmed that "Nepalese suppliers used poor wool in order to compete with India but there was also a change of fashion and lack of interest in area rugs." One of the interviewed respondents believed that the allegations of the Nepalese carpet industry using child labour hit the industry just as production peaked whereas another interviewee replied that the industry suffered because of the arrival of a substitute product: 'Indo-Nepalese' carpets. Indian designers had also learnt to make carpets with the Tibetan style and which were cheaper than Nepalese carpets.

The second set of evidence emanates from industry representatives, supplying firms and an international consumer labelling organization in Nepal (see table 5). According to a former president of CCIA, the main reasons behind the collapse could be traced to: "overproduction and the allegations of the widespread use of illegal child labourers who were exploited in the making of carpets that became a concern for carpet consumers in European countries" (cited in Sitaula, 2001 and in NRF, 2003). Analyzing the reasons for the present downfall of the Nepalese carpet industry, another head of CCIA blames the unprofessional people who plunged into it (the carpet sector) after 1990: "all sorts of

people with some money to invest (e.g. bureaucrats, technicians) have started carpet business. The result was inefficiency and overproduction of sub-standard goods. Then there was the Azo-dye issue and the child labour issue” (in *New Business Age*, January 2002 issue). It is also believed that due to the long unregulated Indo-Nepalese border, some Nepalese producers sourced production in Indian territory to avail of low labour costs which not adhere to quality standards.

Similarly, the industry was asked through its representative to identify the causes for the decline in the mid-nineties (see Table 5). Asked as to what extent did the child labour issue affect the carpet industry a leading consumer labelling programme said that the factor was only “somewhat” responsible.

**Table 5: Industry’s perception of causes for decline in Nepalese carpet industry**

Rank	Factors
1	Poor quality exports
2	Indo-Nepalese carpets
3	Intense global competition
4	Child labour in Nepal’s carpet sector
5	Infrastructure bottlenecks
6	Intense domestic competition

*Source:* Questionnaire from representative of carpet trade association

Notwithstanding the evidence, what is certain is the sharp decline of the sector whose impact has been severe. In table 6, a comparison of the carpet sector’s contribution is made: not only have many firms have exited the industry; the sector shows all symptoms of decline in terms of income, investment and production.

**Table 6: A comparison of carpet sector indicators between 1994/95 and 1999/2000**

Years	Number of establishments	Number of employees	Wages and salaries (in '000 NPR)	Gross fixed assets at the end of year (in '000 NPR)	Census value added (in '000 NPR)
1994/95	719	56, 227	1, 094, 190	-	5, 350, 769
1999/2000	404	218	5, 267	26, 008	57, 330

Sources: HMG/N, *Statistical Yearbook of Nepal 1997*, pp. 354 and *Statistical Pocketbook Nepal 2002*, pp. 179-187, CBS

From the evidences, it can be fairly concluded that Nepalese suppliers who were placed in the global carpet value chain were unable to meet two among the three criteria in the 'inseparable triad:' quality standards were eroded and price competitiveness was also lost. Producers who are exposed to international trade are required to be meet price and quality standards but the liberalization of the sector also brought in many so-called 'fly-by-night' operators who were out to reap profits without adhering to basic rules for sustainable success. This was a classic case of a 'zero-sum game' where one's gain was at the loss of another. Consequently, the whole industry suffered. Child labour allegations deteriorated export prospects as the good in question – carpets – could not prove its credibility. The industry was unsuccessful in assuring buyers it did not employ a high number of children.<sup>31</sup> While concentration of producers had already led to stiff

<sup>31</sup> The earliest estimate of the incidence of child labour in the carpet industry was carried out by the child welfare NGO called Child Workers in Nepal Concerned Centre (CWIN). Based on a sample survey conducted in 1992, CWIN estimated the number of children working in carpet factories of Kathmandu Valley as 150,000 or 50% of the total workforce. Its 1992 report was titled 'Carpet Factory: A Source of Foreign Currency and the Misery of our Children.' The official estimate by His Majesty's Government of Nepal (HMG/N) the following year put the percentage of child workers in the carpet industry at 9% only. The Ministry of Labour published this in the report 'A Glimpse of Carpet Industries in Kathmandu Valley' in July 1993. A report published in 1994 by the Asian-American Free Labor Institute (AAFLI) - AAFLI (1994), *Nepal Report* - on the basis of a sample survey found that at least 30% of the workers to be under 14 years of age. Regardless of the various estimates, as employment of workers below 17 years of age was forbidden as stipulated by the Children's Act 1992, the carpet sector stood guilty of breaching domestic laws. Moreover, although the government had expressed its intention of ratifying ILO Conventions related to abolition of child labour viz. Convention 138 (Minimum Age Convention, 1973); it clearly showed not only the lack of commitment but flagrant violation of international norms. It thus became easier for human rights organizations dealing with child welfare to accuse the industry of corporate irresponsibility and the state of allowing laws to be undermined for the sake of economic gain.

competition, erosion of competitiveness eventually caused declining returns for the good and its displacement by other commodities as the leading export item.

### 3.3 Post-decline phase and upgrading measures

The Nepalese carpet industry experienced a phase of growth followed by a period of rapid decline. We saw how it responded to competition by engaging in a ‘race to the bottom’: the ‘inseparable triad’ was violated and child labour was used as it supposedly improved comparative advantage. The sector has now lost its position as the leading export item to another labour-intensive commodity – garments – in recent years.<sup>32</sup> Nevertheless, it would be useful to see how the carpet sector responded to competitive pressures.

The hand-made carpet industry – especially in South Asia (India, Nepal and Pakistan) – has been one of the arenas of public action for curbing child labour where the campaign has been led by NGOs, human rights groups, donors and by governments who argue that human rights and labour standards are key issues in any debate of trade and development. They have highlighted the scale of child labourers toiling in carpet looms often under exploitative conditions subsequently drawing media attention that was instrumental in influencing public opinion.<sup>33</sup> Producers, exporters and importers feared that the adverse publicity would harm the industry. Their concerns provided an impetus for new efforts – including consumer labelling programmes – to address child labour and check any disruption to business. Actors in these efforts include carpet manufacturers, exporters, importers, governmental, NGOs and international organizations. While some of these groups focus on the removal of children from the carpet industry, others work to address the wider socio-economic conditions that lead children to seek work. However, all wish to improve the image of the hand-made carpet industry that provides livelihood to millions of families in South Asia and income and profits for exporters and importers

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<sup>32</sup> In 1999/2000, garments overtook carpets with 28% share in total exports (The World Bank, 2002).

<sup>33</sup> The New York based Human Rights Watch quotes the US Department of Labor which published a report titled *By the Sweat and Toil of Children: The Use of Child Labor in American Imports, A Report to the Committees on Appropriations, United States Congress, July 15, 1994*. The child labour issue is also raised by Global March, BCFED and Human Rights Watch.

throughout the world (US Department of Labour, 2003: 5).<sup>34</sup> With consumer labelling, it has become easier for 'credence goods' such as hand-made carpets to meet labour standards and is gaining increasing importance. It also requires third party monitoring through certification bodies. According to the CCIA, around 70 per cent of carpets exported from Nepal now have some sort of labelling indicating the non-use of child labour.

Value chain research stresses that insertion into the global economy can either take the form of a vicious circle or 'race to the bottom' resulting in declining income growth; the alternative could be a virtuous circle leading to sustained income growth (Kaplinsky and Morris, 2001: 37). It is argued that upgrading processes (process, product and functional) can ease competitive pressures. As India and Pakistan are also participating in consumer labelling, the competition in the hand-made woolen carpet chain has again entered a level-playing field. The evidence from the Nepalese case suggests that upgrading is occurring at various levels but policy obstacles are widely prevalent.<sup>35</sup> Developing countries that have attained intermediate degrees of success in exporting manufactured products require assistance (Keesing and Lall, 1991: 187). It is encouraging to note in this respect that the EU – which is Nepal's largest carpet export destination – is facilitating process and functional upgrading for Nepalese carpet manufacturers with the aim to improve export supply capabilities and ways to market these capabilities.<sup>36</sup>

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<sup>34</sup> The outcome was the creation of various global non-profit initiatives against child labour in the carpet industry through consumer labelling. The initiatives are two fold: individual product labelling as done by Rugmark and company certification measures followed by Care & Fair and STEP. Such efforts acquire significance for 'credence goods' by certifying that labor standards were met. It was subsequently reported that mainly due to the success of the labelling initiatives, the incidence of child labour in the industry has gone down substantially in Nepal. According to a recent ILO estimate, there are 0.84%, 8.25% and 12% child labourers below 14, 16 and 18 years respectively in the Nepalese carpet industry (based on personal communication with NRF in October 2003). Besides, HMG/N has shown its intention of meeting abolishing child labour in the country by ratifying both related ILO Conventions – the Minimum Age Convention (Convention 138, 1973) in 1997 and Worst Forms of Child Labour Convention (Convention 182, 1999) in 2003 (Source: <http://www.ilo.org>). In November 2003, a pact was signed between Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and the ILO to run programmes with the aim to abolish child labour in the industrial sector.

<sup>35</sup> The next chapter: 'Findings and survey results' deals with perspectives of buyers and suppliers, including policy hurdles.

<sup>36</sup> Since April 2002, the EU has been running a 30-month programme – Upgradation of the Nepalese carpet industry – vis-à-vis its Asia-Invest Programme. The aim is to upgrade quality standards through advance carpet designs as per the needs of European, American and other selected Asian countries and weaving, graphing, dyeing and marketing training measures. According to an industry source, the completion of the programme would help Nepalese carpets 'regain competitiveness.'

### 3.4 Conclusion

By virtue of having a vast and unskilled labour force, the Nepalese carpet industry specialized in the production of a labour-intensive product: hand-made woolen carpets, which occupied the position of leading export commodity in the 1990s. Deregulation policies opened the sector to many new entrants aiming to benefit by producing for the global market and hence to realize profits. The sector as a whole attempted to improve its comparative advantage by engaging unskilled labour, which is abundant in the economy. The use of child labour for enhancing comparative advantage in labour-intensive goods must also be seen in this light. However, producers who were inserted into global value chains were increasingly unable to meet price and quality standards that are deemed essential for maintaining competitiveness and were hence becoming uncompetitive. With the rise of initiatives against child labour in international trade, the 'credence good' characteristics of the product put further pressure on domestic producers. In the mid-1990s, a crisis hit the sector in which demand fell from lead firms leading to loss of markets. Furthermore, not only has carpets been displaced as the chief export item, indicators for production, investment and incomes also reveal decline.

The above episode led the Nepalese carpet sector to firms to learn from experience. Various learning processes are now underway and upgrading measures are being undertaken. With the advent of consumer labelling initiatives, the sector is attempting to meet international assurance standards with regard to child labour. Child labour is now completely banned and by participating in such initiatives, producers attempt to assure buyers. Compliance with such services reduces costs for firms involved in the production of 'credence goods'. Local institutions such as trade associations with the help of labelling bodies are also playing an important role in ensuring that child labour is eliminated from the sector. The exit of many firms has also left no options for existing ones but to adhere to price and quality standards; production is increasingly for orders rather than for inventory. Public support measures attempt at enhancing suppliers' capabilities to upgrade into higher value-added activities. But what are the issues that are perceived by actors in the value chain and where does the Nepalese carpet industry go from here?



## FINDINGS AND SURVEY RESULTS

### 4.1 Purpose

It is known that in buyer-driven commodity chains like the hand-made carpet industry, production is labour-intensive at the manufacturing stage. Businesses (i.e. global buyers and lead firms) also do not own any production facilities but rather merchandize the branded products they sell. There are also high barriers to entry that allow backward and forward linkages to be controlled by core industrial and commercial firms (Gereffi, 1994: 218). With the entry of new actors whose agenda is to facilitate the enforcement of core labour standards, how do actors in various parts of the chain view issues due to their structural differences?

Chapter 3 examined the main issues for the Nepalese carpet value chain on the basis of both primary and secondary data. In this chapter, the issues are analyzed through primary data from questionnaires and interviews conducted with various actors (see Annexures 1 and 2 for respondents and 3, 4, 5 and 6 for questionnaires). It is not only attempted to present the views of suppliers, lead firms, trade associations and labelling bodies but to use the theoretical framework in the background to situate the issues more clearly.

### 4.2 The actors

The survey of actors involved the following respondents:

- European global buyers/lead firms (importers, wholesalers and retailers) who also participate in consumer labelling programmes (Care & Fair, Rugmark and STEP).
- Nepalese exporters participating in the above consumer labelling programmes.
- Representative of the Nepalese carpet trade association viz. CCIA.
- Representative of a consumer labelling programme viz. NRF.

As Europe is the prime market for Nepalese carpets, the lead firms were chosen only from the continent. Of the 5 lead firms who responded to questionnaires, 2 were importers and wholesalers, 1 was an importer and retailer, 1 was only an importer and 1 was a retailer. These three firms were also licensees of two consumer labelling initiatives viz. Care & Fair and Rugmark. All the respondents contacted were senior managers in their respective companies. Only 4 carpet exporters in Nepal replied to the questionnaire. These respondents – all who were owners and also managers of their firms – included licenses of the three main consumer labelling programmes. There was also diversity among the suppliers as 2 manufacturers belong to the small scale category whereas 2 are large enterprises. The small-scale exporters participated in the same consumer labelling programme (Rugmark), 1 of the large exporters participated in another (Care & Fair) whereas another large exporter participated in all consumer labelling programmes (Care & Fair, Rugmark and STEP).<sup>37</sup> Other respondents are an official of the carpet trade association viz. CCIA and another official from the consumer labelling body viz. NRF.

The respondents in the ‘lead firm’ side of the value chain included all categories of buyers – importers, wholesalers and retailers – whose functions are defined by Egan and Mody (1992: 322-324): “Retailers buy finished products directly from foreign manufacturers, often maintaining networks of international representatives to both seek out potential suppliers and maintain overseas buying offices. Importers/wholesalers buy from foreign manufacturers for resale to either retailers or to other intermediaries; specializing in importing, market identification and development of new sources of supply. Some importers also develop design specifications for products.” In value chains, “buyers play a pivotal role in connecting producers to final consumers in other countries and in almost all cases, these buyers tend to be located in the major importing countries (Kaplinsky et. al., 2002: 1163). The view of global buyers of Nepalese carpets based in Europe – which had a share of almost 80 per cent of Nepalese carpet exports in 2001/02 – assumes relevance in this context.<sup>38</sup>

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<sup>37</sup> The proprietor of one of the small-scale exporting firms was elected to the post of general secretary of Rugmark International in January 2002 during the Rugmark International Conference in Hannover, Germany (NRF, 2003: 55).

<sup>38</sup> The shares of countries in Nepalese carpet exports are as follows: Germany (64%), Belgium (4%), Switzerland (3%), UK (3%), The Netherlands (3%), France (1%) and Austria (1%). The data is based on statistics published by the Nepalese carpet trade association, CCIA (<http://www.nepalcarpet.org>).

### **4.3 A comparison of hand-made carpet producing nations**

All 5 global buyers revealed that they imported hand-knotted carpets from the one or more of the following countries: China, India, Iran, Morocco, Nepal and Pakistan. Asked about what characteristics made Nepalese carpets distinguishable from woolen carpets from other countries, one importer/wholesaler said that it was: “due to the style of design represented by the Tibetan knot and the colour because of the wool qualities.” In the view of an importer, it was: “the handmade and hand-knotted factor.” An importer/retailer opined that with Nepalese carpets, there was: “the possibility of making custom orders quickly.” For one importer/wholesaler – who stated that customer preferences for Nepalese carpets was “very good” – Nepalese carpets accounted for 28 per cent of the sales turnover in 2002 (the share of China was highest with 36 percent, followed by India with 28.49 per cent Morocco with 4.75 per cent, Iran with 2.23 per cent and Pakistan with 0.46 percent). The shares of carpet imports from Nepal and India for the same period were 60 per cent and 40 per cent respectively for another importer. Nepalese carpets made up only 10.2 per cent of imports for one importer/retailer (Indian carpets occupied 42.85 per cent, Iran made up 19.63 per cent and the remaining 27.32 per cent imports were from other countries). One of the interviewed importers/wholesalers was of the opinion that China’s rapid industrialization would lead to wages increases and the country would lose its advantage as a low-cost manufacturer of hand-made carpets in the coming years.

### **4.4 Buyer-seller links in Nepalese carpet value chain**

Nepal’s participation in the hand-made carpet woolen global trade spans almost four decades. In 2004, the Nepalese carpet industry will mark the 40<sup>th</sup> anniversary of its export regime. Trade in the good has linked Nepal carpet manufacturers to buyers in industrially advanced countries. How do the actors – buyers, suppliers and others – perceive issues in the value chain?

#### *4.4.1 Business ties*

Business ties bind global buyers to developing country suppliers. It is held that in buyer-seller relationships, benefits are maximized when the relationships are collaborative and

long term with performance and trust acting as key indicators (Egan and Mody, 1992: 321). Price, quality and delivery have been identified as the key criteria on which buyers choose their suppliers but business requires upgrading on these and other fronts. A few observations from the links between Nepalese carpet manufacturers and their global buyers in Europe are illustrated.

Questionnaires and interviews suggest that carpet buyers and manufacturers are engaged in a process of mutual learning through continuous communication that seeks to expand capabilities of suppliers and improve the competitiveness of Nepalese carpets. Interaction occurs at various levels. First: “Buyers, before placing an order, come to visit the enterprise, inspect its showroom and samples of products already made, study its plant in operation, and talk with the management and know-how. They also check with other sources on the firm’s reputation and experience, performance, credit standing, financial position and the like. In turn, local entrepreneurs learn to find out quickly about the buyers, and become educated on various kinds of buyers. They also learn to take the initiative in finding and approaching suitable ones, taking with them samples of their previous output (Keesing and Lall, 1992: 183).” Visits were also deemed to be beneficial for cementing business ties. Such interaction provided feedback for one small-scale manufacturer. Second: “Buyers also use trade fairs and conferences as sources of information. Since buyers inspect products at trade shows and product exhibitions, the burden is on potential suppliers to make good presentations. Buyers also undertake visits to suppliers’ factories to assess logistical and human resource capabilities of supplying firms (Egan and Mody, 1992: 329).” Third, buyers also aid suppliers in overcoming marketing barriers – defined as those gaps which need to be filled before the competitive producer becomes a successful exporter – for developing country manufactured exporters (Lall, 1991: 138). Such barriers may be pre-shipment barriers like product design; product quality, production, packaging and presentation; and shipping delivery while exporters also face post-shipment barriers in wholesale, retail, after-sales service and brand-name promotion. It is the influence of lead firms in removing such obstacles that the value chain is one of quasi hierarchy wherein the onus lies on suppliers to upgrade accordingly to maintain and enhance competitiveness.

All suppliers responded that buyers helped them in overcoming ‘pre-shipment barriers.’ As is known, the hand-made carpet industry has a high design content requiring

upgrading in production capabilities, in gaining information on designs and in final distribution and retailing. Suppliers replied that visits by buyers “provided a chance to work together on colour combinations and samples”; “gave insights into prevailing trends in designs and business environments in their local markets”; “strengthened business relationships”, “buyers usually visited to place orders”; “visits laid the groundwork for exhibitions and shows” and also to be “assured that suppliers were maintaining labour standards and promoting corporate social responsibility.” Suppliers in Nepal reported participating in international trade fairs in carpets and floor coverings – at both Hannover and Atlanta – to expose themselves to global markets. For one small-scale exporter, such participation was “very useful.” In the view of an exporter in the large-scale, participation in such events was useful in “getting an idea about trends in design and colour combinations, establish contacts that may lead to purchases later and market/promote the company.”

#### *4.4.2 Buyers’ perceptions of suppliers’ capabilities*

How do they observe and assess suppliers’ capabilities and efforts in being competitive? Do buyers help suppliers in upgrading as well? Three global buyers were asked to assess the performance of global suppliers based on the following criteria: quality, price, design, delivery, marketing and labour standards.<sup>39</sup> The scores are given as the following tables (7 and 8) reveal:

**Table 7: Buyers’ assessment of suppliers’ capabilities from China, India, Iran and Nepal**

Criteria	China	India	Iran	Nepal
Delivery	5	3	2	4
Marketing	3	1	1	1
Meeting labour standards	4	3	1	3

*Source:* Questionnaire from respondent (importer/wholesaler)

<sup>39</sup> The scale was is 1 (implying poor) and 5 (excellent). The limitation is that of the two global buyers who responded (one importer and one importer/wholesaler), none did so fully. The result is a fragmented picture although some comparisons can be comfortably made. Another respondent for table 7 felt that a comparison

**Table 8: Buyers' assessment of suppliers' capabilities (India and Nepal)**

Criteria	India	Nepal
Quality	4	4
Price	4	3
Design	3	3
Delivery	4	3
Marketing	1	1
Meeting labour standards	2	3

*Source:* Questionnaire from respondent (importer)

Interaction with the two interviewed buyers broadly suggested similar assessment made by the above two respondents. Let us examine each of the above 5 criteria (based on table 8).

- *Quality.* Reflecting on the 1994/95 episode, it was known that poor quality exports were one of the leading factors that led to the sector's decline. During the period after 1995, there has also been an exit of many exporters. The Nepalese carpet sector was now on a learning curve and carpet quality was of "good standard that did not require much improvement", one interviewed leading importer/wholesaler of Nepalese hand-made carpets felt. Current suppliers are more conscious of quality, delivered only for orders so that there was not stock of inventory.
- *Price.* Competition in hand-made carpets is intense with so many suppliers competing on the basis of competitive prices. The industry believes that price-related factors also eroded Nepal's competitiveness in 1994/95, a view echoed by a leading Germany importer who felt that a cause of the decline was due to Nepal being unable to compete on price due to global competition. Price support existed earlier and there are still regulations in place which buyers feel strongly about.<sup>40</sup>

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<sup>40</sup> The government has established a price support system wherein the floor price of carpets was greater than the par value, especially for 60 knots per square inch quality until 1995. The current president of the CCIA believes that as prices were above market-clearing levels, it could have affected competitiveness. Subsequently, the government reviewed the single floor price of \$ 48 per square metres but still exercised

One major German retailer said that price regulations were hampering carpet exports from Nepal; urging it to be left to market forces alone.

- *Design.* In highly design-intensive industries, close and continuous information flows between design-setters and manufacturers are paramount (Lall, 1991: 141). In this sense, what type of categories does European wholesalers and retailers of Nepalese carpets fall into: ‘design takers’, ‘design intermediaries’, or ‘design makers’? (Kaplinksy et. al, 2002: 1168)? The carpet industry is not homogenous: large-scale suppliers already use advanced design techniques whereas for small-scale manufacturers, design still requires help of lead firms. Firms that are able to move into higher value-added activities like design also enter activities that are traditionally regarded as the niche of buyers; this depends on whether buyers wish to help suppliers in ‘functional upgrading.’ Both interviewees – one wholesaler and one retailer – displayed their skepticism about the ability of Nepalese suppliers to move into design activities. “Creativity was limited”, felt one while another believed that “they still needed to work with us until their capabilities improved.”
- *Delivery (including infrastructure).* The importance of delivery in the success of manufactured exports has been addressed by many researchers who all agree that it plays a critical role in determining why some suppliers succeed and others do not (Egan and Mody, 1992; Keesing and Lall, 1992; Lall, 1991; Knorringa and Schmitz, 2000). Both interviewed respondents agreed that Nepalese suppliers were quick to respond to buyers’ needs but that the ‘lead time for deliveries’ was quite long. Nepal’s landlocked status made it wholly dependent on India for use of its port facilities and an alternate trade route from Mumbai to the present one through Kolkotta was also preferred.<sup>41</sup>

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controls: the floor price was fixed at \$ 75 (80 Euros) for carpets above 80 knots per square inch and \$ 32 (or 35 Euros) for carpets below 80 knots per square inch. However, both buyers and suppliers are unhappy with this decision.

<sup>41</sup> According to these two global buyers, the cargo took around a fortnight by sea to reach Europe via Kolkotta. If India granted Nepal the use of Mumbai port in western India, the bottleneck could be overcome and considerable time saved.

- *Marketing.* All respondents believed that marketing was a weak area (including suppliers and trade association alike). However, this is also an area that has traditionally been the domain of lead firms. In recent years, the Nepalese carpet industry is also attempting to find potential markets for carpets like the UK and the US. It was asked whether buyers could assist Nepalese suppliers in finding new markets. In response, they expressed doubt and argued that as Europe was the largest market for hand-made carpets, it would be better for Nepalese producers to strengthen their hold on existing markets rather than diversify into newer ones. However, as one global buyer pointed out, in 2002/03, the whole carpet sales in retail in Europe had shrunk considerably for imports from all countries, dampening any marketing effects. The weakness of marketing has also arisen on account of the rise of substitute carpets produced in India, according to exporters (explained in section 4.4.3).
- *Meeting labour standards.* Since 1995, consumer labelling bodies are working closely with Nepalese carpet manufactures and exporters. All registered firms with the trade association are required to enforce labour standards with regard to child labour: children below 10 are not employed. All 5 lead firms in Europe indicated that suppliers had to participate in consumer labelling programmes although views were mixed. The rationale was that it would: “reassure customers that no child labour was involved and would save the importer from disagreeable discussions with customers and NGOs, the alternative could be mistrust and difficulties in selling.” The contribution that both buyers and sellers made were helping in rehabilitating children formerly working in carpet looms. However, some importers also expressed dissatisfaction with consumer labelling initiatives citing that apathy was high among customers; buyers could not know for sure whether their suppliers were not employing under-age children in their factories and that what was important was trust between business partners reflected in their own initiatives to address child labour.<sup>42</sup> Some expressed doubt as to whether labour standards could be improved at the industry-wide level i.e. only single manufacturers could ensure compliance. The conclusion that can be drawn is that while Nepal would not have an edge over its competitors if it did not enforce



labour standards (with regard to child labour), it would still be risky for the country not to do so as it involved the trade of a product with ‘credence good’ characteristics.

#### 4.4.3 Viewpoints of suppliers and industry

How do suppliers and industry envisage the central issues affecting them, their role vis-à-vis each other, with buyers and other actors like government? It is attempted to put the perspectives from the supply-side of the value chain. The representative from the trade association as well as 4 exporters highlighted some of the leading issues.

- *Price.* As mentioned previously, prices refer to both prices of carpets as well as of raw materials. Both industry and suppliers were critical of the government’s decision to impose floor prices. For instance, not only was the rate on carpets fixed, exporters also had to pay an export tax under that price. Exporters complained that this situation was leading to domination of Indian carpets in Germany. Industry sources felt that prices should be revised accordingly whereas one large-scale exporter said that the government was “creating hurdles” through price regulation. All suppliers indicated that profits were falling. It was also a consensus view that the country’s total dependence on raw materials made it difficult to compete with other hand-made carpet producing nations who had their own sources of raw materials. While small-scale exporters complained about the rising price of wool, even large-scale exporters felt the pinch of having to import wool, which was licensed to only a few industries and instances of hoarding (leading to shortage) were not absent.
- *Quality.* During 1994/95, there was a surge of poor quality products, whose cost was cancelled orders, rise in inventories and manufacturing slowdown. Firms who were not able to meet buyers’ quality requirements have quit the industry, leaving remaining suppliers to be wary of exporting defective products (mainly due to poor wool quality or dyes that affect carpet colour). Existing manufacturers have thus learnt about quality control measures along with

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<sup>42</sup> One buyer revealed that some of their suppliers in Kathmandu had undertaken initiatives such as day-care

buyers. Judging by the response of one small-scale exporter who has been in the business for 12 years, buyers do not compromise on quality and hence accorded it a top priority. A large-scale exporting firm that has been in the business since 1974 stressed that “product quality and customer service were instrumental in long-term business relationships with any buyer” (see Table 10).

- *Delivery.* Goods can be delivered on time in the presence of adequate and suitable infrastructure: “The ability of a firm, or group of firms, to compete in global markets is to a significant extent enhanced by the quality of national infrastructure. Since this infrastructure is unevenly spread through the global economy, it provides a form of rent to those firms operating in infrastructure-rich environments (Kaplinsky, 1998: 27).” Nepal’s landlocked status makes it completely dependent on India for third world trade; through use of the eastern port of Kolkotta. Surface transport consumes considerable time although efforts have been taking place to open a railway link from Nepal to India’s eastern port.<sup>43</sup> Although delivery was not considered to be much of a problem, there was still considerable room for improvement.

What are the areas in which upgrading is occurring at the supplier level through public support measures? There is experience of such support in which experts work with developing country firms for extended periods of time to ‘fill in the gaps’ in their current capabilities, including lessons on how to meet international market specifications and quality standards (Keesing and Lall, 1988 cited in Egan and Mody, 1992: 332). Since 2002, the EU – Nepal’s biggest carpet export market – has been engaged in such a public support measure with the prime objective of making the Nepalese carpet sector competitive. The aim is to enhance overall competitiveness of the industry and exporting firms who participate are provided training in advance carpet design as per the needs of global consumers. Weaving, graphing, dyeing and market training measures are being

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centres for the children of women carpet workers as early as in 1986.

<sup>43</sup> India only recently agreed to open a rail link from the port city of Kolkotta. It is reported that trains will complete the 800 km journey in 36 hours against 6 days by road and reduce transport costs by \$16.2 million a year, according to Nepal’s commerce ministry. With the agreement, the World Bank, which set up a \$ 10 million dry port (or inland container depot) on the border-town of Nepal’s business town called Birgunj, will start operations, easing transit problems and boosting trade (<http://www.cnn.com/asia/southasia>).

carried out (outlined in table 9). The upgrading measure being undertaken by the EU is a time-bound project focused on a small number of areas and provides affordable high-quality services to help exporters in areas where the entire industry is considered to be falling behind.

What about upgrading priorities by firms themselves? The respondents were also asked to list areas requiring upgrading, presented in table 10.

**Table 9: Areas in which upgrading is occurring through public support measures**

Area	Rank (in order of priority)
Marketing	1
Design	2
Research	3
Quality	4
Meeting labour standards	5
Partnership building with lead firms	6

*Source:* Questionnaire from carpet trade association

**Table 10: Areas for upgrading according to 4 suppliers**

Criteria	A	B	C	D
Price	2	4	9	4
Quality	1	3	8	5
Design	3	6	11	11
Marketing	5	2	2	6
Timely delivery	4	5	10	2
Improving ties with lead firms	10	7	1	1
Meeting labour standards	8	10	12	9
Strengthening existing markets	6	8	3	3
Finding new markets	7	1	4	12
Access to inputs and credit	9	-	7	8
Access to information	-	-	6	7
Ability to meet orders	-	9	5	10

*Source:* Questionnaires from above exporters. Note: Exporters A and C are in small-scale category whereas exporters B and D are in large-scale category.

- Marketing.* A comparison of tables 7, 8, 9 and 10 reveals that all suppliers recognize the importance of marketing. The four respondents were asked to identify three problems that exporters faced. One small-scale firm responded that “there was decreasing demand due to lack of marketing performance.” Another small-scale enterprise and one large-scale firm listed marketing as the first and second most important areas where suppliers needed to improve. Exporters pointed out that publicity in export destinations was poor and marketing efforts were not being sustained because of “inconsistencies in implementing any policy at the government level.” There was also realization of Nepal’s reliance on one buyer – Germany – and the urgency to market carpets in other countries (exporter B) and the bad publicity arising out of political unstable environments for global trade (exporter C). Marketing also suffered because consumers still could not distinguish genuine Nepalese carpets from its substitutes. According to the carpet trade associations (both CCIA and NCEA), marketing efforts should be done along with inception of Nepal’s trademark or a standard national label against the

so called Indo-Nepalese carpets that will help customers differentiate Nepalese carpets from the products of other countries.<sup>44</sup> The industry has suffered from other exporters that wrongly brand their products Nepal-made.

- *Meeting labour standards and consumer labelling.* The Nepalese carpet industry is now engaged in partnerships with consumer labelling bodies like Care & Fair, Rugmark and STEP in meeting some core labour standards. More than 70 per cent of carpet exports now have some sort of labelling indicating the non-use of child labour and the incidence of child labour had also decreased partly as a result of such initiatives. What effect has the rise of such initiatives had for suppliers? All respondents are also licensees of one labelling initiative or the other. However, views were also mixed here with some admitting that some buyers did not ask about whether they (exporters) participated in such programmes while others felt that partaking in labelling would assure buyers. Despite the various initiatives, lack of monitoring personnel was identified as a weakness of such schemes; with one supplier alleging that firms participating in such initiatives were still using child labour. A child labour initiative cum labelling programme, which revealed that its licensees made up just 8 per cent of total exports of Nepalese carpets, was partly due to the voluntary nature of the programme. As a result, it was finding it difficult to meet rehabilitation costs of removed children. The government was also not doing enough to promote consumer labelling and there was hardly any cooperation among the three main labelling bodies.
- *Partnership building with lead firms.* The quasi-hierarchy feature of Nepalese carpet suppliers and lead firms is well recognized by two firms (exporters C and D) whereas the other two do not accord much priority to building linkages. The explanation lies in that exporter C has been in the business for around 17 years and has close ties with global buyers mainly in Germany and claims to be among

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<sup>44</sup> According to industry sources, suppliers and buyers; some Indian manufacturers has acquired the ability of making carpets with design patterns followed by Nepalese carpets whose hallmark is Tibetan (and Buddhist) images. The effect was that it was acting as a substitute good for Nepalese carpets and one large-scale firm also alleged that some global buyers were selling them as Nepalese carpets. The result was that as a result of their inferior quality, the image of the Nepalese carpets had been tarnished to a great extent. The carpet trade association listed the problem of Indo-Nepalese carpets as the second important factor leading causing the crisis in 1994/95. Two interviewed respondents also expressed that Indo-Nepalese carpets were also responsible for the decline during that period.

the first firms to push the idea for consumer labelling. Exporter D, though engaged in trade for only 5 years, is a large-scale exporter and was selling carpets only to the US and Mexico, relatively new markets for Nepalese carpets. Thus, either for upgrading measures or for realizing potential of new markets, the role of lead firms assumes importance.

#### **4.5 Conclusion**

Hand-made carpet suppliers who have been inserted into global value chains – in this case buyer driven commodity chains – are influenced by lead firms as the bilateral relationship is one of quasi-hierarchy. There is some asymmetry of power that favours buyers over sellers (Gereffi, 1994; Humphrey and Schmitz, 2002). It is suggested that ‘value chain governance’ in which buyers coordinate many functions of suppliers as well as facilitate upgrading in some activities but also hinder upgrading in others characterizes such a relationship. For instance, it is vital not only for exporters but also for buyers that the ‘inseparable triad’ of price, quality and delivery be maintained. With low barriers to entry in labour-intensive products, there is every attempt by supplying firms who are part of the value chain to attempt meeting the above three factors with help from lead firms.

However, as even other studies on value chains point out, buyers aid suppliers to upgrade as far as such upgrading does not encroach upon their (lead firms) areas of core competence and would erode their own competitiveness (Kaplinsky, 1998; Knorringa and Schmitz, 2000). Here, four different types of upgrading may be identified: process, product, functional and inter-sectoral (Humphrey and Schmitz, 2002: 1020). Whereas lead firms mostly help in process upgrading as there are stakes for buyers too, upgrading in other activities depends largely on the ability of suppliers to move into higher value-added activities and which previously engaged firms see a benefiting themselves because of their own graduation into higher rent accruing activities (Kaplinsky, 1998). For instance, the assertion by a lead firm during interviews that Nepalese carpet manufacturers – although performing relatively well in QPD factors – could not be left by themselves to be upgrade functionally (i.e. moving into other links like design and marketing which are areas of lead firms) because “their creativity was limited,” suggests

that even lead firms are under competitive pressure as far as maintaining their economic rents are concerned. Hence, for lead firms, barriers to entry to suppliers in the value chain are deemed necessary and justified. Such a strategy by lead firms does not augur well for suppliers who have improved their capabilities for functional upgrading as they remain locked into areas of competitive pressures.





## CONCLUSIONS

The study addressed topics such as globalization, competitiveness, core labour standards, immiserizing growth and value chain analysis – which are diverse but interlinked – in the context of the Nepalese carpet industry. In this way, the research paper attempted to contribute to the existing literature by inculcating various theoretical frameworks to assess the issues from a developing country perspective specializing in the export of a labour-intensive good in which there is global competition.

Globalization and competition have raised the stakes in an increasingly economically interdependent world wherein most nations are engaged in international trade. For developing nations, globalization and export-led growth strategy offers a route for industrialization to bridge the ‘growth gap’ as was rapidly achieved following the experience of East Asian NICs. Participation in the global economy, however, involves both opportunities and risks and determines who the winners and losers will be. Benefits bring growth and avenues for further opportunities whereas losses could occur both in terms of incomes and markets. At all levels – individuals, households, firms, industries and countries – there is a need to remain not only efficient but also to be competitive. As the policy consensus of today calls for greater integration (for all nations who are at different levels of development) into the global economy to spur growth through market-oriented economic policies, countries are engaged in relentless competition based on their comparative advantage as well as competitive advantage. The emergence of a single global market has made product markets a sphere of heightened trade between nations. In the case of most developing countries, they are increasingly specializing in manufactured exports which, however, are characterized by low-cost and labour-intensive production. Developing countries concentrating in similar products thus directly compete among themselves to tap markets in industrially advanced nations. However, the entry of multiple competitors only keeps on increasing competitive pressures on nations and firms engaging in such activities. In cases where there are many competitors producing goods that are labour-intensive, immiserizing growth occurs in which increase in economic activity exists alongside diminishing returns to investment and declining incomes. As

Gereffi (1994: 227) aptly puts it: “low cost labour – the main asset of Third World exporters in buyer-driven commodity chains – are notoriously unstable sources of comparative advantage”.

One way of analyzing relations between developing country firms and those in the developed ones is through value chain analysis in which value chain governance has significance for suppliers to upgrade their competitiveness. As competition has heightened, so have the rules. Developing country firms and lead firms engage in trade but only after a minimum criteria of price, quality and delivery can be assured from the former. However, with the entry of environmental and labour standards in global trade arena vis-à-vis business and NGO defined standards, countries producing ‘credence goods’ are affected. It is argued that if the social cost borne by society or the economy is not checked upstream, the ‘race to the bottom’ strategy of competition will have adverse implications in terms of equity and sustainability. For labour intensive goods, it has been shown that increase in unskilled labour (including use of child or forced labour in which core labour standards are not observed) improves comparative advantage. Combating child labour has gathered momentum with the ILO and other international bodies committed to maintain core labour standards. Fair trade policies aim to check exploitation of producers by urging development partners and aid-receiving nations on observance of norms in which business can thrive alongside social responsibility. However, moves to link trade and labour standards have had their share of criticism as well; industrially advanced nations are blamed for being protectionist and erecting new forms of non-tariff barriers. Nevertheless, the carpet sector in the South Asian context is the subject of intervention by child labour initiatives in which consumer labelling is the major feature. The results of such interventions are to assure the non-use of child labour – though with varying degrees of success – along with removing children from carpet factories and rehabilitating them.

The carpet industry is identified as a buyer-driven commodity chain in which there is a hierarchy of functions undertaken by producers in low-cost production and retailers, wholesalers and importers are engaged in higher value-added activities. As the preceding chapters have demonstrated with reference to Nepal’s hand-made woolen carpet sector, the country was able to enjoy a fair degree of success on the basis of its comparative advantage viz. low wage unskilled labour but participation in the global economy exerted

competitive pressures for which upgrading did not occur accordingly and other prerequisites for competitiveness were ignored by producers. Although directly competing with some of the largest developing economies like China and India, the advantage of low-cost production was not matched by the country being able to compete effectively on: price, quality and ‘credence good’ characteristics, ultimately leading to a phase of decline. The crisis affected the sector in terms of growth, income and employment. Carpets have also been displaced as the leading export item by another labour-intensive good: garments. Subsequently, various forms of learning have taken place. The role of lead firms – along with public support measures – in upgrading include both process and functional upgrading like implementation of core labour standards (for removal of child labour) but also in new areas like marketing and design. However, it can be seen that although learning may have led to efficiency, it may not necessarily improve competitiveness. Meanwhile, policy obstacles are still in place and suppliers consider regulative measures as hindering growth prospects. Upgrading by buyers also ends where their own sources of rent are threatened. Using a value chain analysis, the experience of the Nepalese carpet industry reveals the interplay of many factors determining competitiveness: traditional factors of price, quality and delivery and new factors like the rise of credence goods in international trade.

How can Nepalese carpet producers remain inserted into the global economy while not being exposed to further risks? There is a need to confront the issues head on. Ignoring price, quality, delivery and core labour standards could lead to loss of markets and action needs to be taken on areas which could be potential sources of export instability in the future. Research suggests that better performance, both in terms of labour productivity and moving into areas of buyers’ competence, requires capabilities that are a function of domestic innovation, worker training (as well as their social development) and an enabling policy environment including provision of credit for identifying areas of competitive advantage. Diversification into similar activities of low-cost production in competition in other producers is fraught with possibility of declining incomes.

Therefore, how can a developing country like Nepal remain plugged into transnational production systems in which increases in productivity and international competitiveness leads to rapid and sustained income growth for its population? There is a danger that development targets cannot be met if stagnation occurs due to export-led growth. While

the standard suggestions of moving up the commodity chain into higher value-added activities and fostering an enabling environment for innovation is deemed urgent, in the wake of globalization and competition, there are few alternatives. Consolidating current strengths while identifying and building new areas of competitiveness appear not as choices but as compulsions.

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## ANNEXURES:

### Annexure 1: Respondents in Europe (global buyers of hand-made woolen carpets)

Firm	Participation in consumer labelling programme
Teppich-Kibek, Reichenstrasse 3-15, 25366 Elmshorn, Germany	Care & Fair/Rugmark
Rudolf F. Petersen, Ottensener Strasse 2, D-22525 Hamburg, Germany	Rugmark
Talis-Vertriebs GmbH, Gossmannsreuth 1, D-91289 Schnabelwaid, Germany	Care & Fair/Rugmark
BENELUX Orient N.V., Woudstraat 1, B-3600 Genk, Belgium	Care & Fair/Rugmark
Tapis Hertz s.a.r.l. et Cle, 44, Grand-rue, L-1660, Luxembourg	Care & Fair/Rugmark

*Source:* Rugmark Germany ([www.rugmark.de](http://www.rugmark.de))

## Annexure 2: Respondents in Nepal

Firm/Organization	Function
Central Carpet Industries Association, P.O. Box 2419, Bijuli Bazaar, Kathmandu	Trade association
Nepal Rugmark Foundation, P.O. Box 12698, Adwait Marg, Kathmandu	Child labour initiative/Labelling body
Formation Carpets, P.O. Box 3459, Ekantakuna, Lalitpur	Carpet exporter
Soorya Carpets, P.O. Box 1765, Buddha Nagar, Kathmandu	Carpet exporter
Creation Exports Nepal, P.O. Box 1244, Chabahil, Kathmandu	Carpet exporter
Chhiring Carpet Center Udhyog, P.O. Box 1210, Bhaktapur	Carpet exporter

Source: NRF ([www.nepalrugmark.org](http://www.nepalrugmark.org))

### Annexure 3: Questionnaire for European global buyers of hand-made carpets

#### Part A: General

1. Name of company and location (mention country)

2. Type of buyer (please underline):

- (a) Importer
- (b) Wholesale buyer
- (c) Retailer
- (d) Both (a) and (b)
- (e) Both (a) and (c)
- (f) Both (b) and (c)

3. From which country do you import woolen carpets?

Country	Percentage (%) of imports
Iran	
India	
Turkey	
Nepal	
Pakistan	
China	
Others	

4. Some factors explain better performance of some countries over others. Based on the following criteria, please assess (on a scale between 1 and 5; with 1 indicating poor and 5 indicating excellent) the countries.

Factors	Iran	India	Turkey	Nepal	China	Pakistan
i. Quality						
ii. Price						
iii. Design						
iv. Timely delivery						
v. Marketing						
vi. Adhering to labour standards						

5. Do you make investments in some of the countries you buy carpets from?

If yes,

- (a) which ones?
- (b) what type of investments?

6. Do you participate in any labeling programme? If so, which of the following labels or standards the company is affiliated to (please underline)

- (a) Rugmark
- (b) STEP
- (c) Care & Fair
- (d) Both (a) and (b)
- (e) Both (b) and (c)
- (f) Both (a) and (c)
- (g) Others (name)
- (h) None of the above

7. (a) What does the labelling do i.e. what is its rationale?  
 (b). Why do you think it is good for you and your business?  
 © In the absence of labelling, what could be the consequences?
8. Do you enforce labour standards on your suppliers (Yes/No)?
9. (a) Have you visited production facilities in the carpet producing countries to check whether labour standards (especially with regard to child labour) are met or not?  
 (b) If yes, in which countries?  
 ©How regularly do you visit those sites?
10. In which areas do you perceive that carpet producers have to improve in the coming years? For example, they could be quality, marketing, design, conforming to labour standards, etc.

Countries	Areas
Iran	
India	
Turkey	
Pakistan	
China	
Nepal	

### Part B: Nepal

11. Do you import carpets directly or indirectly from Nepal?
12. With how many suppliers in Nepal do you have business relationships?
13. How do you assess the preferences of customers in terms of purchasing Nepalese carpets? Please underline.  
 (a) Very good  
 (b) Satisfactory  
 (c) Discouraging
14. What are the perceptions about the characteristics of carpets made in Nepal?
15. What factors make Nepalese carpets special as compared to those from other countries?
16. Exports of Nepalese carpets to Europe declined during the early 1990s. What could be the possible causes?  
 (a) Intense domestic competition leading to low quality exports  
 (b) Use of child labour in carpet factories  
 (c) Global competition in which Nepalese carpets could not compete on price  
 (d) Both (a) and (b)  
 (e) Both (b) and (c)  
 (f) Both (a) and (c)  
 (g) None of the above  
 (h) All of the above  
 (i) Others (please specify):
17. Do you think that countries that do not enforce labour standards are in a better position in terms of meeting large export orders and have edge over their rivals? If yes, how?

18. The carpet sector in Nepal is now upgrading its production process to eliminate child labour. Labour-standards enforcing non-profit organizations like Rugmark are monitoring that child labour is not used and both producers and buyers have to pay a nominal charge for rehabilitating displaced children. Do you think that this step is in the best interest of the industry?

19. Do you think that the Nepalese carpet industry is successful in meeting the challenge of meeting core labour standards, especially in removing child labour? Comment.

20. Mention the quantity of Nepalese carpets imported by you during two periods as given (units in square metres).

(a) In 1995

(b) in 2002

21. What other obstacles, in your opinion, limits Nepalese carpet producers from realizing their potential?

22. What role can you – as buyers – play in helping Nepalese carpet firms to upgrade?

#### Annexure 4: Questionnaire for carpet exporters in Nepal

1. (a) Name of business/enterprise/firm  
 (b) Type of business (please underline)
  - (i) Single entrepreneurship
  - (ii) Partnership or joint venture
2. Depending on your fixed assets, which category of enterprise do you fall into (please underline):
  - (a) Small enterprise (with fixed assets of less than Rupees 1 crore)
  - (b) Medium enterprise (with fixed assets between Rupees 1 and 5 crores)
  - (c) Large enterprise (with fixed assets of more than Rupees 5 crores)

3. Please mention the years in which:
  - (a) You set up business
  - (b) Started export of carpets
 © Provide data on quantity and value of carpets exported in 2002.

Quantity (in square metres)	
Value (in US dollars or Nepalese rupees)	

4. As compared to five years ago,
  - (a) Has the quantity of carpets exported by your firm increased or decreased?
  - (b) Has the value of carpet exports of your firm increased or decreased in 2002?
5. With which countries do you have business relationships?
6. For how long have you had business relationships with foreign carpet buyers?
7. Do you:
  - (a) Visit trade shows in foreign destinations to expose yourself to demands of global markets?
  - (b) If yes, how frequent do you make such visits?
  - (c) How are these visits useful for your business?
8. Do buyers:
  - (a) Also visit your factories to assess your own capabilities?
  - (b) If yes, how frequent do they visit you?
  - (c) How do you benefit from their visits?
9. In which labeling initiatives do you participate? (please underline)
  - (a) Only Rugmark
  - (b) Only Care&Fair
  - (c) Only STEP
  - (d) Both (a) and (b)
  - (e) Both (b) and (c)
  - (f) Both (a) and (c)
  - (g) All
  - (h) None
  - (i) Other (mention name)
10. How did you come to know about the labeling initiative?



11. As mentioned, labeling requires exporters to pay a levy (fee). How would you characterize the charge? (please underline)
- (a) High
  - (b) Medium
  - (c) Low
12. Do you think that the labeling has different impacts on large and small firms? If so, how?
13. Although the label guarantees that the carpets produced have not used child labour, do you know of situations wherein child labour is still being used?
14. Do you think monitoring for child labour is difficult? If so, what could be the possible reasons? (please underline)
- (a) Lack of monitoring personnel
  - (b) Wide geographical spread of carpet factories making monitoring challenging
  - (c) Unscrupulous producers who are using child labourers even after obtaining license from Rugmark, Care&Fair, STEP
  - (d) Other reasons
15. List 3 main problems that carpet exporters face.
16. State briefly what role do carpet producers expect the Central Carpet Industries Association (CCIA) to play for the sustainable growth of the sector?
17. How would you describe the current state of the Nepalese carpet export sector? (please underline more than one if required)
- (a) Too many exporters
  - (b) Not many exporters
  - (c) Intense domestic competition
  - (d) Limited domestic competition
  - (e) Intense competition with other countries
  - (f) High profits
  - (g) Falling profits
  - (h) Losses
  - (i) Highly regulated by government
  - (j) Too much deregulation
  - (k) Others (state)
18. What role, do you think, can global buyers of Nepalese carpets (say, based in Europe) play in:
- (a) Helping the Nepalese carpet industry realize its potential and become a truly global player?
  - (b) In which areas do you need to improve (please rank according to priority)?

Criterion	Rank (1 to 10)
Price	
Quality	
Timely delivery	
Design	
Meeting labour standards	
Improving linkages with foreign buyers	
Marketing	
Strengthening existing markets	
Finding new markets	
Access to information to build capacity	
Access to inputs and credit	
Ability to meet orders from importers	

19. What has been the most important lesson (if any) that you have learnt in the last 3 years and how has it helped your business?

## Annexure 5: Questionnaire for Central Carpet Industries Association

1. Name of respondent and designation.
2. When was
  - (a) CCIA established?
  - (b) registered with HMG/N?
3. According to recent data, what is the share of Nepalese carpet exports as a percentage of global carpet exports?
4. Under what category of the government's industry classification does the carpet industry fall into (please underline):
  - (a) large enterprise
  - (b) Medium and small-scale enterprise
  - (c) Cottage industry
5. Is the carpet sector open for foreign investment? If so, how many firms registered with CCIA are affiliated to foreign enterprises (wholly owned or joint-ventures)?
6. How do you assess the government's past and present policy towards the carpet sector? (Please underline)
  - (a) Encouraging
  - (b) Favourable
  - (c) Satisfactory
  - (d) Unsatisfactory
7. What areas need to be strengthened to improve the competitiveness of the carpet sector?
8. The carpet sector's share in Nepal's total exports has reduced substantially. According to World Bank data, carpets comprised 43.8% of total exports in 1994/95; the figure fell to 19.7% in 1999/2000. What do you think are the primary causes for this decline? Some possible causes are given below. Please rank accordingly.

<i>Factors causing decline in carpet industry</i>	<i>Rank (1, 2, 3, 4, 5, 6 and 7)</i>
Intense domestic competition	
Poor quality exports	
Intense global competition	
Child labour in Nepal's carpet sector	
Carpets made in India but exported from Nepal	
Infrastructure bottlenecks	
Others	

9. According to CCIA, what is the prevalence of child labour in the Nepalese carpet industry?  
In number:  
As % of workforce:
10. At present, labour standards have emerged as an important factor in determining international trade. Nepal Rugmark Foundation (NRF) was formed in 1995 to stop child labour in the carpet sector.
  - (a) How do you assess the sector's record in removing children from carpet factories?

(c) Why has the carpet sector not regained its competitiveness as the share of carpets in total exports is still falling?

(c) Which of the following labels or standards is CCIA adopting (please underline)?

- i. Rugmark ii. STEP iii. Care & Fair iv. Others

11. What percentage of exported carpets, according to latest figures, now has some sort of labeling indicating the non-use of child labour?

12. In the global commodity chain, Nepalese carpet exporters are connected with global buyers mainly based in Europe and the US. Do they help in upgrading? How?

13. If so, rank the areas in which they help in upgrading.

<i>Area</i>	<i>Rank (1, 2, 3, 4, 5 and 6)</i>
Design	
Research	
Marketing	
Adhering to labour standards	
Partnership building	
Production quality	

14. What are the main areas identified by CCIA for the sector to be truly a global player in carpet exports?

15. Which countries are considered to be Nepal's main competitors?

16. In which areas do they have advantages vis-à-vis Nepalese carpets?

17. How do you assess your interaction with the following bodies in terms of the healthy growth of the carpet industry?

<i>Bodies (government, market and civil society)</i>	<i>Assessment (Encouraging or discouraging)</i>
Government: His Majesty's Government (HMG/N)	
Private sector: Federation of Nepalese Chambers of Commerce and Industry (FNCCI)	
Civil society: Nepal Rugmark Foundation (NRF) Child Workers in Nepal Concerned Centre (CWIN)	

18. Since April 2002, the European Union is providing, through its Asia-Invest Programme, a training programme for the up-gradation of the carpet industry in Nepal. The training is for a period of 30 months (and will end only in August 2004).

(a) To what extent is CCIA satisfied with the programme?

(b) What are the areas that the programme does not cover but is thought to be vital by CCIA for the carpet sector in Nepal?

19. Based on current government policies, global competition, domestic skills, and other factors, how does CCIA view the prospects for the Nepalese carpet industry? (please underline)

- a) Very good  
b) Satisfactory  
c) Lot needs to be done

## Annexure 6: Questionnaire for Nepal Rugmark Foundation

1. Name of respondent and designation.

2. To what extent do you think did the allegation of child labour in the Nepalese carpet industry contribute towards falling carpet exports during the 1990s (please underline)?

- (a) Very much
- (b) Somewhat
- (c) Not at all

3. Since its establishment in 1995, what percentage of carpet exports is labeled by Rugmark during the following years?

<i>Year</i>	<i>% of carpet exports carrying the Rugmark label</i>
1996	
1997	
1998	
1999	
2000	
2001	
2002	
2003	

4. Does Rugmark have any sort of cooperation with other consumer labeling programmes in Nepal?

<i>Consumer label</i>	<i>Form of cooperation</i>
STEP	
Care & Fair	
Others	

6. Carpet enterprises who are licensees have to pay fees to Rugmark. Is it done on time? (Please underline)

- (a) Very punctual
- (b) Usually on time
- (c) Payment is often late

7. NRF was established in 1995 but since which year did it start the labeling programme certifying Nepal's carpets as child-labour free?

8. What are your own estimates of child labour in the carpet industry?

9. How do you rate NRF's efforts at removing child labour from the carpet sector (please underline)?

- (a) Very successful
- (b) Encouraging
- (c) Satisfactory
- (d) Much needs to be done

10. Despite Rugmark's labeling initiatives, the share of carpets in Nepal's total exports has fallen substantially: from 43.8% in 1994/95 to 19.7% in 1999/2000. What other issues have led to erosion of competitiveness of Nepalese carpets?

11. How long do you think will it take for Nepalese carpet exports to be fully free of child labour (please underline)?

- (a) 2-3 years
- (b) 3-5 years
- (c) More than 5 years

12. What are some of the challenges identified by NRF in removing child labour in Nepalese carpet factories? State some of them briefly.