



POLICY BRIEF

ADDRESSING THE IMPACTS OF THE PHASING OUT OF TEXTILES AND CLOTHING QUOTAS IN LAO PDR



HUMAN DEVELOPMENT ASSESSMENT IN POST-AGREEMENT ON TEXTILE AND CLOTHING IN LAO PDR

Over the last decade, the Lao garment industry has played a significant role in the economy in terms of generating foreign exchange earnings and employment opportunities. The Lao garment industry started in the early 1990s and since then, garment exports have steadily increased. Since 2000, the number of exporting companies increased from 53 to 59 in 2006. The export value rose by 24 percent in 2000 compared to 1995 and 32 percent in 2005 compared to 2000. However, the value dropped significantly in 1996 due to the suspension of the Generalised System of Preferences (GSP) as a result of violation of the Rules of Origin (ROO). In 2001 and 2002, garment sector exports slightly decreased further, but have picked up since the negotiations for the extension of GSP provisions.

Contribution of Garment Exports to the Economy and Human Development

In 2005, the contribution from the garment sector to the national revenue was approximately US\$143.2 million. The garment sector has generated thousands of jobs, particularly for women from rural and urban areas, with women making up approximately 80 percent of the workforce. There has been an overall increase in the number of workers since the early 1990s; there were 28,000 people employed in the garment industry in 2006, more than double the level in 1993. With a large portion of the labour force employed in the garment industry, this industrial sector has not only expanded benefits for workers, but has also had positive impacts on local economies. Through employment creation, the industry has indirectly enhanced female empowerment, created income and harmonized the social interaction among workers, and directly enhanced labour skill development and knowledge. Through these developments, living standards have improved in workers' villages, directly contributing to the reduction of poverty.

International Competitiveness of Lao Garment Exports

Lao garment exports appear to be less competitive than rival exporters in neighbouring countries, such as Thailand, Vietnam and China, and other developing countries such as India and Bangladesh. The international competitiveness of Lao garment

exports is mainly determined by labour costs, productivity and lead time.

Labour costs: Low labour costs are frequently claimed as one of the competitive advantages of producers from LDCs. Lao PDR has one of the lowest labour costs amongst Asian LDC producers. However, low wages do not always translate into higher competitiveness, as productivity levels need to be also taken into consideration.

Survey findings show that 57 percent of respondents invested in the Lao garment industry because of the low labour costs. Hourly wages for Lao garment workers are less than in neighbouring countries like Cambodia, China and others like Bangladesh and India. The hourly wage is US\$0.125 per hour compared to China, where the rate ranges from US\$0.68-0.88. The official minimum wage is about US\$26 per month.

Labour and capital productivity: Labour productivity in the Lao garment industry is lower than neighbouring countries and other LDC and DC exporters. To illustrate, the average Lao garment worker produces 1,350 pieces per year, compared to the average Chinese worker at 7,500. Low productivity means having to work for longer hours to finish the work, which offsets any gains in labour costs and can also cause health risks. Low labour productivity can be a result of a number of factors, such as low wages, which discourage staff to work hard and make it difficult for firms to attract or retain

skilled workers. It can also result from the low skills and education of workers, with the majority of companies not providing vocational or technical training to their staff.

Another cause for low productivity in the Lao garment sector is the high rates of staff turnover. The average labour turnover rate among Lao garment companies is approximately 40-60 percent per year. This turnover rate includes “temporary” and “permanent” staff turnover. The “temporary” turnover is the result of the proportion of seasonal workers; various incentives and offers; and the absence of work contracts. The high turnover of permanent staff is due to low wage rates; workers being unfamiliar with tedious and repetitive garment work; and the perception of the garment industry as a transitory profession.

Low capital productivity is also an issue that reduces the competitiveness of Lao garment exports. Many factories have second-hand machinery imported from Thailand or other countries. Lack of financial capital, access to credit markets, and risk-averse behaviour are all reasons why companies may be hesitant to invest in new technology.

Low labour and capital productivity levels, therefore, largely offset any gains in competitiveness due to low labour costs.

Lead time: A short lead time is essential for “season-sensitive” or fashion garments. The survey findings show that the lead time in the Lao PDR is significantly longer than that of its competitors. In Lao PDR, it takes an average of 70 days from when the order is placed to transporting the finished products to the main markets. The standard period is 30-45 days. However, the Lao average is still better than Cambodia and Bangladesh, where lead times vary from between 90 and 120 days.

The long lead time for Lao garment exports can be explained by three major factors: transportation and distance from major markets; a lack of supporting industries; and inefficient inland facilities.

Strategies to Improve Competitiveness in Production and Exports

The removal of quotas generally means intensified competition in the textiles and clothing industries. In order to maintain and even expand the competitive

edge, producers have to move away from simple assembly to “full-package” production. Key policy areas in this regard include the identification of specialised niche products and markets; skills training and technological upgrading; investment in information technology; and improvement of infrastructure such as ports and export processing zones.

Many firms in the Lao PDR strive to improve their competitiveness through adopting a mix of measures to tackle such issues. The majority of Lao-owned companies (64 percent) envisage increasing pay for skilled, diligent and productive workers, and diversifying products as their intended strategies.

Lao (65 percent) and Joint Venture (JV) (68 percent) companies have considered diversifying their products. Interestingly, only about 38 percent of Foreign Direct Investment (FDI) firms state this as an intended strategy. While product diversification can lead to increased revenues by tapping into new markets, it is also the case that producing only a few products can increase the level of specialised skills, which in turn leads to productivity and quality improvement. Furthermore, certain installed machineries only serve the production of similar products, so product diversification may require additional capital investment.

A relatively high proportion of respondents from Lao, FDI and JV firms all expressed the intention to upgrade and meet factory and social compliance standards. Many managers reported that before clients place orders, they come to inspect the factory conditions, labour rights, and health and safety regulations. If their requirements are not met, they are less likely to place their orders. Therefore, attempts have been made to upgrade factory health and safety standards and labour rights, with a view to improve confidence and trust from clients.

In comparison to domestic and JV companies, 60 percent of FDI companies consider increasing investment in capital in order to increase the level of output. This corresponds to the optimistic views of many FDI in terms of production, raw material and machinery imports and exports to the EU post-Agreement on Textiles and Clothing (ATC). However, a lower share of JV and Lao firms intend to use this strategy. This may be due to the lack of confidence in their export performance in the post-ATC era and financial constraints.

Implications of the ATC phase out and removal of safeguards on China in 2008

The survey findings show that the predicated negative impacts on small LDCs from the ATC phase-out have not yet been felt in the Lao PDR. The continuing rise in export revenues and employment in the garment sector largely justifies this. FDI and JV firms share the view that the end of ATC has brought benefits, while most Lao-owned companies disagree. Most managers are more pessimistic about the removal of the safeguard mechanism imposed on China until December 2008.

Competition with foreign suppliers: The majority of the survey respondents (76 percent) have witnessed a strong increase in competition with foreign suppliers who have more integrated supply chains, economies of scale and closer proximity to major markets. Those competitors were identified as China, Hong Kong (China), Vietnam, Bangladesh, Sri Lanka, Thailand, Cambodia, India, South America (such as Mexico), and Eastern Europe (such as the Czech Republic, Romania and Poland). Managers and owners anticipate increasingly intensive competition with international suppliers, particularly China after the safeguard removal in 2008.

World export prices: More than half of the companies interviewed stated that export prices for their products have decreased since the beginning of 2005. This trend was mainly experienced by FDI and Lao-owned firms. This contradicts the stable world garment prices reported by the Asian Development Bank (2006). Trade statistics show that the overall Lao export values have increased, particularly from 2004. This could have been the result of the price increase or increase in export volume. Approximately 40 percent of companies interviewed expect export prices to decline after the removal of safeguards on China in 2008.

Exports to major markets: There seems to be no general consensus among companies regarding this subject as a result of ATC phase-out. The survey findings show that 34 percent of companies have experienced increases in exports to the EU, while a similar proportion has experienced a reduction. FDI companies with an established international network and access to markets are optimistic, while Lao companies are more pessimistic about this issue. Forty-four percent of companies surveyed foresee a decline in garment export prices, and expect a

declining share of Lao garment exports in the world market, particularly the EU, after the safeguards are removed in 2008.

Employment: Changes in employment after ATC varied among companies with different ownerships. Forty-five percent of respondents cite employment growth post-ATC, 24 percent state a decline of employment and 28 percent have experienced no change in employment levels. After the safeguards removal in 2008, 33 percent of respondents expect employment to remain stable, while 27 percent perceive a decrease, and 30 percent do not know what will happen.

Imports of capital goods and raw materials: About 44 percent of FDI companies say that the ATC phase-out has resulted in an increase in raw material imports, and 38 percent cite an increase in capital goods imports. FDI firms have fared better after the removal of quotas, and this is due to the fact that since the ATC phase-out, FDI firms have maintained or increased their export production, thereby stimulating demand for increased imports.

On the other hand, 44 percent and 33 percent of Lao companies perceive a reduction in imports of raw materials and capital goods, respectively. This implies that under quota-free circumstances, Lao-owned firms tend not to expand their production plants, and some may have been forced to downsize their businesses. After the elimination of safeguards, 29 percent and 31 percent of all respondents expect imports of capital goods and raw materials, respectively, to decrease.

Workers' productivity: In the post-ATC period, labour productivity has had to increasingly keep pace with the rising competition. There is a shared understanding amongst the factories surveyed of the critical need to increase labour productivity in preparation for the end of the safeguards on China in 2008. A majority of the respondents have observed an increase in labour productivity, while another 41 percent reported that the productivity of workers have remained stable.

Assessing the Impact of the US and EU Duty-Free Scenarios

Potential Effect of the US Duty-Free

Prior to the adoption of Normal Trade Relations (NTR) with the US, Lao exports faced very high tariff rates to the US market. The NTR regulations were applied at the end of 2004, although actual implementation started in February 2005. Nevertheless, after the NTR, garment exports to the US showed only a marginal increase of almost one percent. Therefore, the Association of the Lao Garment Industry (ALGI), in close collaboration with other Asian LDC and Landlocked LDC countries have initiated negotiations for the GSP from the US. If successful, Lao PDR would receive tariff-free entry to the US for 4,650 products.

Assuming that Lao PDR receives the full tariff preference from the US-GSP, there would be no quota or tariff barriers applied to imports from Lao PDR. The result of this scenario would be an increase in export revenue and employment. If Lao PDR received full tariff preference from the US, the export value would potentially increase by US\$6.3 million and the number of garment workers could potentially raise to 35,280 workers, a 31 percent increase upon existing 2005 levels.

If the US-GSP is granted, Lao garment exporters will be able to diversify their export markets and reduce concentration on the EU market. However, to realise the potential increases in export revenue and employment, it is essential to overcome the demand and supply constraints that currently impede Lao garment exports.

Potential Effects of EU's Flexible Rules of Origin on Lao Exports

Similar to other LDCs, Lao PDR has benefited from the tariff- and quota-free conditions under the Everything But Arms (EBA) initiative, which has been applicable in 48 LDCs since 5 March 2001. Because of this, Lao garment exports have been mostly concentrated in the EU. However, in order to be eligible for preferential treatment under the EBA, exports of Lao garments are subject to the EU-ROO criterion. Even though Lao PDR has received the ASEAN Cumulation and Derogation from the EU, 42 percent of imported materials originate from countries excluded from the EU-ROO specifications.

ALGI estimates that Lao garment exports to the EU market will continue to grow at existing rates of about 10 percent per annum and employment growth will also increase at 10 percent per annum. Given the current performance of the Lao garment industry, this estimate appears to be reasonable and realistic.

Potential effects of complete duty-free access to the US markets (based on 2005 data)

Import demand elasticity	Export supply elasticity	Baseline scenario - export revenue (US\$ million)	Increase in export revenue (US\$ million)	Increase in %	Baseline scenario - employment (person)	Increase in employment (person)	Total projected employment	Increase in %
0.5	0.5	143	6.32	4	27,000	7,814	34,814	29
0.5	1	143	14.33	10	27,000	9,683	36,683	36
1	0.5	143	38.68	27	27,000	15,358	42,358	57
1	1	143	13.15	9	27,000	9,408	36,408	35
1	2	143	10.41	7	27,000	8,769	35,769	32

Possible Actions and Recommendations

In order to improve the competitiveness of Lao's garment industry, specific actions to address constraints are crucial. For example, the lack of skills

among workers due to the shortage of vocational training will require the strengthening of cooperation between the government and the private sector by operating existing training centres with curriculum more adaptive to industrial garment production, and

by using practical trainees. Training could also include management and line supervision levels, as well as mechanisms to promote the transfer of knowledge from foreign expatriates to local employees.

Small and medium companies tend to operate on their own, a risky policy in an increasingly competitive market, and the team points to strengthened networks within the garment industry where larger companies, ALGI and the government should develop mechanisms to assist small and medium companies in the sector.

On social (labour and environment) compliance, enterprises should be encouraged to comply with standards as expressed in the labour laws and requirements from international customers. However, small companies not operating within these standards should coordinate their policies towards less restrictive customers. Industry guidelines and measures to gradually deal with compliance issues are encouraged. Other measures concern the strengthening of trade unions, better use of protection accessories and other improvements in working conditions

Lao-owned companies with problems accessing information on market trends and developments should be assisted by international and industrial trade organisations, and a government body should be assigned to provide job search information and databases. More modern communication means should be used to disseminate information from ALGI and the assigned government body.

On trade barriers, the team suggests that to ease the current situation in which ROO requirements and tariffs imposed by the US are still barriers for Lao exporters, the government and the private sector should work for flexible ROO and promote negotiations on US-GSP, as well as carry out additional research on potential impacts and assess the changes proposed.

The study “Addressing the Impacts of the Phasing out of Textiles and Clothing Quotas in Lao PDR” comprises findings published in four volumes:

1. **Human Development Assessment in Post-Agreement on Textile and Clothing in Lao PDR**
2. **Diversification and Value Addition,**
3. **Assessment of the Trade and Industrial Policy Environment in Lao PDR**
4. **Trade Negotiation Strategy**

Investment in new technology should be enhanced; current inefficient machinery still in operation should be gradually changed to more multi-tasking machines, and companies with financial capacity are encouraged to invest in this area.

On infrastructure and trade facilitation, the team points out that as transit transport costs and border checkpoints continue to cause problems for exporters in the form of high costs and constraints, the concerned industries and governments of involved countries should explore alternative transportation routes, and promote an attractive investment climate for domestic and international investors in the shipping and transporting industry, including longer opening hours and strict monitoring of regulations at customs checkpoints.

In dealing with possible employment losses in the garment sector, significant efforts are required from stakeholders from both the public and private sectors to improve the competitiveness of the Lao garment industry. It is also important to identify and develop other sectors that have the capacity to accommodate workers, especially women. In the meantime, providing information about the labour and job markets to workers is vital.

In conclusion, strengthening the competitiveness of Lao garment exports, thereby sustaining employment and ensuring other HD gains, is crucial. This will come through the training and transfer of technical skills; improving production capacity; access to information and markets; better management infrastructure; access to banking systems; improved government regulations; adopting product and target market diversification; and identifying niche products and markets.



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