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Tattered: Why the Tibetan Carpet Industry of Nepal Is Declining, and How To Mend It

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Tattered

Why the Tibetan Carpet Industry of Nepal is Declining, and How To Mend It

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Abstract

The Tibetan carpet industry of Nepal, once one of the country's leading exports, is quickly becoming unprofitable and uncompetitive compared to regional competitors. This is a trend that started over a decade ago, but requires renewed focus due to current alarming trends. My objective was to uncover why carpet manufacturers in Nepal are suffering from a decline in sales, and what separates the manufacturers who are still in business from those who are not. I stayed in the community of Boudha, where most of the carpet business owners live or work, and conducted interviews and electronic written correspondences with several business owners. I also conducted thorough research of written material, including contemporary news publications, scholarly journals, and books.

Acknowledgements

I would like to thank a future star in the international development community, Bryan Pratt of George Washington University, for his guidance and editing. I would also like to thank Alex Seher and Leo Senai for their editing efforts. Nyima and Yeshi deserve many thanks for hosting me during the period. Their children, Dassel and Chutso, brought much needed spontaneity and comic relief to my days.

Table of Contents

Abstract....2

Acknowledgements....2

Table of Contents....3

Introduction....4

Labor Dysfunction, A Collective Effort....5

Effects of Emigration....11

Unfortunate Customs....12

Rupee Woes....13

Tariffs....17

Government, The Inactive Player....18

Success Stories....20

Conclusion, Recommendations....23

Opportunities For Further Study....26

Methodology....27

Bibliography....28

Introduction

Nepal today lies between India and China, physically, bordering one to the south and the other to the north, politically, with a fledgling democratic system in which a communist party has plurality, and culturally, containing different ethnic groups with large similarities to those found in both neighbors. Curiously, however, the same cannot be said for economics. While India and China are moving steadily in to the 21st Century at impressive rates of growth, the Nepalese economy has, some would say, devolved in to one based solely on tourism, remittances, and agriculture. As a regional expert told me, "Anyone who has anything to lose in Nepal has already left," leaving the country with a deficit of entrepreneurship and capital.

The economy of Nepal has not always been so undiversified. The well-documented Tibetan carpet industry once gave employment to a large workforce through the creation of a competitive export product.[1] The wealth generated from this industry could have given rise to further industrial ventures, creating more and more jobs inside a country that sends many young men and women abroad to find work.

This natural progression of events never occurred. One by one, the factories closed. The industry still lives on today, and the successful owners of these long-running businesses show what has worked and what has not. Still, carpet export levels are diminutive compared to in the 1980s and 1990s. More critically, it is still on the decline. Orders for next year, 2012, are considerably down from 2011.[2] The causes behind the current alarming trend, and how owners are coping, are the focus of this study. What I've

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[1] Chodrak, Trinley. *Of Wool and Loom.* Orchid Press, 2000. Also see Kapstein, Matthew. *The Tibetans.* Blackwell Publishing, 2006.
[2] Ghimire, Prabhakar. "Rising cost of production blunts Nepali carpet's competitive edge." *Republica*, October 2, 2011.

found is that a variety of factors are making it difficult for carpet manufacturers to compete on the international market - labor regulations, lost days of productivity, an unstable currency, and lack of export incentive government policies. Owners who are still operating today have survived because of long-standing connections, the ability to make luxury goods that do not need to be priced competitively, and, often, adopting a model of small-scale production.

Labor Dysfunction, A Collective Effort

When asked about challenges to industry in Nepal, business owners immediately spoke about the volatile labor market. They were quick to mention that pressure from labor unions adversely affects industry profits. "The reputation of carpet industry in Nepal that has been built over the last decade in its ability to deliver special custom orders in high quality and on time has been greatly effected by all the negative influences of the Labor Unions on the work force. The insatiable demands of the Labor Unions for higher wages and facilities with little or no improvement in production output and quality have in turn further greatly disturbed the production of High Value production orders," explained one owner, who wished to remain anonymous regarding the subject. Other business owners in the carpet-making community reflected these same sentiments. In an interview with the Kathmandu Post, Nepal Carpet Exporters Association President Kavindra Nath Thakur emphasized the fact that high production costs, including labor wages, have made Nepali carpets less competitive in the international market.[3] The facts support these claims. Labor costs in Nepal are the highest in all of South Asia, with a

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[3] Ghimire. "Rising."

total annual cost per worker of US$1,789, compared to a cost in Sri Lanka of $1,619, Pakistan $1,052, India $943, and Bangladesh $789. Between October of 2010 and October 2011, labor costs have increased by 35% for carpet manufacturers in Nepal.[4]

The rate of labor market efficiency, meanwhile, is among the lowest in Asia, according to the Global Competitiveness Report.[5] Carpet owners lament a lack of productivity, noting that wages and productivity do not rise equally. As Chanden Sapkota, a researcher at SAWTEE wrote in the newspaper Republica, "If the unions want industrialists to double the minimum wage (instead of simply adjusting existing wage with inflation), they should also guarantee that labor productivity would also double. Else, why double the wages when the industrial sector is losing competitiveness and is in a downturn?"[6] One owner, when asked what the government could do to help the carpet industry the most, made productivity the central focus. "Laborers here, they don't want to work. Tibetans, we work hard. I tell the Maoists, look, why don't you try setting up an operation, building a client base, turning materials in to a quality product? They don't get it. Workers, they come in at ten, leave at eleven, and their union is still asking for more money. So if the government could do one thing, it would be to just tell the laborers that they need to work hard if they want more money." For a foreigner, one simple question comes to mind: Is that really the job of the government?

In the American working world, management ensures the productivity of their workforce. By examining labor laws in Nepal, however, one can elucidate the link our distressed owner makes between government policy and worker malaise. According to

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[4] Ibid.

[5] "Ghimire, "Rising."

[6] Poudel, Kashab. "Lockup Mode Pang of Protest." *Republica.*

Nepalese labor laws, after 240 days workers are to be given a "permanent" position, after which time, dismissal for reasons of discipline or reduced demand, or any other sort of disciplinary action is severely restricted.[7] Employers in Nepal, who note a drastic reduction in worker productivity after they are granted "permanent" status, commonly criticize this legislation.[8] In one extreme case highlighted in an International Labor Office report, the manager of a large manufacturing plant explained that when he terminated an employee whose productivity was suffering from the regular intake of drugs on the job, the Labour Court ruled that the worker must be reinstated.[9] At the same time, the government also imposes restrictions on pay scales. Workers in the same position must be given equal pay.[10] Thus, the law does not afford employers the ability to reward workers who are more productive. The same is true of bonuses. Ten percent of a company's yearly profits must be spread evenly among the workers.[11] Again, the law restricts employers from rewarding the most productive employees. In this way, the government prevents employers from motivating workers to improve productivity through either threat of termination or reward of higher pay. Moreover, employers are also denied the ability to adjust their operations according to demand. Some of the business owners claim that, as demand decreased following the Global Financial Crisis in 2008, they found themselves unable to downsize their operations because the law made it very difficult and expensive for them to terminate any employees.

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[7] Kyloh, Robert. *From Conflict to Cooperation.* Geneva: International Labour Office, 2008, p.37.
[8] Ibid.
[9] Ibid., 38.
[10] Ibid., 86.
[11] Ibid., 54.

These restrictions in labor laws and the rapid increase in wages can be mainly attributed to aggressive and influential labor unions. Unions in Nepal are formed along political party lines. Thus, instead of workers of a common profession or employer having one union, they are split between the union affiliated with the Maoist party, with the UML, with the Congress Party, etc. In a process described to me by various business owners with whom I spoke, a negotiator for a union receives a commission from every deal. As a result, wage disputes become a profit-making venture, with the amount of money a union negotiator makes being directly proportional to the number of new deals with businesses he makes and the amount of the wage increase. With this powerful incentive, negotiators are driven to create labor disputes. So, they travel from factory to factory, making speeches to workers, and motivating them to demand higher wages and better benefits. Sometimes, when demands are not met, unions have resorted to violence.

One high-profile case of this occurred at a Biratnagar factory for Surya Nepal Private Limited, a garment company that made popular brands such as John Players and Springwood. The plant opened in 2004, with an initial investment cost of NRs. 700 million.[12] In the summer of 2011, tension increased between management and labor unions over the payment of workers on days they were out making political protests. The company said it followed a "no-work, no pay policy." Unions nonetheless called for a strike instructed workers to hold the management hostage and beat them. Corporate executives in India were appalled by these actions and subsequently decided to close the factory, rather than meet union demands. This resulted in the loss of work for hundreds of

[12] "Imprudent unions & weak industries of Nepal." *Republica,* August 27, 2011.

employees, who were given severance pay, as mandated by law.[13] This example demonstrates that the demands of unions do not always align with the interests of workers. For a worker to have a "permanent" job, they need to work for a company that is profitable and confident about the future of its business. Demonstrating heavy-handed negotiation methods such as the use of force erode this confidence, and excessive wage and benefit demands inhibit a company from being profitable.

However, I must emphasize that factory owners, as a collective group, are partially responsible for the violence and frequency of strikes. Prior to the rise of All Nepal Trade Union Federation (ANTUF), the union of the Maoist Party, in 2006, many businesses actively avoided adherence to labor laws.[14] They avoided permanent status protection for employees either through failing to grant appointment letters[**] or by filling their payroll with contract employees, who didn't enjoy the same legal protection. Many were paid below minimum wage.[15] The labor unions that were active at the time were complacent with these conditions, but more importantly, the legal institutions in place were not capable of enforcing adherence to the laws. The state had only ten inspectors for the whole country, and these workers were trained to ensure the adherence to health and safety laws, not laws regarding legal protection for workers. Not only were they responsible for inspection, but also for the mediation of disputes, thus adding to their already excessive workload. Young appointees improperly prepared for their assigned duties often were the administrators of Labour Courts. There was only one Labour Court

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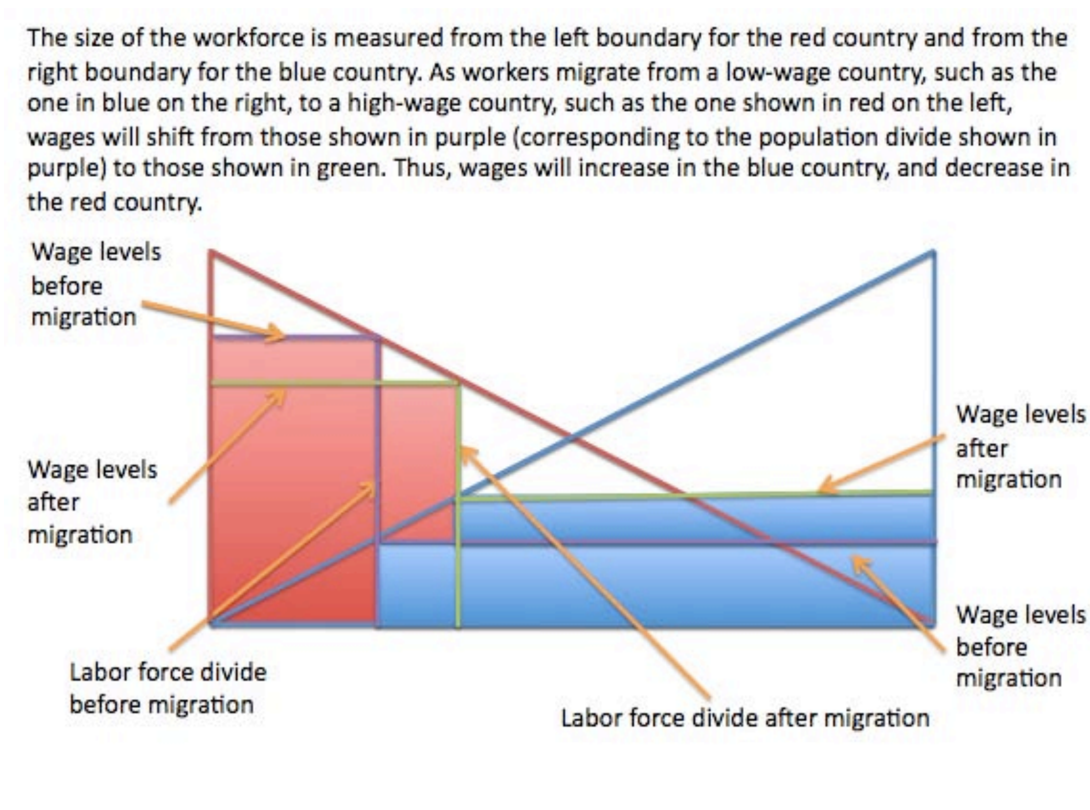
13 "Imprudent," *Republica*.
14 Kyloh, 57.
** An appointment letter is a legal document given to an employee upon hire, proving his/her start date and thus, the date they are to be granted permanent status.
15 Ibid.

judge for the entire country, and so the backlog of cases grew from year to year by the hundreds. Even if companies were found to be in violation of the law, the penalty was only a NRs. 5,000 fine. Inspectors or other officials would often use the violations as leverage for extracting bribes instead of seeking justice.[16] Thus, the increased militancy of the unions starting in 2006 was a response to the failure of the state to hold businesses accountable. The power they found in their newly adopted aggressive tactics then allowed to press for greater benefits, which they rapidly accumulated.

Figure 1 - Created by author with knowledge obtained from Dr. Xiaoyang Chen of George Washington University. Further explained on following page.



16 Ibid.

Effects of Emigration

Aggressive unions do not destabilize the labor market in Nepal alone, though. Remittance work is another unique challenge that factory owners must combat. "The Huge Labor market that has opened in the Middle East and South East Asia in the last decade has seen a large number of skilled carpet weavers from the industry migrating to this new labor market to earn their livelihood.

This in turn has further left the carpet industry with less productive labor force to meet increasing demands and requirements of the production," said one owner, who wished to keep anonymity. As Gopal Krishna Joshi, vice-president of Carpet Producer Association Nepal, told *Republica*, "Nepali carpet producers and exporters are also facing a shortage of skilled carpet weavers, making us unable to fulfill the demand from US market which has improved with the housing sector slowly returning to normal."[17] The loss of productive workers to foreign labor markets is inevitable in a country where wages are low. In addition, as the flow of labor continues, a rise in wages domestically will be a natural by-product, as demonstrated in Figure 1. Employers in Nepal neither willingly compete with foreign wages levels nor are compelled to do so as a result of the supply of unemployed workers in Nepal. However, the lure of foreign work will be a constant draw for employees, who will find employment abroad easier with their past work experience. It is the experienced workers who tend to leave for better opportunities, and hence we see the phenomenon described by employers, where skilled workers are becoming harder to find. Lower or stagnant wage levels will only encourage migration further. Hence, migration is a significant factor in the inflation of domestic wages.

[17] Ghimire, "Rising."

Unfortunate Customs

I was surprised to find conflicting holiday calendars to be another challenge that makes labor in Nepal less able to meet production goals. "Generally the months of October and November experiences an increase in orders from our clients to meet the demands for the Christmas holidays in the West," explained one owner. "But, during this key production period the carpet factories are almost empty due to the October and November Festival holidays. Since the carpet industry comprises mostly of people from the hilly regions of Nepal, during the October and November Festival holidays most of the labor force go back to their villages. After the labor force is back in the factories there is often very less time to fulfill all the orders as per their delivery schedules." Tihar and Dasain are very significant holidays to Hindu Nepalis, and being able to observe these holidays is imperative for their morale. Yet it is easy to see how, with Dasain lasting ten days and Tihar lasting five, their observance during a crucial period can leave owners at a disadvantage when competing with businesses in other countries to supply holiday orders for the West. Nepali economic observers share this opinion as well.[18] Sujeev Shakya in *Unleashing Nepal*, also highlights the need to ration out public holidays for the sake of greater growth and productivity.[19] Again, holidays are an important part of every culture, and it would take a perhaps unrealistic amount of will-power for government and the people to embrace a reduction from the 52 public holidays (not including Saturdays). It is critical to understand, however, that the impact of the loss of workdays during peak production time is a severe detriment. 40% of US retail sales occur in between

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[18] Poudel, "Lockup."
[19] Shakya, Sujeev. *Unleashing Nepal.* India: Penguin, 2009.

Thanksgiving and New Years Day in America.[20] Thus, the months of October and November can be said to be the pivotal point of production for an export industry like that of carpets. It is easy to see then, how 15 days of vacation in October and November are less than ideal for carpet makers.

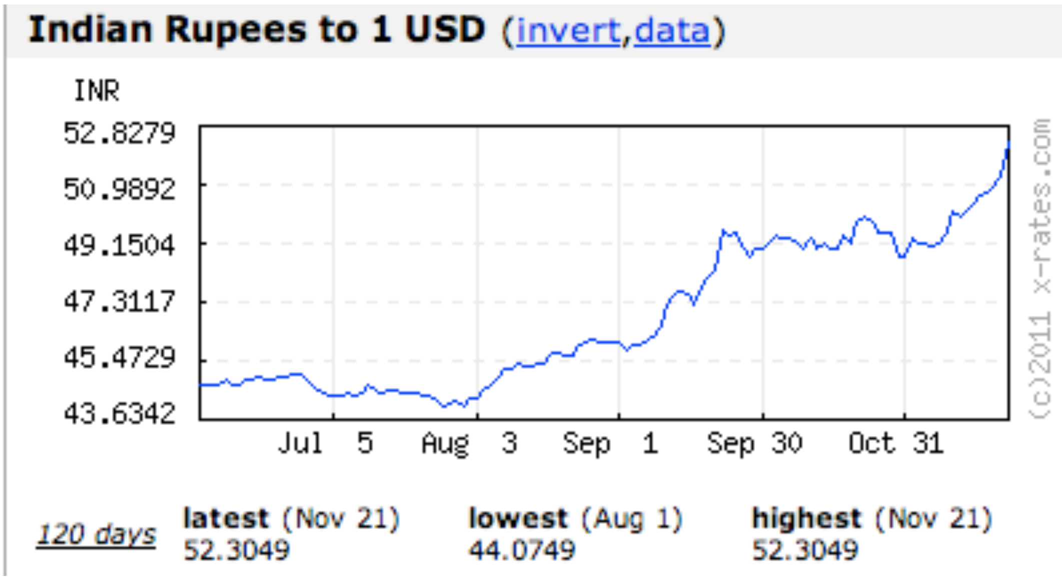


Figure 2 - Between August 1 and November 21 of 2011, the rupee declined by 18.4% against the dollar.

Rupee Woes

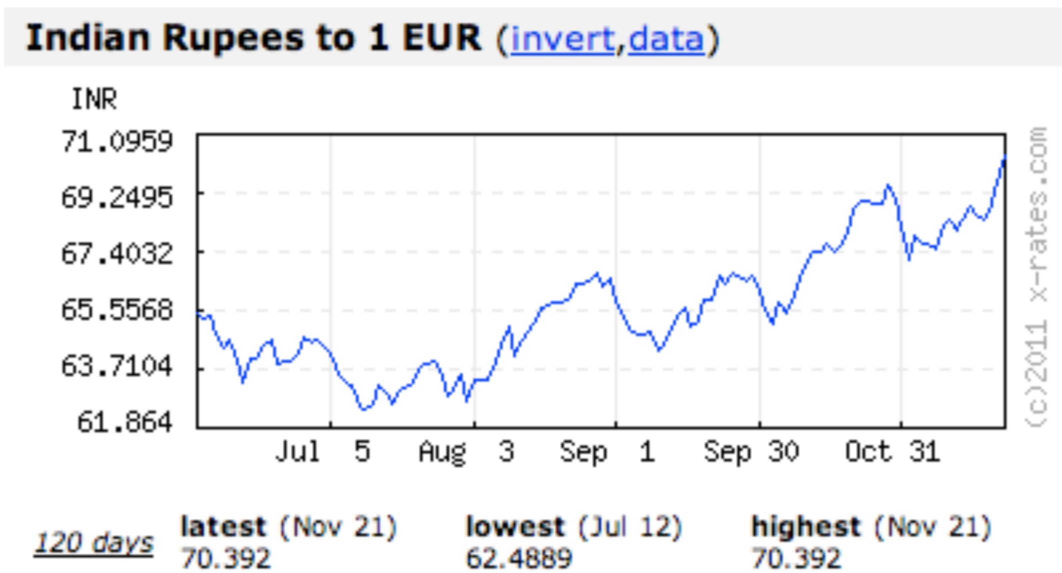
Between July 12, 2011, and November 21, 2011, the Indian rupee decreased by 12.6% against the Euro, as can be seen in Figures 2 and 3.* Between August 1 and

[20] Douglas, Daniel. "More shoppers, more spending, but no revised holiday spending forecasts," *Washington Post.* November 28, 2011.

* The Nepali rupee is pegged to the Indian rupee. 1 Indian rupee=1.6 Nepali rupee.

November 21, it decreased by 18.4% against the US dollar.[21] There was much volatility in this time period for the value of the Euro. A debt crisis in Greece that contributed to increased borrowing costs for Italy and Spain increased investor anxiety over the possibility of another

Figure 3 - Between July 12 and November 21 of 2011, the rupee decreased in value by 12.6% against the Euro.



global financial crisis. While one may think this would cause an appreciation of the rupee, it rather resulted in what is called in the investment world a "risk avoidance" mentality, causing investors to move their money to "safe havens" such as the US dollar or the yen, and away from developing world currencies.[22] India is also suffering from a growing trade deficit. Even though exports grew by 10% in the past year, the value of imports grew by over 20%, fueled in large part by growing oil prices.[23] The debt problems of Europe, combined with a rapidly slowing Chinese economy, and slow

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[21] Kapur, Gaurav. "Strong dollar, weak external macros weigh on rupee." *Daily News and Analysis*, November 14, 2011.

[22] Kapur, "Strong dollar."
[23] Ibid.

growth in the United States have influenced investors' belief that export growth will continue to slow in India. Rising interest rates and inflation that fails to abate has made investment in India a less attractive option. Moody's, an international ratings agency, downgraded its assessment of the Indian banking system from "stable" to "negative."[24] All of this has combined to lead to a decrease in demand for Indian currency, and hence a drop in value. In fact, the Indian and Nepali rupee underwent the largest decrease in value of any Asian currency between July and December of 2011.[25] All factors indicate that this trend is likely to continue.

By conventional economic wisdom, this would be a boon for exporters. Because of the rupee's weak exchange rate, export products could be marketed at a lower price in America or Europe, and economic models always indicate more sales at lower prices for a product with any amount of elasticity. Additionally, the drop in value for rupee compared to other Asian currencies means that Indian and Nepali products would benefit from more competitive pricing *vis a vis* other Asian products in European and American markets.

In practice, however, the process determining pricing is more complex. Carpet manufacturers in Nepal have to import nearly all of the necessary input material. Therefore, when the rupee devalues, input costs increase. In India, as will be explained, there is a system of duty drawbacks that is not in place in Nepal.[26] This means that for wool, for which the tariff is 5%, Nepali manufacturers are paying 5% more than Indian

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[24] Ibid.
[25] Ibid.
[26] Oh, Hong-Choon. "Global multiproduct production–Distribution planning with duty drawbacks." American Institute of Chemical Engineering. September 28, 2005.

manufacturers. As the cost of wool increases due to a depreciating currency (which is happening equally in both Nepal and India), 5% represents a larger and larger figure. This means that even as the cost of imported input products increase in both countries, Nepali-made carpets are becoming more expensive compared to their Indian counterparts.

Carpet business owners, overall, seem to view the rapid depreciation of the rupee with more anxiety than hope. Nobody said they would lower prices in US dollar or euro terms, as the rise in input costs would offset the increased value of foreign exchange. Citing the rise in input costs, one owner said, "The depreciation of NRs against the EURO and the US$ in the current fashion will only make short term profits for orders already received, but in the long run this will hamper the business... It would be beneficial for all if most of the raw materials were produced indigenously so that we can offer better prices to clients and therefore help to increase orders and production." Certainly, if input products could be produced domestically, the cost of production would be more stable, and Nepali carpets could be offered at more competitive prices on the international market. Other owners, such as Nawang Lama of Nepal Rug Co., said his company was reluctant to change prices in the euro or US dollar markets because they were unsure if these currencies would keep their value, underscoring the instability of the global financial market today.

The rapid depreciation of rupee also has consequences for businesses that take out loans, as almost every industrialist must at one point or another. Typically, a depreciating currency is seen to benefit borrowers. The currency with which they repay their loans is worth less than it is when the loan is issued. In the specific context of Nepal, however, it seems to be having a detrimental effect. In 2009, following the collapse of a real estate bubble in Nepal, banks faced a liquidity crisis - they did not have enough deposits to meet the demand of loans. The result of this was a significant rise in interest rates paid out on deposits and an even higher increase in interest rates received on loans. This was detrimental to businesses, as the cost of loan repayments cut in to their profits.[27] Banks must first look after banks, however. The lack of discrimination in lending, falling real estate values, and a worsening business climate resulted in many banks being unable to recover many of their loans.[28] In a country where defaults are so frequent, banks have proven leery of lowering lending rates. High interest rates act as a safeguard against losses from default, as it allows banks to recover more of the initial principal quicker. In this context, the dropping value of the rupee has given banks another reason to keep interest rates higher than for which they are demanded. Thus, an unfriendly credit market continues to hamper carpet businesses in Nepal.

Tariffs

Import tariffs are another limiting factor in profits for Nepali business owners. The Nepali government can collect revenue much more effectively by stopping trucks crossing the border than stopping in on the countless one-room shops throughout the country. In doing so, however, they impose taxes that hurt domestic producers rather than help them. This is especially true of the carpet industry, since nearly every input product must be imported. What is more, imports in Nepal suffer taxes beyond those imposed by the state. As Shakya explains in one of his Arthabeed columns titled "Sandalwoodonomics," the informal extraction of tolls has become a lucrative business

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[27] "Act Urgently." *Republica*. October 26, 2011.
[28] "Bad loans eat in to banks' profits," *The Himalayan Times*, July 20, 2011.

for many Nepalis. This increases the cost of imports considerably by the time they reach their final destination.[29] In addition, transport syndicates can also increase costs for businesses in this manner.[30] These costs have been a normal part of business in Nepal for years, but they are costs that are not factors in other countries, and thus help account for higher input costs for carpet makers in Nepal.

Government, The Inactive Player

A reason commonly cited for the downfall of the carpet industry is the lack of government support. Many current and former businessmen mentioned this when asked of the challenges to conducting business in Nepal as opposed to other countries. Not surprisingly, none of them wished to be named. "Tibetan-owned businesses have become soft targets for extortion and abuse from local and politically affiliated organizations," said one owner. What he is implying is a system of unwilling political patronage that is quite common in Nepal. According to a 2010 report by Transparency International, businesses and entrepreneurs are the largest financiers of campaigns, but these funds are often collected in the form of extortion.[31] Thus, many campaign contributions are given without even the pretense of a return benefit in policy. Shakya argues that extortion such as this is deeply embedded in the society of this country. Calling it the "two laddoo syndrome," he argues, "If we are ready to bribe gods for our own good, why should it be surprising when we bribe mere mortals? Similarly, when we are so used to being extorted in the name of religion or government, why would we react differently when we are

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[29] Shakya, Sujeev. *Beed Bytes*. Kathmandu: Fine Print, 2008, 164.
[30] Shakya, Sujeev. "Ignored Economy." *Nepali Times.* July 16, 2010.
[31] Bhattarai, Binod Kumar. "Report on Transparency in Political Finance in Nepal." Transparency International Nepal, February 2010, p. 25.

being held to ransom by political parties?"[32] Apart from stronger law and order, Shakya argues that there needs to be an expansion of legalized political contribution so that parties can raise funds by legitimate means.

The current limited legal channels for campaign finance not only promote the raising of funds by dubious measures, but also actually limit the influence of business. The maximum expenditure per candidate is 459,500 NRs. ($5,600) in first-past-the-post elections and 50,000 NRs. ($610) for proportional representation elections.[33] Media restrictions are also present, with limits in airtime proportional to a party's number of candidates.[34] While these laws are meant to ensure a fair electoral process, limited exposure of the public to proposed policies also limits what voters can understand. Campaigns are an opportunity for public education of government policies, current and proposed (albeit a biased education). When limits on financing and media exposure constrict campaigns, it encourages parties to adopt policies that have simple appeal. "We need laws that make workers work harder," would not be one such example in a country where most of the population identifies itself with the working class.

In India, the power of the business lobby has influenced the government to create a system of policies that allows exporting industries to flourish. One such policy is a duty drawback. A duty drawback is the reimbursement of a company for input costs that are the result of tariffs on imported goods or excise taxes on domestic input goods. For instance, in Nepal the tariff on wool, which is almost entirely imported, is 5%.[35] With a duty drawback system, the government would pay exporting carpet makers 5% of what

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32 Nepali Times
33 Bhattarai, "Report," 15.
34 Ibid., 16.
35 "Customs Tariff 2010-2011," Government of Nepal, Ministry of Finance, 2010.

they spent on imported wool. It may not seem like much, but the existence of such programs in India and lack of them in Nepal is part of the reason production costs are 30% higher in the latter than in the former.[36]

Success Stories

Despite this, the range of carpet business owners to whom I spoke is proof that companies have been able to adapt to the hostile business climate. Though they are anxious about current conditions in the country and trends in the market, they have developed a model that insulates them from the detrimental effects of rising production costs. Every single owner to whom I talked that is still in business today made the transition from large-scale basic productions to producing high-end custom orders . A luxury carpet has a more inelastic demand - someone who is willing to pay $5,000 for a custom-made carpet is not likely to change his or her mind when the price rises to $5,500. In addition, most of them noted a shift in sales from a mainly European market to the US market. This may benefit them in the future, given the current instability in Europe with the Euro-zone financial crisis. Nawang, who is currently conducting business both in high-end custom orders, mainly in the US, and in large-scale orders, mainly in Europe, noted that the doubling of prices for his large scale orders from a price hike in wool has caused clients to look for substitutes elsewhere, such as machine-made rugs or rugs made from synthetic material. Thus, even in companies that have maintained a variety in production techniques, it is custom orders that have proved more stable.

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[36] Ghimire, Prabhakar. "Rising cost of production blunts Nepali carpet's competitive edge." *Republica*, October 2, 2011.

A long history in the business was also a common theme, with everyone having started his or her operation before 1995. Owners who did not have a long history with their employees were more vulnerable when unrest from increased union aggression overtook the country. In addition, the lack of much rapport with clients meant customers were more prone to switch suppliers. In this way many entrepreneurs who entered the carpet business late in its heyday were quickly culled from the market. This left the producers who were able to take advantage of the relationships they had built over the course of years, both inside the factory and out.

History alone doesn't make for good relations, however. With regards to employee relations, owners emphasized the need for fair treatment. "It really comes down to the dharma," Tsering Dolkar said. "If you treat your employees well, they will work well and not let others turn them against you. It's about compassion. Business is more than making money. If you have compassion for your employees, you will have an environment that is more conducive to work." She wasn't alone in this message. "We have over the years also treated all our employees with respect and dignity," said another owner. "We have encouraged a friendly work place without the rigidity of the hierarchy system in management. A sympathetic approach to employee problems has also in turn greatly limited outside negative influences into our work place." Given the rhetoric about worker oppression that is sometimes fed to employees by outside influences, one can see how limiting the viability of this message with fair treatment and compassion is an important part of running a successful carpet business.

Figure 4 - This processing center employs about a dozen people. In total, the company has less than seventy workers on its payroll, according to the owner.

Another owner mentioned small-scale production as key factor in her company's success. This may seem counterintuitive, but given Nepal's labor laws, it is actually quite logical. Since government approval is needed to dismiss unproductive or redundant workers, businesses are not easily afforded the ability to adjust the size of their workforce to changes in demand. Thus, companies who were aggressive in the expansion of their operation were stuck with a workforce much larger than needed as demand receded. It is not hard to imagine how under such circumstances many companies went bankrupt. By using restraint and keeping a limited workforce despite the lure of greater profits from increased production, small companies were well suited to the new market of custom orders and limited production, without large costs of excess overhead.

Tsering Dolkar described a successful client base as being a key to success. As is usual among carpet manufacturers here, Tsering's clients are shop owners and distributors. One such client has in their ranks a well-known designer who creates copyrighted designs. Tsering's company then produces carpets of these designs in limited quantities, thus allowing them to sell the carpets at higher prices to high-end consumers. She too, emphasized the stability that comes from selling carpets as luxury goods - small-scale production with high profit margins. The global economic downturn affected everyone, but the wealthy still have expendable income despite a decrease in wealth. They still have a need to display their affluence, and they'll still buy carpets.

Conclusion, Recommendations

The economy is a complex and often nebulous system. Thus, it is to be expected that so many factors are partly responsible for the competitive disadvantage carpet makers in Nepal face. It is also why no single action will ensure growth for the industry in the future. It will take cooperation on the part of labor, businesses, and the government, and action in a variety of areas.

Firstly, it must be understood that, although limited production of high-quality goods has been a common strategy of successful carpet owners today, it does not necessarily represent a model that can be widely replicated. By their nature, luxury goods are the products of an exclusive group of producers. Greater competition would lower the price, and a lower price would negate its value as a symbol of status. Those who produce these products are able to do so because of years of experience in the field, allowing them to create a product that is judged to be more valuable by the market. Thus, in order for the industry to expand and thrive, it cannot do so by avoiding competitive pricing through the production of luxury goods. Luxury carpet makers will continue to do well in their business as long as they stay on the forefront of quality design and production, but the industry as a whole will never rebound as a large employer and earner of foreign exchange through the replication of this business model. Thus, companies must be able to produce quality products at market prices, and retake business from other Asian competitors.

As mentioned, labor costs in Nepal are currently the highest of any South Asian country, and this is a large factor in comparatively high costs of production. Suggesting wages be lowered is unrealistic, but their growth must be slowed, and it must match growth in company profits. Unions that are organized at the enterprise level would better serve laborers. In this way, they could decide for themselves what they're goals are and work with management in a cooperative manner. Solutions would then be found that address workers needs while ensuring the long-term sustainability of their place of employment. Labor laws must be changed to give companies greater ability to dismiss uncompetitive or redundant workers. The *raison d'être* for permanent worker laws previously was a lack of a social safety net. This changed this passed year with a tripartite agreement between businesses, labor unions, and the government.[37] The social safety net, albeit limited, is now in place. Unions promised greater worker productivity, but this is unlikely to happen if no incentive system is in place. Also, the owners to whom I spoke unanimously agreed that if companies were allowed to reduce their payroll in an economic downturn, they would be more prone to hire more workers during profitable

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[37] Poudel, "Lockup."

times. Also, employers must be able to give higher wages to workers they deem more productive, and terminate employees who repeatedly prove themselves unproductive. With a more efficient workforce, laborers will earn the wages for which they have hard-bargained, and the disparity between unit costs for labor in Nepal and in the rest of South Asia will shrink.

Law and order is one of Nepal's greatest deficiencies, and its implication for business is clear. The case of the Biratnagar garment plant is an example of militant labor unions driving away investment, and this, indeed, needs to cease if this country wants its companies to succeed. Companies need to be held accountable as well, however. State inspections need to be a more regular occurrence, and inspectors need to be better trained regarding labor laws. They also need to be better compensated so that they have less incentive to sacrifice workers rights by extorting guilty company owners instead of criminalizing them. Penalties for breaking labor laws need to be tougher. If the state can hold companies responsible, labor unions will not need to take aggressive measures to ensure workers rights.

Sadly, Nepal's financial system is not stable and accountable enough to manage its own currency, so the peg with the Indian currency is the only option. The country has no control over the rupee's rapid inflation. It can minimize its effects on production costs, however, by finding input materials inside Nepal or India. Interest rates are likely to stay high because of the inflation. If banks were better able to identify companies and individuals who are likely to payback loans through a credit-rating system, however, responsible companies would be able to find loans at more affordable rates.

India's system of export incentives is strong and a model that needs to be replicated. Duty drawbacks are one such example. For input goods that must be imported, the government can offer companies a rebate for the cost of the tariff. A more efficient option, of course, would be to eliminate the tariff on input products that cannot be found domestically.

Businesses in Nepal need to take a more active role in lobbying for change. As mentioned, this would be easier with relaxed campaign financing laws. Regardless, and whatever ethnicity, business leaders need to realize that an informed public will see that what is best for business, what is best for workers and what is best for the country is often the same thing. In the carpet industry there are many owners who exemplify this, and they need to show their example in the proper light.

Opportunities For Further Study

Elections here are an ever-changing field of study with complexities that are difficult to imagine for an American observer. Yet an understanding of elections, how parties come to power, and how they form their policies is imperative in order to understand the country's problems. The relationship between labor unions and their associated parties, and the effect this has on policy is a related topic in to which one could delve deeper. The business lobby in this country appears to be very weak and overmatched by the power unions have over every party. Understanding why this is the case, and creating a viable way for this to change would be an important extension of this study.

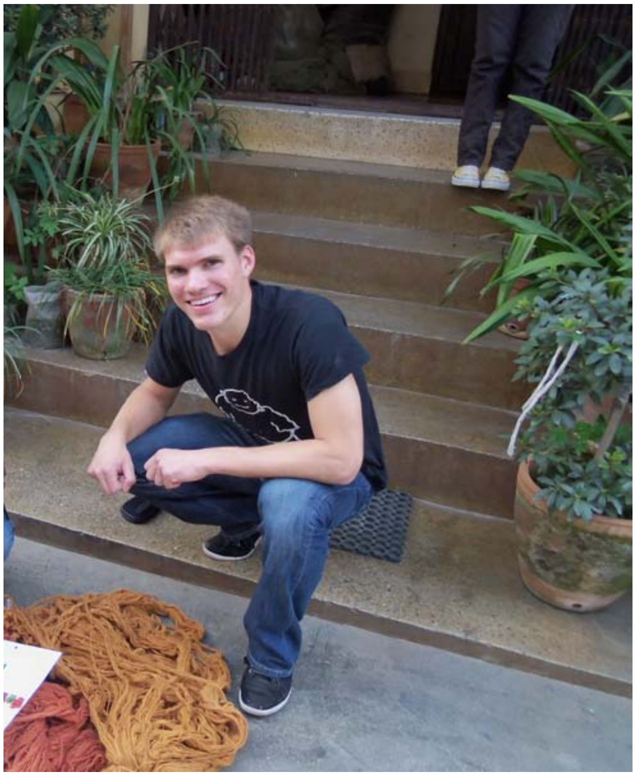

Figure 5 - The author helping to inspect an incoming order of dyed wool.

Methodology

I first pursued interviews with carpet-factory owners through the connections of acquaintances. These owners provided me with insight in to the problems of the carpet industry today. I then acquired academic material to enrich my understanding of these problems. Timely periodicals and newspaper articles were also very instrumental in providing up-to-date information and different perspectives on the various topics discussed.

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