

5. Firm-level perspectives on LDC graduation

Firm-level perspectives provide important insights into graduation-related challenges and policy imperatives.

As part of this study, consultations with 20 to 40 T&C manufacturers in each of the Asian graduating LDCs – Bangladesh, Cambodia, Lao PDR, and Nepal – were conducted to gather firm-level perspectives on the perceived challenges of LDC graduation. As many as 30 leading international fashion companies (i.e. brands, retailers, and sourcing agents) were also approached to request a preliminary assessment of whether LDC graduation might result in changes to their sourcing practices. These consultations were held between May and August 2021 and resulted in the following findings:

- Most surveyed firms in these LDCs confirmed they engage only in the CMT stage of the apparel-making process, focusing on relatively simple products such as T-shirts and trousers.
- LDC firms recognized LDC preferences and lower wage levels (and thus lower cost of production) as their critical competitive edge.
- T&C manufacturers from Cambodia, Lao PDR, and Nepal reported an overwhelming reliance on imported raw materials. Bangladesh has been able to develop considerable production capacity, mainly to cater to the need of domestic consumers, but it has also been able to establish strong backward integration in the knitwear sector.
- Firms procure raw materials and intermediate inputs primarily from abroad, especially from Asian markets such as China, the Republic of Korea, and India. Notably, China is playing an increasingly critical role as a leading textiles supplier for graduating LDCs.
- T&C manufacturers expect LDC graduation to impact their export performance significantly. In general, the surveyed firms are concerned about the potential negative impact on their apparel exports. Given intense price competition, many manufacturers are worried about competing with other leading apparel suppliers, such as Viet Nam, once their apparel exports have lost eligibility for LDC trade preference programmes.
- While FTAs or the GSP that may be available after LDC graduation might help mitigate some negative impacts, complying with these

programmes' more restrictive rules of origin could be another challenge. Most T&C factories from these LDC countries do not seem ready to comply with rules of origin that are more restrictive than the typical "cut and sew" rules they are currently subject to under LDC-specific trade preference programmes. Besides the minimal local textile production capacity in most countries, the surveyed T&C manufacturers in many instances lack sufficiently detailed knowledge about the complex rules of origin.

- As the timeline for LDC graduation is several years away, many surveyed T&C factories acknowledged having no response plan yet. Entrepreneurs and firm managers stressed the importance of continued financial support from their national governments (e.g. Bangladesh and Nepal), skills development, policies to attract investment, and the negotiation of trade agreements or alternative preferential arrangements such as the European Union's GSP+ programme following graduation.
- Despite unfavourable prospects and intense competition, many T&C manufacturers in these hLDCs still hope to expand their exports to conventional markets, including the European Union, United Kingdom, and United States. In comparison, expanding into new export markets generally does not yet seem a priority for most surveyed firms, given the unknown market potential and additional resources required to explore opportunities.

Bangladesh

- Most surveyed T&C manufacturers in Bangladesh consider lack of product diversification to be a major factor constraining further export growth. While manufacturers recognize they are generally operating in relatively low-value CMT stages, many also view "bulk production capacity" as a unique advantage to be matched by

competitors. Some Bangladeshi firms have moved into relatively more complex products such as jackets. Unlike basic knitwear or woven products (T-shirts and polo-shirts), making these items requires more specialized skills and complex production facilities.

- Most Bangladeshi manufacturers recognize that RoO requirements would be more stringent and difficult to comply with after LDC graduation. In general, knitwear factories are more likely to meet the rules of origin requirements than those making woven apparel. Almost two-thirds of knitwear firms said they are currently using domestic-made yarns, dyes, chemicals, and accessories, in comparison with just 36 per cent of woven apparel manufacturers.
- Many Bangladeshi exporters are investing in product upgrades and automation, with the objective of enhancing productivity and becoming more competitive. They are adopting new technologies and are training workers on upgraded machines and processes. Firms also reported adopting energy saving and greenhouse gas (GHG) emission-reduction technologies, implementing software-based production tracing, and digitalizing administration activities, including employee tracking and payment processing.
- The surveyed Bangladeshi T&C manufacturers called for support to help them mitigate the impact of LDC graduation. Over two-thirds of respondents think that the erosion of trade preferences could potentially affect their export performance after graduation.
- For the majority of respondents, negotiating free trade agreements with their most critical trading partners could help mitigate the impact of LDC graduation. The European Union, the United States, Canada, the United Kingdom, Japan, and Australia are their top priorities for potential trade agreement considerations.

Cambodia

- Nearly all of the factories in the Cambodian garment, footwear and travel bag industries are owned by foreign investors, especially from China, with only 6 per cent owned by domestic investors. Over 75 per cent work mainly on contract from their headquarters, parent companies or agents.
- Respondents confirmed that heavy reliance on imported textile raw materials means low-value-added sewing work can generate only a marginal profit. Their production and exports are focused on relatively simple and basic clothing items such as T-shirts, trousers, and shirts, targeting primarily the mass and value markets, which are concentrated largely in the European Union, United States, Japan, and China. For almost two-thirds of surveyed firms, at least 40 per cent of export earnings are sourced from one or two top export markets.
- Nearly 60 per cent of respondents reported not using any domestic-made textile raw materials due to limited supply. About 40 per cent of firms source less than 10 per cent of their total inputs from Cambodia, and these products are limited to packaging materials and label printing services.
- Overall, the surveyed T&C manufacturers in Cambodia expect LDC graduation to impact their exports negatively. Nearly 45 per cent of respondents anticipate that the loss of LDC-specific tariff preferences will cause a decline in demand for their products. Respondents expressed particular concern about their lack of export competitiveness beyond the tariff exemption provided for LDC countries.
- Two-thirds of respondents mentioned not yet having any plan to prepare for LDC graduation. Others are considering reducing production costs and improving efficiency through automation and the adoption of new technologies following LDC graduation.

- Most respondents do not have any concrete plan to diversify their export markets. Instead, the surveyed T&C manufacturers in Cambodia still see the European Union and United States as their top export priorities in the years to come.
- To help mitigate any potential adverse consequences, T&C manufacturers seek policy support to facilitate the upgrade of production processes, including automation; a continuation of the tax holiday programme; an expansion of training facilities for workers; and the prioritization of infrastructure and logistics improvements.

Lao PDR

- Respondents to the survey mainly produce garment items for export purposes. Most manufacturers operate at a small scale, making it challenging for them to fulfil large sourcing orders. Many manufacturers are sub-contractors of larger companies headquartered in other countries.
- Respondents reported primarily targeting those countries that offer Lao PDR LDC-style preferential market access, including duty-free treatment and liberal rules of origin.
- Survey respondents seemed to suggest that LDC graduation might have an overall detrimental impact on Lao garment exports, although the magnitude of that impact would differ among export destinations, given the varying levels of preferences that are granted by importing countries and which may still be available after graduation through GSP schemes for non-LDC developing countries and/or FTA arrangements (e.g. the ASEAN-Japan CEPA and the ASEAN-China FTA).
- Most respondents are of the view that the loss of preferential market access to the European Union could significantly impact their

production and exports, as it currently serves as the single largest export market for many garment factories in Lao PDR. It was also suggested that complying with rules of origin requirements would be challenging even if Lao PDR eventually manages to qualify for GSP+.

- Some respondents argued that LDC graduation would disproportionately hurt Lao PDR's exports of relatively simple products to the European Union (such as T-shirts) but be less damaging for exports of more sophisticated products.
- As transport costs are a major issue for the Lao garment industry, most surveyed firms showed interest in exploring opportunities from the Lao PDR- China railway that opened in December 2021 and could help companies develop closer links with regional value chains.
- Some of the surveyed Lao garment manufacturers plan to improve the sophistication of their products or invest in technologies to improve the competitiveness of their exports in preparation for LDC graduation. However, the lack of a skilled labour force remains a concern in terms of facilitating technological upgrade. On the other hand, respondents did acknowledge that extensive automation would lead to many fewer jobs and thus reduce the main benefit the sector provides to the country.

Nepal

- The surveyed T&C manufacturers in Nepal mainly produce cotton-based garments, primarily focusing on basic items such as T-shirts, sweaters, jumpers, trousers, and shorts. According to respondents, garment manufacturing, although labour-intensive, does not require specialized skills.
- Respondents reported that being located in a landlocked country drives up costs for sourcing raw materials and export activities,

and that this affects their competitiveness. India is their top textile supplier (i.e. of yarns and fabrics) for cotton-related apparel items, followed by China. For man-made fibre clothing, China is the leading supplier of synthetic textiles. Nepal's manufacturers import most cashmere or wool yarns from China and New Zealand.

- Respondents said almost all their clothing exports took advantage of the trade preference schemes provided to LDCs by importing countries. In particular, the European Union's Everything But Arms (EBA) programme plays a uniquely critical role in supporting Nepal's garment exports.
- Overall, respondents expressed concerns about the likely negative impact of LDC graduation on their export and business operations.
- Nearly 75 per cent of respondents said they currently do not have a plan or strategy in relation to LDC graduation. For others, the primary approach will be to reduce production costs.
- Some respondents anticipate their apparel exports may still qualify for preferential market access through general GSP schemes and other preferential arrangements, including FTAs, following LDC graduation. However, most expressed concerns about not meeting rules of origin requirements under these arrangements as those are more restrictive than the cut and sew RoO they are currently subject to.