

# Bangladesh Diagnostic Trade Integration Study

## Beyond Low Wage Labor: Strengthening Bangladesh's Competitiveness

*Using Trade to Leverage the Demographic Dividend*

### Volume 1: Main Report



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# Preface

This Diagnostic Trade Integration Study (DTIS) has been prepared under the Enhanced Integrated Framework (EIF) for Trade Related Technical Assistance to Least Developed Countries, in response to a request from the Government of Bangladesh. The EIF is a multi-donor program, which supports LDCs to become more active players in the global trading system by helping them tackle supply-side constraints to trade. The ultimate objective of the study is to build the foundation for accelerated growth by enhancing the integration of its economy into regional and global markets.

[to be completed]



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# Acronyms and Abbreviations

AD	Antidumping Duties	DTIS	Diagnostic Trade Integration Study
ADM	Application Development And Maintenance	EEF	Equity Entrepreneurship Fund
AGOA	African Growth and Opportunity Act	EPZ	Export Processing Zone
AEO	Authorized Economic Operators	ERP	Effective Rates Of Protection
APIs	Active Pharmaceutical Ingredients	FDI	Foreign Direct Investment
APICCAPS	Portuguese Footwear, Components and Leather Goods Manufacturer's Association	FERA	Food and Environment Research Agency
ATC	Agreement on Textile and Clothing	FTA	Free Trade Agreement
ASEAN	Association of Southeast Asian Nations	FY	Fiscal Year
ASYCUDA	Automated System for Customs Data	GDP	Gross Domestic Product
BASIS	Bangladesh Association of Software and Information Services	GoB	Government of Bangladesh
BB	Bangladesh Bank	GSP	Generalized System of Preferences
(BDT) Tk	(Bangladesh) Taka	GTSF	Global Trade Supply Finance
BGMEA	Bangladesh Garment Manufacturers and Exporters Association	HDPE	High Density Polyethylene
BIDS	Bangladesh Institute of Development Studies	EEF	Equity and Entrepreneurship Fund
BIWTA	Bangladesh Inland Water Transport Authority	EPAs	Economic Partnership Agreements
BJMC	Bangladesh Jute Mills Corporation	EPB	Export Promotion Bureau
BKMEA	Bangladesh Knitwear Manufacturers and Exporters Association	EU	European Union
BOI	Board of Investment	FYP	Five Year Plan
BPO	Business Process Outsourcing	HS	Harmonized System
BQSP	Bangladesh Quality Support Programme	ICD	Inland Container Depot
BSIC	Bangladesh Standard Industrial Classification	ICT	Information and Communications Technology
BSTI	Bangladesh Standards and Testing Institution	IDLC	Industrial Development Leasing Company
BUILD	Business Initiative Leading Development	IFC	International Finance Corporation
CBC	Carpet Backing Cloth	IMF	International Monetary Fund
CD	Custom Duty	IPO	Import Policy Order
CKD	Complete Knock Down	IPS	Internet Protocol Suite
CPD	Centre for Policy Dialogue	IT	Information Technology
DCC	Dhaka City Corporation	ITES	Information Technology Enabled Services
DFID	Department for International Development	IWT	Inland Waterways Transport
DGDA	Directorate General of Drug Administration	JICA	Japan International Cooperation Agency
JDPC	Jute Diversification Promotion Centre	PVH	Phillips-Van Heusen
KPMG	Klynveld Peat Marwick Goerdeler (accounting firm)	RCA	Revealed Comparative Advantage
L/C	Letter of Credit	RD	Regulatory Duty
LDC	Least Developed Country	R&D	Research And Development
LDPE	Low Density Polyethylene	RMG	Ready-Made Garment
LFMEAB	Leather Goods & Footwear Manufacturers & Exporters Association Of Bangladesh	RoO	Rules Of Origin

LLC	Limited Liabilities Corporation	SAFE	Safety Advancement For Employees
LPI	Logistics Performance Index	SBW	Special Bonded Warehouses
Mbps	Megabits per second	SD	Supplementary Duty
MFA	Multi Fiber Arrangement	SKD	Semi Knock Down
MPV	multi-purpose vehicle	SME	Small and Medium Enterprises
MRAs	Mutual Recognition Agreements	SMM	Shipbuilding, Machinery and Marine Technology
MT	Metric Ton	SPS	Sanitary And Phytosanitary Standards
NDP	National Drug Policies	TIR	Transport Internationaux Routiers.
NBR	National Board of Revenue		
NE	North Eastern	TEU	Twenty Foot Equivalent Container Units
NPR	Nominal Protection Rate	UPS	Uninterruptible Power Supply
NTB	Nontariff Barriers	UNIDO	United Nations Industrial Development Organization
NTM	Non-Tariff Measures	US	United States
ODYs	Off-Dock Yards	USAID	United States Agency for International Development
OECD	Organisation for Economic Co-operation and Development	US\$	United States Dollar
OEM	Original Equipment Manufacturer	USITC	United States International Trade Commission
PMO	Prime Minister's Office	VAT	Value Added Tax
PP	Polypropylene	VCA	Value Chain Analysis
PSDSP	Private Sector Development Support Project	WCO	World Customs Organization
PRI	Policy Research Institute	WPC	Worker Participation Committees
PSI	Pre-shipment Inspection	WTO	World Trade Organization

**GOVERNMENT FISCAL YEAR**

July 1 – June 30

**CURRENT EQUIVALENTS**

Currency Unit = Bangladeshi Taka (Tk)

US\$1 = Tk 77.8 (June 2013)

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# Synopsis

Bangladesh's ambition is to build on its very solid growth and poverty reduction achievements, and accelerate growth in order to become a middle income country by 2021, continue its high pace of poverty reduction, and share prosperity more widely amongst its citizens.

This includes one of its greatest development challenges: to provide gainful employment to the over 2 million people that will join the labor force each year over the next decade. Moreover, only 51.5 million of its 90 million working age people are employed. Bangladesh needs to use its labor endowment even more intensively to increase growth and, in turn, to absorb the incoming labor.

The Growth Commission report (2008) suggests that all the thirteen country cases of sustained high growth over the postwar period were marked by full exploitation of the knowledge, resources and deep and elastic demand that the global economy offered. Bangladesh will need to do the same, and exploit the international market more intensively, building on the pivotal role that exports have already played in providing gainful employment and access to imports.

Bangladesh's exports have grown strongly and doubled their world market share between 1995 and 2012, owing to success in garments, catering largely to the EU and USA. Since 2009, it has become the world's second largest garment exporter, making it unique amongst LDCs in its high share of manufactures in total exports, which reached 90.1 percent in 2012 compared to about 21.1 percent for LDCs.

Garments can continue to grow, in existing and newer markets. Newer products will emerge more slowly. Thus, more rapid export growth will initially rely on capturing higher market shares in Bangladesh's existing strengths, i.e., basic garments--both in current markets, and penetrating newer and dynamic markets such as Japan, China, ASEAN and India. In addition, many firms are starting to produce higher value garments, and this will expand the target market for Bangladesh. Other products are emerging, such as jute goods, footwear, sea food, information technology enabled services (ITES), etc., and some of these may over time become part of a larger product cluster.

To achieve the above and sustain and accelerate export growth will require actions centered around four pillars. These are: (1) *breaking into new markets* through a) better exploitation of regional trading opportunities; and b) better trade logistics to reduce delivery lags and become more competitive in nearby markets, especially Asia; as world markets become more competitive and newer products demand shorter lead times, to generate new sources of competitiveness and thereby enable market diversification; (2) *breaking into new products* through a) more neutral and rational trade policy and taxation and bonded warehouse schemes; and b) concerted efforts to attract foreign direct investment, to spur investment and export diversification; (3) *improving worker and consumer welfare* by a) improving skills and literacy; b) implementing labor and work safety guidelines; c) making safety nets more effective in dealing with trade shocks; and (4) *building a supportive environment*, including a) sustaining sound macroeconomic fundamentals; b) easing the energy constrain; c) strengthening the institutional capacity for strategic policy making geared to the objective of international competitiveness to help bring focus and coherence to the government's reform efforts.

Detailed studies of a number of growing export sectors confirmed the cross-cutting findings highlighted above, and added other, sector-specific issues. In shipbuilding, enforcement of standards for domestic ships would help bring domestic and export market segments closer, and help exporting yards to achieve better scale economies. More credible enforcement of standards in pharmaceuticals would help people's health and also reduce the disincentives of firms including foreign firms that practice self-enforcement. Training to upgrade skills was a critical need in many sectors, including shipbuilding, ITES, and bicycles. FDI could play a much bigger role in many sectors, especially those with technology upgradation needs, such as pharmaceuticals, bicycles, and shipbuilding. Improvements in access to finance and ease of

Bangladesh Bank-monitored current account transactions would relieve constraints across all sectors. Additional submarine cables would help reliability of internet services for the ITES sector.

A neutral trade policy needs to be defined by consumer interests, and not just those of domestic producers and exporters. Currently, distortions affect critical areas that affect consumer welfare, such as medicines and consumer products, and producer interests have tended to dominate over consumer interests. For example, allowing a due role for trade and FDI in drug supply will enhance choice and quality of medicines and enable a more effective health strategy. In addition, societal demands for better regulation of imports to address an expanding array of issues, like public safety, food safety, and plant and animal health, will increase, and this will need to be done in a credible and efficient manner that respects the balance between safety and access to a variety of imports.

Trade regime signals are critical for defining domestic production structures and shaping the usage of labor and capital. Bangladesh needs to increase the share of labor-intensive manufacturing in its overall GDP, and a stronger export-orientation will play a critical role here. Increasing basic skills will be critical—for Bangladesh to remain competitive in exports, improve worker productivity and enable sustainable wage increases. For skill flows, development of cognitive and non-cognitive skills through a focus on the quality of primary and secondary education, along with industry-specific skills, will bring immense dividends.

An example of outward orientation will help. If Bangladesh were to capture 20 percent of China's current garment exports, its own total exports would more than double, increasing by US\$29 billion, and, based on current parameters, create 5.4 million new jobs and 13.5 million new indirect jobs. These would be virtually enough to absorb all new entrants into the labor force over the next decade.

With the implementation of the four pillar agenda, a virtuous circle of export-led growth can be put in place, with multiple sources of strength. This will help improve overall competitiveness of the economy and provide sources of strength other than low wages.

The ultimate goal of export-led growth is poverty reduction and enhanced welfare of Bangladesh's citizens. Rapidly growing exports and the millions of new jobs accompanying them, along with skill-upgradation, will increase productivity and wages, which over the long term is the only sustainable way to improve living standards; it will also begin a discourse to move beyond wage-based competitiveness. Improving skills will also allow effective participation of people in growth. Improving labor standards and worker safety is also part of this agenda, and, in the wake of recent tragic incidents in the garment sector, has become a part of the preconditions for garment exports.

Bangladesh is well placed to take on some its strongest development challenges, provided it displays the right leadership. Its track record on growth and employment is strong. To grow faster and absorb more labor, and continue its pace of poverty reduction, it will need to build on that record and improve upon it. The good news is that a number of reforms are relatively low hanging fruits, may be implemented in the short to medium term, and can bring large pay-offs.

The example of Vietnam shows that accelerated, export-oriented development is possible, even in the context of the current global environment. Vietnam moved from being one of the poorest countries in the world to a lower middle income one in the space of 25 years, with FDI and trade playing a dominant role in the economy: exports and imports each form 90 percent of GDP, and, with 88 million people compared to Bangladesh's 150 million, it exports four times as much as Bangladesh today.

Bangladesh will need strong leadership to support its multi-sector competitiveness agenda. In many cases, it will require taking on strong domestic interest that may not welcome competition, either through imports or FDI. In other cases, it would require cohesion and coordination between different ministries/departments, such as the National Board of Revenue, the Ministries of Commerce, Finance, and Industry, the Roads Division, and so on. If the Sixth Plan and Vision 2021 goals are to be achieved, this leadership has to be exercised.





# Section 1: Overview and Key Messages

*This DTIS, prepared at the request of the Government of Bangladesh, analyzes the internal and external constraints to further integration with the world economy, keeping in view the end goals of job creation and poverty reduction, as well as enhancement in citizens' welfare. It seeks to identify policies as well as gaps in physical and institutional infrastructure that will consolidate Bangladesh's strengths in existing markets as well as help diversify export products and export markets. At the same time, it spells out the linkage between these policies and consumer and worker welfare, which focuses additional attention on import policies, skill enhancement and labor safety. To illustrate and anchor these policy constraints to further integration, the DTIS includes a large number of industry/service sector studies. While the study is comprehensive in its coverage of issues and sectors as requested by the Government, it is not intended to be an exhaustive study of different industries or services. The identified policies and constraints are summarized at the end of Section 1 as well as in an Action Matrix presented at the end of this Volume.*

## 1.1 The Imperative of Engaging with the World Economy

1. Bangladesh aims to accelerate growth in order to become a middle income country by 2021, continue its high pace of poverty reduction, and share prosperity more widely with its citizens. It seeks to increase the growth rate of its economy to about 7.3 percent per annum over the Sixth Plan period (FY11-15), and reduce the poverty headcount by about 10 percentage points. It also seeks to pay closer attention to wider prosperity of its citizens and improve access to and quality of health, education and nutrition services.

2. **This includes one of its greatest development challenges: to provide gainful employment to the 2.1 million people that will join the labor force each year over the next decade, and to improve the utilization of existing labor.** While Bangladesh has the eighth largest population in the world and the third largest in South Asia after India and Pakistan, only 51.5 million of its 90 million working age people are employed. Moreover, the working age population is growing at a higher rate than the overall population, at 2.5–2.8 percent per year and 1.4 percent respectively. This presents a potentially major demographic dividend. But it also represents a major challenge to lift incomes and citizens' welfare. Bangladesh needs to use its labor endowment even more intensively to increase growth and, in turn, to absorb the incoming labor. In this context, the 6FYP plan's emphasis on export-oriented manufactures, with their job potential, seems appropriate.

3. **The Government of Bangladesh recognizes that export-led growth and a broadening of the country's export structure is pivotal to its growth ambitions.** In the Sixth Five Year Plan (6FYP), trade is considered as a strong source to accelerate growth, and to provide high productivity and high income jobs. The government recognizes that a dynamic manufacturing sector will benefit from greater outward orientation, particularly based on the experience of other successful Asian exporters such as Korea, China, India, Thailand and Vietnam. The government has put emphasis on product and market diversification, and regional and global integration. The 6FYP projects "...the share of exports in relation to GDP to rise by 7.7 percentage points to 23.9 percent of GDP by the end of the 6FYP, reflecting a leading role that [the] export sector is envisaged to play in increasing domestic activity (Vol. 1, 6FYP, p. 85)." This strategy recognizes the pivotal role that higher export-orientation has already played, with the impressive export and job creation of the garment export sector.

4. **But current policies place limits on the extent of labor-intensive growth.** Presently, policies are heavily skewed towards favoring production for the domestic market, which limits growth because the

market is limited, and, because of protection, production does not necessarily have to be competitive: many sectors have very high effective rates of protection. Production for exports, on the other hand, is necessarily competitive, usually implying in the Bangladeshi context, that it is highly labor-intensive, and the potential market, in practical terms, is immense.

5. **Addressing Bangladesh’s prime development objective of more and better jobs will require:**

- a neutral trade policy that seeks to exploit the world market and favors exports as much as domestically oriented production;
- a regime that pro-actively encourages FDI;
- infrastructure improvement, especially relating to energy and trade logistics.

6. **Ensuring consumer and worker welfare is not only an end in itself but will also help sustain export growth and better jobs.** It would entail:

- Improving skills and literacy to allow a move up the quality ladder and enable higher productivity and wages;
- Implementing labor and work safety guidelines;
- Taking into account consumer interests in trade policy, balancing issues such as food safety and animal health with efficient access to imports.

7. **The Growth Commission report (2008) highlights the deep link between sustained growth and the world market.** It finds that all the thirteen country cases of sustained high growth over the postwar period were marked by full exploitation of the knowledge, resources and deep and elastic demand that the global economy offered.

8. **Thus, if Bangladesh were to capture 20 percent of China’s current garment exports, its own total exports would more than double, increasing by US\$ 29 billion, and, based on current parameters, create 5.4 million new jobs and 13.5 million new indirect jobs. These would be virtually enough to absorb all the new entrants into the labor force over the next decade.** It is certainly doable, given the strengths that Bangladesh has, but would need sustained implementation of the agenda highlighted in this report.

## 1.2 Strong Record on Growth, Poverty Reduction, and the Current Account

9. **Bangladesh has posted a robust and resilient economic performance over the past decade, accompanied by a sustained decline in poverty.** Real GDP grew at a healthy rate of around 6 percent per annum (Table 1) over the past decade, accelerating by a percentage point compared to the previous one. GDP growth was remarkably stable with a low standard deviation of 0.7 percent during this decade (half of what it was from a decade earlier). This robust growth was accompanied by a uniform and steady decline in poverty headcount rates between 2000 (48.9 percent) and 2010 (31.5 percent), and a continuous decline in the number of poor people—from nearly 63 million in 2000 to 47 million in 2010, despite a growing population.

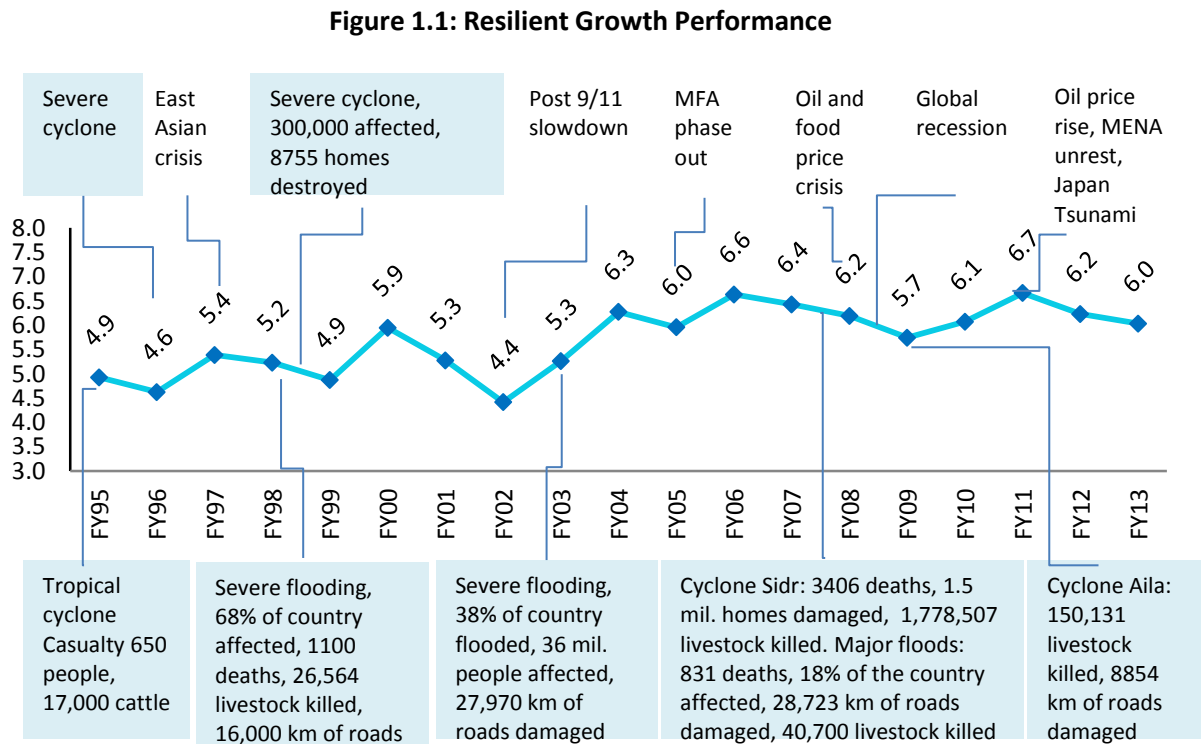
10. **The Bangladesh Poverty Assessment shows that during 2000-2010, poverty reduction was closely linked to the growth in labor income and changes in demographics (World Bank 2013a).** The most important driver of poverty reduction was growth in labor income. An increase in the share of the adult population in the country (i.e., within each household as well) was also a significant factor, implying a declining dependency ratio.

11. **How did Bangladesh grow in such a sustained fashion?** Economic growth accelerated largely since the 1990s, because of the accumulation of physical capital, increase in the size of the labor force,

and to a much smaller extent, an increase in total factor productivity.<sup>1</sup> Underpinning this were several economic reforms: sound macro-economic management, targeted trade policy reforms that enabled the garment sector to thrive and similarly-focused policies that facilitated take-offs in other specific sectors (e.g., as frozen foods in European markets), import and financial sector liberalization, and investment in human development and social protection. Remittances and garment exports were the twin drivers of growth in the economy—remittances through their effect on consumption and construction as well as easing the foreign exchange constraint, and garment exports through providing sustained direct and indirect employment for millions of workers in garments, input and ancillary suppliers, etc. Also, the manufacturing sector has been the largest single contributor to growth in the past two decades. As a result, the share of manufacturing in total GDP increased from 10.8 percent in FY80 to 18.9 percent in FY13. Modest investment rates notwithstanding, capital deepening in both agriculture and industry played an important role.

12. **Bangladesh has also proven to be relatively resilient to global economic shocks** (figure 1). Its growth continued to be resilient despite several external shocks that slowed exports, remittances, and investment growth, including the end of the Agreement on Textile and Clothing (ATC) in 2005 and the 2008-09 global financial crisis, thanks largely to strong fundamentals at the onset of the crisis, relatively under-developed and insulated financial markets as well as pre-emptive policy response. However, while slow growth in Europe and the US, the two main export markets, has dampened Bangladesh’s export growth, exports have nevertheless recovered and continue to grow at a reasonable pace.

**Figure 1: Resilient Growth Performance**



<sup>1</sup> For a detailed analysis, see World Bank (July 2007), “Bangladesh: Strategy for Sustained Growth,” and World Bank (2012b), Bangladesh: Towards Accelerated, Inclusive and Sustainable Growth—Opportunities and Challenges.

13. **The current account and balance of payments have been stable, thanks to remittances.** Bangladesh relies heavily on imports for capital goods, oil, intermediates, and even a variety of consumer goods. Exports are not sufficient to pay for all imports, but the current account has been positive since FY06, owing to growing remittances, which have proved critical to the stability of the balance of payments. Despite some concerns in FY11 and FY12 about oil imports and their impact on the balance of payments, the external sector has by and large proved very stable over the years. Reserves have grown, and stood at almost five months of goods and services imports in FY13. Macroeconomic pressures that had developed on account of energy subsidies have also eased recently, supported by more restrained fiscal and monetary policies (see IMF 2013, <http://www.imf.org/external/pubs/ft/scr/2013/cr13157.pdf>, for details).

### 1.3 Emerging Issues in Export Growth and Its Sustainability

14. **Bangladesh's unique manufacturing performance raises a puzzle.** Bangladesh appears to have mastered labor-intensive mass manufacturing as displayed in its many large garment factories; the high share of manufactures in exports is unique at its income level. Yet, this success has so far not led to the creation of another large labor-intensive cluster, and garments dominate the export basket. It raises some potential issues about the sustainability and volatility of export growth.

15. **Although growing over time, the role of trade in the overall economy is still low. Trade could play a more significant role in promoting faster GDP growth and poverty reduction.** Imports as a percent of GDP stand at 32.1 percent while exports account for 23.1 percent in FY12 (table 1), which is significantly lower than Vietnam (exports and imports each about 90 percent of GDP), Thailand or even Indonesia.<sup>2</sup> Higher volumes of trade can increase the efficiency of domestic production, and also contribute to a greater labor-intensity in the economy. Thus, if the share of trade in GDP is higher (with the same net exports balance), then, even with constant GDP levels, it could mean an increase in overall employment in the economy. In addition, trade policy could be used in a more deliberate way to enhance consumer welfare.

**Table 1: Key Macroeconomic Indicators, FY05-FY13**

Indicators	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
<i>Output and prices</i>									
Real GDP growth (in percent)	6.0	6.6	6.4	6.2	5.7	6.1	6.7	6.2	6.0
Gross investment (percent of GDP)	24.5	24.7	24.5	24.2	24.4	24.4	25.2	26.5	26.8
CPI inflation (average)	6.5	7.2	7.2	9.9	6.7	7.3	8.8	10.6	7.7
<i>External accounts</i>									
Exports (US\$ million)	8,655	10,526	12,178	14,111	15,565	16,205	22,924	24,288	27,018
Annual % change	13.8	21.6	15.7	15.9	10.3	4.1	41.5	5.9	11.2
Garments/Total exports (%)	74.2	75.1	75.6	75.8	79.3	77.1	78.1	78.6	79.6
Imports (US\$ million)	13,147	14,746	17,157	21,629	22,507	23,738	33,658	35,441	33,575*
Annual % change	20.6	12.2	16.3	26.1	4	5.5	41.8	5.3	-0.4*
Remittances (US\$ million)	3,848	4,802	5,979	7,915	9,689	10,987	11,650	12,843	14,456
Annual % change	14.2	24.8	24.5	32.4	22.4	13.4	6	10.2	12.6
Current account balance (% GDP)	-0.9	1.3	1.4	0.9	2.7	3.7	0.8	1.5	2.0*
Gross official reserves (US\$ million)	3,024	3,484	5,077	6,151	7,471	10,750	10,912	10,325	15,576
In months of GNFS imports	2.6	2.8	3.4	3.4	3.7	5.1	3.9	3.3	4.9

Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Export Promotion Bureau, Ministry of Finance, IMF and World Bank Staff estimates. \* Till FY13 July-May

<sup>2</sup> In 2012, comparable countries had export and import to GDP ratios of 78 and 75 percent (Thailand), 89.8 and 90.2 percent (Vietnam), 31.6 and 29.4 percent (Indonesia).



16. **The positive current account in a low income economy speaks to the lack of investment opportunities.** A low income economy usually draws on foreign savings to supplement domestic/national savings to increase the overall rate of investment. Yet, in Bangladesh's case, the current account has been positive, since FY06 in recent years, indicating the lack of sufficient investment opportunities and an inadequate climate for investment. This means that acceleration of export growth, which will demand a significant increase in overall investment, will require a concerted policy effort.

17. **The macroeconomy is stable, but institutional weaknesses and several vulnerabilities loom large.** Despite recent weakening in the pace of economic activity and ongoing political tensions, Bangladesh's macroeconomic position has remained stable, with declining inflation supported by prudent monetary and fiscal policy. Nevertheless, the ongoing political uncertainty, together with frequent general strikes and associated violence, has added to the longstanding energy and infrastructure deficits in dampening investment, posing a nontrivial threat to sustaining the recent average 6 percent growth, let alone raising it to 7 percent in the near future. Moreover, deep rooted institutional capacity weaknesses underlie the failure to speed up implementation of top priority infrastructure projects, and are not easily addressed. Bangladesh's near and medium-term macroeconomic outlook is subject to several vulnerabilities—prospects of a resurgence in inflation, possibly arising from expected large wage increases that are not matched by increases in productivity; a possibility of export slowdown; fiscal expansion due to increased recurrent expenditures in response to political pressures; a weak financial system that has been further exposed by recent stock market volatility and financial scams; and remittance inflows that have become vulnerable with the recent sharp decline in the number of workers going abroad.

18. **The energy shortage is an overarching constraint affecting virtually all segments of the economy.** In 2012, the demand supply gap of electricity was around 5000 Gwh (Ministry of Finance, 2013). Bangladesh ranks last among its Asian competitors (only above Nepal) in prevalence of power outages. Power outages are a key reason why manufacturing productivity in Bangladesh is much lower than in Vietnam and China. And the use of captive generation to compensate for outages adds to costs (World Bank 2012b). The sector studies done for this DTIS corroborate this, from sectors as varied as IT enabled services to shipbuilding. A comparison of World Bank's Investment Climate Assessment (ICA) between 2002 and 2007 revealed that the value lost due to electrical shortages increased from 2.9 percent of sales to 12.3 percent (World Bank, 2012b). While access to reliable source of electricity tops the list of concerns for the region as a whole, the losses that Bangladeshi firms suffer are much higher compared to 5.4 percent of sales lost in Pakistan and 5.5 percent in India.

19. **The overall low use of labor in the economy is a concern, and increasing labor-intensive, export-oriented manufacturing will need to be part of the solution.** Of Bangladesh's 90 million working age population, only 51.5 million were employed in 2010, reflecting a low 35 percent female participation in the labor force. Moreover, the labor force will grow faster in coming years, with 2.1 million people entering the prime working-age population annually over the next decade. Increasing the employment rate (utilization of the working age population), and providing jobs for the growing labor force, will be a major challenge; part of the solution will involve a re-orientation of the economy away from its anti-export bias, improvements in trade infrastructure to shorten lead times, etc. (see end of this section).

20. **Bangladesh will need to focus more attention on skills development: skills are emerging as a major constraint, even in the garments sector, let alone other, more skill-intensive sectors.** While educational access has increased significantly over the last decade, particularly at the lower levels of education and especially for women, currently 96 percent of the labor force has less than secondary education, and two-thirds has less than primary education. According to the World Bank (2013a), just a third of the primary graduates acquire the numeracy and literacy skills they are expected to master by the time they graduate. Moreover, among the labor force the percentage of persons having professional education such as engineering and medicine is very small (only 0.17 percent of the labor force has such

degrees). A World Bank survey of 1000 garment firms in 2011 found that skills were the major disadvantage if firms located outside Dhaka. High rejection rates in a 2010 UNIDO survey also point to low average skills of garment workers. In sectors such as ITES, shipbuilding and pharmaceuticals, part of this DTIS, higher skills were in constant demand (World Bank 2012a, 2012b).

21. **The low level of literacy and years of schooling of the labor force make skill acquisition more difficult.** About 46.5 percent of the population of the country remains illiterate, and the average years of schooling among the labor force is 4.8 years in the year 2010. As compared to many other Asian countries, Bangladesh has a rather low level of literacy. Moreover, the average years of schooling is also very low compared to countries that are currently competing with Bangladesh's garment sector. The lower time spent in school complicates the process of learning and skill acquisition. In contrast, Sri Lanka has provided a skills environment that allowed garment firms to quickly move up the value chain. Bangladeshi firms' choice is restricted to only primary school graduates and high school dropouts.

22. **Labor issues (i.e., wages, workplace safety, and compliance with labor standards) can generate major reputational risk for Bangladesh's overall garment exports, and will need to be carefully managed.** Labor standards and safety issues can affect future exports and Bangladesh's overall reputation in the exporting sector. Concerns have been heightened recently following a series of fatal incidents, and the Government has been pressured to take a number of measures to improve workers' safety. International buyers and governments have also reacted strongly to these events (box 1). The US suspended GSP trade privileges for Bangladesh over concerns about safety problems and labor rights violations in the garment industry on June 27, 2013. Whatever measures the government will implement under domestic and international pressure, the important issue will be enforcement and commitment to ensure better and safer practices. Continued improvement in labor conditions in the garment sector, in coordination with international business and development partners, would be important.

#### 1.4 Enabling Exports and Imports to Play a More Prominent Role in the Bangladesh Economy

23. **Bangladesh needs to not just raise the rate of growth of exports, but also move beyond the low-wage paradigm.** As noted earlier, growth acceleration will require Bangladesh to become more export-oriented. Thus far, it has enjoyed strong success in exports, primarily based on low-skill, low-wage based competitiveness in garments, which dominate the export basket. However, this strategy does not guarantee continued growth in exports, given the pressures of global competition and the possible emergence of future competitors with a better wage/productivity combination. In any case, living standards of workers can only rise if their real wages go up—and to enable sustained real wage increases, worker productivity, and therefore skills need to improve. To capitalize on developments in educational access, Bangladesh will need to make structural changes in the economy, create more and higher productivity jobs and improve education and skill development to derive maximum benefit from the demographic dividend.

24. **Thus, the DTIS identifies several other sources of competitiveness so that low wage labor is not the only comparative advantage of Bangladesh.** This report emphasizes the great potential for Bangladesh to increase its trade competitiveness and investment attractiveness including through some of the measures highlighted below.

### Box 1: Will the Collapse of Rana Plaza Create a Wave of Far-reaching Reforms?

The fallout from the April 24 collapse of the 8-storey Rana Plaza multipurpose building in Savar, Dhaka, has had domestic and international repercussions. The death toll exceeded 1,100, mostly female garment workers who worked in the upper floors of the building in several garment factories supplying about 30 Western clothing retailers. Early analysis suggests that the building was not built to code; was not fit to sustain the additional weight of the three highest floors added after the original building was built; and was not suited to carry the weight of people and equipment that a garment factory requires or withstand the vibrations of the back-up generators that were installed in the upper-floor factories. A few people have been jailed for complicity in this situation, including the building owner and some factory owners (who urged factory workers to return to their work places a day after large cracks were found in the building and a structural engineer pronounced the building to be unfit for use), and others have been suspended, including public officials who authorized the building's construction.

In the meantime, international clothing retailers which source products in Bangladesh as well as the European Union (which has given Bangladesh preferred trader status for garments) are re-evaluating their ties to Bangladesh. On July 8, 2013, a mostly European consortium of 70 retailers and apparel brands has agreed on a legally binding plan to inspect within nine months all Bangladeshi garment factories that supply the companies. Among the few American companies that have joined the European-dominated plan are PVH, Abercrombie & Fitch and Sean John. To allow for inspections, the Western retailers agreed to send in the names and addresses of all the Bangladeshi factories they import from, by July 15. In an unusual move, the list of these factories, expected to total nearly 1,000, will be made public, as will the inspection reports. Companies often resist disclosing the names of their overseas suppliers for fear of competitors stealing them.<sup>3</sup>

Two days later, seventeen American retailers, which have formed the Alliance for Bangladesh Worker Safety, have announced their non-binding initiative developed with the help of the Bipartisan Policy Center to improve factory safety in the Bangladeshi garment industry<sup>4</sup> It calls for inspections of 100 percent of alliance member factories within the first year; common safety standards to be developed within the next three months; inspections results that are transparently shared; and that all alliance factories actively support the democratic election and successful operation of Worker Participation Committees (WPC) at each factory. Members of the alliance are providing the funding necessary over the five-year period - currently at \$42 million and growing- to support the specific programs of the initiative, with some companies offering an additional combined total of over \$100 million in loans and access to capital to assist factory owners they work with in Bangladesh for factory safety improvements.

At least one American company--Disney--has decided to "cut-and-run" rather than to "stay-and-improve".<sup>5</sup> If others follow Disney's lead, the impact on Bangladesh's garment industry, which accounts for about almost 80 percent of export earnings, and therefore on its GDP, could be very significant. Under pressure to respond to the Savar tragedy, the GoB has pledged to raise garment workers' minimum wages, improve factory safety standards, expand inspections, and improve worker rights to form unions and bargain collectively. A new Labor Law was passed by Parliament on July 15, 2013; its contents are being reviewed.

*Source:* Authors.

25. **Product diversification is a desirable goal for exports.** Even though growth in garment exports can be sustained in the near future with the right supporting environment, greater product diversification is a desirable policy goal. It can reduce export volatility as well as the risk to aggregate exports of relying on a 'single' product line. A diversification goal also anticipates an eventual slowdown in growth of garment exports, and an increasing contribution from other sectors. It helps to put flesh on the longer-term

<sup>3</sup> <http://www.nytimes.com/2013/07/08/business/global/clothiers-in-deal-for-inspecting-bangladeshi-factories.html>

<sup>4</sup> [http://www.nytimes.com/2013/06/28/business/us-to-suspend-trade-privileges-with-bangladesh-officials-say.html?hp&\\_r=0](http://www.nytimes.com/2013/06/28/business/us-to-suspend-trade-privileges-with-bangladesh-officials-say.html?hp&_r=0); [http://az204679.vo.msecnd.net/media/documents/bangladesh-alliance-press-release\\_130179348070616796.pdf](http://az204679.vo.msecnd.net/media/documents/bangladesh-alliance-press-release_130179348070616796.pdf)

<sup>5</sup> Disney's decision was actually taken before the Savar building collapse, in response to a fire which killed 262 garment workers in another garment factory in Tazreen in Nov. 2012; Disney also explained that Bangladesh's low ranking in the Worldwide Governance Indicators, partly drove this decision.

goal of structural transformation and rising employment in higher wage and higher productivity sectors, including higher-value garments (World Bank 2012a).

26. **However, such diversification will not be easy, since it involves developing capabilities that revolve around product types.** The product space literature (see Section 2) suggests that Bangladesh's strengths are still centered around the garments and footwear cluster, and that exports of bicycles and ships, for example, are in the periphery and not part of a bigger cluster. While a number of export products have emerged, and some, such as jute products and frozen foods, have become quite large, the dominance of garments continues: their share of total exports rose even further, from 74.2 percent to 79.6 percent between FY05 and FY13.

27. **A good number of sector studies were conducted as part of this DTIS, in order to better illustrate and understand constraints to diversification.** These studies seek to anchor the thematic analyses of the DTIS in the sector chapters, but are not meant to be exhaustive in coverage. A number of common themes emerged, which support the thematic analysis on constraints to export and trade development. In addition, some sector-specific constraints to exports also came up, and these will be detailed in Section 4 of this volume, and some highlighted below.

28. **The agenda laid out in this DTIS is ambitious, given its objectives and the linkages of those objectives with development goals.** To recapitulate, the DTIS analyzes the internal and external constraints to further integration with the world economy, keeping in view the end goals of job creation and poverty reduction, as well as enhancement in citizens' welfare. It highlights policies as well as gaps in physical and institutional infrastructure that will consolidate Bangladesh's strengths in existing markets as well as help diversify export products and export markets. At the same time, it spells out the linkage between these policies and consumer and worker welfare, which focuses additional attention on import policies, skill enhancement, and labor safety.

29. **Prioritization of the agenda is essential.** Given the vast agenda, implementation will require prioritization and sequencing, keeping in view capacity constraints. There is no exact science of sequencing, but some priorities can be identified, based on the diagnostics and international experience.

30. **An initial focus on market diversification as well as worker safety issues, both in partnership with the private sector, will provide high payoffs.** This follows from the diagnosis that market diversification with existing products is likely to be the most important source of export growth in the short to medium term (see Section 2). Given the recent accidents in garment factories, improved labor safety and work conditions have become necessary to sustain and accelerate growth in garments and overall exports.

31. **Product diversification may face higher fixed costs and will require overcoming potential resistance, and policy moves here are likely to be gradual.** Bangladesh has not yet built up a product cluster other than garments and footwear, with exports of other products being relatively low as well as on the 'periphery' in the product space (Figure 4 and Box 2). Developing another major cluster like garments will take more time and involve more investments. Also, rationalizing trade policy and improving the environment for foreign investment are critical inputs for product diversification, and both face potential resistance from domestic producer interests. Policy changes here are likely to be gradual to allow time for adjustment.

32. **Other elements of the agenda include building a supportive macroeconomic environment, easing energy constraints and improving worker and consumer welfare, and these are mostly part of ongoing efforts.** The continuation of a sound macroeconomic environment is a necessary condition for sustained export growth. Easing energy constraints is a critical part of Bangladesh's overall development program, and is no less critical for the export agenda. Improving skills will enable productivity and wage increases and hence worker welfare. All of these are part of ongoing priorities in Bangladesh, but would nevertheless benefit from reiteration and being part of the export agenda as well. Finally, consumer

welfare is directly affected by import policy including tariff and non-tariff measures and this may need additional effort beyond that aimed at reducing the anti-export bias.

33. **To implement this agenda, leadership will be critical and should be part of immediate priorities.**

34. **The DTIS has identified a four-pillar strategy that could contribute to accelerated development of the export sector, a priority for jobs and growth (see Action Matrix and Sections 2 to 4), enhance worker and consumer welfare and enable sources of competitiveness beyond low-wage labor.** Some of these areas, such as the macroeconomic environment, skill development, the energy constraint, and creating effective safety nets, are not explored in any depth in the thematic sections of this report (Volume 2), being outside the scope of the DTIS. However, some of the key issues/remedies in these areas are summarized in the following sections (referring to other pieces of analysis) for the sake of completeness, and also mentioned in the Action Matrix. Many of them also come up in the sectoral analysis (Volume 3). The following could be considered as priority action areas:

### **Pillar 1: Breaking into New Markets**

- A. *Promoting Economic Integration with Asia.* Exploiting market diversification opportunities would involve taking advantage of Bangladesh's location in the fastest growing region in the world, and in between India and China. Given geography and potentially lower trading costs, the possibilities for greater exports to Asia are immense. Economic relations with India can be deepened significantly, and Bangladesh can increase its exports to India several fold through mutual recognition agreements (MRAs) for harmonization of standards, mutual reduction of non-tariff barriers (with an efficient dispute resolution mechanism), harmonization of border clearance procedures, and signing of the TIR convention by both countries, with a view to allowing transit traffic. China and Japan are major potential markets as well, and FDI from all three countries can help bring exports back to the source countries as well as other destinations.
- B. *Improving Trade Facilitation.* Improving trade logistics will help reduce delivery lags, and thereby enable Bangladesh to become more competitive, especially in the nearby markets of Asia. It would also help in the quest to diversify into products with shorter lead times, including higher value garments. Key actions here include the launching of a National Logistics Strategy, establishing the rail ICD at Tongi, on the outskirts of Dhaka, development of the Inland Water Transport sector, improving the efficiency of Dhaka-Chittagong road connectivity, working closely with the Government of India to improve the efficiency of common land border posts. Reducing trade finance costs by leaving title documents open and not assigning them to a local bank, and making current account transactions like payments for samples and consultants, etc., hindrance-free, would also facilitate exports.

### **Pillar 2: Breaking into New Products**

- A. *Rationalizing Trade Policy to level the Playing Field.* (i) Rationalizing trade taxation and moving towards eliminating the anti-export bias as seen, for example, in high and varying rates of effective protection, will mean that it is not just garments that enjoy a more neutral tariff regime. The critical actions here include reducing overall tariff protection, and simplifying the import tax regime such that cross-sector tariff distortions are reduced and para-tariffs are eliminated or applied equally on domestic production. Such goals can be achieved without risking revenue generation. (ii) Ensuring efficient imports for exports will progressively make the private sector's production and export decisions less dependent on domestic availability of inputs. In practice, given the poor functioning of duty drawback, the best answer seems to lie in ensuring well-

functioning bonded warehouse schemes that are *de facto* available to all sectors and firms. Such schemes have been critical to explain the initial success of South Korea's exports. Reviewing mandatory standards to ensure a smooth flow of imports would also be useful.

- B. *Improving the Environment for Domestic and Foreign Investment.* Attracting much larger FDI flows would help upgrade technology and improve market linkages, and improve upon an area where Bangladesh has had only narrow success. To accomplish this, Bangladesh needs to better allocate serviceable land for business use, including through the 2010 EPZ Act; more pro-actively welcome FDI and promote it through high level missions to potential FDI sources such as Japan, India and China; reduce discretionary practices, increase transparency and enforce standards more strictly so that foreign firms that enforce strict compliance and standards are not penalized. Enforcing standards would also help bridge the gap between the domestic and foreign markets. Many of these measures as well as those relating to energy, skills, logistics and trade policy, would also improve the environment for both domestic and foreign investment.

### **Pillar 3: Improving Worker and Consumer Welfare**

- A. *Improving Skills and Literacy.* Improving skills and literacy will allow current products such as garments to become more competitive, enable a move to higher quality products, and allow productivity and wage increases. It will require an articulation of a comprehensive vision for skill development; reskilling the current labor force through greater access to non-formal training and skill-building; and improving the quality of foundational education.
- B. *Implementing Labor and Work Safety Guidelines.* Minimizing the chances of further tragedies in the garment/export sectors in Bangladesh has become a pre-condition for sustained export growth. This will require strong and credible Government action and a partnership with the private sector, both domestic and international. Seriousness of intent on the part of the Government will play a critical role in convincing the EU and USA, the major players in post-Rana Plaza events.
- C. *Making Safety Nets more effective in dealing with Trade Shocks.* Starting preparation of a safety net strategy that recognizes possible winners and losers in trade liberalization could help reduce opposition to a neutral trade policy. Apart from cash transfers, a key part of this strategy would focus on training and re-training, and hence be linked to the skills agenda.

### **Pillar 4: Building a Supportive Environment**

- A. *Sustaining sound Macroeconomic Fundamentals.* Continuing its record of sound macroeconomic management will help Bangladesh keep inflation at bay, and help price competitiveness. Implementing the ongoing IMF program will help anchor the macroeconomic framework.
- B. *Easing the Energy constraint.* Resolving energy constraints will help all segments of the economy and provide a major boost to investment. It would be critical for Bangladesh to implement sustainable solutions that are able to provide unsubsidized power at competitive prices. Critical actions involve both the public and private sector, including: increasing generation capacity in low cost base load power plants; commissioning of the large gas-fired/dual fuel combined cycle power plants awarded to the private sector; conversion of BPDB's simple cycle plants to combined cycle plants; accelerating moves to import power from Bhutan, Nepal, Myanmar and from India's North Eastern states. These would help focus attention away from measures taken by Government so far, that have focused on shorter-term solutions, which raise costs and subsidies and add to fiscal vulnerabilities.

- C. *Building Institutions for Trade Policy Coherence and Implementation.* Implementing the multi-sector competitiveness agenda outlined above will require strong leadership, such as through an empowered inter-ministerial body housed in the Prime Minister's Office, and is a top priority. This body can also take on the more gradual process of institution building to ensure that institutions are working coherently and in a coordinated manner towards the objective of trade competitiveness. Important steps here include NBR and MOC jointly formulating tariff policy, with due consultation; strengthening the in-house economic capacity of the MOC, and linking MOC's policy-making and trade negotiation roles more strategically with think-tanks; making the EPB more effective by augmenting its in-house capacity, enabling greater private sector participation and targeting market diversification in key markets such as Japan, China and India; allowing private sector providers to provide quality services in areas under government regulation.

### *Sector-Specific Issues:*

35. **Detailed studies of a number of growing export sectors confirmed the cross-cutting findings highlighted above, and added other, sector-specific issues.** In shipbuilding, enforcement of standards for domestic ships would help bring domestic and export market segments closer, and help exporting yards to achieve better scale economies. More credible enforcement of standards in pharmaceuticals would help people's health and also reduce the disincentives of firms including foreign firms that practice self-enforcement. Training to relieve skill shortages was a critical need in many sectors, including shipbuilding, information technology enabled services, and bicycles. FDI could play a much bigger role in many sectors, especially those with technology upgradation needs, such as pharmaceuticals, bicycles, and shipbuilding. Improvements in access to finance and ease of Bangladesh Bank-monitored current account transactions would relieve constraints across all sectors. Additional submarine cables would help reliability of internet services for the ITES sector. The energy constraint was ubiquitous, almost taken as a given in all sector discussions.

## 1.5 Conclusions

36. **To achieve its development objectives, Bangladesh will need a fundamental policy shift that is geared towards international competitiveness and is neutral between the interests of the domestic producer, exporter, and consumer.**

37. **A virtuous circle of export-led growth can be put in place, which would lead to more effective integration with the world economy.** Better logistics and linkages with neighbors, a more neutral trade policy that corrects the anti-export bias, ensuring trouble-free imports for exports, a hospitable FDI regime, and a cohesive policy establishment geared to competitiveness, along with a focus on improving the quality of primary and secondary education and industry-specific skills, will enable sustained labor-intensive export growth, and allow effective participation of people in that growth.

38. **With the implementation of the four pillar agenda, Bangladesh would have multiple sources of strength.** Implementing the four pillar agenda will help improve overall competitiveness of the economy and provide sources of strength other than low wages.

39. **The ultimate goal of export-led growth would be poverty reduction and enhanced welfare of Bangladesh's citizens.** Rapidly growing exports and the millions of new jobs accompanying them, along with skill-upgradation, will help increase productivity and wages, which over the long term is the only sustainable way to improve living standards. Improving labor standards and worker safety is also part of this agenda, and, in the wake of recent tragic incidents in the garment sector, has become a part of the preconditions for garment exports. Rationalization of trade policy that balances consumer and producer interests will contribute significantly to citizen welfare. For example, allowing a due role for trade and FDI in drug supply will enhance choice and quality of medicines and enable a more effective health

strategy. To complement this, the quality system would need to be improved and the list of mandatory standards reviewed, to determine whether they meet legitimate regulatory objectives and can be effectively enforced. The objective is to ensure that imports flow smoothly while respecting the legitimate needs for import regulation, like food safety.

40. **Openness brings opportunities, but also vulnerability to global shocks, and appropriate safety nets should be an important part of the globalization process.** Globalization allows countries to benefit from the knowledge and technologies that have been developed anywhere in the world, whether embodied in machinery, intermediates, FDI or people. At the same time it greatly increases the need for governments to ensure that citizens are able to benefit from these opportunities: workers must be able to acquire the needed skills; firms need to be able to access credit to finance profitable investment opportunities; and farmers need to be connected to markets (Porto and Hoekman, 2010). Greater openness also increases the vulnerability of countries to global shocks, with potentially major adverse consequences for the poorest households that do not have the savings needed to survive a period of unemployment or sharp falls in the prices of their outputs (and thus incomes) resulting from global competition. Therefore, it is important that countries have in place mechanisms to assist those adversely affected by trade shocks. These mechanisms should be targeted towards those households that are most vulnerable and have to manage shocks. Governments should more systematically assess, *ex ante*, possible trade-related, poverty-distributional outcomes of policy changes. This will help design better complementary or transitional policies as well as compensation mechanisms and targeted programs to ensure that firms and workers can benefit from the new opportunities generated by trade openness. Policies and actions to achieve these objectives require actions by labor and finance ministries and are not necessarily part of the mandate of trade ministries.

41. **Bangladesh is well placed to take on some its strongest development challenges** and begin a discourse to move beyond wage-based competitiveness. Its track record on growth and employment is strong. To grow faster and absorb more labor, and continue its pace of poverty reduction, it will need to build on that record and improve upon it. The good news is that a number of reforms are relatively low hanging fruits, may be implemented in the short to medium term, and can bring large pay-offs.

42. **The example of Vietnam shows that accelerated, export-oriented development is possible, even in the context of the current global environment.** Vietnam moved from being one of the poorest countries in the world to a lower middle income one in the space of 25 years, with FDI and trade playing a dominant role in the economy: exports and imports each form 90 percent of GDP, and, with 88 million people compared to Bangladesh's 150 million, it exports four times as much as Bangladesh today.

43. **Bangladesh will need strong leadership to support its multi-sector competitiveness agenda.** In many cases, it will require taking on strong domestic interests that may not welcome competition, either through imports or FDI. In other cases, it would require cohesion and coordination between different ministries/departments, such as the National Bureau of Revenue, the Ministries of Commerce, Finance, and Industry, the Roads Division, and so on. If the Sixth Plan and Vision 2021 goals are to be achieved, this leadership has to be exercised.



## Section 2: Bangladesh's Export Performance

44. **Bangladesh's exports have performed impressively, based on the growth of its garment sector.** This section discusses the different dimensions of export growth in Bangladesh, including product and market concentration. It then addresses the oft-voiced concern that Bangladesh is too heavily reliant on garments, drawing on international experiences to understand the prospects for continued export growth in garments, and the potential for product and market diversification.

45. **Future export growth will likely rely first on market penetration with existing products.** Garments can continue to grow with the right supporting environment, not only in the current lower quality segment, but can also move up in the quality space, which will provide further room within the sector. In terms of product diversification, the product space literature suggests that Bangladesh has not developed another large cluster apart from garments and footwear. This would make the move to other clusters, such as light engineering, more difficult, but a cohesive set of supportive government policies could provide impetus to that shift. Services such as information technology enabled services can also grow and lead to skilled job creation. To diversify markets, Bangladesh enjoys some natural advantages, such as location between some of the fastest growing economies in the world, and this advantage can be exploited much more pro-actively. More details on trade outcomes and performance can be found in Chapter 1 of Volume 2 in this DTIS.

### 2.1 Characteristics of Export Growth

46. **Bangladesh's export growth, especially in manufactured products, has been impressive so far.** While still a Least Developed Country (LDC), Bangladesh is unique in the unusually high share of manufactured exports in its export basket relative to its income level, which illustrates its strengths in mass manufacturing and labor availability. As measured by the ratio of exports plus imports to GDP, trade openness in Bangladesh increased from 16 percent on average in the 80s to over 40 percent in the 2000s. Its exports grew on average by 15.6 percent during FY04-13. Its world market share doubled from 0.08 percent in 1995 to 0.16 percent in 2011. During 2005-10, Bangladesh gained world market share in most of its top 25 export products. Exports remained strong during the 2008-09 crisis, owing to the so called "Walmart Effect," driven by low-value garment exports.

47. **Concentration of both export markets and products is very high.** Bangladesh's exports are heavily concentrated at the sector and even the product level, where five products<sup>6</sup> account for over 50 percent of sales in the U.S. and E.U. markets. Twenty one out of the top 25 products are clothing articles. In general, product concentration is Bangladesh in much higher than in comparators. Similarly, in terms of markets, the EU and US together account for about two-thirds of the country's total exports. Exports have been boosted by duty-free access to the European Union, Canada, Australia, Japan, Norway, and China. The U.S. does not provide duty-free access for key Bangladesh exports, and only a few goods qualify under the U.S. Generalized System of Preferences (these privileges were suspended in June 2013, see Section 1). Before the suspension, only 0.6 percent of the country's goods exported to the U.S. qualified under the GSP, so that import duties on Bangladesh exports to the United States amounted to US\$ 732 million in 2012 (USITC Trade Database). . At present, 96 percent of Bangladesh's exports to the

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<sup>6</sup> The products are (i) T-shirt, singlets and other vests, HS code 6109, (ii) Jerseys, pullovers, cardigans, etc., HS code 6110, (iii) Men's suits, jackets, trousers and shorts, HS code 6203, (iv) women's suits, jackets, skirts and shorts, HS code 6204, and (v) Men's shirt, HS code 6205

United States consist of readymade garments and textile products, which are bought by retail groups such as Walmart, Gap, and Target.

48. **Bangladesh's transactions data shows that existing products have not exploited new markets sufficiently.** Bangladesh is an outlier in the lack of export growth of existing (old) products in new markets, where India had 45 percent growth, and Sri Lanka had 39 percent (table 2); but Bangladesh only had 12 percent.

**Table 2: Comparative Decomposition of Export Growth, Percent (1998-2008)**

Margin	Components of export growth	Bangladesh	India	Pakistan	Sri Lanka
Intensive	Increase of old products in old markets	94.6	60.7	72.2	99.0
Margin	Decrease of old products in old markets	-7.3	-4.1	-17.1	-35.8
	Extinction of exports of existing products to existing markets	-2.5	-2.4	-8.3	-9.9
Extensive	Increase of new products in new markets	0.1	0.3	4.6	0.2
Margin	Increase of new products in old markets	2.8	0.7	3.7	7.4
	Increase of old products in new markets	12.3	45.0	44.8	39.1

Source: World Bank using National Board of Revenue transactions data.

## 2.2 Growth in Garments, and Product and Market Diversification: The Evidence

49. **Future strong growth will first be able to build upon the success in ready-made garment.** The garment sector in Bangladesh has about 5700 running factories, employs about 4 million workers,<sup>7</sup> with indirect employment estimated at around 10 million. Among developing countries, Bangladesh is the second-biggest exporter of clothing after mainland China. The garment sector, mostly knit and woven garments, generates 80 percent of export revenues, with exports concentrated in basic garments, and growth being mostly volume-driven. Bangladesh is also relatively diversified at the product level compared to other LDCs, where many countries are single-commodity exporters.

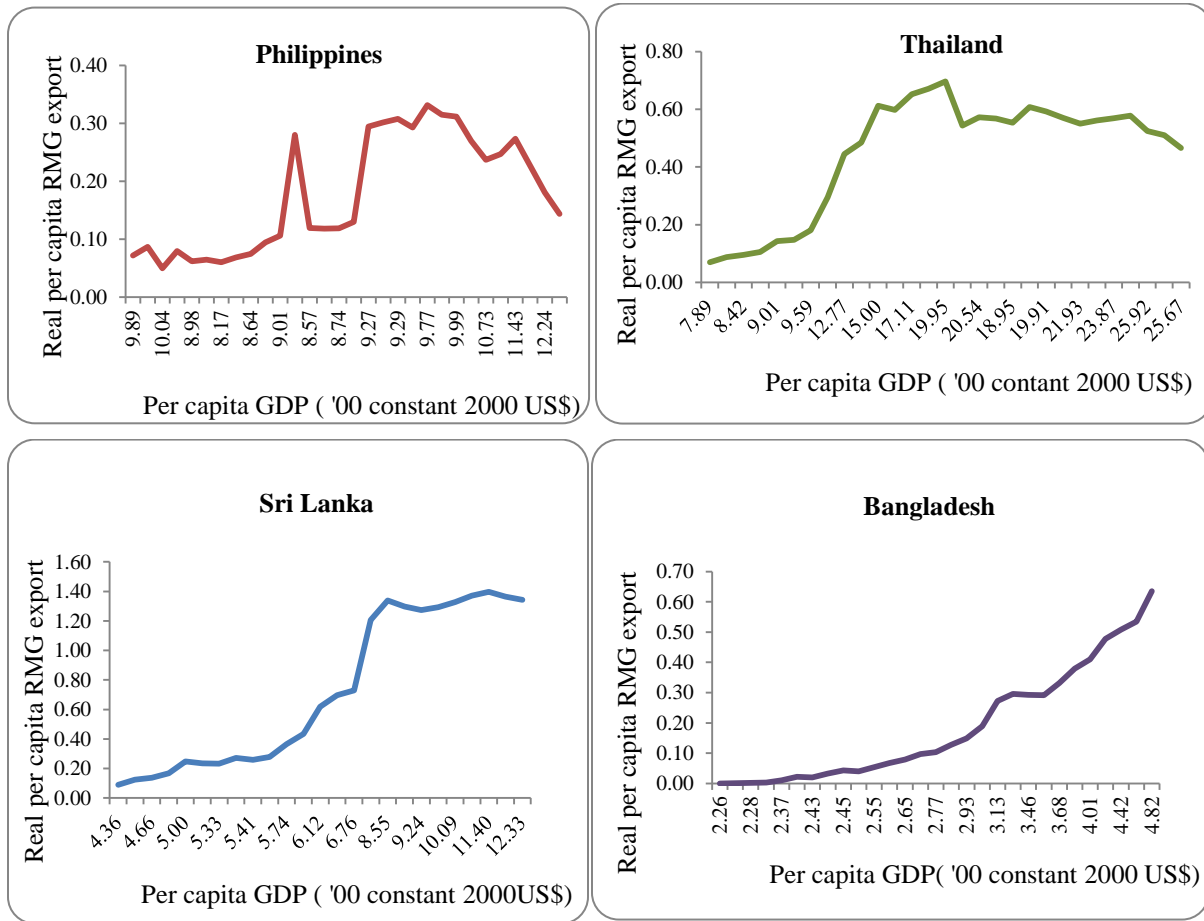
50. **There is much evidence to demonstrate that Bangladesh's garment exports can continue to grow.** There is a body of literature that indicates that long periods of export growth in developing countries can be attributed to consolidation and growth of existing products. The garment industry grew at an annual average rate of 16.9 percent since the MFA was abolished in 2005. This period includes the opening up of world garments trade to full competition, as well as the global economic crisis that started in 2008. There is more room to grow. Japan is now actively seeking to diversify its garments import base away from a focus on China to "China plus." Chinese investors themselves are seeking to source from Bangladesh, given rising wages in China. Growing diversification away from garments of large countries like India and China gives Bangladesh an opportunity to not only increase world market share in garments, but also to find markets in these countries. And despite recent increases, wages in Bangladesh remain very competitive.

51. Evidence from other countries indicates that Bangladesh's current level of per capita income should allow continued dynamism in garments exports for the foreseeable future. Figure 2 shows that real per capita exports of garments in Thailand grew till it reached a per capita GDP of about US\$2,000 (in constant 2000 US\$). The same 'threshold' was reached in the Philippines at about US\$1,000, and in Sri Lanka at about US\$1,150. By this reasoning, Bangladesh's garments sector should be able to continue to grow and capture world market share. Figure 2 indicates the steep trajectory of Bangladesh's success in

<sup>7</sup> BGMEA website <http://www.bgmea.com.bd/home/pages/aboutus>

garments—its per capita GDP of US\$482 (in constant 2000 US\$), well below the apparent threshold, could allow this trajectory to be sustained (provided the investment conditions improve to enable even larger volumes of production). The composition of exports also shows that before reaching the threshold where per capita garment exports start to decline, a country’s basket has a relatively diversified mix of basic-and-higher-value garments. This is because the increasing upward pressure on wages and benefits erodes competitiveness in basic garments.

**Figure 2: Per Capita Income and Per Capita Garment Exports of Selected Countries (constant 2000 US\$)**



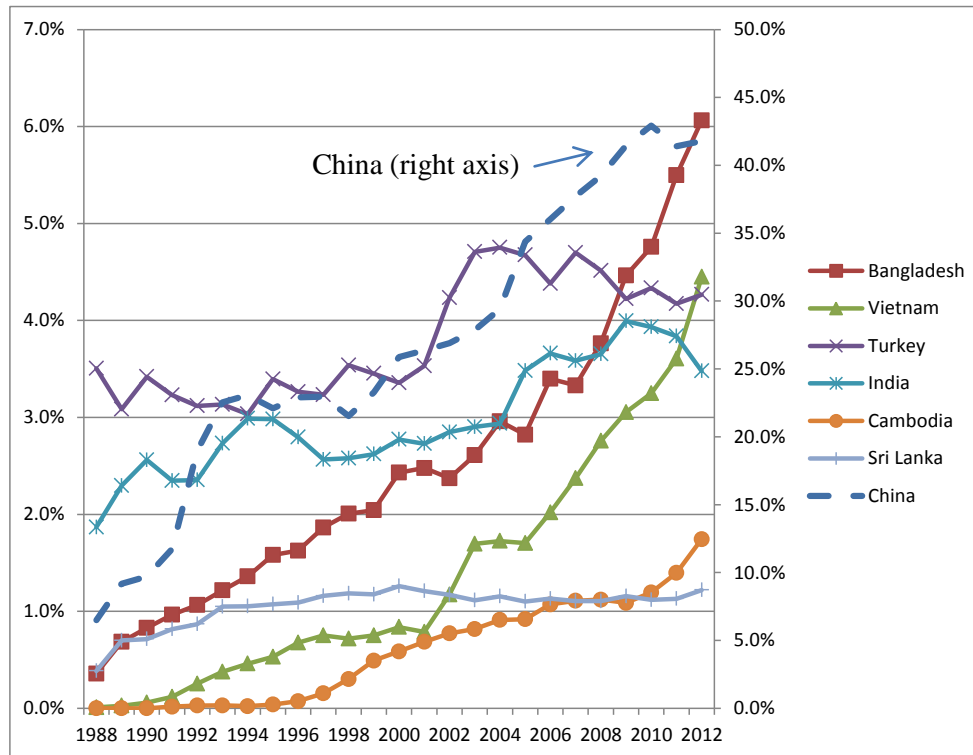
Source: World Bank 2012a.

52. **The external environment is not a major issue in the growth of garments or of exports in general.** The global economic crisis, if anything, boosted Bangladesh’s garment sector, as buyers worldwide switched to less expensive garments—the so-called “Wal-Mart effect.” In addition, the ongoing rise in Chinese wages and currency has made Bangladesh a favorable investment destination. The other oft-cited constraints relate to trade barriers such as tariffs in the US. Another issue is the relative preferences given to some African countries. The African Growth and Opportunity Act (AGOA) allow duty- and quota-free access of a number of goods including garments from African countries to the U.S. market since 2000. However, Bangladesh is a major player in garments and these preferences do not seem to affect its ability to compete worldwide. This is evidenced by the continuous growth of the garments sector and the fact that many garment firms report an inability to service all the orders that they receive on account of power, logistics, and skill constraints.

53. Capturing 20 percent of China's garment export markets would more than double Bangladesh's total exports, but this will not happen automatically. There is a lot of room for the garment sector in Bangladesh to grow and capture an increasing share of the world market. Bangladesh's share of world garments trade has risen gradually to 5 percent. Vietnam has been catching up and is now close to Bangladesh, with a market share of almost 5 percent. If Bangladesh can address the key constraints hindering exports, it could take some of the market being gradually vacated by China: 20 percent of China's garment exports would than double Bangladesh's total exports and absorb almost all the new entrants into the labor force over the next decade.

54. **Bangladesh has been the world's second largest exporter of garments since 2009, followed by Vietnam, which has closely tracked Bangladesh's rapid rise (figure 3).**

**Figure 3: World Market Share in Clothing, Bangladesh and Comparators, 1988-2012**



Source: UN COMTRADE data and authors' calculation

55. **If Bangladesh fails to act sooner, other competitors could march ahead and take the markets China is vacating.** China is currently either vacating some price competitive product segments or investing abroad in more competitive locations, offering great opportunities for Bangladesh. Bangladesh could potentially become an important player in manufacturing based on a strong comparative advantage in labor intensive industries, with wages half those in India and less than one third of those in China or Indonesia. This comparative advantage, matched with a large population, has translated into very strong price competitiveness in the garment sector and possibly could, with the right policies, translate into competitive positions in other manufacturing industries. Unskilled wage rates vary between US\$50 and US\$100 in garments, about half of the going wage in EPZs in sub-Saharan Africa and even less of average garment wages in Chinese EPZs. Bangladesh's competitors are becoming

expensive too. Chinese wages are rising above US\$150-250 per month due to rising income and skills, serious shortages of labor in the Chinese coastal areas, and adoption of labor regulations.<sup>8</sup>

56. There appears to be diversification potential in different goods, but despite starts, Bangladesh has not yet achieved scale in products other than garments. The product space literature (see Box 2 and Figure 5) suggests that Bangladesh's strengths are still centered around the garments and footwear cluster, and that exports of bicycles and ships, for example, are in the periphery. While a number of export products have emerged, and some, such as jute products and frozen foods, have become quite large, the dominance of garments continues, with their share of total exports going up further, from 74.2 percent to 79.6 percent between FY05 and FY13. Moreover, even a large labor-intensive cluster has not yet emerged: jute goods were 3 percent, and leather 1.4 percent, of total exports in FY13. However, because footwear is in the dominant cluster, the product space literature would suggest that it could grow.

57. **Bangladesh could also diversify into services, leading to skilled job creation.** Bangladesh has untapped potential for diversifying into services exports. Given the large and growing size of the global information technology enabled services – business process outsourcing (ITES-BPO) market, even a small share for Bangladesh could result in significant benefits in terms of generating employment, raising incomes and diversifying exports. This sector is thriving in neighboring India and Sri Lanka, but is limited in Bangladesh.

58. **International experience shows that export diversification comes naturally along the process of economic development.** The product space literature provides one way to judge the near-term possibilities of diversification. However, to the extent that Governments are pro-active in providing a supporting environment, they can speed the process along. This DTIS is an attempt in that direction, and provides a menu of policy options that Bangladesh can use to accelerate and, in time, diversify its exports.

59. **Market diversification is likely to present the most important source of trade expansion in the short and medium term.** Bangladesh is fortunately placed, between the world's fastest growing and potentially largest economies, which are now changing from competitors to markets for Bangladeshi exports. Currently, the shares of China, India, and ASEAN in its exports are only 0.8 percent, 1.9 percent, and 1.5 percent, respectively. Bangladesh needs to make the most of the growth of the Asian giants. In doing so, it will be helped by the fact that it costs less time and money to export to Asian markets than to the US and EU.

60. Future export growth will likely rely first on capturing new markets and increasing market share in existing markets, with existing products. Bangladesh's exports have grown strongly and doubled their world market share between 1995 and 2012, owing to the success in garments, catering largely to the EU and USA. Garments can continue to grow, in existing and newer markets. Newer products will emerge more slowly. Thus, more rapid export growth will initially rely on capturing higher market shares in Bangladesh's existing strengths, i.e., basic garments--both in current markets, and penetrating newer and dynamic markets such as Japan, China, ASEAN and India. In addition, many firms are starting to produce higher value garments, and this will expand the target market for Bangladesh. Other products are emerging, such as jute goods, footwear, sea food, information technology enabled services (ITES), etc., and some of these may over time become part of a larger product cluster.

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<sup>8</sup> According to Institute of Global Labour and Human Rights, Bangladesh garment wages are the lowest, at only 21cents per hour. Wages of other competing countries are Vietnam (52 cents/hour), Cambodia(24 cents/hour), India (55-68 cents/hour), Pakistan (37 cents/hour), Sri Lanka (46 cents/hour) and Thailand (56 cents per hour).

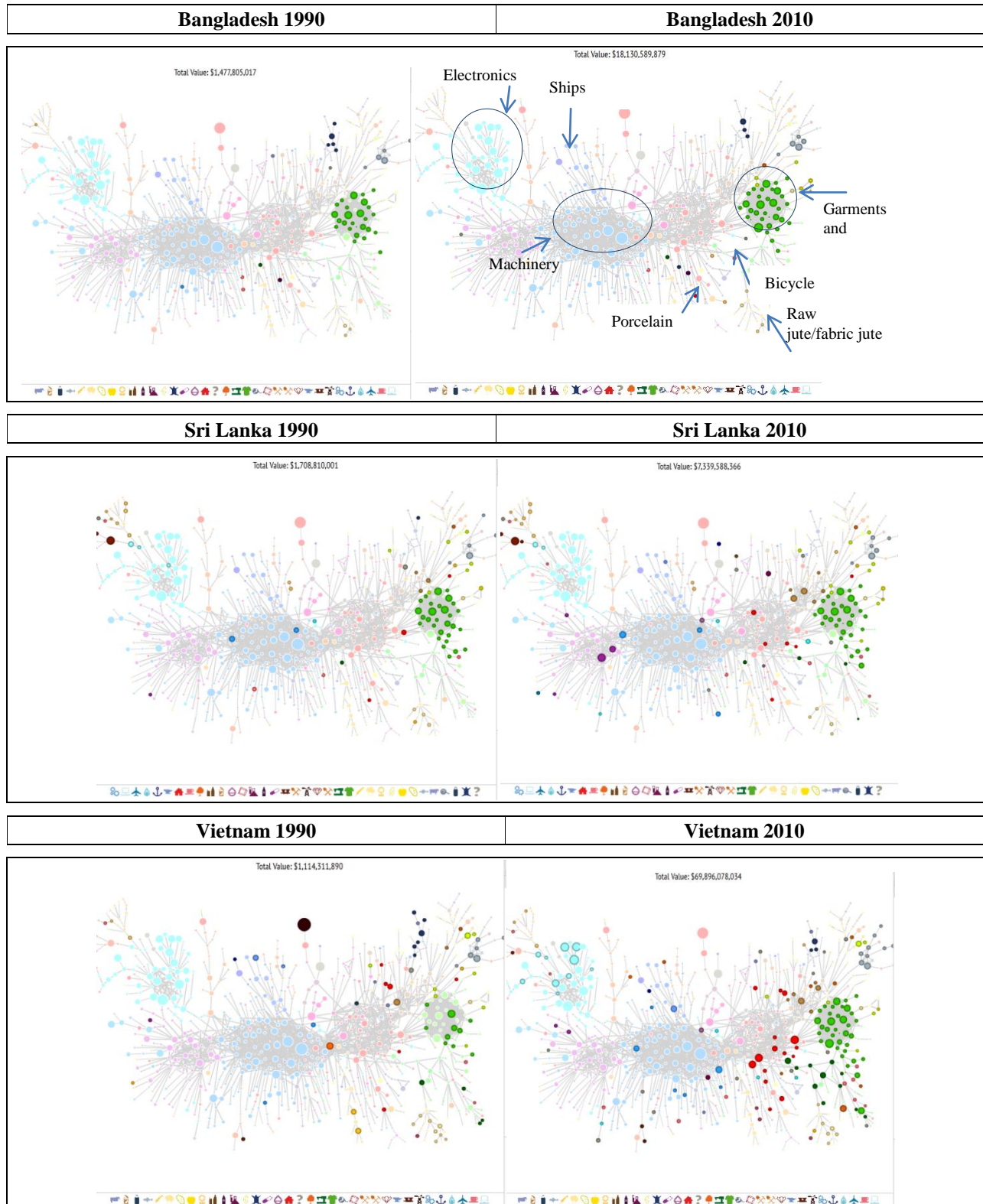
## Box 2: Product-Related Capabilities and Discovery of New Products

**Structural transformations are not smooth movements along a continuum, but a messy process beset by market failures.** Hausmann and Klinger (2007) argue that every product requires capabilities that are specific to it, from labor training and physical assets to regulatory requirements, property rights, and infrastructure. Exporting mangoes requires different capabilities (such as a decent sanitary and phytosanitary regime) from producing synthetic apparel, but the capabilities for producing mangoes are likely to be similar to exporting vegetables. The ease with which an economy can move to producing new exports depends on what its installed capability looks like. The hypothesis is that countries that build up competence in producing a certain good can redeploy their human, physical, and institutional capital more easily if they seek to produce goods that are “near” to those that they are currently producing. Location of firms in the denser parts of the forest (see figure 1.1) creates more opportunities for diversification and technological upgrading, because market failures are less binding when firms have to make smaller adjustments to move to produce nearby goods that require similar capacities. The central part of the map has a large number of products that are clustered together, particularly related to industries such as chemicals, machinery, and metals. Peripheral products (on the outside) include petroleum, agriculture, cereals, and labor-intensive products. Whether a country’s exports, in which it has comparative advantage, are located in the denser part of the product space or in the periphery, can predict the ease with which that country transforms itself economically.

**Bangladesh has reinforced its revealed comparative advantage in garments, located at the periphery of the forest.** Figure 4 shows the product space for Bangladesh in 1990 and 2010, indicating the sectors in which Bangladesh has acquired or lost revealed comparative advantage (RCA)<sup>9</sup> over time (outlined and colored dots indicate exports with a RCA higher than 1), and provides a glimpse of the pace of structural transformation in the economy. Bangladesh’s product space of 1990 is relatively similar to its 2010 one, with not much movement along the product space (e.g., from garments to machinery or electronics, which are more knowledge intensive). Bangladesh did increase the number of products (defined at SITC 4 digits) with RCA higher than 1 from 47 in 1990 to 65 in 2010, mostly garment and textile products. The location of garment at the periphery of the product space indicates that moving to another sector would require different capabilities than those used for garments. Interestingly, the two products with the highest RCA are processed raw jutes and jute woven fabric. The product space for Vietnam reveals how Vietnam has caught up with and even passed Bangladesh over the same period. Starting with around the same level of exports as Bangladesh in 1990, Vietnam exported four times more than Bangladesh in 2010. It expanded its garment exports but also built capabilities in new products such as electric wire, furniture, electronics, and machinery. Sri Lanka, another garment exporter in the region, was able to maintain its competitiveness in garment and strengthen its global competitiveness in chemicals and medical instruments, as well as foodstuffs (figure 1). Malaysia was able to diversify away from garments over the same period, and improved its competitiveness in electronics, and chemicals and medical instruments, and machinery, a denser area of the forest.

<sup>9</sup> The concept of RCA can be defined very simply: Balassa’s (1965) measure of relative export performance by country and industry, defined as a country’s share of world exports of a good divided by its share of total world exports. The index for country  $i$  good  $j$  is  $RCA_{ij} = 100(X_{ij}/X_{wj})/(X_{it}/X_{wt})$  where  $X_{ab}$  is exports by country  $a$  ( $w$ =world) of good  $b$  ( $t$ =total for all goods). An RCA index above 1.0 indicates that a country’s share of exports in a sector exceeds the global export share of the same product.

**Figure 4: What Bangladesh, Sri Lanka, and Vietnam Export: Product Space, 1990 and 2010**



Source: Authors generated from <http://atlas.media.mit.edu/>.

Note: Colors indicate different sectors; outlined circles indicate exports with RCA higher than 1

## Section 3: A Four-Pillar Strategy to Spur Faster, Export-led Growth

61. **Towards a Trade Competitiveness Centered Growth strategy:** The distinguishing feature of countries that have proved successful globalizers such as Singapore, Taiwan, or Korea is that their governments put in place consistent long-term strategies centered around export competitiveness and encompassing all issues relevant to productivity growth—credit, infrastructure, energy, facilitation, education, and the business/regulatory environment, apart from sound macroeconomic environments and competitive exchange rates. Bangladesh currently has not been able to translate its 6FYP’s vision of export-orientation into implementation of a coherent and coordinated trade competitiveness strategy.

62. **Overall constraints:** Infrastructure issues continue to be the most binding constraints on investment. Bangladesh ranks last among its Asian competitors in terms of high prevalence of power outages. Currently, 76 percent of the country’s power plants use natural gas as the primary energy. Inadequate electricity supply is a major problem even in cases where the private sector has installed captive gas-based generators; unreliability of gas based supply to run these pose a major challenge. Power outages are a key reason for manufacturing productivity in Bangladesh being much lower than in Vietnam and China. Transportation has become another critical constraint. The DTIS did not investigate the important constraint of power shortages in Bangladesh, as this is already a well-known and much-analyzed theme. Instead, it focused on trade logistics as the infrastructure issue to focus on. As elaborated in this section, some persistent bottlenecks clearly need to be urgently addressed to expand exports.

63. The remainder of this section will discuss the main challenges and discuss selected priority actions. It provides a four-pillar strategy that includes prospects of penetrating new markets, especially in the South Asia and Asia more broadly; trade facilitation measures; reduction and eventual elimination of distortions in the trade regime; a more pro-active FDI policy; and stronger institutional capacity. It will be followed, in Section 4, by an illustrative discussion of some sector specific measures to enhance trade potential, based on detailed studies of seven key industries/sectors. As explained in Section 1, the DTIS did not investigate solutions relating to the skills constraint, dealing with trade shocks, or sustaining sound macroeconomic fundamentals, these being the subject of ongoing analysis and/or programs in the World Bank and the IMF, as well as other development partners. Nonetheless, for the sake of completeness and for providing a marker, the discussion below summarizes key concerns relating to these themes, including the energy constraint.

### 3.1 Pillar 1: Breaking into New Markets

#### A Promoting Economic Integration with Asia

64. **Bangladesh’s exports have not benefited from access to new and growing markets.** Bangladesh’s export market concentration largely reflects the preferential access its garment sector has been benefitting from in the EU market, and strong demand from the US market. It will continue to benefit from this preferential access following the EU adoption of new Rules of Origin for its Generalized System of Preferences (GSP)<sup>10</sup> scheme which has become effective from January 1, 2011. However,

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<sup>10</sup> The GSP is a trade arrangement that gives preferential tariff treatment (reduced or zero) to the imports from developing countries.



Bangladesh has not been able to sufficiently penetrate new and growing markets like India and China, nor use its proximity to the broader Asian region, increasingly the world's economic center of gravity.

65. **Major gains would derive from integration with East Asia.** Bangladeshi merchandise exports would be 52 percent higher and the country could gain around US\$1.8 billion from broader South Asia–East Asia integration. Export growth to East Asia has significantly greater potential. A recent formal analysis using computable general equilibrium (CGE) modeling confirms that broader South Asia–East Asia integration that includes all members of South Asia would provide large gains to exports and trade, and overall welfare, for Bangladesh (Francois, Rana, and Wignaraja 2009). In fact, such analyses considerably understate growth impacts, because the models incorporate limited dynamic effects from cross-border investment flows in support of trade. This type of cross-border investment could be a much bigger factor for Bangladesh, and such opening to investment could raise economy-wide productivity and scale economies of domestic firms and industries.

66. **Bangladesh has significant import complementarities** with key members of the Association of Southeast Asian Nations (ASEAN), China, and India. They are comparable to Eastern European countries' complementarities with developed EU members (Germany, France, and the United Kingdom) prior to joining EU.<sup>11</sup> Bangladesh maintains the highest levels of import complementarity with Indonesia, India, Malaysia, Thailand, Singapore, and China, owing to the high degree of sourcing of textiles for the RMG sector. Although prospects for increasing existing exports to East Asia may be weak on the basis of export complementarity, dynamic, medium-term impacts may give rise to new export industries, such as the export of processed foods that are currently domestically oriented.

67. **Bangladesh has the potential to increase trade with South Asia, particularly India.** Under SAFTA, Bangladesh and other LDCs have now secured duty-free quota-free access to India. This scenario could increase Bangladesh's exports to India by 134 percent; if Bangladesh also offers free trade status to India (in effect an FTA), its exports to India could rise by 182 percent, since inputs used in exports will become cheaper. However, estimated gains from trade facilitation between Bangladesh and India are much bigger than the gains from trade liberalization. Due to the size and proximity of the countries, a Bangladesh–India FTA plus improved connectivity<sup>12</sup> can raise Bangladesh's exports to India by about 297 percent (for details, see De, Raihan and Kathuria 2012). Improvements in connectivity provide the largest payoff in merchandise trade, and the spillovers could facilitate trade with third countries. Note that these are static estimates, and hence can be considered as lower bounds of potential gains. Dynamic gains can be much larger and can be realized by encouraging new trade in goods and services, especially through FDI in goods, infrastructure services, and other services.

68. **In this context, the experience of the India–Sri Lanka FTA is salutary.** It shows that, beyond the exchange of preferences, the agreement provided a “boost of confidence” to the private sector, resulting in substantial new investments by India in Sri Lanka's service sectors. Also, the liberalization of air travel between the two countries resulted in a major growth in Indian tourism in Sri Lanka. Bilateral trade has also increased fivefold since the FTA became effective in 2001.

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<sup>11</sup> The trade complementarity index (TCI) can provide useful information on prospects for intraregional trade. It shows how well the structures of a country's imports and exports match. Furthermore, countries considering the formation of a regional trade agreement can examine the TCI values of others that have formed or tried to form similar arrangements. The TCI between countries  $k$  and  $j$  is defined as:

$$TCij = 100 - \text{sum}(|m_{ik} - X_{ij}|/2)$$

Where  $x_{ij}$  is the share of good  $i$  in global exports of country  $j$  and  $m_{ik}$  is the share of good  $i$  in all imports of country  $k$ . The index is zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match.

<sup>12</sup> To capture the improvement in connectivity, a 25 percent drop in the bilateral trade-cost margin between Bangladesh and India is simulated.

69. **Stronger and deeper regional cooperation would benefit the poor disproportionately.** Lagging border regions of Bangladesh, among the poorest in South Asia, need to be part of the new market expansion to help reduce poverty. In Bangladesh, the border districts tend to have lower than average per capita income, higher than average poverty, and poorer human development. Regions that share a border with India are not well connected to the national economy and lack the market linkages and infrastructure to formalize trade. Alternative bilateral and regional mechanisms, including cross-border bazaars and related facilities, can operate in parallel with FTAs to extend local market opportunities. Cross-border trade—defined as the flow of goods and services up to 30 kilometers across international land borders—is important to the prosperity of border communities.

70. Major constraints lie in the policy choices of the countries such as differences in axle load limits between Bangladesh and India, with which it shares the longest border (table 3). Axle load limits in Bangladesh are consistently lower than those in India, for the same class of trucks. This could be a reflection of weaker pavements in Bangladesh; or it could reflect a regulatory legacy where the limits have not kept pace with recent trends in trucking technology. In fact, the differences in axle load limits are cited as one reason for denying India transit rights across Bangladeshi territory. This may be only one reason, and possibly not the main reason, for denying such transit rights. Various other political, social, and economic considerations are also pertinent. Whole industries and a large number of people are already engaged in transloading of cargo at the borders. These stakeholders would be affected by a change in policy, regardless of the economic inefficiencies involved in the status quo.

**Table 3: Gross Vehicle Weight Limits in Bangladesh and India (in tonnes)**

Vehicle type	Bangladesh	India
3 axle (1 front, 2 back)	22	25
4 axle (steering + 3 axles)	25	31
5 axle (3 prime mover, 3 trailer)	38	44
6 axle (3 prime mover, 3 trailer)	41	44 <sup>a</sup>
7 axle (3 prime mover, 4 axle)	44	—

*Source:* World Bank staff estimates, data from various sources.

*Note:* a. Nominal weights are 45.4 and 54.2 tonnes, but 6-axle vehicles are restricted to 44 tonnes.

— = Not available.

71. **Trade disputes are also particularly frequent between Bangladesh and India.** The private sector frequently complains that nontariff barriers (NTBs) on the Indian side severely hamper Bangladeshi export opportunities. Bangladeshi media frequently report on such NTBs, in particular concerns over the complicated technical regulations and standards when exporting processed food to India. Similarly, the Indian side has also recorded its complaints against Bangladeshi NTBs. Working level discussions to reduce trade-restricting NTBs and an effective dispute resolution mechanism would help to chip away at the barriers.

72. **Problems are most commonly found at the major land customs stations such as Petrapole-Benapole and Akhaura-Argatala,** the largest ports between mainland India and Bangladesh and Bangladesh and NE India respectively. Access roads to land border crossing points are often narrow with not enough space for vehicles to be parked on the road side. This creates congestion and delays which result in high truck demurrage charges to Bangladesh exporters. Moreover, there are differences in border opening hours on the Bangladesh and India sides as the early closure at 5 pm reduces the average work day to 6-7 hours. In addition, there are differences in holidays each week, further reducing the commercial work week to only four days.

### ***Exploiting Regional Opportunities to Enhance Exports***

73. Due to the shape of borders in the region, Bangladesh could serve as a transit country for trade between mainland India and Indian northeastern states, and also for Nepal and Bhutan. Currently, movement of vehicles is not possible across Bangladesh's borders, whether for transit or for goods bound for Bangladesh. Goods therefore have to be offloaded at the border and transferred to vehicles from the other country. This practice is inefficient. The same applies also to railways where locomotives have to be changed. Recently, however, the governments of India and Bangladesh have been discussing how Indian traffic can cross from the mainland to the northeast states across Bangladesh. The intention is primarily to allow traffic between West Bengal and the landlocked Indian states in the northeast. Such transit would halve travel distance to about 500 kilometers.

74. The adoption by the governments of India and Bangladesh of a trade transit agreement has the potential to transform the trade facilitation environment in South Asia. The immediate problem is a very specific one that requires a practical transit solution that would allow India's cargos crossing from its mainland to its North-Eastern states across Bangladesh, on a few identified road corridors with significant traffic potential. In practice, a phased approach could be adopted and could include (a) a bilateral road transport agreement between India and Bangladesh to allow trucks to cross and deliver goods in each other's territory; and (b) agreeing a road infrastructure cost recovery mechanism that applies to both countries. The proposal has the potential to transform the trade facilitation environment in South Asia if the framework can be extended to also accommodate traffic to and from Nepal and Bhutan which may then be able to access Bangladeshi ports, especially Mongolia.

75. **Bangladesh and India should also sign the *Transports internationaux par la route Convention (TIR)*.**<sup>13</sup> One of the likely benefits of India and Bangladesh in particular acceding to the TIR are the potential spillover effects beyond the SAR region. Nepal and Bhutan are landlocked and need access to seaports and harmonized agreements to reduce time and costs. They could therefore more easily access the ports of Bangladesh in particular which are closest. A functional regional transit system would unlock very significant benefits for the South Asian region.

76. **Regional trade in South Asia and with East Asia would benefit from open skies policies.** The Association of Travel Agents of Bangladesh (ATAB) and the main exporters are pressing for an open skies policy, which would reduce costs and provide more airfreight capacity for the garments sector. More generally, liberalization leads to increased air service levels and lower fares, which in turn stimulates additional traffic volumes and can bring about increased economic growth and employment. In South Asia region, Sri Lanka concluded a number of open skies agreements since 2005, including with the United States, Malaysia, Thailand, Singapore, and Switzerland. Open skies has been rolling out in stages in ASEAN since 2009, helping to make Southeast Asia home to the world's fastest expanding low-cost airlines.

77. **Moreover, trade disputes might be addressed by the conclusion of bilateral mutual recognition agreements (MRA).** An MRA states that technical regulations, standards, and conformity assessment procedures undertaken on one side of the border are essentially equal to the ones undertaken on the other side. Thus, goods produced in one country can be freely marketed in the other. MRAs facilitate trade by enabling manufacturers to have their products tested and certified in the country of origin, for compliance with the regulatory requirements of the importing country. By eliminating the time delays and costs associated with obtaining regulatory approval in the importing country, MRAs benefit the parties' businesses by delivering significant savings in time and money. Under MRAs, one government agrees to recognize the results of another's testing, inspection, SPS certification, or other procedures.

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<sup>13</sup> The TIR is a system of bonds, operated in nearly 70 countries, that guarantees that any customs and other duties will be paid on goods transported in transit trucks. Its objective is both the improvement of transport conditions and the simplification and harmonization of administrative formalities in international transport, particularly at frontiers.

78. **Development partners could fund a road map of mutual recognition of food-related border procedures.** The elements of this road map will consist in examining the concurrent Indian and Bangladeshi legislation; assessing the standards and conformity assessment procedures applied; promoting mutual trust and bilateral cooperation in food production and trade; working toward mutually recognizing the critical elements of each other's regulations; holding technical discussions about the necessary steps for achieving mutual recognition; identifying and supporting necessary reforms; and establishing regular contacts and communication concerning standards, technical regulations, and conformity assessments in the Indian-Bangladesh border trade.

79. **Harmonization and cooperation at the border will be a major boost to speed up flows of goods.** India has built or is planning integrated check posts at several borders with Bangladesh. However, while the facilities should help address the space constraints that are faced, the access roads between the two sides are not always properly aligned. There should be active engagement between the two sides on development plans. There is also need to synchronize border opening hours between the two sides. Space for transloading should be larger on the side that is importing more volume than the other. There is need to match capacity to need. Finally, Bangladesh should allow pre-arrival clearance of goods. Some countries have realized significant gains from allowing the processing of documents to start before goods get to the border. The goods can therefore be cleared as soon as they arrive and customs and other agencies are able to carry out any physical verification they may desire.

80. **Broader markets in Asia should also be targeted.** Japan, China, India, ASEAN, South Korea, etc, are major world markets, with little Bangladeshi penetration. Targeted promotion to these markets by the Export Promotion Bureau, in cooperation with BGMEA and BKMEA (in the first instance), for example, can reap some dividends. This activity can have synergies with BOI's efforts to promote FDI into Bangladesh from these markets. The building of a Bangladeshi brand can be a longer-term objective. Improving trade facilitation will also be critical to improve Bangladesh's competitiveness in global and regional markets (see next section).

## **B Improving Trade Facilitation**

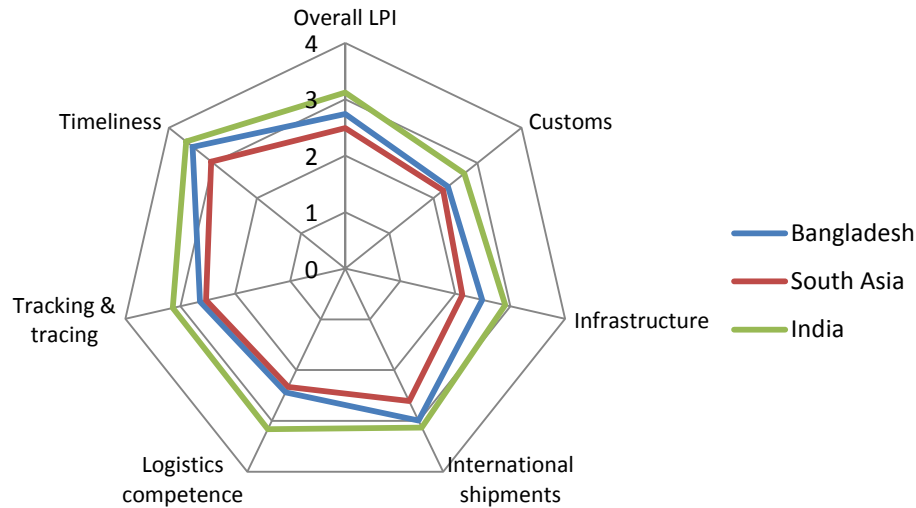
81. The costs of trade-related transport and logistics and their timeliness and reliability are core elements of trade competitiveness. Research has clearly demonstrated that high trade transaction costs are among the most important obstacles that developing countries currently face in exploiting the trade opportunities presented by the world trading system (Wilson, Mann and Otsuki, 2003; Hoekman and Nicita, 2011). These costs are often fixed and disproportionately affect small firms, farmers and the poor, prohibiting their participation in trade and limiting inclusiveness. Thus, the costs associated with inefficient trade facilitation, weak logistics and trade finance, have a direct bearing on poverty reduction. Trade facilitation also lowers import costs, which have a direct impact on the prices paid by the poor for the goods they consume (World Bank 2012c).

82. Bangladesh's cost advantage resulting from low labor cost is reduced or sometimes wiped out by disadvantages on the trade facilitation side. High logistics costs can be seen as an implicit tax that biases the economy away from exports. On the contrary, efficient logistics are important for enhancing Bangladesh's competitive edge in exports. They reduce costs and delays for exports and expedite imports for consumption and for domestic production. In particular, superior logistics performance offers a competitive advantage in an era of increasing globalization, more production sharing across countries, and shortened product lifecycles. To date, low wages have benefitted Bangladesh's ready-made garment (RMG) exports and have partially compensated for poor logistics performance. But to ensure general growth of exports, logistics performance in Bangladesh will need to improve considerably.

83. Despite some progress in improving its logistics performance, Bangladeshi logistics performance lags in customs, infrastructure, competence of logistics service providers, and tracking and tracing (figure 5). There are ongoing reforms in customs and there has been considerable expansion of the road network

and performance improvements at the main trade gateway port of Chittagong. However, the 2010 Logistics Performance Index (LPI, World Bank 2010) suggests that although Bangladesh performs above the regional average for South Asia in logistics, it generally ranks below India, which leads the region in performance, as well as other countries at similar income levels. The analysis in the trade facilitation chapter identifies options for tackling four interrelated issues that are critical to Bangladesh's logistics efficiency. These four issues are (i) the limited use of containers on the Dhaka–Chittagong Corridor; (ii) customs and border management modernization, (iii) air transport capacity and connectivity, and (iv) regional transit and connectivity.

**Figure 5: Bangladesh's Logistics Performance, 2010**



Source: World Bank 2010.

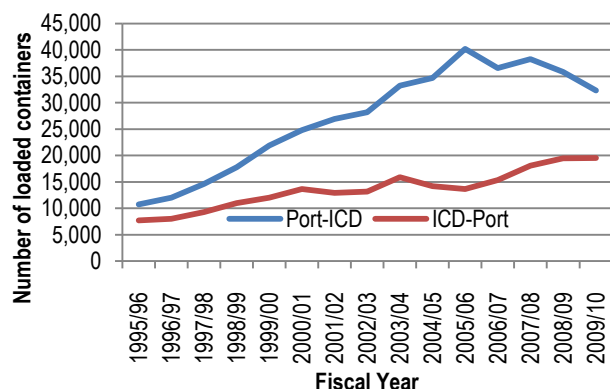
84. Containers are not used much in the domestic movement cargo in Bangladesh despite the rapid growth of containerization worldwide. There is still limited movement of containers inland, and the trend is in the wrong direction. Though Bangladesh joined the containerization revolution in 1981 it has not fully exploited the benefits of containerization. Presently, while approximately half of the cargo passing through the port of Chittagong is containerized, less than 15 percent of containers are moved inland. The rest are stuffed and unstuffed either in the port or in privately operated inland container depots outside the port but within its vicinity. The containers that move inland are transported mostly by rail, with only a few transported by road. In 2009 rail moved around 3 percent and 5 percent of loaded import and export containers respectively. Inland waterways within Bangladesh are generally not used to ship containers, although the authorities see great potential in utilizing waterways.

85. **Transit times can be as high as 12 hours when they should be less than 4 hours with free-flowing traffic.** Transit times by rail, the only other mode of transport, are even longer (close to 20 hours). The stripping of containers adds to handling costs as the goods are then loaded into trucks instead of the more efficient route of transporting containers. As a result, there are a high number of road trucks that move cargo between Dhaka and Chittagong. The Dhaka-Chittagong highway is congested from the high volume of traffic, as well as from bottlenecks at specific locations such as bridges and intermediate centers. Congestion increases transit times and decreases reliability on the corridor. The long transit times by both road and rail discourage shipping lines from shipping containers to the inland container depot (ICD) in Dhaka. In addition, Customs regulation imposes that containerized cargo may only be removed from the port by rail (to the inland container depot in Dhaka) or to bonded facilities in the export

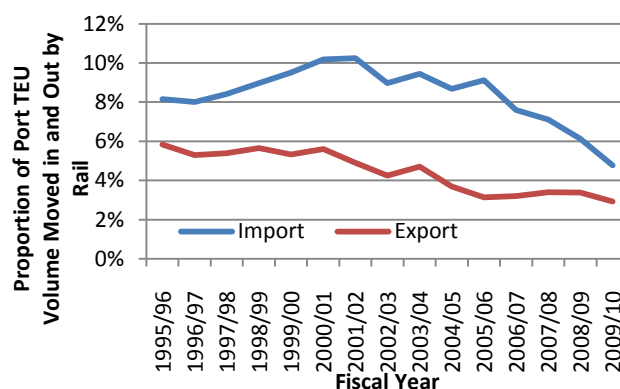
processing zones. As the volumes of containers that are removed by rail are small, current practice is that containers are stripped within the port and then the goods are loaded into covered trucks for removal. A large proportion of the export and import containers are stuffed and stripped within the port itself (around 60 percent).<sup>14</sup>

86. **Growing container volumes moved by rail and inland waterways is key to better integration in the domestic logistics system.** This would require arresting a two-decade decline in railway capacity (figures 6 and 7) and improving inland waterway infrastructure. The latter would help in two respects: (i) avoiding congestion at Chittagong port, and (ii) moving containers using a cheaper mode than road and railways. Improvements in infrastructure at the Pangaon Container Terminal and introduction of customs facilities will help reduce cargo dwell time, as cargo would be cleared inland; this is already the case with railway-borne cargo. The government has also reportedly authorized the construction of privately owned inland container terminals that will operate the same way. A few such facilities are already being developed near Dhaka and Narayanganj. However, a major constraint with the inland waterway system is the slow speed of movement.

**Figure 6: Dhaka–Chittagong Corridor: Number of Containers Carried by Rail**



**Figure 7: Proportion of Chittagong Container Moved In and Out by Rail**



Source: Estimates using data from Bangladesh Railway. Note: ICD = inland container depot.

87. The poor performance of the Chittagong-Dhaka corridor (DCC) has been identified as one of the constraints to further expansion of the industry, including the garment sector. The DCC is the most important trade link in the country and serves more than two thirds of the country's import and export flows. It has multimodal transport possibilities as it is comprised of road, rail, and inland waterway links. Within the corridor, road transport handles just over half the traffic, followed by inland waters with 43 percent and rail with just over 6 percent<sup>15</sup> (railways are presently the most important mode for container movement inland). In 2012, Bangladesh Railways operates unit trains of 76–80 TEU twice a day between Chittagong and the Dhaka ICD in Kamalapur.<sup>16</sup>

<sup>14</sup> Customs allows only 17 types of goods that can be cleared in off-dock yards (ODYs) in the Chittagong area (annex A in Chapter 6). These are mostly bulk commodities that are not containerized.

<sup>15</sup> Nationally, road transport is the most important mode of transport, moving more than 80 percent of traffic. Inland waterways handle 16 percent and rail 4 percent. The share of traffic moved by road transport has been growing while that by the other modes has been in decline.

<sup>16</sup> Dhaka ICD has a storage capacity for only 1,000 TEU at any one time. It was established in 1987 under the joint ownership of Bangladesh Railways and Chittagong Port Authority. Container handling operations are under the control of Chittagong Port Authority. Since August 1991, dedicated container block trains have operated between Dhaka and Chittagong.

88. **The inefficiency of the DCC is partly due to low use of railways for freight.** Generally, railway capacity is limited by short train length due to track configuration and loop lengths. Also, long headways are needed due to the signaling and loop configuration. For freight train operations, there is the additional constraint of the wagon braking systems that limit maximum speed to 29 kilometers per hour. Despite the high level of demand and the potential for future growth, Bangladesh Railway has not increased the frequency of unit train operation. Yet, the unit train operation is Bangladesh Railway's only profitable service and has helped to offset some of the losses from passenger services. The reasons for not increasing the container service include the following: (i) Heavy demand on those sections that serve the passenger traffic from the northeast, for example, between Tongi and Bhairab Bazaar and between Laksam and Chakiasma. This is compounded by the limitations of a single track between Tongi and Chinki Astana. The government is now building another track with financing from the Asian Development Bank. This should remove a major operational bottleneck on the railways, although a shortage of wagons and locomotives will still constrain improvements in capacity; (ii) Government policy favoring passenger services over freight services. Most of Bangladesh Railway's capacity is dedicated to interurban passenger train movements;<sup>17</sup> (iii) Lack of commercial incentives for management, which is satisfied with rationing capacity to collect a premium (both formal and informal) for the service; and (iv) Rail ICD capacity, which has difficulty handling three trains a day in each direction.

89. **Trucking services are highly distorted and inefficient in the non-garment industry.** The garment industry has encouraged the emergence of modern trucking services based on contracts for services at an agreed price. While these services tend to be expensive, they offer a predetermined quality of service, for which they charge a premium. However, the non-RMG trucking services suffer from poor quality and low reliability. There are numerous operators using old fleets. In addition, there is a high level of vehicle overloading. In an effort to mitigate competition, the operators typically have to go through transport brokers to obtain loads, especially on the Benapole-Dhaka route. The market is therefore distorted, because the brokerage industry or clearing and forwarding agents control access to and competition for services. Moreover, one of the major constraints faced in this secondary market is the lack of access to financing that could be used to modernize fleets and improve access to new business.

90. **Besides road transportation, water transport has a large but unutilized potential in Bangladesh.** More than 10 percent of the population of Bangladesh has direct access to the inland waterways transport system (IWT). Although inland waterways are cheaper than other modes of transport, they suffer from poor performance. Generally, the volumes of cargo moved by the IWT have stagnated over the past decade. This mode is slow (16-20 hours between Chittagong and the ICD to the south of Dhaka). Although this is somewhat faster than the current rail service for inbound containers, it is slower than road transport, especially when door-to-door movement is considered. The IWT has great potential to move higher volumes of cargo, especially between Dhaka and Chittagong and between India and Bangladesh. It can help relieve some of the pressure from low railway capacity and congested roads.

91. Air freight has been growing steadily but with many problems experienced on the ground, in particular with respect to the management of the air cargo terminal in Bangladesh. Through hubs in the Middle East and the East Asia region, Bangladesh is connected to the rest of the world. Airfreight is used mostly by the garment industry, usually at the buyer's request, and sometimes in the case of a missed ocean shipping date. For normal shipments, one of the practices is to use a sea-air combination: ship by sea to Dubai and air freight from Dubai to Europe and the United States. Air charters are also used, especially during the periods of high demand, July to October. However, clearing and forwarding agents report problems with ground handling and management of the air cargo terminal at the airport in Dhaka, performed by a subsidiary of the national carrier, Biman Airlines. The terminal area is often congested, partly due to increasing cargo volumes but also due to poor performance in the handling and clearance

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<sup>17</sup> About 90 percent of train kilometers are passenger services, nearly all of which are customers travelling second class.

processes. Furthermore, although agents pay Biman for all services, they often have to hire their own labor for the same purpose, increase costs for airfreight logistics. Another complicating factor is the absence of a simplified Customs clearance procedure even for small consignments, samples, nor a de minimis provision. All packages are treated the same, resulting in clearance times that take 1–5 days even for garment samples.

92. **The government is taking steps to further automate customs processes.** It has recently introduced ASYCUDA World<sup>18</sup> in 2013 starting at the Port of Chittagong. The plan is to interconnect all the customs stations so that declarations can be lodged from anywhere. In addition, the National Board of Revenue (NBR) is also working to introduce a “single window system” starting at Chittagong Customs House. Already, ship agents can file vessel manifests electronically, though hard copies still have to be submitted. However, presently most of the land customs stations are not automated and use manual systems. Bangladesh has an extensive network of land customs stations. The most dominant one is Benapole, which is on the main land trade route with India. Clearance times are typically 2–3 days at the smaller stations and within 5–6 days at Benapole. At Benapole, 80 percent of declarations are assessed within a day of being lodged, whereas it takes up to 5 days to clear 80 percent of goods for release after declaration. The clearance times at the land customs stations are affected by several practices that increase time and cost. The main one is the transloading of cargo between trucks registered in Bangladesh and those registered in India. This practice has several consequences, including the need to provide warehousing space and equipment to handle and store goods, and labor to handle the goods.

93. **Informal payments are also still common to facilitate clearance of goods.** In part because of this, as well as lack of internal capacity, Bangladesh customs relied on the services of pre-shipment inspection (PSI) companies. While it is claimed that the PSI improves revenue collection, reporting on the declarations,<sup>19</sup> and cargo clearance time by 1–2 days on average, the program has not been without controversy (Arnold 2010). On paper, 10 percent of PSI and 100 percent of non-PSI shipments were supposed to be subject to physical examination. However, the actual physical examination rate for PSI shipments was much higher (close to 50 percent). There were around 8,000 disputes pending in the courts relating to the certifications by the PSI agencies—a small proportion of the total declarations. The disputes were usually about classification and valuation of imports and what was regarded as poor performance by the PSI companies (Mahmud and Rossette 2007; Uzzaman and Abu Yusuf 2011).

94. **Finally, Bangladesh does not have an effective institutional mechanism to promote trade facilitation and logistics upgrading.** The existing mechanism has been effective in meeting trade facilitation obligations under the WTO framework, but some of the constraints now faced are much more about the interface between the physical infrastructure and meeting regulatory requirements for the movement of goods. Like other countries, Bangladesh has numerous agencies that play a role in trade facilitation and logistics. These include customs, chambers of commerce, the land port authority, port operators, railways, roads, inland waterways, clearing and forwarding agents, security services, and so forth. The lack of proper coordination is evident in the manner in which transit issues have been pursued, where a holistic assessment of the costs and benefits of transit has not gained enough traction. This is also reflected in the present poor coordination among agencies at the border, which increases costs and clearance time and reduces reliability. In other countries such as Pakistan, coordination of trade facilitation reforms is pursued through a national trade facilitation committee.

### *Improving Logistics to Reduce Lead Times and Enhance Competitiveness*

95. **A coherent and comprehensive National Logistics Strategy would help improve the efficiency of the transit regime.** The government of Bangladesh can help improve the efficiency of the

<sup>18</sup> See <http://www.asycuda.org/>.

<sup>19</sup> Review of pre-shipment inspection in Bangladesh, Manzur Ahmed [http://www.thefinancialexpress-bd.com/more.php?news\\_id=17515](http://www.thefinancialexpress-bd.com/more.php?news_id=17515).



movement of good by reducing the lead time and the cost of logistics for imports and exports through the DCC. Such strategy would potentially have important implications on infrastructure development, and quality and performance of logistics services. It would entail a set of coordinated reform pillars: (i) Improve road and rail capacity; (ii) Improve Customs Procedures at Port of Chittagong; (iii) Support Customs' efforts to gradually phase-out from the services of Pre-shipment Inspection (PSI) companies and adopt and implement an appropriate roadmap, including capacity building for Customs officers; (iv) Enhance air shipment capacity; and (v) prepare for Single Window's implementation.

96. Bangladesh should both broaden the coverage and strengthen the capacity of the national trade facilitation committee to play a more proactive role in guiding trade facilitation and logistics reforms in the country. Good logistics are important for enhancing Bangladesh's competitive edge in exports. To date, low wages have benefitted Bangladesh's RMG exports and have partially compensated for poor logistics performance. But to ensure continued rapid growth of exports, logistics performance in Bangladesh will need to improve considerably. Moreover, while the focus to date has largely been on international trade facilitation reforms, recent empirical evidence suggests that measures to improve logistics performance at the sub-national level in order to facilitate connections to international trade corridors and supply chains is as, if not more, important. In geographically large or dispersed countries such as Bangladesh, the performance of internal corridors is a key priority for reducing poverty in lagging regions and addressing rising concerns about development disparities across regions within countries (Kunaka, 2010).

97. **The plan to establish a rail ICD at Tongi should be implemented as soon as possible.** The existing Dhaka rail ICD in Kamapur operates more efficiently than the container yard in Chittagong Port, but its location in the congested city center restricts access. The rail service provides a cost-effective means for repositioning of empties through lower backhaul tariff. There are no serious delays for the southbound movement from Dhaka to Chittagong and the ICD provides sufficient storage for empties. However, the benefits to exporters are limited since the ICD does not currently operate as a dry port with a through bill of lading. The shipping lines continue to charge exporters for the round trip movement of the boxes, even if they are loaded in both directions. Further, they require a bank guarantee for movement of empties from the ICD to the factory for stuffing of cargo. Given their interest in controlling how the boxes are used and coordinating their repositioning, the shipping lines have little incentive for offering attractive rates for a backhaul-loaded movement. It is left to the freight forwarders to encourage the loading of the empties stored at the ICD with export cargo. They are able to move the boxes to the factory under a company guarantee rather than a bank guarantee and they can negotiate lower rates with the shipping lines for a loaded southbound movement. The relocation of the ICD to Tongi should encourage this business.

98. **Development of the IWT sector would require strengthening the regulatory oversight of transport services.** There are two bodies with regulatory responsibilities for IWT in Bangladesh. These are the Department of Shipping, which is responsible for safety and overall regulation of the sector, and the Bangladesh Inland Water Transport Authority (BIWTA). BIWTA is responsible for dredging services, navigational aids, management of inland ports, and regulation of transport operations, among other functions. Often the separation and allocation of responsibilities between the two is not clear. With proper regulation, inland water transport can help Bangladesh reduce the environmental impacts of transport operations as it is more efficient and generates lower carbon emissions than other modes. Priorities for improving use of the IWT should also include improving service performance by dredging channels, improving IWT port capacity near Dhaka, and the acquisition of more efficient vessels (see also chapter on shipbuilding). Some of the improvements can be made by the private sector.

99. **A number of measures could be taken to improve overall efficiency at the land border posts.** Some of the measures can be short-term measures including: (i) Increase and harmonize border working hours. Presently the land ports do not operate fully on Friday in Bangladesh and on Sunday in India. Two days of clearance are therefore lost each week; (ii) Allow pre-arrival clearance of goods. Some countries

have realized significant gains from allowing the processing of documents to start before goods get to the border. The goods can therefore be cleared as soon as they arrive and customs and other agencies are able to carry out any physical verification they may desire; and (iii) Increase capacity for handling transloaded goods. In the interim before phasing out transloading of goods, capacity for handling such cargo should be increased. Current practices are designed around significant use of manual labor and the involvement of hundreds of people at each border post in the transloading business. Some of the processes can be automated to expedite movement of goods. Both India and Bangladesh could also agree on modalities for the penetration of trucking services into each other's territory.

100. **The government should complement the phasing out of PSI by implementing an Authorized Economic Operators (AEO)<sup>20</sup> program.** After years of postponement, the government has finally phased out PSI as of July 2013 as announced by the minister of finance in the FY14 budget statement. Chief among the actions taken was a significant increase in and training of customs staff. An AEO program for Bangladesh would help address several objectives, including faster clearance of some goods and, as a corollary, freeing customs and other border management resources to target those consignments that pose the most risk. Typically, an AEO program is developed and implemented in phases, reflecting the capacity of both the authorities and private sector readiness to participate in such a program. An AEO regime can be introduced for selected supply chain participants such as with the established garment manufacturers. Such a program would free customs resources to target those consignments that pose the most risk. In addition, the management of risk should be automated as much as possible, based on international best practices. The ASYCUDA World system that is being developed has a capability to enhance risk management in a flexible manner.

### 3.2 Pillar 2: Breaking into New Products

#### A Rationalizing Trade Policy to level the Playing Field

101. **Trade policy has served Bangladesh well so far, resulting in sustained export growth.** Dollar exports have doubled over the last six years. Bangladesh is now the second biggest exporter of garments, and could benefit significantly from China's rising wages and the ongoing move to cheaper garment producers. Also, Bangladesh has an unusually high share (at its income level) of manufactured exports in its export basket, which illustrates its strengths in mass manufacturing and labor availability.

102. **The economy has become increasingly open since independence.** Bangladesh went through a phase of heavy controls on export and import, price controls, and state trading (1972-75), followed by gradual market-based reforms including domestic deregulation in agriculture, trade and services, denationalization, abolition of most elements of state trading, and introduction of bonded warehouse facilities for the emerging garments sector. Since 1990, trade liberalization was stepped up, albeit it was interspersed with periodic reversals. Trade policy reform included a substantial scaling down and rationalization of tariffs, removal of trade-related quantitative restrictions, elimination of import licensing, unification of exchange rates and move to a managed float exchange rate regime. In 1994, Bangladesh was declared to be conforming to the IMF's Article VIII, marking convertibility on the current account.

103. Yet, significant inconsistencies stemming from lingering trade protectionism for some industries, and a focus on revenue targets raises questions about the overall efficacy of trade policy and sustainability of export growth. Trade policy often responds to protectionist pressures, reminiscent of the import-substituting trade regime that prevailed before the 90s. Revenue and/or protectionist considerations have usually dominated over trade policy issues. Thus, trade policy in Bangladesh has been skewed, where consumers and export sectors other than garments have not been conscious beneficiaries of such policies.

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<sup>20</sup> The World Customs Organization (WCO) SAFE Framework of Standards defines the SAFE Authorized Economic Operator (AEO) as an entity complying with WCO or equivalent supply chain security standards and with legal obligations in relation to tariff and nontariff requirements on the import, export, and transit of goods.

Any protectionist measures should be justified in terms of economy-wide positive spillovers and should also be temporary. However, in recent years, border taxes have increased and grown more complex, and have led to high and varied rates of effective protection. Overall, the trade policy regime has translated into reduced incentives to export and diversify, and has led to higher domestic prices.

104. **The tax treatment of imports in Bangladesh is complex.** While average Customs Duties (CD) have come down over the past decade from 70.6 percent in FY92 to 13.2 percent in FY14, a proliferation of para-tariffs has resulted in a complex import tax regime and substantially increased the rate of border protection. Supplementary duty (SD) and regulatory duty (RD) seem to have become standard instruments for raising revenue or offering protection to domestic import substituting industries. Such tariff changes that raise overall protection and also increase its dispersion across products potentially set back the agenda for trade diversification. The combination of the tariff rate with para-tariff rates gives an average nominal protection rate (NPR) of 27.3 percent in FY14, up from 20.1 percent in FY09 (albeit with a decline in FY14, compared to the 28.9 percent rate of FY13).

105. **Inter and intra-sector variations in border taxation abounds.** Border taxation varies substantially at the sector level for both tariffs and para-tariffs.<sup>21</sup> It varies substantially between and also *within* sectors, potentially reinforcing distortions to individual decisions, opportunities for rent-seeking, and the consequent need for enforcement. In general, tariff rates are more dispersed (less concentrated) than para-tariff rates, reflecting tariff escalation (see figures 8 and 9).

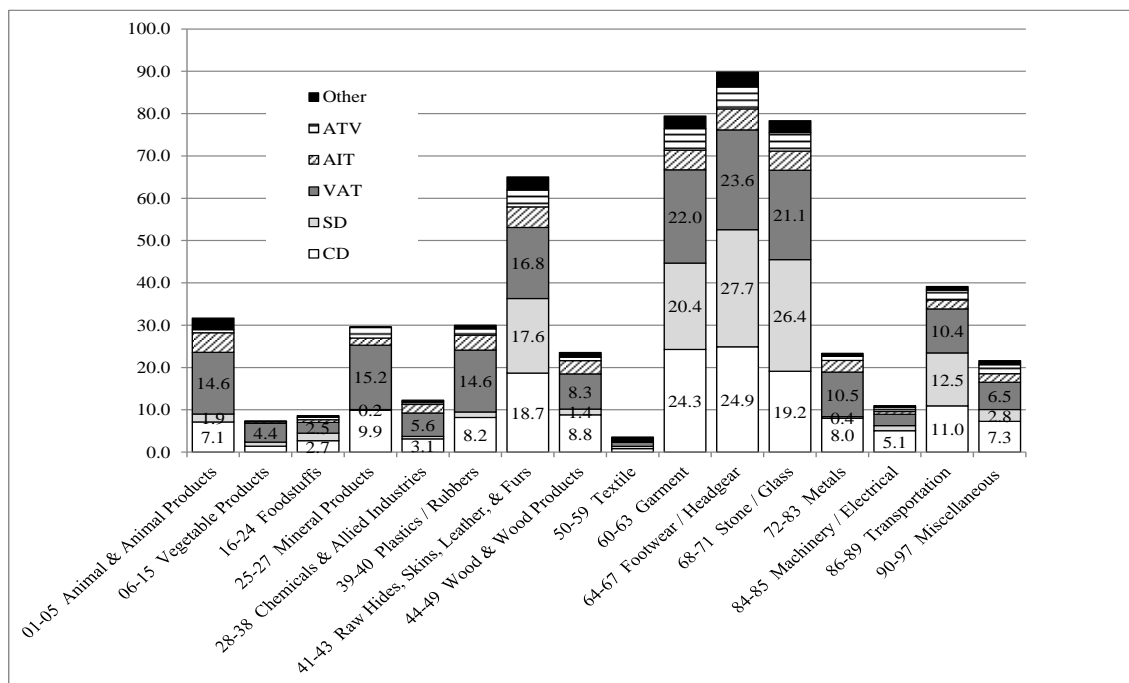
106. **Consumer goods are overly protected in Bangladesh, and there is a growing wedge between input and output tariffs.** The government levies significant SD and RD on top of the 25 percent tariff for final goods, mostly on products that are produced domestically. Thus tariff escalation is the highest at the last stage of processing—from intermediate goods to final goods (figure 10). The wedge between the average Nominal Protection Rate on inputs and final consumer goods has been rising since FY09, and appears designed to offer higher protection to domestic industries primarily engaged in consumer goods production. Tariff escalation appears to be the outcome of pre-budget consultations with producer groups only, without consultation with other stakeholders such as consumers who could suffer welfare losses through higher prices or reduced choice.

107. **There has been no critical evaluation of the impact of protection.** In general, higher tariffs on a product encourage its domestic production and discourage exports, since the former is protected by the tariff and the latter is a far more competitive marketplace. The low protection for intermediate and capital goods arguably discourages domestic production of these goods; and high protection for consumer goods encourages domestic production. If there is no ‘sunset clause’ or expiration date for protection, and the impact of protection on the protected sector and the rest of the economy is not evaluated, as is the case in Bangladesh, this can lead to economic inefficiencies.

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<sup>21</sup> Border taxation is different from protection, since VAT is levied on both domestic and import transaction. The data illustrates the size of the tax relative to that of the transaction rather than the degree of discrimination between imports and domestic production.

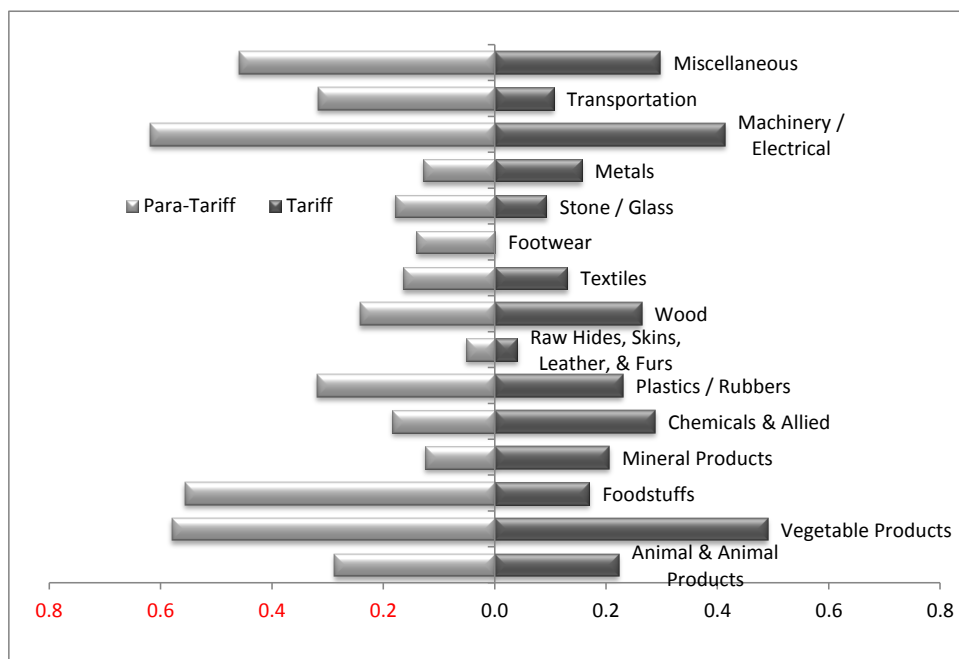
**Figure 8: Decomposition of Border Taxation at the Sector Level**



Source: Authors' calculations using NBR data.

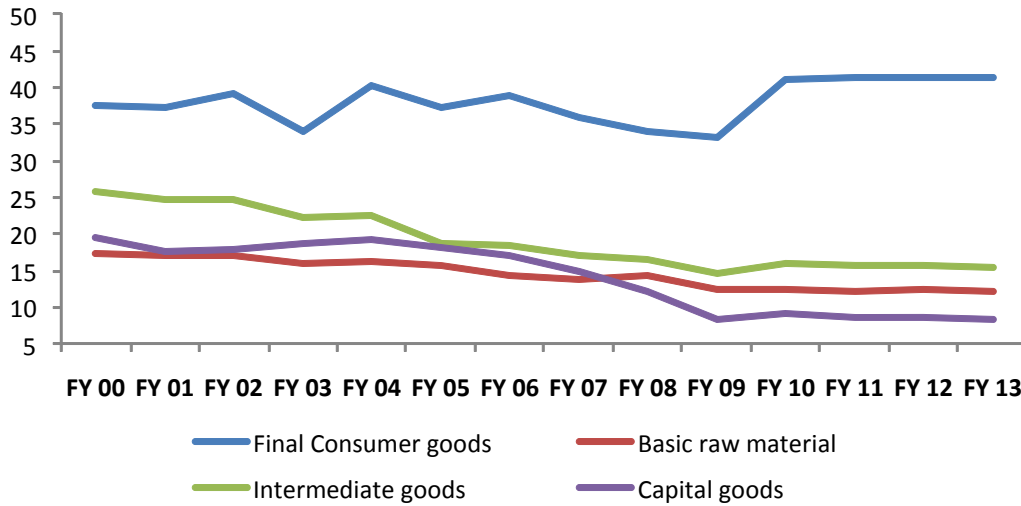
Note: AIT: advanced income tax; ATV: advanced trade VAT (a tax levied nominally at 3 percent of the VAT inclusive price of commercially imported goods); CD: customs duty; PSI: pre-shipment inspection; RD: regulatory duty; SD: supplementary duty

**Figure 9: Intra-Sectoral Concentration of Tariff and Para-Tariff Rates**



Source: Authors' calculations using NBR data.

Note: The length of bars measures the concentration of tax rates measured by Theil's concentration index. A long bar means that, within a given sector, a small number of sub-sectors shoulder a disproportionate share of the tax burden; a short bar means that the tax burden is spread relatively evenly within the sector.

**Figure 10: Average Tariff on Import Categories FY 00-13**

Source: Authors' calculations using NBR data.

108. The escalating structure of protection results in high effective rates of protection (ERPs) for domestic production,<sup>22</sup> which biases incentives against exports. The analysis confirmed especially high ERP in sectors like footwear, some agrifood products, bicycles and ceramics. Pharmaceuticals fall in a unique category with ERPs only modestly positive (but this is not the full picture, since competing imports are not allowed, see Section 4). By contrast, output destined for exports receives no protection, and export ERPs are typically zero when imported inputs are duty exempt via mechanisms such as duty drawback, or are exempt from duty and other import taxes altogether through special bonded warehouse (SBW) arrangements. Often, cash subsidies compensate for duty drawback or SBW. Comparing export ERPs with the high domestic protection, incentives to export are stifled (see Section 4).

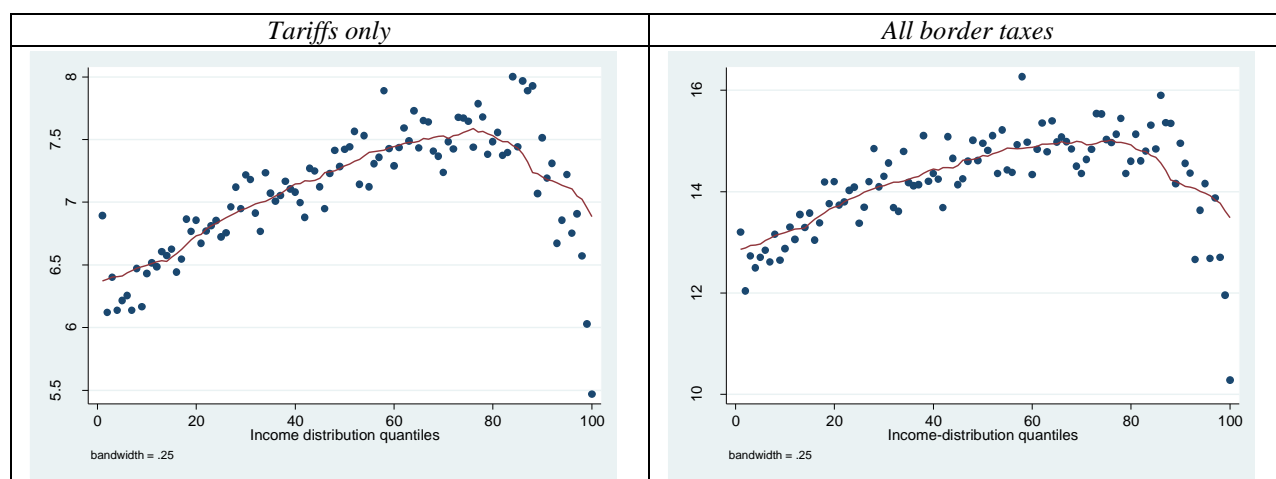
109. **High import tariffs also affect consumers' welfare through prices.** Simulations using household expenditure surveys show that tariffs add 7.5 percent to the cost of living of the median Bangladeshi household. Adding up all border taxes can increase living costs by up to 15 percent for the median household. Moreover, they seem to heavily tax middle-income households while sparing the richest (figure 11). Replacing the current array of tariff and para-tariff measures by a flat combined border tax at a uniform 10 percent would raise consumers' real incomes by 11.3 percent on average—enough to lift 11.2 million people, or 7.4 percent of Bangladesh's population (and 17.2 percent of Bangladesh's poor population i.e., those living below \$1.25 a day), above the poverty line.<sup>23</sup> While these numbers seem large, they illustrate the significant prevalence of imports in household expenditure baskets, as well as the high tariffs on many consumer goods.

<sup>22</sup> The effective rate of protection (ERP) is the proportional increase in local firms' value added (or processing margin) resulting from the combined influence of tariff rates on the final good and on intermediate inputs (a pure price effect—a higher ERP does not mean that the protected good has intrinsically higher value added). An escalating tariff structure (higher rates on final goods than on intermediates) raises local value added and protection levels compared to what would prevail under a zero or uniform tariff structure.

<sup>23</sup> This number is a rough approximation. It is obtained by replacing the current total of tariff and para-tariff charges by a flat 10 percent combined border tax in each household's basket and calculating the reduction in expenditure needed to buy the same basket given the new tax rates. This reduction (an increase in real income) is then extrapolated to the population using data on household size and sampling weights. The last step consists of calculating the poverty headcount (the number of individuals below the national poverty line) before and after the simulation. Note also that this is a partial equilibrium analysis.

110. **NTMs are also prevalent and may affect firms' competitiveness and household incomes.** Private-sector surveys such as those conducted by the International Trade Center have repeatedly shown that NTMs are costly and burdensome, and make products less competitive in the destination market.<sup>24</sup> NTMs can also penalize domestic firms who need to buy critical inputs from abroad, thus reducing national competitiveness. The heavy reliance on Pre-shipment Inspection until June 2013, and overly restrictive standards also increase the price of imports and hurt consumers' welfare.

**Figure 11: Consumption-Weighted Tariff as a Function of Household Income, by Centile**



Source: Authors' calculations using Bangladeshi tariff data and Bangladesh's household survey

Note: the authors approximate income with total consumption. For readability, the data is aggregated by centile of the distribution of income. Thus, the point to the extreme left of the diagram is the consumption-weighted tariff affecting the lowest centile of Bangladesh's income distribution. For example, given the expenditure pattern of households in that centile, they face, on average, a tariff at 6.2 percent

111. Bangladesh's trade policy is still heavily influenced by considerations of revenue and assistance to local industries rather than trade competitiveness. Import policy is legally set in the Import Policy Order (IPO) issued by the Ministry of Commerce in consultation with Customs. However, the National Board of Revenue, which does not have export promotion as its policy goal, seems to have the final authority on tariff setting (see also chapter on Institutions). But at the same time, border tax exemptions are widespread, and translate into significant revenue losses. The import tax structure is marked by a large number of exemptions of all kinds, including some that benefit single companies or under non-transparent "special order" labels. An analysis of customs transaction data at the tariff line level shows that exemptions figure is almost 30 percent of the total number of transactions and 44 percent of total trade value. These exemptions add up to significant revenue shortfalls—13 percent of collected revenue in FY11—especially in the foodstuffs sector where less than half of the nominal taxes are actually collected.

112. In the future, as import duties go down, Bangladesh's ability to harness economic opportunities from global trade will depend on its management of the quality of the products it exports and imports. Bangladesh faces a quality challenge for both its exports and imports. For exports, buyers and importing countries will set more stringent standards and technical regulations in the future. The success of Bangladesh's attempts to develop and diversify its exports will depend on how it meets this quality challenge. Simultaneously, in the future the population of Bangladesh will demand better regulation of imports to address an expanding array of issues, like public safety, food safety, and plant and animal health. Meeting the quality challenge in both export and import markets will help maximize trade,

<sup>24</sup> NTMs specifically can raise trade costs, divert managerial attention, and penalize small exporters and those located in low-income countries, where access to legal and regulatory information is difficult.

accelerate growth, and reduce poverty. Imports need to flow smoothly both to support the import needs of the export sectors and the needs of the domestic population.

113. Currently, a large number of Bangladeshi quality-related laws and regulations influences trade and unduly disturbs the free flow of imports. The problematic laws and regulations may be divided into three broad groups. The first group consists of mandatory standards on a range of products including food and agricultural products, chemical products, textiles, electrical and electronic products, and engineering products. The second group consists of SPS measures, notably food safety laws and regulations and plant health laws and regulations. The third group includes a number of “special rules” stated in the Import Policy Order (Ministry of Commerce 2012).

### *Trade Policy Reforms to Reduce Anti-Export Bias and Balance Consumer Interests*

114. **The gains from a balanced trade policy are multi-faceted.** For developing countries, exports are not only important for their well-established static and dynamic gains (scale economies, competition, knowledge transfer, etc.). Exports are also a main source of foreign currency necessary to finance the import of capital goods and other inputs. Indeed, the gains to trade are as much derived from imports as from exports. Openness to imports also acts as a disciplining force on domestic markets, leading to lower cost, higher-quality inputs and intermediate goods for producers. Access to a variety of products also encourages innovation and technological change. The smooth flow of imports is particularly critical for exporters who need to be competitive globally and are constantly competing with other players. Imports need to flow smoothly both to support the import needs of the export sectors and the needs of the domestic population. Imports benefit consumers by decreasing prices and increasing product variety. Services imports have also become a pillar of countries’ export competitiveness agenda by making services, as input to the industry, more efficient and cost effective.

115. **While garments exports growth can continue, government needs to level the playing field so as to not discourage diversification.** A more harmonized and simpler import tax regime would reduce distortions and ensure a level playing field among and within sectors and firms, favoring the development of new export sectors and SMEs. There are several ways Bangladesh could deal with para-tariffs, all of which aim to phase in a more trade-neutral tariff structure: i) Eliminate para-tariffs and put everything in the import tariff to boost transparency; ii) Lower para-tariff rates; iii) Ensure that the para-tariffs apply both to domestic production as well as imports which would help reduce their distortionary impact. Successful implementation of the National Board of Revenue’s reform agenda will be critical to help the government shift trade policy from a focus on revenue generation to a long-term national competitiveness strategy. The objectives of the reform are to: (i) continue to reduce the budget’s dependence on border tax; (ii) close tax loopholes and make the fiscal playing field less uneven across sectors and types of actors; (iii) generate the resources needed for the massive infrastructure investment effort that awaits national authorities if growth is to continue at the same pace.

116. **In general, revenue goals are achievable with more trade-neutral border taxation.** Simulation indicate that removing tariff exemptions would increase revenues by about 7-9 percent (while reducing imports by around 1 percent), and help compensate for the reduction or removal of others taxes while inducing more economic efficiency. Another simulation capping tariff peaks at 15 percent (international peak) would induce a loss in tariff revenue between 3-7 percent. Tariff revenues would actually decline by about 20-23 percent but the induced increase in imports (between 1.7 percent and 3.2 percent) would increase the contribution of other taxes.<sup>25</sup> A third simulation that removes SDs and adopts a uniform rate of 15 percent for CD+RD would increase tax revenues by 0.9 percent, which illustrates the efficiency and revenue potential of simple and uniform taxation. Removing exemptions would increase

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<sup>25</sup> For technical reasons, taxes had to be combined because of the large number of duties and taxes in Bangladesh. The simulation removes exemptions for CD+RD and not for other duties and taxes. The 15% cap is for the combination of CD and RD (considered as one single duty).

fiscal revenues significantly. These simulations do not reflect changes in the production structure and consequent changes in VAT revenues on domestic production. However, timely implementation of the new value added tax law will also help increase revenues and modernize the tax regime.

**117. Bangladesh’s quality management system can benefit from a more pragmatic approach.**

Measures include value chain interventions, ensuring the supply of services for quality, and promoting the smooth flow of imports while respecting legitimate needs for import regulation like food safety. Potentially fruitful areas for reform of the existing quality infrastructure in Bangladesh include the following: (i) Consider opportunities to open fishery testing markets for private sector service providers; (ii) Review the new Plant Protection Act and develop an implementation plan that provides clarity to importers about the prevailing rules. At the same time, meet the regulatory needs of Bangladesh; (iii) Review the list of mandatory standards to determine whether they meet legitimate regulatory objectives and can be effectively enforced; and (iv) Continue ongoing work by UNIDO and the Indian government to reform/provide technical assistance to BSTI, with the aim of bringing the BSTI structure into closer alignment with international best practice, and avoiding conflicts of interest.

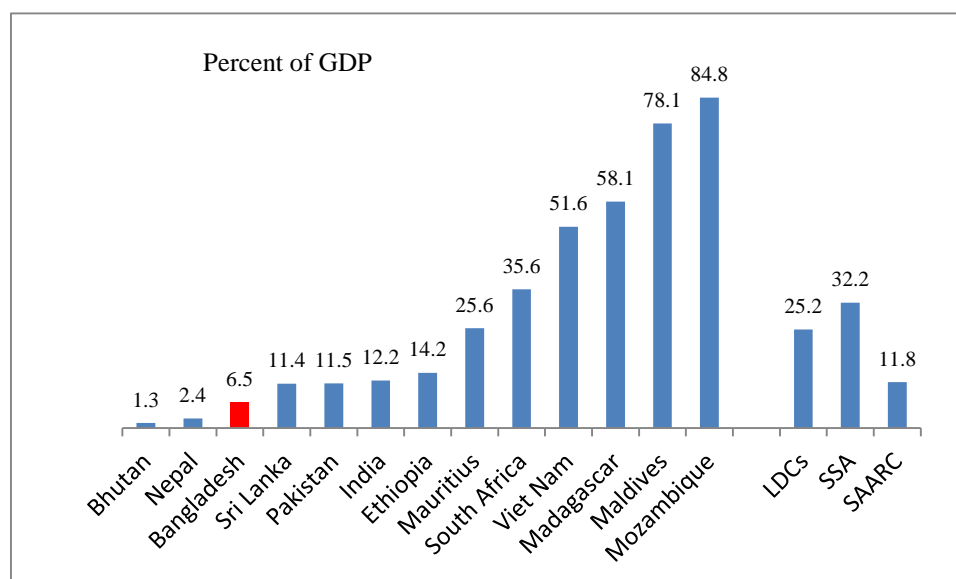
118. Openness brings opportunities, but also vulnerability to global shocks, and appropriate safety nets should be an important part of the globalization process. Globalization allows countries to benefit from the knowledge and technologies that have been developed anywhere in the world, whether embodied in machinery, intermediates, FDI or people. At the same time it greatly increases the need for governments to ensure that citizens are able to benefit from these opportunities: workers must be able to acquire the needed skills; firms need to be able to access credit to finance profitable investment opportunities; and farmers need to be connected to markets (Porto and Hoekman, 2010). Greater openness also increases the vulnerability of countries to global shocks, with potentially major adverse consequences for the poorest households that do not have the savings needed to survive a period of unemployment or sharp falls in the prices of their outputs (and thus incomes) resulting from global competition. Therefore, it is important that countries have in place mechanisms to assist those adversely affected by trade shocks. These mechanisms should be targeted towards those households that are most vulnerable and have to manage shocks. Governments should more systematically assess, *ex ante*, possible trade-related, poverty-distributional outcomes of policy changes. This will help policy makers better design complementary or transitional policies as well as compensation mechanisms and targeted programs to ensure that firms and workers can benefit from the new opportunities generated by trade openness. Policies and actions to achieve these objectives require actions by labor and finance ministries and are not necessarily part of the mandate of trade ministries.

**B. Improving the Environment for Domestic and Foreign Investment**

119. **FDI has persistently represented a tiny fraction of GDP and private investment.** Bangladeshi FDI inflows reached around US\$1 billion in 2012, but overall FDI stocks remain below 7 percent of GDP. Average FDI stock as a percentage of GDP was 25 percent in LDCs as a whole. It was also higher in comparator countries such as Vietnam (51.6 percent of GDP), or 11.5 percent in Pakistan (despite difficult conditions there), almost 12 percent in South Asia as a whole, and 32 percent in Sub-Saharan Africa (figure 12).



**Figure 12: Foreign Direct Investment Stock as a Share of GDP in Bangladesh and Selected Developing Countries, 2012**



Source: <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (SAARC: South Asia Association for Regional Cooperation; SSA: Sub Saharan Africa)

120. To reach East Asian growth rates of 7–8 percent, private investment levels in Bangladesh need to rise to at least 33 percent of GDP (see World Bank 2012b). Foreign direct investment (FDI) could help to augment both the quality and quantity of investment. Foreign-owned firms are a source of innovation spillovers and perform significantly better than domestic firms in terms of labor productivity and profit margins. They can also help to increase the overall amount of private investment by accessing their own savings as well as international financial markets, thereby easing at least a part of Bangladesh's financial sector limitations.

121. **FDI in Bangladesh has mostly flowed into the services sector.** The telecommunications industries and banking sector have attracted the most FDI, followed by the garment, gas, and petroleum sectors. Bangladesh has attracted three totally foreign-owned mobile telephone providers, as well as a majority foreign investor in the firm with the largest market share. The banking sector also includes a number of globally renowned banks. The textile and clothing industry has received less FDI, which is partially due to obstacles in this sector (UNCTAD 2013). Moreover, Bangladesh has attracted investment from a diverse set of countries. Egypt was the largest foreign investor during 2005–11, with investment concentrated in telecommunications. The next largest foreign investors are the United Kingdom, the United States, and Singapore. An important share of foreign direct investment in Bangladesh takes place in Export Processing Zones (EPZs). EPZs are export oriented industrial enclaves which provide the infrastructure, facilities, and administrative and support services for a wide variety of enterprises. Bangladesh's successful EPZs in Dhaka and Chittagong are now complemented by new EPZ developments around the country. As of March 2012, about 280,000 jobs were created in EPZs, mostly the ones in Chittagong and Dhaka, although these cannot be attributed to foreign firms alone, since some domestic firms also locate in EPZs.

122. An unfavorable business environment deprives Bangladesh of the full benefits of using FDI as a source for export growth and diversification, technology transfer and quality upgradation. Capacity constraints make access to scarce energy and infrastructure resources a zero-sum game, with the consequence that local incumbents sometimes view FDI (and new entry in general) as game spoilers rather than as sources of technology transfers and overall dynamism. The result is a general lack of

competition, diversification and growth opportunities for smaller firms, as entrenched incumbent positions make entry difficult for both local and foreign entrants. Finally, while foreigners can work with corruption, it raises the cost and uncertainty.

123. While the FDI regime does not seem to be overly restrictive, in practice the regime could be considered unfriendly for foreign investors, in part due to its asymmetric impact on foreign firms. Moreover, the government does not appear to be particularly pursuing an aggressive policy to attract FDI in any sector, neither to properly value the benefits of FDI in terms of technology transfer, quality upgradation, product and market diversification, integration into regional and global supply chains, and employment generation (the ultimate objective of the government). Thus, opposition to FDI by strong domestic firms, a strong business presence in Parliament, lax product standards' enforcement, and uneven governance standards, in particular, affect foreign firms' incentives to invest. In addition, inadequate land for business purposes, and lack of a pro-active FDI promotion campaign owing to a rather weak Board of Investment with multiple mandates, are other major factors. The asymmetry faced by foreign firms vis-à-vis local firms in Bangladesh is a more serious issue than might appear at first sight. This is a kind of 'regulatory arbitrage' that local firms enjoy, and it will be an obstacle to attracting sustained, quality FDI.

124. Bangladesh has the potential to attract significantly higher levels of FDI in spite of the challenges it faces, but it has much work to do to turn that potential into reality. It can position itself as a competitive center for labor-intensive manufacturing, and attract efficiency-seeking FDI. Its attractions include abundant labor supply, a mastery of large-scale labor-intensive manufacturing in garments and to some extent footwear, a favorable location between two large and dynamic economies, India and China, as well as wide understanding of the English language. Preferential access to key consumer markets in developed countries makes it an attractive platform for export-seeking FDI. Its entrepreneurial private sector is another important asset that could be exploited further with a business-enabling regulatory framework in place. In addition, if Bangladesh is able to stay on its current growth path, its market size could increase quickly and attract a wave of market-seeking FDI. However, to make good this potential, it would have to address some critical constraints to FDI including availability of serviced land, the asymmetry between local and foreign firms, and also adopt a more welcoming and more pro-active stance towards FDI.

125. Sector studies conducted for the DTIS point to the important role FDI can play in terms of export diversification and technology transfer in Bangladesh. The Republic of Korea has led investment in the garment industry. FDI was critical in the emergence of bicycle exports. Malaysian investors seized an opportunity in the EU market by establishing the first bicycle exporting firm in Bangladesh in 1995. They invested US\$2 million in a new plant named Alita in Chittagong. FDI in the shipbuilding sector is close to zero for the moment; however, FDI and joint ventures could help gradually improve Bangladesh's capacity and reputation in shipbuilding, and FDI could especially help the linkage industries through technological advancement, improvement of processes as well as worker skills. Korean and Chinese investors in particular seek to capture some of the growth in Bangladesh's textiles and services sectors.

### ***Encouraging FDI to Support Jobs, Growth, and Diversification***

126. One of Bangladesh's greatest development challenges is to provide gainful employment to the 21 million new entrants to the job market over the next decade. Properly used, FDI could complement domestic investment and become increasingly important in addressing this challenge, not only to provide more jobs but also higher quality jobs in terms of pay and benefits, as well as safety and other working conditions. Both domestic investment and FDI will benefit from unlocking infrastructure constraints, in particular energy and trade facilitation, and access to land. Improvement in the doing business environment will facilitate investment by reducing the cost of transactions and risk taking, leading to a more dynamic private sector.

127. Moreover, there is a strong need for a major effort to change the perception of Bangladesh through some institutional and regulatory changes. Entry conditions are subject to general FDI as well as

sector regulations, which lead to discretionary administrative procedures. BOI plays a rather minimal role in the overall FDI process. A more transparent law on investment should be adopted by parliament. Also, the dispersed administration of public land makes it difficult for Bangladesh to adequately manage its holdings. While it is vital for local authorities to be involved in land management, a higher degree of coordination should be achieved at the national level to allocate public land to its most productive and essential use. This could be achieved through a coordination institution or body and the establishment of a public land database that would list all plots available for development by location, size, facilities, and other (UNCTAD 2013).

128. Bangladesh should adopt a more proactive and welcoming stance toward potential foreign investors, with BOI playing a key role to overcome Bangladesh's rather ambiguous attitude to FDI. Foreign investors should get more administrative support early on when desiring to invest in Bangladesh, thereby reducing the hurdles and uncertainty they may face in a new environment. BOI should arrange more high-level investment promotion missions to large emerging economies, especially in Asia, including to Japan, China, and India. These missions should be preceded by preparatory missions to identify short-term FDI opportunities and requirements.<sup>26</sup> The cost of not seeking out investors may be high, as other competing countries such as Vietnam and Cambodia are aggressively pursuing Chinese and other Asian FDI. Bangladesh should also reduce discretion in decision making and more strictly enforce standards so that foreign firms that enforce strict compliance and standards are not penalized. With the persistent global crisis and slow growth, foreign capital will become choosier. This means that attracting FDI will become even more difficult. The domestic private sector, with vested interests, would unlikely support this agenda, and reforms would likely have political costs since they may affect powerful business groups even if they benefit society. The agenda is daunting, and addressing it requires a vision of growth and development that recognizes the major role that FDI can play.

### 3.3 Pillar 3: Improving Worker and Consumer Welfare

#### A. Improving Skills and Literacy

129. **As much as 96 percent of the labor force has less than secondary education, and two-thirds has less than primary education.** This, despite educational access having increased significantly over the last decade, particularly at the lower levels of education and especially for women. According to the World Bank (2013a), just a third of the primary graduates acquire the numeracy and literacy skills they are expected to master by the time they graduate. Moreover, only 0.17 percent of the labor force has professional degrees such as engineering and medicine. A World Bank survey of 1000 garment firms in 2011 found that skills were the major disadvantage if firms located outside Dhaka. High rejection rates in a 2010 UNIDO survey also point to low average skills of garment workers. In sectors such as ITES, shipbuilding and pharmaceuticals, part of this DTIS, higher skills were in constant demand (World Bank 2012a, 2012b).

130. Bangladesh's performance on literacy rates and secondary school enrollment is extremely poor and undermines the development of all sectors (table 4). Basic tasks conducted in all sectors, from garment to IT Enabled Services (see Section 4), typically need a labor force that comes out of secondary schools and colleges that can then be trained. In this respect, Bangladesh has one of the poorest records of comparators. The low level of literacy and years of schooling of the labor force make skill acquisition more difficult. In contrast, Sri Lanka has provided a skills environment that allowed garment firms to quickly move up the value chain. Bangladeshi firms' choice is mostly restricted to primary school graduates and high school dropouts.

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<sup>26</sup> These missions will be supported by the Private Sector Development Support Project (PSDSP), financed by the World Bank (UNCTAD 2013).

**Table 4: Benchmarking Literacy and Enrollment Rates, Bangladesh 2011**

Country	Secondary School Enrollment	Adult Literacy
Sri Lanka	90%	91%
Philippines	82%	95%
Egypt	81%	66%
China	76%	93%
Malaysia	70%	92%
Vietnam	70%	93%
India	59%	62%
<b>Bangladesh</b>	<b>44%</b>	<b>56%</b>
Pakistan	33%	55%

*Source:* Data compiled by Global Development Solutions, LLC from UNESCO/A.T. Kearney

131. Improving skills and literacy will allow current products such as garments to become more competitive, enable a move to higher quality products, and allow productivity and wage increases. Over the longer term, improvements in product quality may enable Bangladesh to eventually target higher-value apparel segments that require more complex production processes. This agenda will require an articulation of a comprehensive vision for skill development; reskilling the current labor force through greater access to non-formal training and skill-building; and improving the quality of foundational education. Skill building should not be limited to line workers but should also involve management in order to develop the talent needed to run effective and efficient international manufacturing enterprises. Realization of this goal is complex and involves many stakeholders including firms, institutions, and government.

## **B. Implementing Labor and Work Safety Guidelines**

132. Minimizing the chances of further tragedies in the garment/export sectors in Bangladesh has become a pre-condition for sustained export growth. Workplace safety standards and their implementation, in particular in the garment sector, have become very important in light of the many fatal accidents and deaths among workers. Factory physical layout and management practices can contribute to production inefficiencies and hazardous conditions. Ignoring worker safety concerns could result in major damage to Bangladesh's reputation among international apparel firms. Urgent action to address worker safety as well as welfare issues is required so that future tragedies are averted.

133. **A coalition of stakeholders needs to work together to ensure that implementation of promised actions is undertaken.** Implementation of standards requires formation of and coordination with worker groups, support of government, and collaboration with the private sector and factory owners. To the extent capital improvements are required, increased access to financing may be needed as well. Numerous buyers and customers have expressed interest in and pledged funds for enhancing production safety, and the sector should leverage this support. Recent decisions taken by EU and US buyers, and the amendment of the Labor Act are steps towards this important objective. The ILO could coordinate some of these efforts, partly through Bangladesh's application to join the "Better Work Program." Seriousness of intent on the part of the Government will play a critical role in convincing the EU and USA, the major players in post-Rana Plaza events (see CPD 2013 for an update on post-Rana Plaza commitments and the implementation status of these).

### C Making Safety Nets More Effective in Dealing with Trade Shocks

134. **Openness brings opportunities, but also vulnerability to global shocks.** Globalization creates immense opportunities for countries to leverage global demand for goods and services. It allows countries to benefit from the knowledge and technologies that have been developed anywhere in the world, whether embodied in machinery, intermediates, FDI or people. At the same time it greatly increases the need for governments to ensure that citizens are able to benefit from these opportunities: workers must be able to acquire the needed skills; firms need to be able to access credit to finance profitable investment opportunities; and farmers need to be connected to markets (Porto and Hoekman, 2010). Greater openness also increases the vulnerability of countries to global shocks, with potentially adverse consequences for the poorest households that do not have the savings needed to survive a period of unemployment or sharp falls in the prices of their outputs (and thus incomes) resulting from global competition.

135. **Making the gains from globalization more inclusive and beneficial to poor households is critical to poverty reduction.** The adjustment processes associated with increased global integration contribute to skill- and gender-differentiated inequalities in labor market opportunities and outcomes. Similarly, the benefits from trade are often concentrated in the largest metropolitan areas, further exacerbating inter-regional inequalities. Promoting *internal* trade, as well as exports, therefore also matters; it is important to help connect lagging and more remote regions to high growth areas within countries as well as between them (as discussed in the Trade Facilitation Chapter 6). The main priorities in this area should include: (i) assisting the most vulnerable to manage trade shocks; (ii) doing more to address any gender differentiated impact of policy changes; and (iii) extending the benefits of trade to lagging regions within countries by ensuring that poor people in these areas can better connect to places where agglomeration occurs.

136. **It is important that countries have in place mechanisms to assist those adversely affected by trade shocks.** These mechanisms should be targeted towards those households that are most vulnerable and have to manage shocks. Governments should more systematically assess, *ex ante*, possible trade-related, poverty-distributional outcomes of policy changes. This will help policy makers better design complementary or transitional policies as well as compensation mechanisms and targeted programs to ensure that firms and workers can benefit from the new opportunities generated by trade openness. Policies and actions to achieve these objectives require actions by labor and finance ministries and are not part of the mandate of trade ministries.

137. **Starting preparation of a safety net strategy** that recognizes possible winners and losers in trade liberalization could help reduce opposition to a neutral trade policy. Apart from cash transfers, a key part of this strategy would focus on training and re-training, and hence be linked to the skills agenda.

### 3.3 Pillar 4: Building a Supportive Environment

138. While the DTIS recognizes the importance of sustaining sound macroeconomic fundamentals and easing the energy constraint, these issues have been/are being addressed in several World Bank and IMF reports, as well as development projects and the ongoing IMF program. However, for the sake of completeness, the issues are summarized here and reference made to other relevant work. In terms of in-depth analysis, the DTIS focuses on the institutional capacity of the government of Bangladesh to lead and implement successfully a trade competitiveness centered agenda, in line with its 6FYP.

#### A. Sustaining sound Macroeconomic Fundamentals

139. **While its macroeconomic situation is stable, Bangladesh's near and medium-term outlook is subject to several vulnerabilities** (some of which are discussed further below)—prospects of a resurgence in inflation; a possibility of export slowdown; fiscal expansion due to increased recurrent expenditures in response to political pressures; a weak financial system that has been further exposed by

recent stock market volatility and financial scams; and remittance inflows that have become vulnerable with the recent sharp decline in the number of workers going abroad.

140. **Inflation is still high and could rise further.** Deceleration in inflationary pressure notwithstanding, the level of inflation at 8.6 percent in June (y-o-y) is still high. Production and supply chain disruptions due to intensified political violence in the run up to elections are a major near-term inflation risk. In addition, with large wage increases expected across all sectors of the economy including the garment and public sectors, wage push inflationary pressures may build up and this, without commensurate increases in productivity, could reduce the competitiveness of exports.

141. **Continuing its record of sound macroeconomic management** will help Bangladesh keep inflation at bay, and help price competitiveness. Implementing the ongoing IMF program will help anchor the macroeconomic framework.

## **B. Easing the Energy Constraint**

142. While the energy situation is grim, mitigating measures taken by Government have focused on shorter-term solutions, which raise costs and subsidies and add to fiscal vulnerabilities. The Government has added 3594 MW of capacity in the last four years (Ministry of Finance, 2013). However, about 2,400 MW of this increase comes from government contracts with rental and quick rental plants (for 3-5 year terms) that run on expensive (and government-subsidized) liquid fuel. Although this strategy has helped to reduce power shortages during summer and the irrigation season in the last three years, it has further increased the power sector's dependence on the budget for large subsidy payments to these private generators. Thus, the annual budgetary transfer to the power sector was around US\$85 million per year during FY07-09, US\$140 million in FY10, US\$600 million in FY 11 and US\$815 million in FY12, the increase coinciding with the introduction of liquid fuel power plants. The annual budgetary transfer is expected to go down to about US\$600 million in FY13 due to tariff adjustments in phases since February 2011, but is not expected to reduce further unless short term rental contracts are terminated and replaced by low cost base load power plants. A number of large gas-fired/dual fuel power plants were awarded to the private sector including one large coal fired plant (1,320 MW) based on imported coal, but they are yet to even reach financial closure.

143. It would be critical for Bangladesh to implement sustainable solutions that are able to provide unsubsidized power at competitive prices, and this will help all segments of the economy and provide a major boost to investment. Critical actions involve both the public and private sectors, including: increasing generation capacity in low cost base load power plants; commissioning of the large gas-fired/dual fuel combined cycle power plants awarded to the private sector; conversion of BPDB's simple cycle plants to combined cycle plants; accelerating moves to import power from Bhutan, Nepal, Myanmar and from India's North Eastern states. Measures taken by Government to address this constraint have focused on shorter-term solutions, which raise costs and subsidies and add to fiscal vulnerabilities.

## **C. Building Institutions for Trade Policy Coherence and Implementation**

144. The success of the proposed government export-led development strategy as depicted in the Sixth Five-Year Plan would depend on the institutional capacity to lead this agenda. Implementing this policy agenda will require a dedicated high-level team, a strong coordination across various government departments and agencies, and a clear understanding of the objective of promoting trade competitiveness in global markets (and in the domestic market). However, trade policy is currently carried out through a number of institutions in a piecemeal fashion undermining the effectiveness of the reform agenda. This fragmentation is exacerbated by the absence of a national trade strategy that could otherwise provide an overarching mandate in the formulation of each institution's individual policies. Continuous consultation and consensus building among ministries and agencies involved in trade policymaking and negotiations is

essential for effectively responding to opportunities and challenges presented in the international trading environment, and a broad based consultative process is a pre-requisite for good economic governance.

145. **The implementation of reforms may be jeopardized by rather weak institutional capacity.** The economic growth reform agenda spans several ministries and authorities, and would require a strong leadership at the very top to succeed. Despite a credible willingness and commitment to the reform agenda, such leadership seems to be missing and rather diluted in several layers of public-private committees and initiatives led by different stakeholders. The trade policy agenda is scattered among a number of authorities and institutions, not necessarily in a coordinate way or with adequate capacity. The reform agenda is further weakened by a strong rivalry between the two main political parties. The next elections taking place in six months have already translated into political conflict and instability.

146. **In addition, the absence of a formal system for dialogue between the public and private sector has been felt widely.** Another characteristic of Bangladesh policy space is the role and weight of the private sector. From one side, the private business sector seems very powerful and heavily involved in the policy making, with very influential industry chambers and high representativeness in parliament. However, the private sector also appears as a recipient of policies and information, rather than an equal partner. In fact, the system is characterized by the strong role of certain industry chambers, influencing the policy formulation on an ad hoc basis, depending on ruling political parties and connections. However, there is no system in place to guarantee a transparent public-private consultation process, with the objective to defend all players in the industry, large and small, urban and rural.

147. For example, the formulation of selected NTMs is based on a broad consultative process but lacks transparency and analytical rigor. The MoC routinely formulates an Import Policy Order to regulate imports by laying out the criteria and conditions under which import controls, bans, permits, licenses and conditions of its renewal, standards, and pre-shipment inspection (PSI) are implemented. MoC scrutiny is basically compliance with the WTO, besides chairing the Consultative Committee. The coordination in the formulation of Import Policy is complicated by a lack of transparency, weak capacity of MoC and key agencies such as BSTI (which is under Ministry of Industries), and the lack of analytical rigor in assessing implications of proposed measures. Moreover, while a range of private sector stakeholders are consulted, the process is, for the most part, captured by the large trade association, BGMEA, BKMEA, and Chambers of Commerce and Industry. Other important non-governmental stakeholders (for example, representatives of consumer interests) are missing from the process. The entire process of formulation of import policy is said to be time-bound, to take almost a year from receiving proposals until it reaches the cabinet Sub-Committee.

### ***Improving Policy Formulation and Coordination to Support Competitiveness***

148. A more cohesive trade policy framework is needed to ensure strategic, consistent, and neutral policies that affect trade and the incentive to export. A more cohesive trade policy framework would recognize that trade policies encompass a much broader agenda, including both the direct and indirect ways in which trade and trade-related policies affect welfare. The starting point for creating a more cohesive policy-making process is to reach a consensus on a national vision and strategic direction of trade policy reform that is aligned with Bangladesh's broader economic development objectives as laid out in Vision 2021 and the Sixth Five-Year Plan. The objective of such an agenda is to create a unified framework for the development of trade-related policies that balances the interests of all key stakeholders (including the often-forgotten consumer), is linked with Bangladesh's international commitments and helps guide future positions on international negotiations, and has a clear monitoring and implementation plan that clarifies roles and responsibilities. Trade policy formulation is not a one-off event but an iterative process that requires effective inter-agency coordination, stakeholder consultation, backed by data and analysis throughout the policy making lifecycle.

149. Coordination among the numerous public sector actors and stakeholders engaged in trade policy lifecycle is critical to assure the benefits of Bangladesh’s participation in global trade are realized. Effective coordination mechanisms that can adapt to ever evolving demands from the global trading environment—such as the ongoing fiscal and financial crisis in and rebalancing after the crisis and the expected shifts of global growth towards a more multi-polar world—require regular re-assessment of the scope and priorities of Bangladesh’s trade policies. It is recommended that all trade policies, including tariffs, import taxes, and standards, be vetted through a uniform, standardized process. Moreover, without broader policy consultation with economic and social partners, inter-agency coordination alone cannot achieve national consensus on trade policy objectives. Inter-agency coordination and stakeholder consultation processes are complementary and need to be conducted systematically across all stages of the policy making process.

150. The new Business Initiative Leading Development (BUILD) will help address the effective contribution of the private sector in the policy formulation. This is a joint initiative of the IFC-managed and DFID and EU-funded Bangladesh Investment Climate Fund, Dhaka Chamber of Commerce and Industry (DCCI), Metropolitan Chamber of Commerce and Industry and SME Foundation. It has been designed as a sustainable platform for action-oriented business reforms that simplify the process of doing business in Bangladesh, by working closely with the government. BUILD will feature public private dialogue on four thematic areas—Tax, SMEs, Financial Sector and Trade and Investment, backed by rigorous analysis and advocacy. The initiative has received commitment from the Bangladesh Bank, National Board of Revenue, and Ministries of Commerce and Industries to co-chair these Working Committees. It will be supported by a strong independent Secretariat that will undertake much of the analysis and advocacy to support the dialogue process, and assist in ensuring that BUILD develops specific, measurable, and results-based recommendations for the Government to implement.

151. **BUILD will particularly focus on SMEs.** Through different working groups co-chaired by a representative from the public sector and one from the private sector, BUILD will focus on issues facing the small and medium enterprises. It aims to help create at least 2 million jobs and generate at least 40,000 new SMEs. However, BUILD’s biggest impact is when this permanent change is brought in the way the government and private sector work together to achieve the nation’s development goals and ensure a brighter future for Bangladesh.

152. **Strong analytical and research capabilities should underpin the policy formulation process.** Both coordination and consultation can only be effective if built on a sound foundation of economic research and analysis to understand the potential *ex ante* economic impacts of alternative trade policy reforms and the *ex post* impacts on the economy. Currently, the knowledge pool and expertise capable of comprehending demands of the emerging trade agenda is sparse and difficult to attract to the public sector due to compensation and poor image of public institutes. Eminent economists with competence in Bangladesh are either attached to academic institutes, international organizations or leading think tanks, such as CPD, PRI, or BIDS. They have often obliged the government with research and advocacy, either formally, such as through BIDS’ statutory role under Ministry of Planning and the CPD’s role in the EU-funded work to develop a ‘comprehensive trade policy’, or through the various Consultative Committees.

153. Mobilizing key economists from Bangladesh’s existing think tanks and policy institutes more formally to support policy-making throughout the life cycle. They would be beneficial to bring to bear the analytical and research capacity of these institutes to support policy-making, to undertake *ex ante* studies of options, e.g. for trade negotiations, regulatory impact assessments (e.g. for licensing and standards), and *ex post* measurement of impacts of trade policy reforms. There is also a need to strengthen the capacity of the lead trade policy institution, the Ministry of Commerce.

154. Bangladesh Export Promotion Bureau’s effectiveness could also be improved by augmenting in-house expertise in and greater private sector participation. As part of the World Bank global survey of EPAs, EPB has been compared to other EPAs in several dimensions. EPB has a broad mandate with

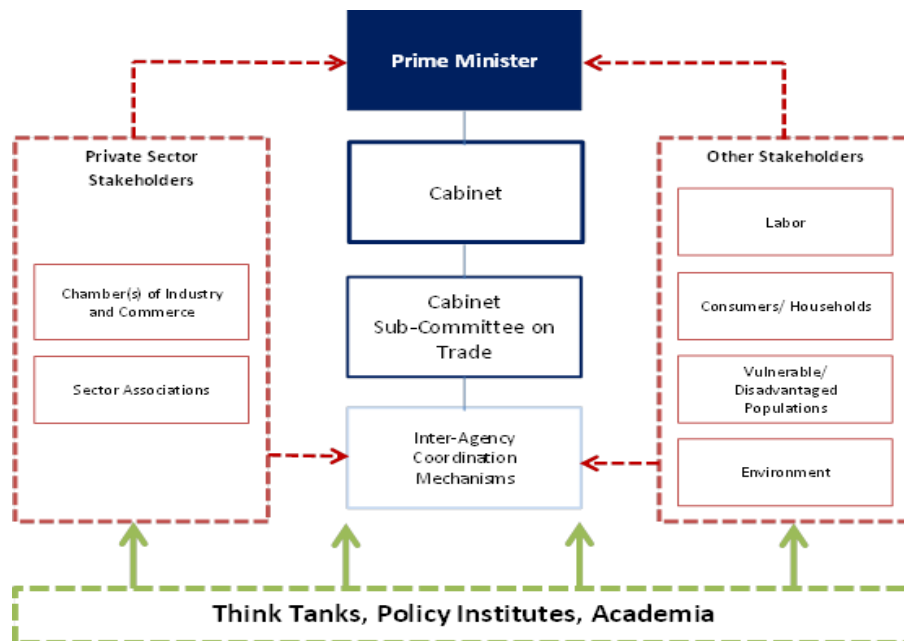


limited resources, as well as much more narrowly defined strategic objectives than typical EPAs. In terms of in-house capacity of EPB, development partners can consider providing long-term resident experts to augment EPB's skills and capacity development. These experts can be given focused objectives, such as helping exporters to diversify into specific, targeted markets, such as Japan, China and India. Moreover, image building and policy advocacy are strong functions in many EPAs worldwide, but not in Bangladesh. Less than 10 percent of its budget is allocated to technical assistance and country image building. EPB could help to prop up Bangladesh's brand image and position it to better exploit production-sharing opportunities. Finally, EPB could improve its effectiveness by giving the private sector more representation on its board.

155. **BSTI structure should also be brought into closer alignment with international best practice to avoid conflicts of interest.** It is international best practice to separate regulatory powers (such as setting mandatory standards) and conformity assessment (such as testing, inspection, and certification). In contrast, BSTI strongly influences the adoption and formulation of mandatory standards while simultaneously benefitting from the incomes from testing, inspection, and certification against these mandatory standards. In OECD countries, it is highly unusual to give National Standard Bureau regulatory functions. In addition, BSTI does not provide information services or undertake any promotional activities on standards for trade and industry. The awareness of the utility and benefits of standards is low with many officials equating standards with technical regulation. It has developed some capacity to participate in international standards during BQSP, but participation mostly remains on observation basis for limited sectors (Raj Sud 2010).

156. While there is no one-size-fits-all approach to organizing trade institutions, international experience provides a number of good practices. These could be incorporated into Bangladesh's existing framework to improve the quality of trade policy-making, through a systematic approach to make inter-agency coordination more effective, increase the transparency and scope of stakeholder consultation, and strengthen the quality of research and analysis required to support the policy-making process. Figure 13 provides an illustrative approach to organizing Bangladesh's trade-related institutions and stakeholders to initiate, formulate, implement, and monitor trade policy reforms.

**Figure 13: Toward a New Institutional Framework**



Source: Authors; Chapter 4.

## Section 4: Illustrating the Thematic Analysis: Export Constraints and Potential in Selected Sectors

157. **Introduction:** The objective of this part of the DTIS is to assess the performance of selected manufacturing value chains in Bangladesh, with a view to illustrate the thematic analysis and ground it in sector experiences. It is not intended to be an exhaustive analysis of all potential export sectors.

158. **This section discusses the export potential of seven products:** shipbuilding, jute and jute-based products, non-leather footwear, polo shorts (garments), bicycles as a light engineering product and IT enabled services, and pharmaceuticals. The sectors were carefully chosen, in consultation with academia, the Government and other stakeholders, to include light manufacturing, engineering, services. It was also sought to bring in diverse issues relating to employment intensity and sectors that use both skilled and unskilled labor; the potential for export growth and for diversifying into higher value products; and the intensity of local input and land in the production process. This diversity was expected to be useful in finding common themes and constraints to exports across sectors, as well as policy options.

159. The discussion below begins with some common themes that emerged across the sector analyses. It is then followed by individual sub-sections that summarize the current challenge and policy options in each of the sectors. Whenever relevant and possible, competitiveness bottlenecks and key performance indicators in Bangladesh were benchmarked against leading exporters in China and Vietnam.

### *Some Common Themes Across Sectors*

160. Bangladesh's industrial competitiveness is concentrated in a limited number of sectors with the key being the US\$21.5 billion textiles/apparel export manufacturing sector. Most manufacturing sectors other than garments have, by and large, not been able to create jobs and generate export revenues of any significant scale.

161. **In Bangladesh, lack of export diversification arises in large measure from distortions** due to variations in export facilities across sectors, including special bonded warehouses (SBW) and cash incentives. SBWs have been mostly provided to RMG and footwear, although they are supposedly open to all exporting sectors. The facility has been selectively offered to other sectors after much red-tape, as the authorities believe it is prone to abuse if given generously; hence, SBW has not become very popular. Based on a firm survey to measure Effective Rates of Protection (more in next paragraph), 31 out of 89 exporting firms used SBW, of which 14 were RMG accessory suppliers (deemed exporters), 11 footwear exporters, one leather products exporter, two jute textiles exporters, two bicycle exporters, and one pharmaceuticals exporter. The cash incentive scheme, originally intended to offset input tariffs, has benefited jute textile exporters significantly, though their imports (under 5 percent of output) are subject to low raw material duties. Until the end of FY2012, 19 export sectors were eligible to receive cash incentives (table 5). In FY2014, however, the number of export-oriented sectors eligible for incentives was reduced to 14 sectors. Sectors removed from the stimulus package were bicycles, poultry, finished leather and crust leather. One of the primary reasons for removing bicycle exports was that the sector

already enjoys duty-free access to its main market in the E.U.<sup>27</sup> Light engineering products other than bicycles, however, would continue to be eligible for cash incentives of 10%.

**Table 5: Export Promotion Cash Incentives, Bangladesh (% of assessed FOB export value)**

	FY 2011/12	FY 2012/13	FY 2013/14
<b>Total budget, cash incentives stimulus for exporters</b>	US\$ 290 million		
<b>Number of sectors receiving incentives</b>	19	15	14
- Agricultural and Agro processed goods	20%	20%	20%
- Home Textiles	5%	5%	5%
- All textiles (incl. home textiles) exploring new markets (exc. Canada, US and EU)	2%	2%	2%
- Jute goods	10%	10%	7.5%
- Shrimp and other fishery products	10%	10%	10%
- Ships	5%	5%	5%
- Light engineering products	10%	10%	10%
- Leather products	12.5%	15%	15%
- Finisher leather	4%	0%	0%
- Crust leather	3%	0%	0%
- Poultry	15%	0%	0%
- Bicycles	15%	0%	0%

*Source:* Compiled from Bangladesh Bank circulars

162. **Moreover, the escalating structure of protection results in high effective rates of protection (ERPs)<sup>28</sup>** which bias incentives against exports. As part of the DTIS, the Dhaka-based Policy Research Institute undertook a survey of 118 manufacturing firms located in and around the cities of Dhaka and Chittagong in May-July 2012.<sup>29</sup> The objective was to quantify the size of the distortions for firms producing selected consumer goods with potentially high ERPs. The analysis confirmed especially high ERP in sectors like footwear (214-342 percent), some agrifood products (381 percent for chira/muri), bicycles (117-386 percent), and ceramics (190-239 percent). Pharmaceuticals fall in a unique category with ERPs only modestly positive. Tariffs on locally produced generic equivalent of brand name drugs are zero or 5 percent, but a highly restrictive drugs policy prohibits imports of all drugs produced domestically – so that local production now meets practically all domestic demand for these drugs (95 percent of local demand according to a World Bank study (World Bank 2008). ERPs on drugs could actually be higher than the actual tariff but is restrained by some price controls imposed by the Drug Administration (Drug Control Act of 1982).

163. **With domestic market production protected at high rates, incentives to export are stifled.** The bicycle industry, whose initial export drive quickly lost momentum given the asymmetry of

<sup>27</sup> See Chapter 10 on bicycles in Volume 3 for a broader discussion on the sector.

<sup>28</sup> The effective rate of protection (ERP) is the proportional increase in local firms' value added (or processing margin) resulting from the combined influence of tariff rates on the final good and on intermediate inputs (a pure price effect—a higher ERP does not mean that the protected good has intrinsically higher value added). An escalating tariff structure (higher rates on final goods than on intermediates) raises local value added and protection levels compared to what would prevail under a zero or uniform tariff structure.

<sup>29</sup> With financial support from the World Bank, and in partnership with the local survey firm, Data International.

incentives, is a case in point. Similarly, in ceramics, exports have virtually stagnated despite the industry's intrinsic strengths in terms of know-how. Given the prevailing tariffs, potential profitability in the domestic market far exceeds that in export markets, though export products are differentiated from what is sold domestically. In the case of footwear, anti-export incentives have been somewhat compensated by a ban on exports of raw leather, which depresses its domestic price and provides an indirect subsidy to footwear exports but also to domestic sales. Notwithstanding the fact that such indirect subsidies are actionable under the WTO's countervailing duty regulations, they contribute to a maze of regulatory distortions, the net effect of which is unlikely to foster economic efficiency.

164. **The issue of skill inadequacy and poor logistics and internet connectivity are recurring obstacles to sector growth** according to the detailed industry studies. Low Literacy rate is a key reason for low productivity in Bangladeshi plants. This issue has been raised in the sectoral chapters and recent World Bank reports on education and skills and exports (World Bank, 2013b and 2012a). Moreover, long lead times make products more expensive and less competitive. To the extent that lead times are reduced, the handicap imposed by lack of local input industries is reduced, but imported inputs can never provide the flexibility and range of options to the exporting sector that a strong local parts industry can.

165. **The cost of trade finance and hindrances in small value payments are other recurring issues for both small and large firms.** Commercial banks currently lend at 15 percent on average, significantly higher than competitors. Moreover, near 100 percent of trade finance is bank-intermediated in Bangladesh, while only about 20 percent of total world trade is bank intermediate worldwide, the remaining 80 percent being conducted on open account or pre-payment basis. Bangladesh Bank (BB) export guidelines constrain alternative cheaper financing as they require the title document to all exports to be assigned in favor of a local Bangladeshi bank. This effectively prohibits the ability of off-shore lenders to enter the market and provide diversified trade finance to exporters. The title documents cannot be released to the overseas buyers without the local bank first receiving payment. In the case of documents being released against acceptance, they must be routed through the importer's bank for release after acceptance. Making current account transactions like payments for samples and consultants, etc., hindrance-free, would also facilitate exports. The government is actually preparing a strategy paper to review the FERA and, in particular, to lay out a roadmap towards exchange control liberalization, assisted by IMF TA. The objective of this reform is to facilitate foreign direct and portfolio investment (IMF 2013).

166. BB Export Guidelines could be changed to open up the country's trade finance to a whole range of new financing structures from abroad, increasing liquidity and reducing interest costs. The change would primarily support the garment industry, because it is the largest sector, but would also assist the growing number of other exporters in Bangladesh. It would further help broaden the exporter base and provide finance to small suppliers to the export industry. The IFC's Global Trade Supply Finance (GTSF) program could also be introduced. It would, at least in the initial stages, create a controlled environment under which to implement the above proposal. This would ensure close control over the new procedures, including repatriation of funds, and provide a high level of comfort for BB and the local authorities.

#### 4.1 Emerging Sectors—The Case of Shipbuilding

##### *Background*

167. The shipbuilding sector in Bangladesh has recently shown increased activity and has been identified by the government of Bangladesh as potential future export growth area. Export of shipbuilding is considered a success story and has significantly improved over the past decade. Nevertheless, the industry is still in its infancy. The story of building seagoing vessels for export in Bangladesh began with Ananda Shipyards and Slipways Ltd. in Dhaka, currently the second biggest shipyard in the country. In 2005, after participating in an international tender, the yard was awarded an order for two multipurpose vessels (MPVs) with 2,900 dead weight tonnes (dwt) each from Danish Stella Shipping. The yard already

had some experience with building tugs, pontoons, and ferries “under class”—that is, vessels adhering to the design, building, and quality requirements of a shipbuilding classification society. After Ananda, Bangladesh’s Western Marine Shipyard in Chittagong followed, building on its experience in ship repair and maintenance of classed vessels. Western Marine entered the new building market in 2008 after having attended the Shipbuilding, Machinery and Marine Technology (SMM) International Trade Fair in Hamburg. The first orders from Stella Shipping were followed by orders for larger MPVs from European owners such as Komrowski, Wessels Reederei, and Grona Shipping. Although several of these orders were cancelled, more than 20 vessels have been delivered by these two shipyards to date, with an export value well above US\$100 million. Bangladesh has demonstrated capabilities to build different types of vessels (see figure 9.1), but only MPVs and ferries have been exported up to now.<sup>30</sup>

**168. The production of the vast majority of Bangladeshi shipyards is still directed towards the domestic market with lower quality requirements.** Total output is estimated to be around 250,000 gross tones (GT) per year, of which 185,000 GT are for the domestic market (registered production)<sup>31</sup>. Production conditions have improved significantly since the mid-2000s. In particular, Western Marine Shipyard has achieved the reputation of a quality player that delivers good ships on time. Due to lower quality requirements, domestic demand for ships is higher than for exports. Local materials and equipment may include steel plates, angles, winches for mooring, anchor windlasses, chain cables of 10–15 millimeters diameter, furniture, upholstery, kitchen utensils, electric cables, switch boards, and power transformers. Against international standards, Bangladesh is also currently able to produce steelworks and minor items, such as electrical cables, furniture, and welding electrodes. However, engines installed in Bangladesh-built vessels originate exclusively from foreign suppliers. Capabilities in the maintenance sector are sound, but expansion of activities is limited by the lack of dry-dock facilities for larger vessels above 20,000 dwt.

**169. Smaller domestic vessels are often built without application of international (class) or national standards** (such as Bangladesh’s “Domestic Vessel Code”<sup>32</sup>), for several reasons. International classification is expensive and legally not required for inland waterway and coastal vessels. Furthermore, most yards do not have the skill to produce under class standards. These vessels must adhere to local standards, which are enacted and enforced by the government. However, local rules and standards are low quality and in many cases they are not even enforced. According to government officials, only three surveyors are taking care of design approvals and supervision tasks for the entire domestic fleet in Bangladesh at present. As a result, domestic nonclassed vessels generally have quality levels that are low and that vary greatly depending on the executing yard.

**170. Bangladesh has little local supply and is largely dependent on importing both raw materials and components.** This also holds true for Vietnam, but to a lesser extent. China, on the other hand, now has significant own capacities for both steel and marine components, with substantial competition among national and international suppliers. Basic commodities such as iron ore and coal are traded on the world market and are similar for all buyers, but China enjoys abundant availability through its sheer size. Therefore, it will remain difficult for Bangladesh to create a beneficial position for the most important single cost position, materials. In addition, while export shipbuilding is exempt from all tariffs and has been granted full green channel customs support, domestic shipbuilding is subject to import duties for

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<sup>30</sup> The actual number of people employed in the shipbuilding industry in Bangladesh could be under 100,000. The number for semiskilled and skilled employees of Bangladeshi shipyards often quoted in publications is 150,000 to 200,000. However, this results in a high average figure of 750 staff at each of the 200 yards with a total production volume of 250,000 GT. The largest yards—Western Marine Shipyards and Ananda Shipyards—employ around 3,000 and 2,000 people respectively, whereas smaller yards employ less than 100 people. As a comparison, in 2008 China employed 400,000 people in 2,000 shipyards and related industries, with a production volume of 14 million GT; in 2010 Vietnam employed 110,000 workers for a production volume of 600,000 GT.

<sup>31</sup> Data collected from Department of Shipping, as of 2011

<sup>32</sup> Published in 2001 in accordance with Inland Shipping Ordinance, 1976

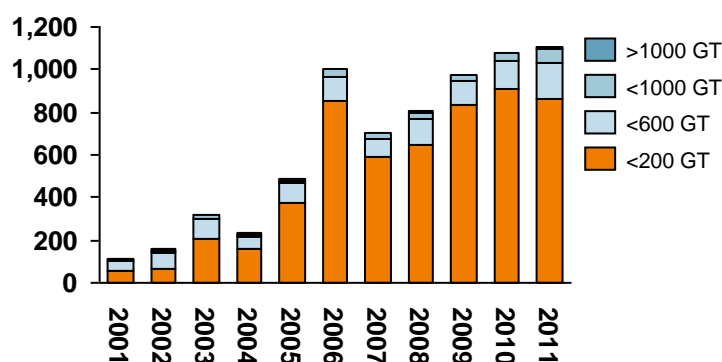
almost all sorts of materials and components. These duties range from 3 percent for sophisticated components and steel to more than 100 percent for components that are easy to manufacture.

### Prospects

171. **Stable and growing domestic demand will help the sector improve its quality and productivity.** Shipping and shipbuilding markets are in a poor condition at the moment, and it will not change significantly over the next few years. Against this background, the question is how Bangladesh can further build up its capabilities, broaden the shipbuilding value chain, and establish its shipbuilding sector as an important part of the economy. In a more positive domestic market situation and with improved competitiveness, Bangladesh could increase the volume and quality of its exports in the long term.

172. **Solid domestic growth rates will provide good opportunities to further develop the sector.** Domestic demand has been constantly growing over the last decade, with average growth rates of 25 percent by number of vessels<sup>33</sup> (figure 14). Larger vessels are usually more complex and require more capabilities. In addition to the general economic growth forecasted at around 6–7 percent (IMF 2013b), the Bangladeshi government and private investors have initiated infrastructure projects that create an additional demand for domestic water transport. Several fuel power stations are being built across the country. In order to transport the oil to these plants, 60 tankers of approximately 2,000 dwt have been planned and are under construction. Furthermore, two inland container terminals are already built to handle container traffic on inland waterways, which is currently transported overland. The government has assigned 32 licenses for container vessels of 140 TEU (2,000 dwt) to various parties to operate on container lines in the country. It is expected that another 32 licenses will be granted soon. Both vessel types, tankers and container vessels, need to be built under class, which makes them export quality. However, as the Bangladeshi shipbuilding industry is not able to deliver sophisticated vessels in sufficient quantities, it is expected that half of these vessels need to be built in China. Overall, domestic demand in Bangladesh will likely be detached from international shipping markets. Besides oil tankers and container vessels, demand for inland passenger vessels could increase. Due to high accident rates, safety regulations for these vessels could change. Experts predict there will be demand for 300–400 smaller ships over the next 10 years.

**Figure 14: Number of Inland and Coastal Vessels Produced in Bangladesh (2001–11)**



Source: Department of Shipping 2012.

Note: GT = gross tonnes.

<sup>33</sup> Although this is the officially reported number, and shipbuilding at unregistered yards (of the approximately 200 shipyards in Bangladesh only 124 are registered) might have a significant share, it can be expected that the number for large vessels above 200 GT is fairly exact.

173. **A general shortage of suitable land in Bangladesh makes it difficult for shipyards to expand.** Infrastructure around shipyards has been rated rather problematic by many stakeholders. Reliable road and rail connections do not exist for many shipyards, making transportation of goods difficult. Furthermore, the supply of power, gas, and water is not reliable. Existing sites are sufficient to maintain levels of production for small vessels, but growth and scaling up is hardly possible. The Ministry of Industry estimates that about 2,000 acres of land needs to be declared as shipbuilding zones to attain significant growth of the sector. Furthermore, the depth of waterways and clearance of bridges puts a natural cap on ship size.

174. **Another big challenge to the industry at the moment is intermediate financing.** It is a key enabler and is related to other factors such as cost, quality, and growth. Shipyards finance themselves at very high interest rates of 15 percent on average. In addition, they bear the cost for import L/Cs and bank guarantees. The administrative effort for these L/Cs is significant for both suppliers and yards, which affects both export and domestic shipbuilding. For export vessels, it drives up cost significantly and diminishes the competitive advantage that can be generated from low labor costs. For domestic vessels, it has another important implication. Local materials and components are more extensively used in domestic vessels, since regulations for building these is less strict than for export vessels, and local materials are cheaper and do not bear the cost and administrative burdens associated with L/Cs. However, this lack of regulation has a negative effect on quality and does not allow firms to build experience in the production of quality components.

175. **Foreign direct investment (FDI) in the shipbuilding sector is close to zero at present.** Reasons often mentioned are the poor infrastructure, absence of proper management structures, no critical mass for shipbuilding products in the domestic market, lack of a skilled workforce, and widespread corruption (Transparency International 2011). Bureaucratic and nontransparent decision making, including allegations of corruption at the top, has also turned away foreign investors. In past years, Bangladesh has conducted efforts to attract more FDI with the help of the International Finance Corporation and in partnership with the U.K. Department for International Development and the European Union.

176. **Lack of adequate management and technical staff for yards is another constraint to the growth of the shipbuilding sector.** Limited capabilities in work organization and planning by senior staff are a problem often mentioned by industry stakeholders. This affects the productivity and the time taken to produce a vessel. In terms of senior staff, high-quality shipbuilding has relied to a significant extent on foreigners or Bangladeshi staff educated and trained abroad. Universities and marine academies have recognized the demand for qualified graduates and have increased enrollment and made the curricula more relevant, which will influence the situation positively in the long term.

177. **The expansion of maintenance and repair services could create new opportunities.** Maintenance and repair services for fleets in service are more stable and labor-intensive businesses than building new ships. Since both larger and smaller vessels ply Bangladeshi waters, there is a general opportunity to benefit from this traffic and expand maintenance and repair facilities for larger vessels as well. This would require establishing further appropriate sites/dry docks beyond the existing Chittagong dry dock with its maximum capacity of 20,000 dwt.

### ***Reform Agenda***

178. **An important area where the government can play a critical role is quality upgradation.** Whereas quality is rated “good” for export vessels, only a small number of export vessels have been built by only two yards in Bangladesh. The majority of yards is building vessels under lower quality standards as classification is not legally required and would mean higher cost. Quality for local sales is not enforced, although measures such as the domestic vessel code exist in theory. The code is not applied for several reasons, mainly lack of resources. The supervisory body (the government) does not have enough

qualified staff, and employees at the yards do not have sufficient training to put the rules into practice. To build up quality the following actions are considered essential: (i) enforce the current rules by appropriately educated surveyors employed by the government, (ii) update and improve the domestic vessel code with stricter technical rules and standards, and (iii) increase the share of classified vessels among domestic vessels. Note that most countries delegate the quality control and enforcement of their local standards to so called “recognized organisations” (ROs) due to cost reasons. The government could also improve the quality of materials and components and make shipbuilding more attractive and cheaper for domestic market by reducing import taxes for critical materials/components.

179. **FDI and joint ventures could help bridge the capability gap with more advanced shipbuilding nations, and increase reputation.** FDI could bring shipbuilding in Bangladesh forward, especially in linkage industries, as it fosters technological advancement, improves processes, and enhances the capabilities of people in the industry. It is difficult to build up the industry to provide more complex marine components without technological know-how from foreign manufacturers. Improvement of the local market and the infrastructure situation would help attract more FDI, especially for those product families that have applicability in other sectors, such as generators. FDI could also provide an important source of financing, as shipbuilding is a capital-intensive industry, and investment in large yard facilities is associated with significant risk. An investment of approximately US\$50 million is needed for setting up a shipyard with an annual capacity of ten 40,000 dwt vessels.

180. **Proper training is the most urgent need as formal training for workers is rare.** The training at Western Marine Shipyards is a good model to follow. The situation at the management and engineering level is more challenging than at the shop floor level, where productivity gains are leveraged more easily.

## 4.2 Reviving Jute and Jute-Based Products

### *Background*

181. Bangladesh is the second-largest producer of jute in the world, after India, and the leading exporter of jute and jute products.<sup>34</sup> Bangladesh is considered to produce higher-quality jute than that of India and is a bigger player than India in the export market. While Bangladesh exports over 60 percent of its jute products, India exports only 10-12 percent.<sup>35</sup> Jute and jute products constituted Bangladesh’s only 3.8 percent of all exports in FY13, down from about 30 percent in FY90 (figure 15). Within the overall jute sector, low value added and traditional products account for more than 99 percent of exports, thus diversified jute products currently represent less than 1 percent of jute sector exports. Production capacity for all jute, raw and processed, is higher than demand, indicating an opportunity to add value and manufacture products in demand in domestic and international markets.

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<sup>34</sup> The jute sector can be viewed in three major categories: (1) raw jute; (2) traditional products (hessian (burlap) cloth, gunny sacks and carpet backing cloth (CBC)); and (3) diversified (also known as nontraditional) jute products including specialty yarns and fabrics.

<sup>35</sup> Jayajit Dash, India Declines to Import Jute Bags from Bangladesh and Nepal, Business Standard, 7 September 2012.



**Figure 15: Share of Jute and jute Goods Declined Over Time, Overtaken by Garments**

Source: Authors.

182. **Bangladesh has both public and private sector jute mills, all operating below capacity.**<sup>36</sup> The private sector accounted for 80 percent of the total export of jute goods during FY2011-2012. Combined earnings of the public and private sectors totaled Tk 50 billion (US\$610 million) from the export of jute goods. Bangladesh Jute Mills Corporation (BJMC) is the largest public enterprise and operates 27 mills. There are also private jute mills and spinning facilities in the country. Additionally, within Bangladesh, there are 177,315 installed spindles in jute spinning mills, of which 85 percent are operating. All firms operate below capacity. For example, mills under the Bangladesh Jute Mills Corporation (public sector), overall capacity utilization of looms is 63 percent, while at the Bangladesh Jute Mills Association (private sector), capacity utilization is only 38 percent of installed capacity (table 6).

**Table 6: Select Public and Private Sector Jute Milling Operations in Bangladesh 2012**

Organization	Status	Number of mills	Number of employees (est)	Average production of jute goods (Tons)	Average internal consumption of jute goods (Tons)		Average export of jute goods		
					Tons	Type	Tons	BDT x 10 <sup>6</sup>	US\$ x 10 <sup>6</sup>
BJSA	private	81	62,000	422,000	27,000	yarn/twine	387,362	2,972	36.2
BJMA	private	106	45,000	160,000	35,000	sacking/hessian	97,891	713	8.7
BJMC	public	27	64,000	207,000	31,500	sacking/hessian	123,025	932	11.4
Total		221	171,000	789,000	93,500		608,278	4,617	56.3

Source: Bangladesh Jute Spinners Association

183. **Much of the milling machinery in Bangladesh is 50 – 60 years old.** India, China, Japan, Turkey, and other countries purchase raw jute from Bangladesh and process it on modern, more cost effective equipment than is available in Bangladesh. Compounding the age of the machinery in Bangladesh is the fact that the company that manufactured the machines, Dundee (Scotland), went out of business decades ago and spare parts are not available. As such spares must be custom made in local machine shops making it difficult to match the original parts. Replacement parts are therefore

<sup>36</sup> Sector stakeholders for raw material include farmers, intermediaries, processors and exporters; for finished product, stakeholders include spinners, millers and manufacturers of traditional and diversified jute products.

increasingly less reliable. More modern equipment is being used in India and the newer machines are more efficient and are able to weave four times faster than the machines in Bangladesh. All these factors add up to India producing fabric for 30 percent less cost than Bangladesh. Part of this challenge is due to the lack of information and awareness regarding available technology and equipment in the market. New entrants to jute milling are purchasing new machines, but these mills (private sector) are typically small enterprises.

184. **Raw jute and jute goods for mills/spinners are granted subsidy (10 percent of FOB export value).** This applies to traditional products, raw jute and yarn. If a manufacturer who does not operate a jute mill of any type exports a jute based product that is not considered a handicraft, there is no subsidy. Example would be a jute goods producer with no backward integration into the jute processing segment (i.e., milling/spinning) that produces machine made nursery pots (not considered handicrafts<sup>37</sup>). This is a jute product but the producer does not qualify for the 10 percent jute export subsidy. In addition, the industry benefits from duty drawback; 100 percent VAT exemption for exports; 15 percent Income tax rate (as opposed to standard 37.5 percent); For those who are 100 percent exporters of jute, VAT exemption on gas and energy used in the factory (can be applied as a drawback (takes 3 – 6 months) or the factory can be approved and VAT is not charged (exemption); and duty on imported capital equipment is 1 percent (as opposed to standard 3 percent).

185. **Although a relatively simple product, Bangladesh has high potential in jute bags** for several reasons highlighted in the value-chain analysis conducted as part of the DTIS: First, jute bags are simple products and do not require large capital investment, and are made by Fair Trade artisans as well as commercial factories. Second, shopping bag demand is growing and expected to continue based on external market forces.<sup>38</sup> Substitute materials other than jute (i.e., cotton, linen, synthetics such as nylon, woven poly, non-woven plastic, etc.) are available but buyers continue to increase orders for jute shopping bags. One large producer of jute shopping bags in Bangladesh states that orders over a two-year period went from 300,000 pieces to 2,000,000 pieces. Third, examining the production process (shown below), shopping bags require better quality fabric which is typically laminated, require some type of printed design (logo, pattern or otherwise), and may also be dyed. Therefore, several different production processes and supply chain dynamics must be considered which captures the types of analysis required for other diversified products. Finally, value addition of the shopping bag returns a minimum of three-fold higher profits over raw jute. For example, one ton of jute can produce 1,500 yards of fabric, which in turn can produce 2,300 shopping bags at a profit of approximately Tk 27,600. This profit is 3.9 times greater than profits from the sales of raw jute, which is approximately Tk 5,000–Tk 7,000 (US\$61–US\$85) per ton. The advantage of jute products is that these earnings stay within the country since the jute is locally sourced and labor is a significant component along much of the jute and jute products value chain. As such, shopping bags cover several issues that can arise in the diversified sector.

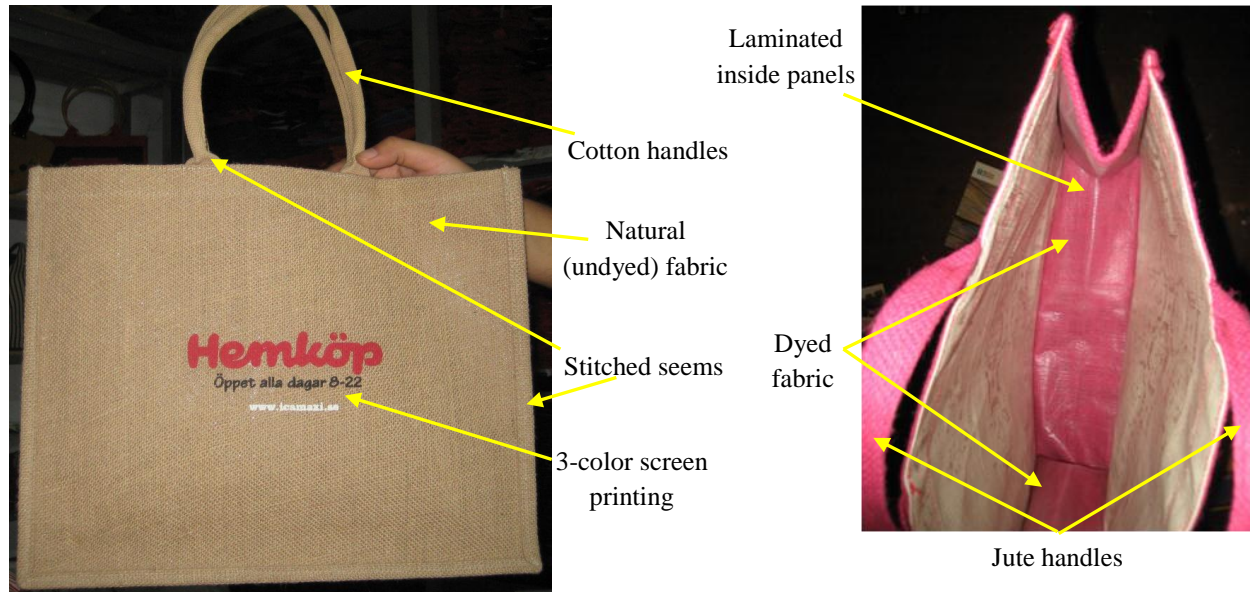
186. Depending on the buyer's requirements, the production process for the jute shopping bag may rely on outsourcing certain processes. The jute fabric is acquired and, if dyeing is necessary, the fabric must be dyed externally at a dyeing facility (not done at the jute mills but in some cases the fabric producer will provide the service of getting the fabric dyed; more typical of small miller developing a clientele). If lamination is required then this too necessarily is outsourced to a laminating facility (there are 17 such facilities throughout Dhaka). The fabric is returned to the shopping bag producer, cut to size and, if silk screening is required by the buyer then this too is usually outsourced. Virtually all export-

<sup>37</sup> Handicrafts can receive 15–20 percent subsidy but this is not specific to jute; it covers all handicrafts so it is not support specifically to the sector.

<sup>38</sup> While a few large international firms have been purchasing jute shopping bags for the past several years as part of their efforts to position themselves as environmentally friendly, foreign governments have recently been banning disposable plastic shopping bags Italy and Uganda have already banned plastic bags. UAE has declared a ban scheduled to take effect January 1, 2013. Canada is scheduled to ban plastics and Japan is considering the same. The EU as a whole is set to ban plastic bags in 2015.

bound shopping bags require some form of screen printing. While in-house printing is possible to do for some producers, most prefer to send the panels out for printing. While the panels are out, the handles are readied. The panels are returned and then the bag construction (stitching) takes place.

**Figure 16: Example of Jute Shopping Bags, Design Features, Two Styles**



*Global Development Solutions, LLC*

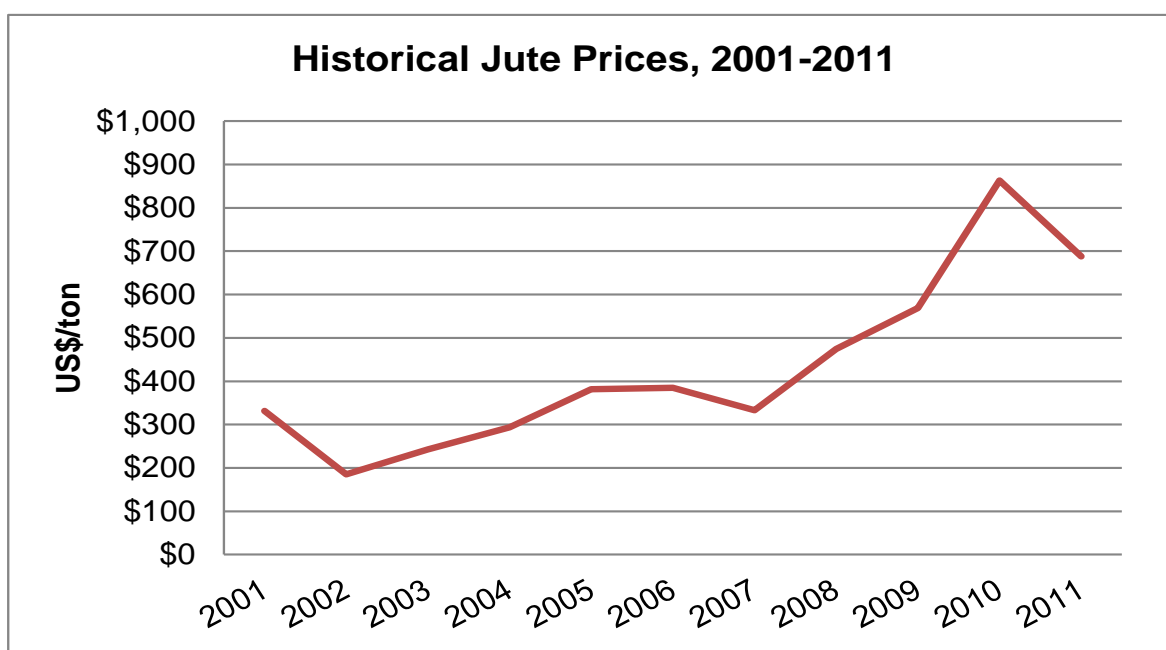
187. **In Bangladesh, the two leading cost drivers, fabric and laminating, are particularly noted as uncompetitive** when compared with the counterpart pricing in India.<sup>39</sup> Fabric preparation dominates the value chain as it accounts for nearly two-thirds (62.4 percent) of the overall cost of producing the bag. Also, as is the general case with diversified jute products, the jute fabric itself is the highest cost driver. Moreover, stakeholders agree that Indian lamination is far superior in terms of durability and lamination material. Lamination in Bangladesh is either polypropylene (PP) or high density polyethylene (HDPE), with the one noted exception of cellulose, whereas bag producers claim low density polyethylene (LDPE) is preferable. Indian equipment accommodates LDPE and adheres better and for a much longer period (multiple years as opposed to approximately a year for lamination applied with machines in Bangladesh). Equipment generally used in India can cost as much as US\$150,000, which is not only prohibitive for most manufacturers in Bangladesh, but volume of production in the country is sufficiently small that it would warrant only two facilities operating such equipment.

188. **The spot market price for raw jute is set in Bangladesh.** The price of raw jute has risen dramatically in the past 10 years, more than doubling (107 percent) between 2001 and 2011, from US\$331.47/ton to US\$687.78/ton (figure 17). The majority of the price rise has occurred in the past five years (2006-2011) when prices rose 79 percent, due to increased demand for jute as a substitute for other fibers as well as mandatory packaging laws that required (in the case of India sacks) or encouraged (in the

<sup>39</sup> The unit cost per yard (48 to 52 inch width) for typical shopping bag fabric is Tk 70 (US\$0.85) and a bag of the given dimensions requires 0.65 yards of material. This brings the cost of jute material used to construct the 15" x 17" x 7.5" bag to a total of Tk 45.5 (US\$0.55), which comprises more than one-third (35.5 percent) of the cost of the entire value chain including packing and packaging materials. The unit cost per yard of laminating in Bangladesh varies depending on laminating material, from Tk 15 (US\$0.18) for polypropylene to as high as Tk 50 (US\$0.61) for cellulose.

case of plastic shopping bag bans) use of jute. Rising prices in 2010 led to expanded jute cropping in 2011 which resulted in oversupply and depressed prices. However, the overall trend is still positive given the many and expanding uses of jute in various products and applications. Among major jute producing countries, while Bangladesh enjoyed the lowest producer prices in 2005, by 2009 that advantage had eroded and Bangladesh, India and China had similar producer prices. Thailand now has a cost advantage and Nepal is expensive relative to other major jute producers.

**Figure 17: Historical Jute Prices, 1998-2011**



*Source:* Bangladesh Jute Mills Corporation – The Public Ledger, as quoted on FAOSTAT

*Note:* Annual Averages, Jute-BWD (F.O.B. Mongla, at sight, Friday closing price).

### **Prospects**

189. Jute was declared a priority sector according to the Government's Industrial Policy Order 2010, implying a number of incentives for the sector. Furthermore, the Government adopted a jute policy pursuing the following major objectives in 2011: (i) Ensuring production of jute and jute goods according to the consistent demand of local and foreign markets; (ii) Developing land use planning for jute cultivation; (iii) Producing quality jute seed and supplying it to farmers; (iv) Preserving and expanding jute and jute goods markets to assist in developing a favorable trade balance for the country; (v) Innovating various jute diversified products and increasing production activity of diversified jute products; (vi) Ensuring effective networking of all stakeholders related to the jute sector and (vi) Developing and maintaining a jute related information management system. Moreover, the Government has passed a mandatory jute packaging law (Law 53 in 2010) but it has yet to be enforced. A jute diversified products manufacturing industry is also expected to be set up in Mongla Export Processing Zone at a cost of US\$36.94 million. The MOU was signed in November 2011, but nothing has transpired since and there is no schedule for the development of the program. The handicraft sub-sector by itself offers a wide variety of possibilities ranging from various rugs and carpets (flat weave, braided, plush) to bags of all fashion levels to toys and Christmas ornaments.

190. In Bangladesh, diversified products have come to light only over the last five or so years and, as such, it is a sector in its infancy. By contrast, India has been developing the diversified jute sector for at

least 15 years. Bangladesh has much to do to catch up from the perspective of public policy in the form of government support programs, availability of formal support institutions, and support for market linkage and development, and product diversification.

191. **Bangladesh has the potential to further broaden its scope within jute and realize higher value addition from its rich jute resources.** Despite the small share of diversified jute products relative to the jute sector as a whole, there are a wide range of products within the subsector. Manufacturers and exporters of jute products often are involved in both traditional and diversified products. For example, one firm interviewed exported hessian cloth, hessian bags/sacks, mesh soil savers, twine, yarn, carpet backing cloth, webbing, shopping bags, wine bottle bags, women's handbags, gift bags, children's bags and food bags (for tea, coffee, flour, rice, etc.), all made of jute. Looking at the jute goods product mix on a metric ton basis, Bangladesh's predominant categories are other goods, specifically yarn and twine (55.4 percent) followed by jute sacks (30.5 percent), whereas India's jute products consist primarily of jute sacks (64.9 percent) and hessian cloth (19.0 percent). In terms of its ability to produce high volumes of yarn, Bangladesh is better positioned than India in the area of non-traditional jute goods. However, as India makes much of its diversified jute goods from Bangladesh fibers and cloth, Bangladesh is not fully realizing its value added potential in the subsector.

192. **Demand for jute shopping bags has increased, as did demand for other alternatives to plastic bags.** As a consequence, orders for Bangladesh shopping bags reportedly have increased from 300,000 units in FY2011 to nearly 2,000,000 units in FY2012. Among the buyers are prominent international corporations such as Wal-Mart, The Body Shop, Home Depot and Tesco. Jute bags are favored because they are perceived to be less harmful to the environment while still retaining the durability and convenience of plastic. Despite the recent success, jute shopping bags represent a negligible portion of the total annual world demand for shopping bags of approximately 500 billion pieces. In selecting reusable shopping bags, shoppers seek bags that are affordable, durable, washable, and sometimes fashionable. Those who are more environmentally conscious may also want to buy a more "natural" bag, i.e., one made from natural textiles, biodegradable or recyclable. In this respect, while the "bring your own bag" movement represents an opportunity for jute shopping bags, in reality there are many materials out of which such bags can be made, including cotton, canvas, linen, or recycled polyester. Many bags are marketed as eco-friendly simply because they are durable enough to be reused, even if the underlying material is not of natural fiber. Thus the jute sector needs to make a strong case for its product, perhaps in cooperation with India and the Jute Study Group.

193. **The first challenge for diversified jute producers has been to competitively source the original fabric.** For small producers, this had been a problem in the past. Many small jute goods producers are located in and around Dhaka, while the closest mill to Dhaka is an hour and a half out of the city, making it difficult for small scale producers to effectively source fabric. In response to this challenge, JDPC established a consolidation program in 2011 so that fabric is available in Dhaka at the JDPC warehouse. Small producers can now purchase quantities according to their needs from the warehouse rather than having to meet prohibitive minimum orders. Fabric still requires dyeing and the jute goods producers must bring their fabrics to the dyeing mills or mills can deliver fabric to dyeing facilities at a small charge. In general, the lapse time between procuring the fabric and having the material dyed and laminated is approximately a week.

194. **Limitation of available fabric types is another advantage that Bangladesh concedes to India.** For example, in Bangladesh, only a half-dozen or so fabric varieties are readily available on the market whereas in India the selection covers 50 to 55 different fabrics. The mindset of the Bangladeshi jute sector, particularly the public sector, is still largely set on the traditional uses for jute. Specifically jute continues to be viewed as a basic packing material which does not require a variety of colors, uniform weave and fabric variety (different thicknesses). Recently established private mills, however, are more apt to pursue better equipment and to produce diversified fabric. A recent entrant, albeit very small, to the market expressed that his reason for investing in a mill was his inability to find jute-cotton fabric blends.

As a result, at a cost of Tk 2,000,000 (US\$25,000) this entrepreneur self-financed the establishment of a mill that employs second-hand Chinese machinery capable of weaving 1,000 meters of jute-cotton blend fabric per day.

195. **Only a few mills are experimenting with new fabrics, all from the private sector.** For example, there is only one mill that experiments extensively with developing new fabrics and can produce very soft fabrics for fashion items (e.g. handbags) and very thin fabrics for garments. It, however, does not manufacture the fabrics for inventory so the fabrics are only produced upon a buyer's request. Being specialty fabrics, delivery can take up to one month, minimum purchase orders are required (10,000 yards or greater depending on the type of fabric, which is well in excess of what many small and medium diversified jute product manufacturers require for most consignments), and the mill requires payment in advance. While high quality jute fabrics are considered specialty products in Bangladesh, similar products are readily available in India where there are multiple suppliers of blended and fine jute fabric. In Bangladesh, the prospective buyers may not be able or willing to purchase that much in one order so the fabrics remain difficult to access.

196. **Bangladeshi firms will also continue to face threat of new entrants in terms of markets and products.** While currently Bangladesh and India control more than 96 percent of world jute production, other countries including China, Uzbekistan, Nepal and Vietnam have had success on a limited scale (40,000 MT or less). Given the right growing conditions there is no reason why these countries could not grow their indigenous jute rather than importing it. Moreover, while Bangladesh is a leading exporter of jute and jute products, the country has not exploited this position and made Bangladesh synonymous with jute as say France is with cheese or Thailand with rice. In terms of products, despite the versatility of jute, many other materials perform similar functions in common with jute products. For example, while the jute shopping bag is a niche product for Bangladesh, reusable shopping bags of various materials are popular in the global market, including other natural fibers such as cotton or kenaf as well as synthetic materials such as nylon or recycled/laminated plastic. In jute footwear components (i.e., espadrille soles exported to be made into finished shoes elsewhere), while the traditional base (sole and midsole wrap) of espadrille soles is jute, substitute materials have been introduced globally to the footwear component market, including hemp rope, synthetic jute, and cork footbeds, threatening Bangladesh's footwear component niche. Substitutes for jute twine include cotton, polycotton, staple fiber polyester, high tenacity multifilament polyester, tobacco, and sisal.<sup>40</sup>

197. However, while a tiered supply chain is an essential element for effective and efficient growth of a sector, the current supply chain system in Bangladesh revolves mostly around informal structures and relationships between a number of small-sized players, particularly with respect to dyeing, laminating and printing. In this context, even if a high volume of high quality, fine jute fabrics becomes available in the market today, the subcontracting supply chain as illustrated above is unlikely to be able to handle the volume and quality of product to be competitive with Indian manufacturers.

### ***Reform Agenda***

198. **The jute packing law needs to be enforced.** Enforcement will result in increased domestic demand for raw jute and should provide a possibly more stable source of demand for the jute industry. This could affect exports, but the primary concern of policy makers should be total employment and output which includes that which owes to export demand.

199. **The incentives to public jute mills may hurt the long-term strength of the sector.** Subsidies in general are not sustainable. They also hurt the private mills, arguably more efficient (since they compete without subsidies) and prevent the stronger ones from becoming larger players. If such subsidies are no longer provided, private mills can expand and could be encouraged to hire from the public sector. This could help keep overall jute mill employment intact. The money saved by Government can be used

<sup>40</sup> Abingoini Packaging Equipment Suppliers – Africa, [www.abingoini.com/twine.htm](http://www.abingoini.com/twine.htm).

for other support programs such as more effective research and outreach to farmers, and more effective marketing and branding support.

200. **The high cost of borrowing and difficulties accessing finance present significant obstacles to stronger sector performance and new entrants.** Restricted access to finance pushes firms to internally finance growth, which contributes to slow growth and slow product diversification. Even with a letter of credit as a guarantee, a local bank will usually provide only 35 percent of the working capital requirement. Entrepreneurs generally must rely on 100 percent internal financing to grow their companies from micro enterprises to small enterprises. One such entrepreneur interviewed was able to diversify into weaving with the purchase of an internally funded power loom, although his development has taken two decades to attain this level.

201. **Development partner financing for reducing costs and increasing fabric variety could be considered.** Development partner financing to stimulate further R&D in the sector for the development of additional diversified fabrics and to decrease the cost of the currently available high end fabrics could be useful. The Jute Research Institute, for example, has a pilot project regarding diversified jute fabrics and is exploring collaboration with some garment/textile units for large scale runs. Fabrics further developed can also be provided in the fabric bank for diversified jute product producers.

202. **Lack of production and trade data and poor access to market information make strategic benchmarking and planning difficult for companies.** Interviews with stakeholders along the diversified jute sector indicate continued lack of and access to market information, particularly in regard to available production technology, and sources of equipment and technology for upgrading production of basic and complex fabrics. Moreover, there is little to no current, readily available information regarding diversified jute products due to the range of products within diversified jute; inconsistent application and lack of product-specific codes; and lack of internal census carried out with regularity and often overlooks non-traditional jute products. As a consequence, Bangladesh as well as jute products are off the radar of many international databases, limiting the country's marketing reach.

203. **Some of the issues such as marketing, research and branding could be addressed together with India and Nepal.** If the numbers are correct, there is potentially a huge demand for natural fibers like jute, which could be more effectively realized with a joint approach to marketing and branding. If South Asian countries get together and share marketing and branding costs under a regional approach, this can help all parties. Another approach is to restrict this to the two largest production countries, and brand "Bengali" jute from Bangladesh and India. Either of these initiatives could be undertaken under the Jute Study Group's mandate. Joint research and development to complement domestic research efforts offers another possibility

### 4.3 Diversified Jute—Non-Leather Footwear

#### *Background*

204. **Bangladesh is highly competitive in the espadrille market and this could be another major niche area in the future.** Bangladesh is among the top Asian producers of footwear, with production in 2011 of 276 million pairs and a 1.3 percent world market share. Bangladesh exports mostly leather footwear, although non-leather footwear is growing. Footwear exports totaled US\$335 million for FY 2011/12, consisting mostly of leather footwear (US\$240 million or 71.5 percent); others included non-leather footwear (US\$76.5 million or 22.8 percent) and footwear components (such as soles).<sup>41</sup> All of Bangladesh espadrille production is exported. Of the leading non-leather footwear categories, Bangladesh's largest export markets are Spain, the Republic of Korea, and Japan (HS640419); Germany, France, and Spain (HS640220); and France, Italy, and Germany (HS640520). Bangladesh's non-leather

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<sup>41</sup> Volume data is unavailable in comparable terms with the rest of the world.

footwear is currently in the nonluxury niche. Therefore, changing consumer attitudes bode well for demand for Bangladeshi shoes.

205. As a producer of high-quality jute, Bangladesh has become a manufacturing center for premium quality jute soles and complete espadrilles. The shoe design originated in the Pyrenees (Spain and France), but today espadrilles are made in full or in part in a number of countries. It is possible that much or most of the world's total production of complete espadrilles is manufactured in Bangladesh,<sup>42</sup> while manufacturers in France, Italy, and Spain import jute soles from Bangladesh to finish espadrilles in those countries. Complete espadrilles are also manufactured in Argentina, Bolivia, Colombia, Paraguay, and Venezuela.

206. **The Bangladeshi non-leather footwear industry is dominated by four companies, and includes a multitude of small entities.** According to LFMEAB, there are four companies (very recently down from five) in Bangladesh that export non-leather shoes.<sup>43</sup> Of these four, three can be classified as large firms (more than 250 permanent employees, assets of at least US\$122,000) with the fourth company on the cusp between medium and large. All four companies boast strong annual sales growth of over 20 percent for the past several years. A fifth manufacturer, and most recent entrant, exited the espadrille market in 2011 but continues to operate in the footwear sector.<sup>44</sup> The sector also includes a multitude of small and micro companies that are available to the larger firms during peak season. These smaller entities may be an individual working from home, or a group of individual producers coordinated by a contractor (acting either as a subcontractor to the large companies to handle peak season overflow, or directly filling local orders for simple shoes such as PVC/PU shoes and sandals). By the nature of its organization, it is not possible to quantify the number of entities in the subsector, although overall worker estimates in the non-leather footwear sector were quoted upwards of 30,000 people.<sup>45</sup>

**Figure 18: Sample Espadrille Styles**



Source: Global Development Solutions, LLC.

<sup>42</sup> Wikipedia article on Espadrille (<http://en.wikipedia.org/wiki/Espadrille>).

<sup>43</sup> This does not include companies located in export processing zones (EPZs) since those companies are not represented by LFMEAB. The only EPZ with non-leather shoe manufacturers is located in Chittagong.

<sup>44</sup> From 2008 – 2011 three new market entrants were unable to compete and have since left the market.

<sup>45</sup> Bangladesh institutes a census of manufacturing industries, which is supposed to be collected monthly/yearly and classified by manufacturing sector activities following the Bangladesh Standard Industrial Classification (BSIC) at the 4-digit level. The most recent information on the Bangladesh Bureau of Statistics web site is for November 2010 and is incomplete, having only tracked leather footwear manufacturers.



207. **Large firms rely on local subcontractors to meet demand during the high season.** They produce as much as 1.5 million pairs of basic espadrilles and 150,000 pairs of various high-fashion espadrilles throughout the year. Since most of these orders are received during the peak season, a short period of time, producers must regularly rely on local subcontractors. Examples of this are sewing uppers onto the completed sole subassembly (performed manually) or sewing elaborate decorations (such as sequins and beads) onto uppers. While the current subcontracting structure with individuals and micro-enterprises creates employment opportunities for local workers, the informal nature of the relationship and the lack of a structured subcontracting supply chain inhibit producers from responding effectively to large production orders.

208. **Footwear manufacturers must compete for access to fabric from domestic producers in a very competitive and tight market.** As a major exporter of ready-to-wear garments, demand for textile fabric in Bangladesh is high, not only from domestic garment producers, but also from foreign markets, which account for more than three times the demand compared to domestic demand for both knit and woven fabric. For example, the projected demand for fabric in 2014–15 is estimated to be about 15,712 million meters, of which 4,123 million meters are expected to be absorbed by the domestic market. Moreover, as of 2009, there were 363 spinning and 1,131 weaving mills operating in Bangladesh producing fabrics to meet the growing domestic and export demand.<sup>46</sup> As a consequence, footwear manufacturers are required to have a minimum order size of 5,000 meters of fabric. This amount of fabric can produce as many as 35,000 pairs of basic espadrilles. But the average order size received by large producers ranges from 15,000 to 20,000 pairs per consignment, thus creating a challenge for producers to figure out what to do with the remaining material.

209. **The value chain analysis suggests that raw material is the primary cost driver for the production of espadrilles in Bangladesh.** Subassembly accounts for nearly 60 percent of the total value chain for the production of an espadrille. Further breakdown of the value chain for subassembly shows that jute preparation and mid-sole and the outer sole account for more than 97 percent of subassembly costs. As the diagram indicates, raw material inputs, namely jute and rubber, account for more than three-quarters of the total subassembly cost. The second highest cost associate with espadrille production is the preparation of uppers, which accounts for nearly 25 percent of the total production cost. Similar to the subassembly, breakdown of the upper preparation costs also points to input material as the highest cost driver in the value chain.

210. There is no current foreign direct investment (FDI) in the espadrille sector, but export processing zones (EPZs), particularly Chittagong, have received FDI in non-leather footwear (not espadrilles). Some foreign assistance has been provided to local espadrille manufacturers in the past. For example, a private French company assisted one of the manufacturers in setting up its espadrille manufacturing operations. The espadrille producer purchased machinery in France and the French company aided in the set-up and training of the processes. While there is also no EPZ specifically for footwear, there are footwear companies (not specifically non-leather) in the three EPZs. Nonetheless, industries tend to form informal clusters in geographic areas where labor with relevant skills and know-how is concentrated. For example, the Comilla EPZ is in close proximity to a large concentration of espadrille producers.

211. **Footwear (leather and non-leather) was designated a priority sector by the Bangladesh government in 2009.** As such it is entitled to the following benefits: (i) bonded warehouse facilities; (ii) 100 percent duty drawback for re-exported inputs; (iii) 1.5 percent income tax (compared to 15 percent for nonpriority sectors); and (iv) tax-free import of capital equipment. In addition, leather footwear exports receive a 12.5 percent export subsidy targeted toward the export of finished leather goods. In reality, the duty drawback is not much for espadrilles, considering the high local content of the shoes (greater than 75 percent).

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<sup>46</sup> in the absence of further investment, given the current installed capacity, the country could face a shortfall of over 6,455 million meters by 2014–15

212. **Small companies face entry barriers due particularly to incentive policies extended to jute products but not espadrilles.** Jute-based products receive an export subsidy of 10 percent but espadrilles cannot collect this subsidy as long as they are classified along with the general footwear sector. Two of the four major espadrille producers have backward linkages into the jute processing sector. This allows these companies to take advantage of the 10 percent jute export subsidy, thus providing them with a built-in advantage over new entrants that do not have an integrated operation in the jute sector. Specifically, unless new market entrants also operate jute mills (either spinning or weaving), they face a 10 percent cost disadvantage against existing market players. Moreover, duty drawback and/or subsidy payments can take up to a year, contributing to cash flow pressures for new entrants. However, in the case of espadrilles, considering that local content is greater than 75 percent, espadrille producers often do not make the effort to claim the duty drawback. Manufacturers claim that the delay is so long that the amount is not significant enough to expend the effort in applying for the drawback. In addition, financing is not easy for potential entrants. It seems to be generally available to those with a pre-established banking relationship, and relationships initially are established through personal or political connections and are not dependent upon viable business plans or creditworthiness.

### *Prospects*

213. **Once considered peasant footwear, designer espadrilles are now widely available in many modern interpretations.** Leather's share of the global footwear market is on the decline, for environmental and other reasons. As the health and environmental repercussions of tanning become known worldwide, there may be a backlash against use of leather in all products, including footwear, which would benefit the non-leather footwear segment. While popularity of espadrilles has ebbed and flowed (boosted notably by Hollywood stars sporting espadrilles in numerous movies and TV shows), today espadrilles are considered a summer staple whose natural material has become synonymous with warm-weather fashion. Its designs include slingback, peep toe, wedge, and platform styles, sold by value-priced as well as luxury global design houses such as Burberry, Ferragamo, Marc Jacobs, and Missoni and may retail for over US\$400 per pair, albeit these higher end espadrilles have leather components. The common denominator in all is the jute (or jute rope-like) sole and/or wrapped midsole. Currently, none of these extremely high-end espadrilles are fully assembled in Bangladesh, although they may be manufactured in countries such as Brazil, France, Italy, or Spain or using Bangladesh components. One espadrille company in Bangladesh reported to have exported more than 1 million pairs of completed espadrille subassemblies (jute midsole with vulcanized rubber outsole) to France in the past year, with orders increasing yearly.

214. With the Generalized System of Preferences (GSP), Bangladesh espadrille manufacturers have an advantage over the Chinese in European markets, but not in the United States. Given Bangladesh's status as a least-developed country, Bangladesh benefits from GSP privileges in most major markets (including Australia, Canada, the EU, Japan, Korea, and New Zealand) and as such has zero import duty. However, non-leather footwear exports to the United States are subject to an import duty of 36 percent<sup>47</sup>—the leading country in terms of both footwear import quantity and value (APICCAPS 2012). Currently, 99 percent of all footwear sold in the United States is imported, of which more than 80 percent is imported from China; a country that also has no GSP privileges in the United States.<sup>48</sup> Bangladesh manufacturers report strong competition from China when vying for U.S. market share, with the long-established

<sup>47</sup> If the textile content is less than 50 percent of the sole that comes in contact with the ground, then the U.S. duty is 36 percent. If the textile content is greater than or equal to 50 percent, then the U.S. duty is reduced to 8 percent. For what is termed the basic espadrille shoe (the proxy non-leather shoe style used in the value chain analysis section), manufacturers have large cut-outs in the sole when selling to the United States. This generally is not possible with fashion espadrilles, however.

<sup>48</sup> American Apparel and Footwear Association: <https://www.wewear.org/aafa-on-the-issues/category/?CategoryId=96>.

Chinese offering a greater variety of styles and materials (amounting to one-stop shopping) and faster delivery.<sup>49</sup>

215. The labor cost advantage over China—combined with locally available jute, fabric, and rubber—creates a substantial competitive advantage for Bangladesh manufactures over its biggest market rival, China. However, espadrille producers in Bangladesh have been confined to selling basic espadrilles at the low end of the market, given the challenges associated with timely access to special-order dyed fabrics. But high-fashion designs fetch three to twelve times the value of a basic espadrille. China, on the other hand, is more prevalent in fashion because there are many fabric producers and dyed material fabric is readily available in virtually any quantity desired. Interviews with manufacturers suggest that even if a particularly unique color is not available, it can be produced within one week in China. It is this fact that lends China a competitive advantage over Bangladesh in the U.S. market.

216. **Espadrille manufacturing is not a utility-intensive process, but the industry suffers from erratic electricity supply.** Thus, many firms rely on generators, which leads to increased production costs. When the generators are running heavily, which was reported to be every other hour during the summer months in 2012, the cost of electricity increases by two to three times, and the total electricity bill per pair was approximately US\$0.054 per pair. While the operating cost of a generator is generally manageable for most producers, the initial investment cost and access to finance to purchase a generator is generally prohibitive for small producers. There are also frequent retroactive electricity rate hikes. Four rate hikes took place in the six months from April 2012 to September 2012, with the latest increase at 15 percent with bulk prices rising by nearly 17 percent. Since February 2011, bulk rates have increased by 70 percent while retail rates have risen 33 percent from Tk 4.0 (US\$0.049) to Tk 5.32 (US\$0.065) per kilowatt hour (kWh) (Reuters 2012).<sup>50</sup> According to the Bangladesh Power Development Board, these increases are still not enough to cover cost of power generation, so enterprises expect the rates to continue to rise. Given the gap between cost and prices of electricity, such hikes can be expected. However, the lack of predictability of rate hikes makes cash flow and financial planning difficult for producers.

217. **Footwear manufacturers point to further challenges related to lack of coordination and market information.** First, there is no forum in which footwear and fabric manufacturers can discuss upcoming trends and fabric needs. As a consequence, no systematic approach to supply and stock management exists in the fabric-to-footwear supply chain. Second, in the absence of up-to-date intelligence on market demand and trends in key markets, particularly in the EU market, nearly all of the orders received by Bangladesh footwear manufacturers occur during trade shows. With a 90-day order-to-delivery window from EU footwear buyers, this leaves little advance notice for fabric manufactures to plan their production once they receive an order from footwear manufacturers. As a result, delivery of fabric takes as much as 60 days, thus leaving footwear manufacturers to regularly subcontract production rather than optimizing their own production facility.

### *Reform Agenda*

218. **To enhance competitiveness, Bangladesh could reduce and eliminate its own policy distortions,** including removing entry barriers, and capitalize on the trend towards non-leather footwear. It can also encourage further local value added and move into higher-quality/higher-value product markets. Policy actions in this context should be seen together with those for diversified jute products. Bangladesh should move towards a more neutral policy regime that does not discriminate between types

<sup>49</sup> With GSP prospects for its footwear uncertain, Bangladesh exports to the United States may possibly be helped by the Affordable Footwear Act, legislation moving through U.S. Congress that seeks to end import tariffs on footwear (American Apparel and Footwear Association, <https://www.wewear.org/aafa-on-the-issues/category/?CategoryId=96>). If this occurs, it will also benefit China and other exporting countries.

<sup>50</sup> It should be noted that during FY2012, average cost of producing electricity was Tk 3.1 per kWh, but for bulk sales was subsidized at a selling price of Tk 2.7 per kWh, while industrial sales of electricity was at Tk 4.4 per kWh (Reuters 2012).

of raw material or by extent of vertical integration. Government provides subsidies to leather footwear exporters and for exports of jute mills. However, espadrille manufacturers that are not integrated into jute weaving or spinning do not get this subsidy. Government should strive to phase out cash incentives and use the saved fiscal resources to provide more generic support to the sector, which will not discourage new entrants as it currently does (see below).

219. **Bangladesh should join the international conference.** Bangladesh is currently absent from membership of the International Footwear Conference (Lan 2012). At the global level, institutions such as the World Footwear Congress and the International Footwear Conference meet periodically (in this case, every three years and every year, respectively) to discuss industry issues. The International Footwear Conference meets annually in an Asian country (last meeting was March 2012). All member countries of the Conference currently are Asian (China; Hong Kong SAR, China; India, Indonesia, Japan, Korea, Malaysia, the Philippines; Taiwan, China; Thailand, and Vietnam).

#### 4.4 Garments: Moving Up the Value Chain—The Case of Polo Shirts

##### *Background*

220. This section presents the value chain analysis of polo-style shirts, which is a value-added apparel product with more complex production than simpler products such as T-shirts. Also, the basic polo shirt model is somewhat standardized globally, thus facilitating comparison of Bangladeshi productivity with other apparel-producing countries for which data is available: China, Ethiopia, and Vietnam. Finally the choice was endorsed by the domestic private sector, polo shirt being a good proxy to represent the sector for value chain analysis. In Bangladesh, most polo shirts are destined for export.<sup>51</sup>

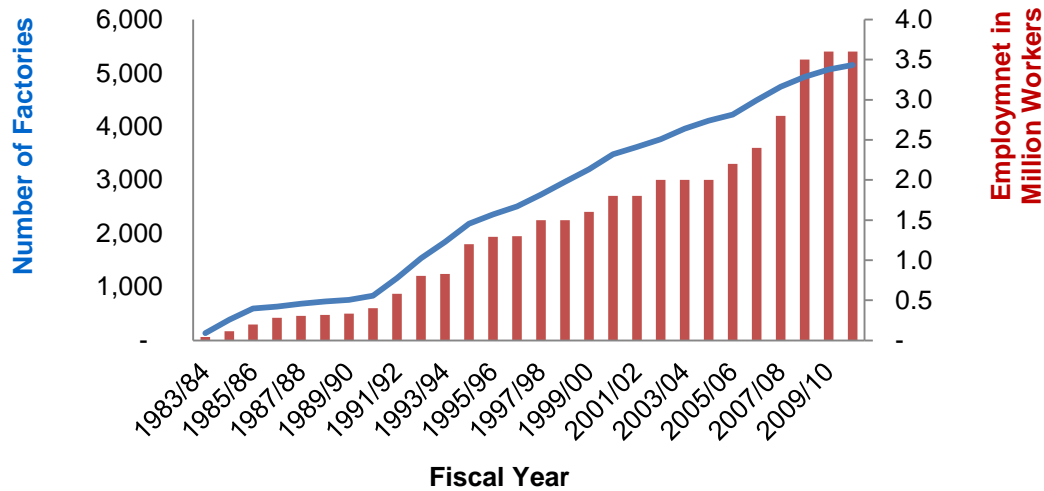
221. The ready-made garment (RMG) industry is a strategic sector for Bangladesh. In 2012 it was the largest employer with more than 5,000 factories, and provided 3.6 million direct jobs, and contributed to more than 75 percent of foreign exchange earnings.<sup>52</sup> About 80 percent of employees in the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) member factories in 2011 are women. The scale and size of RMG factory operations has also grown, with RMG factory employment averaging 300 workers per factory in FY 1983/84 and growing to approximately 700 garment workers per factory in FY 2010/11 (figure 19). The industry has been credited with empowering women and economically disadvantaged populations in general. For example, BGMEA provides scholarships to the children of garment workers, vocational training, distribution of food at a subsidized price during Ramadan, and medical centers. Medical treatment includes HIV/AIDS awareness instruction and reproductive health services.<sup>53</sup>

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<sup>51</sup> Polo shirts are exported at a Free on Board price of Tk 388 (US\$4.80) per polo. Only about 3 percent of total production is sold in the local market, at Tk 340 (US\$4.20) per polo at the factory gate and Tk 500 (US\$6.17) retail. The selling prices are based on the market and are therefore similar among producers. However, the cost of production varies greatly among garment manufacturers and depends on variables including age and quality of machinery and factory-specific wages.

<sup>52</sup> Numbers refer to the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) member factories.

<sup>53</sup> “Leading Bangladesh to Prosperity,” <http://www.BGMEA.com.bd>.

**Figure 19: Bangladesh Garment Industry Factories and Employment, FY 1983/84 to FY 2010/11**

Source: Bangladesh Garment Manufacturers and Exports Association (<http://www.BGMEA.com.bd>).

222. Bangladesh, similar to China, Ethiopia, and Vietnam, maintains various input and/or output subsidies to encourage industrial production and exports. In Bangladesh, support includes subsidies, mainly to mills due to costs they incur from cotton import price volatility, coupled with tax reductions on import of chemicals, machinery and equipment, and spare parts for effluent treatment plants. Additionally, enterprises in EPZs receive tax holidays, duty-free import of machinery and equipment, and duty-free import and export of raw materials and finished goods, among other benefits. (A number of institutions that provide other support for the textile and garment sector of Bangladesh are summarized in annex B). In China, apparel exporters are given a 16 percent rebate on the exported price of apparel; in other words, all apparel manufacturing value added receives a 16 percent rebate. This more than covers the value-added tax (VAT) that manufacturers pay on inputs and allows Chinese exporters significant room for price discounts when negotiating with foreign buyers.<sup>54</sup>

223. Bangladesh's apparel exports have benefited from duty-free access to the EU via the generalized scheme of preferences (GSP) privileges accorded to least-developed countries (LDCs). Besides the EU, Australia, Canada, Japan, and Norway provide duty-free, quota-free market access for Bangladesh exports. However, the EU adopted a new GSP on October 31, 2012, effective January 1, 2014, and prospective beneficiary countries must apply for new GSP+ benefits. Furthermore, Bangladesh benefits from the EU's Everything but Arms (EBA) initiative that provides LDCs with duty-free, quota-free access to the European market for all products except arms and ammunition. Like Bangladesh, China, Ethiopia, and Vietnam are current GSP beneficiaries, but their future status has yet to be determined. Bangladesh apparel is considered "sensitive" by the United States and as such is not covered under the U.S. GSP program (see Chapter 3 in Volume 2 for a broader discussion on GSP). As a result, exported apparel from Bangladesh, like other exporting countries such as China, faces tariffs in the US ranging from 0 to 32 percent.<sup>55</sup> However, the majority of Ethiopian apparel exports to the US are duty free under AGOA. Despite lack of preferences in the US market, Bangladesh is the fourth-largest apparel exporter to the US after China, Vietnam, and Indonesia.

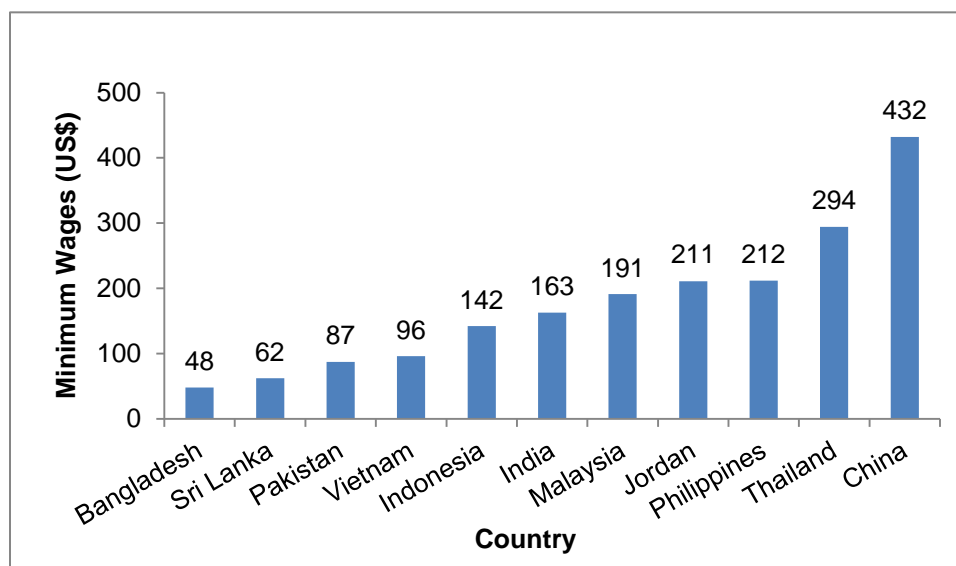
<sup>54</sup> The rebate rates and the list of items that qualify for export rebates change frequently depending on policy-makers' assessments of various trends such as global price outlook, local market developments, etc.

<sup>55</sup> Product-wise custom duties for the United States can be found at <http://hts.usitc.gov>.

224. Bangladesh has built a strong reputation centered on price advantage via low-cost labor and investment incentives; production capacity, particularly within export processing zones (EPZs); and satisfactory quality levels, especially in value and mid-market price point segments. According to Bangladesh Export Processing Zone Authority (BEPZA) in 2010, wage rates in Vietnam are nearly twice as high and in China are nearly 10 times as high as those in Bangladesh (figure 20).

225. **Worker safety and welfare remains a critical issue, as evidenced by numerous fires since 2007 that resulted in the deaths of hundreds of garment workers** (box 1). Bangladesh apparel manufacturers have been troubled by issues related to working conditions, and more hundreds of workers died in Bangladesh garment factory fires over the past five years. Most factory buildings in Bangladesh lack fire escapes, sprinklers, and other modern safety equipment. Fires and other incidents have prompted at least one company, a German apparel brand, to pull out of Bangladesh. In response, international apparel brands have pledged major improvements to safety. The collapse of the 8-storey Rana Plaza multipurpose building in Savar, Dhaka April 24, 2013, has had domestic and international repercussions. A mostly European consortium of 70 retailers and apparel brands has agreed on a legally binding plan to inspect within nine months all Bangladeshi garment factories that supply the companies. In addition, seventeen American retailers called for inspections of 100 percent of alliance member factories within the first year; common safety standards to be developed within the next three months; and inspection results that are transparently shared. Domestically, the government has adopted a new Labor Law on July 15, 2013; its contents are being reviewed.

**Figure 20: Monthly Minimum Wages in Selected Countries, 2012 (US\$)**



Source: Bangladesh Export Processing Zone Authority.

### **Prospects**

226. For Bangladesh, opportunities for growth in the apparel manufacturing sector lie in enhancing productivity within existing production value chains without adversely impacting the social welfare within the sector. Currently, multiple problems persist in Bangladesh's cotton-to-garment processing chain. These include the relatively low-skilled labor force that reduces productivity, the raw cotton

imports that take many days to clear customs, and the inadequate energy and power supply that leads to higher production cost and lower capacity utilization,.

227. **The unit cost of producing a basic polo-style shirt in Bangladesh compares favorably with the unit cost in China.** The value chain analysis (VCA) reveals that the unit cost in Bangladesh is approximately US\$3.46 (Tk 283.72) per shirt, excluding margins and the cost of transportation to port, against US\$3.93 per shirt for China, and US\$3.06 per shirt in Ethiopia.<sup>56</sup> While a polo shirt costs only US\$0.39 to manufacture in Vietnam (figure 13.8 in Volume 3), the VCA analysis for Vietnam is not directly comparable to that of Bangladesh, China, or Ethiopia. Vietnam apparel production is dominated by the cut, make, and trim (CMT) process, and as such Vietnamese manufacturers do not incur the cost of raw materials, including fabric, which is the most expensive component of polo shirt making.

228. **However, the Bangladeshi labor productivity rate of 13–27 polo shirts per person/day is substantially lower than the 18–35 pieces per person/day achieved by similar factories in China.**<sup>57</sup> Bangladesh's minimum wage rates are set by the government, not the employing companies, and minimum wages are higher in the EPZ than outside the EPZ. Wage rates vary by skill level and range from US\$20–22 per month for an apprentice, US\$38 per month for an unskilled worker, US\$45 per month for a semiskilled worker, and up to US\$60 per month for a skilled worker as of 2010. Work weeks reportedly are 48 hours per week, six days per week. No unions or strikes have been permitted so far (though management allegedly encourages worker associations) and turnover is high, with few workers staying longer than a few years.

229. **Relative to Asian competitors, there is clear room for improvement for Bangladesh in rejects, wastage, and labor absenteeism.** In examining polo shirts as a proxy for the apparel sector, Bangladesh capacity utilization was slightly higher than that of Vietnam and significantly higher than that of China and Ethiopia. However, Bangladesh's in-factory average product rejection rates (4–8 percent) were higher—the result of lower-skilled labor. Relative to Bangladesh, both Chinese and Vietnamese enterprises had lower labor absenteeism rates, though absenteeism is a significant issue in Ethiopia. Bangladesh's labor inefficiency (including lower skill levels, lower motivation, absenteeism, and high turnover) and production inefficiency (for example, waste and reject rates) have been documented in the value chain study by Global Development Solutions. Technical efficiency can be measured by wastage, reject rates, labor absenteeism, and capacity utilization (table 7).

**Table 7: Efficiencies in Capacity Utilization, Waste, Rejects, and Absenteeism (Percent)**

<b>Polo shirt manufacturing</b>	<b>Bangladesh</b>	<b>China</b>	<b>Ethiopia</b>	<b>Vietnam</b>
In-factory product rejection	4–8	2–3	2–5	1–3
Product rejection by client	0–3	0	1–3	0–1
Production waste/scrap	5–12	5–10	10–11	1–7
Capacity utilization	90–95	60–85	55–70	80–95
Labor absenteeism rate	1–3	1	6–12	0.3–2

Source: Global Development Solutions, LLC.

230. **Bangladesh also fares unfavorably when it comes to fabric, the highest cost component in polo shirt production in Bangladesh, China, and Ethiopia.** It represents 77.5 percent, 62.2 percent, and 54.6 of total costs, respectively. The Bangladesh textile sector that supplies fabric to the garment subsector relies mainly on imports of raw cotton. China and Ethiopia produce cotton domestically. Ethiopian garment makers import the fabric for polo production, since the locally sourced fabric is of

<sup>56</sup> It is based on factory level cost collected in all 4 countries by the consultancy firm GDS.

<sup>57</sup> However, given the competitive labor rates, the unit production cost per polo shirt produced in Bangladesh (US\$3.46/piece) has the potential to be competitive (both with respect to quantity and quality) with similar operations in China (US\$3.93–4.33/piece).

inferior quality and not competitively priced. There is no cost of fabric for Vietnam manufacturers using the CMT process.

231. **The time it takes to import inputs is another major complaint of textile manufacturers.** They believe that the delay erodes general textile and garment competitiveness since it affects the entire supply chain. On average, based on the requisite steps, procedures, and logistics, it takes 68.2 days (range 61.5 to 75 days) to import inputs from the date of obtaining a valid trade license. Because some activities can be performed concurrently, there is room for major improvements, provided the various parties involved (freight forwarders, transitors, customs authorities, transports, shipping lines, and others) can work more closely together.<sup>58</sup> Similarly, there are delays for exporting finished goods to buyers; and given the nature of fashion trends, buyers can thus only rely on Bangladesh to supply low-value basic garments.

232. The World Bank Garment Firm Survey 2011 (World Bank 2011a) noted that the lead time (number of days from order receipt to delivery) in Bangladesh is much longer than that in India or China, with an average 88 days in Bangladesh but only 40–60 days in China and 50–70 days in India. The difference was attributed chiefly to inefficiency at the Chittagong port, where it reportedly takes 4.5 days to turn around a ship of 800 20-foot equivalent units (TEUs) versus 8–12 hours in Singapore.<sup>59</sup> Additionally, the narrow Dhaka-Chittagong highway slows apparel shipments (Haroon 2012). Long lead time of both imported inputs and exported products are impediments to sector growth. (See also annex G, tables 13G.3 and 13G.4 for import/export transport costs).

233. Bangladesh currently ranks last in electricity availability in relation to its competitors in the VCA analysis. While the cost of on-grid electricity is comparable with competing polo manufacturing countries, the percentage of time off-grid is three times higher, and the cost of off-grid power is substantially higher.

### ***Reform Agenda***

234. While Bangladesh's competitive position for low-cost labor may eventually erode, other factors may drive its RMG growth. And in any case it needs to go beyond low-cost labor as a source of competitiveness.

235. The Bangladesh government recently adopted a new textile policy (Textile Policy 2011), applicable only to textile mills, to replace the textile policy enacted in 1995. The main objective of the new policy is to adapt and reshape the textile sector in light of changes in the global textile industry. The policy emphasizes research and development of technologies, production of value-added multiple items, domestic production of cotton, human resources development, technical support, and fiscal incentives to sustain growth of the textile sector. The policy also indicates that export-oriented textile mills will be licensed to utilize bonded warehouse facilities to import raw materials, chemicals, and accessories at zero tariffs. Moreover, BTMA has been empowered to recommend the renewal of bonded warehouse licenses for its member mills. With regard to cotton waste, a minimum export price has been raised to US\$4.50 per kilogram from US\$1.6 per kilogram (BTMA 2011). Ten percent of the production of EPZ industrial units and 20 percent of the production of outside units would be cleared for sale in the local market, subject to payment of government's taxes and duties as applicable.

236. **An important recommendation is to upgrade worker skills to increase efficiency,** decrease wastage, realize cost savings, and use resources more efficiently. Over the longer term, improvements in product quality may enable Bangladesh to eventually target higher-value apparel segments that require more complex production processes. Skill building should not be limited to line workers but should also

<sup>58</sup> Details of importing inputs are summarized in annex G, table 13G.2 in Volume 3, Chapter 13.

<sup>59</sup> More than 90 percent of import and export activity in Bangladesh is done through the port of Chittagong.



involve management in order to develop the talent needed to run effective and efficient international garment manufacturing enterprises.

237. **Increasing competitiveness would require reengineering import and export logistics.** Significant reductions in import and export times will help Bangladesh participate in fast-fashion cycles and better meet customer inventory management needs. Without this improvement, Bangladesh will be stuck in the low-value garment basics segment and have little ability to utilize its existing production capacity for higher-value garments. The bottlenecks for import and export affect both textile and garment sectors and are for the most part out of the control of the manufacturers. The operations of logistics providers, such as customs authorities, transporters, shipping lines, maritime service providers, insurance providers, also need to be streamlined. These recommendations are detailed in Section 3 and in the Trade Facilitation Chapter 6, Volume 2.

238. **Bangladesh garment manufacturing would benefit highly from better supply of energy and power.** Improved power reliability would reduce manufacturing costs, increase productivity, increase capacity utilization, better utilize human resources and capital assets, and increase overall competitiveness by speeding production and attracting greater sector investment. These improvements require direct government intervention and significant public and private investment.

239. **The sector must create and implement workplace safety standards.** Inadequate standards and implementation can generate major reputational risk for Bangladesh's overall garment exports, and will need to be carefully managed. Concerns have been heightened recently following a series of fatal incidents, and the Government has been pressured to take a number of measures to improve workers' safety. International buyers and governments have also reacted strongly to these events (box 1). The US suspended GSP trade privileges for Bangladesh over concerns about safety problems and labor rights violations in the garment industry on June 27, 2013. Minimizing the chances of further tragedies in the garment/export sectors in Bangladesh has become a pre-condition for sustained export growth. Whatever measures the government will implement under domestic and international pressure, the important issue will be enforcement and commitment to ensure better and safer practices. The Government needs to demonstrate its seriousness by providing leadership on this front, partly in order to convince the EU and the USA, the major players post- Rana Plaza. In doing this, it will need to partner with the domestic and international private sectors. To the extent capital improvements are required for workplace improvement, increased access to financing may be needed as well. Numerous buyers and customers have expressed interest in and pledged funds for enhancing production safety, and the sector should leverage this support.

240. **Bangladesh will gain from becoming recognized as a socially responsible producer.** International apparel companies are increasingly focusing on social and environmental responsibility in their supply chain, both to appease customer and investor demands and to ensure operational sustainability. Particularly for publically traded companies, disclosure is no longer limited to financial statements. Rather, disclosure now involves integrated reporting that reflects the commercial, social, and environmental context within which the entity operates and demonstrates organizational stewardship under corporate social responsibility (CSR) parameters (Pawlicki 2012). Moreover, vendors are increasingly subject to supply chain vendor code of conduct requirements, under which companies must disclose environmental, social, and governance information. In some cases, companies must have this information verified by a third party in order to supply to large retail organizations. Consumer demand is another significant driver of sustainability reporting, as customers are showing a preference for socially and environmentally responsible products, and companies that offer these products can command a price premium.

## 4.5 The Challenge of Moving to More Capital Intensive Light Engineering—The Case of Bicycles

### *Background*

241. **Bicycle exports are the single largest product export within Bangladesh’s engineering sector**, contributing to about 7.5 percent of engineering exports. Exports began around 1995, and have been growing gradually since then. Bangladesh bicycle exports are highly concentrated in three key markets the United Kingdom (64 percent), Germany (14 percent), and Belgium (9 percent). The bicycle and bicycle parts export industry has emerged relatively recently in the industrial landscape of Bangladesh. Investment opportunities emerged for capturing shares in the EU market after the imposition of antidumping duties (AD) on Chinese exporters. The first AD measures were imposed in 1993: after continuous lobbying from the European Bicycle Manufacturers Association, the EU imposed antidumping duties of 30.8 percent on bicycles made in China.<sup>60</sup> This duty provided an opportunity for existing producers and new investors in other countries to enter the lucrative bicycle market of the EU (estimated at US\$7 billion in 2011). Potential linkages with the rest of the economy are potentially substantial in this sector, given the nature of the product as an assembly of a large number of parts. Production is also not very energy-intensive. As such, it was felt that a case study of bicycles could help provide insights regarding the potential of not only bicycles but also about much of the engineering industry.

242. **The bicycle manufacturing sector in Bangladesh is split in two distinct supply chains:** (i) modern export-oriented OEM manufacturers; and (ii) the small-scale cottage bicycle and bicycle parts industry catering exclusively to the local market. These two supply chains operate independently with extremely limited interactions and linkages between the two (figure 21), owing to differences in market demands.<sup>61</sup> There are no suppliers in Bangladesh that occupy the middle part of the supply chain consisting of specialized parts and component manufacturers; local suppliers cannot produce parts and components of the quality required for export-oriented OEMs. Suppliers of bicycle parts and components in Bangladesh historically have been exclusively oriented towards the local market, where quality requirements and standards have been low. Local producers of parts and components have few incentives to make significant quality improvements to their products geared solely to export market demands.

243. **There are strong incentives for small firms to be exclusively oriented towards the local market.** Bangladesh has a cottage industry of small-scale bicycle assemblers, parts manufacturers, and retailers, with beginnings dating to the 1970s. This cottage industry remains understudied, and statistical information is extremely limited. Nevertheless, based on interviews with the Business Owners Association of the Bongshal Market in Dhaka, an estimated 1,500–2,000 people work in the Bongshal market in businesses directly related to bicycle assembly, component manufacturing, and retailing.<sup>62</sup> Firms are small (typically, up to 10 employees), have extremely old machinery (in many cases over 30 years old), and are limited in their ability to graduate out of the low-quality segment of the market. Typically, many small firms combine parts manufacturing with bicycle assembly and retailing of “complete knock down” (CKD) and/or “semi knock down” (SKD) kits imported from China and India. The strong incentive for firms to focus on the domestic market comes from low tariffs on inputs and high tariffs on output (56 percent), creating effective protection rates that average 219 percent for the domestic market. Suppliers of bicycle parts and components have been exclusively oriented towards the local market, where quality requirements and standards have been low. Local producers of parts and

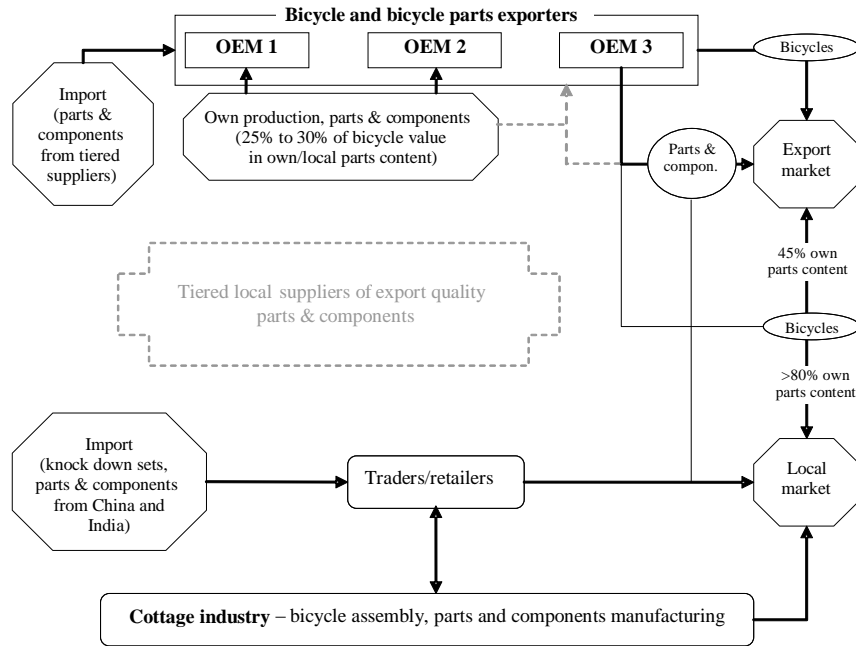
<sup>60</sup> Regulation Number 2474/1993. Initially extended by regulation number 71/97 and subsequently maintained and gradually increased. The current antidumping duty is 48.5 percent, up to October 2016.

<sup>61</sup> The only exception is Meghna’s supply of some components to the local market (mostly steel frame tubes, frame joints, wheels/spokes, and tires and inner tubes).

<sup>62</sup> Nevertheless, based on interviews with the Business Owners Association of the Bongshal Market in Dhaka—the hub of the cottage bicycle industry of Bangladesh—general features of the market can be discerned.

components have few incentives to make significant quality improvements to their products geared solely to export market demands.

**Figure 21: Bicycle Manufacturing Sector Supply Chain, Bangladesh**



Global Development Solutions, LLC

- - - Dashed lines indicate missing linkages in the supply chain

244. Alongside the local cottage bicycle industry, foreign direct investment was critical to the emergence of the bicycle export sector. Malaysian investors were the first to seize the EU market opportunity by establishing the first bicycle exporting firm in Bangladesh in 1995. A domestic trading group, Meghna, was the next firm to enter the bicycle export manufacturing industry. Meghna's founders had been involved in bicycle and parts trading in the 1960s, manufacturing bicycle spokes in the 1970s and doing bicycle assembly for the local market in the 1980s. After diversifying and becoming a highly successful trading conglomerate, the Meghna Group grew to become the largest bicycle and bicycle parts manufacturer in the country. It now has two factories dedicated to the export market, two factories dedicated to bicycle manufacturing for the local market, and five bicycle components factories. The third and last market entrant in the bicycle exporting industry is German Bangla Bicycles, established in 2009 as a joint venture between a German bicycle manufacturing firm (Panther) and a Bangladeshi company (Powertrade Engineering) whose major business interests are in heavy manufacturing (telecom towers, electrical grid infrastructure, and so forth). Like the other two firms, German Bangla is an original equipment manufacturer (OEM), but by and large only for European brands.

245. **Imported parts and components dominate the exportable bicycle value chain in Bangladesh.** The final assembly stage dominates the cost structure of bicycle manufacturing, with a little over 51 percent share, consisting essentially (98 percent) of costs of parts and components. Bangladeshi OEMs import the bulk of bicycle parts and components from China; Singapore; Taiwan, China; Hong Kong SAR, China; Malaysia; and Thailand. Cost of assembly is followed by frame assembly (21 percent) and wheel and tire assembly (10 percent). Frame and wheel manufacturing and assembly are also dominated by input material/parts costs.

246. **The share of labor costs in the production of a bicycle is quite low across all manufacturing stages in Bangladesh.** The share of labor costs is about 10 percent at the frame assembly stage, 13 percent at wheel assembly stage, and 2 percent at final bicycle assembly stage. When all stages of production are included, direct labor costs associated with producing a bicycle in Bangladesh range from US\$3–US\$5 per bicycle, depending on capacity utilization at any given time and on production location.<sup>63</sup> Bicycle manufacturing across all stages, including frame and wheel manufacturing and assembly, is relatively capital intensive. As a consequence, bicycle manufacturing can be and is successful in countries with relatively higher labor costs than Bangladesh. In China, for example, the average monthly payroll per employee in the transport equipment industry (including bicycles) is US\$500. In Taiwan, the average monthly payroll in the industry is US\$1,300.<sup>64</sup> Notwithstanding these comparatively high labor costs, producers in these countries are market leaders in the bicycle industry: China is the world leader in bicycle exports in general, and Taiwan is among the leaders in medium- to high-end bicycles.

### *Prospects*

247. **The lack of a local base of suppliers of quality parts and components has significant implications.** First, OEMs that do not have deep-enough pockets for investing in additional parts and components manufacturing must source parts in foreign markets. Currently, two of the three Bangladeshi OEMs import parts worth 60–75 percent of their ex-works bicycles' export value. Interviews suggest that these producers will likely increase foreign content of parts and components in the future to the maximum allowed by EU rules of origin (RoO).<sup>65</sup> Second, OEMs that are strong financially, like Meghna, have made significant investments in parts and components manufacturing. For bicycles sold locally, Meghna's share of own parts and components is estimated at 80 percent, and for exported bicycles, up to 45 percent. This, combined with the issue of scale economies in parts' manufacture, probably limit opportunities for independent suppliers of export-quality parts and component suppliers to emerge. In modern bicycle production, scale economies and precision engineering are clearly important, and this has allowed China and even higher wage countries to remain competitive in different segments of the bicycle market. In Bangladesh, the modern export firms have vertically integrated to partially overcome the lack of a modern parts supplying industry, but rely on imports for the bulk of their parts' needs. This approach has meant that their export prices are 10-20 percent higher than China's export prices.

248. **The third implication stemming from foreign sourcing of export-quality parts is a negative impact on lead times.** For example, Bangladeshi exporters' lead times to the U.K. market are estimated to be 30–50 percent longer compared to Chinese exporters (see table 8). It is estimated that the bulk of the lead time gap arises from the Bangladeshi firms' need to source a large part of parts and components from abroad, which can take up to a month after all the required paperwork and shipping. Chinese exporters can rely on a vast local supplier base that enables them to source parts and components within a few days. Furthermore, shipping transit times to and from Chittagong are uncompetitive.<sup>66</sup> For example, it takes approximately the same number of days (27) to ship a container from Chittagong to the United Kingdom and to ship a container from much further east in Shanghai to the United Kingdom; it takes half as many days to ship a container from Sri Lanka (two weeks).

<sup>63</sup> Wages in Dhaka are reported to be at least 20 percent higher than in Chittagong.

<sup>64</sup> Global Development Solutions, LLC, from industry sources.

<sup>65</sup> In January 2011, EU RoO were relaxed significantly. First, an exporter from a least-developed country (LDC), including Bangladesh, could import up to 70 percent of the ex-works price of a bicycle in components from the EU. Second, regional cumulation allowed component sourcing between different groups of countries, including between East Asia (Brunei, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, the Philippines, Singapore, Thailand, and Vietnam) and South Asia (Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka).

<sup>66</sup> Most mother vessels do not call at Chittagong port because of poor navigability. As a result, transshipment through major regional ports increases transit times.

**Table 8: Comparative Lead Times, Bicycle Exports, Bangladesh vs. China, 2011**

Lead time (days)	Bangladesh	China
Preprocessing (parts' ordering), Lead Time A (L/C & other paperwork)	8–15	1
Preprocessing (parts' ordering and delivery), Lead Time B (shipping/transportation)	15–20	2–7
Processing lead time (bicycle manufacturing/assembly) <sup>a</sup>	25	25
Post-processing lead time (shipping to United Kingdom)	27–30	27
<b>Total lead time (days)</b>	<b>75–90</b>	<b>55–60</b>
<b>Lead time difference (Bangladesh/China)</b>	<b>+35% to +50%</b>	

*Source:* Global Development Solutions, LLC. Note: a. For illustration, assumes identical order size, processing time and destination market for both countries. This comparison is for illustration purposes only; lead times vary significantly depending on bicycle complexity.

249. **Quality of electricity is extremely poor and creates major problems for SMEs that cannot afford generators.** Even though SMEs consider the price of electricity to be high (US\$0.09 per kilowatt-hour), it is generally the quality of electricity in relation to price that generates this perception.<sup>67</sup> Daily brownouts are a frequent occurrence in Dhaka. The duration of brownouts is reported to range from fractions of an hour and up to three to four hours at least once a week. Frequent brownouts create major production problems. In the example of the steering column producer highlighted in the VCA, all the processes come to a halt and all the cutting, extrusion, and lathing machines have to be retooled. This generates losses in time, materials, and quality of product. Poor electricity combined with other production bottlenecks leads to major losses in this particular SME that amount to as much as 8.3 percent of production.

250. **Furthermore, OEMs report difficulties in finding qualified workers in a number of areas.** The level of workforce education is very poor. The majority of the workers producing parts and components in the interviewed SMEs usually is young and has little to no education. Typically, SMEs have at least one experienced technician, equally uneducated, to pass on process and other knowledge to less experienced workers; “learning by doing” is the mode of operation in all SMEs. Some SME business owners see the uneducated workforce to be an advantage since it is not complicated to make the product and allows for lower wages. Most owners, however, recognize that any future technological and process upgrade in their operations is extremely difficult to accomplish with the current level of know-how and education of its workforce. Finding qualified welders needed for the frame assembly stages of production is reported to be particularly difficult. Welders are among the highest-paid members of the workforce in assembly plants, earning up to US\$150/month in Dhaka. This is a relatively high manufacturing wage in Bangladesh. Yet despite the significant premium over standard assembly line wages (up to 50 percent), finding and attracting a sufficient number of qualified welders is a challenge. Finding and attracting qualified middle managers also is reported to be difficult as management/business graduates are reported to prefer working in the telecom and other service sectors.

251. **Lack of access to finance prevents the modernization of machinery for SMEs.** Old machinery contributes to production inefficiencies and losses among SMEs, in large part owing to lack of access to finance. The value chain of the steering column producer suggests that the SME has three pipe-cutting machines, two lathing machines, and four impact extrusion machines, all of which are at least 25 years old and some of which are 40 years old. The owner would like to replace some of the machines but was not able to obtain a loan from a local bank three years ago. In fact, none of the SMEs interviewed had received any loans from local banks. The few producers that had purchased relatively new machinery

<sup>67</sup> Electricity prices below US\$0.10 per kilowatt-hour are generally considered competitive at international level.

recently did so with own funds. SMEs' technological upgrades will highly dependent on access to finance that is currently not forthcoming.

252. Finally, Bangladeshi OEMs' competitiveness across all stages of bicycle production also suffers from unnecessary bureaucratic practices.<sup>68</sup> For example, OEMs need to obtain two permits to import welding gases (argon-based and other specialized welding gases) that are not available locally: a "prior permission" to import and then a "final permission" to import. Both permits are issued by the Explosives Department of the Ministry of Energy, which regulates the trade in these generally dangerous materials. According to OEMs, this two-stage process is a typical example of an approval process designed for rent-seeking. The so-called prior permission is almost identical to the final permission: most information sought in the prior permission (gas content and cylinder specifications) is also provided to the authorities at final permission stages (via packing lists, invoices, and specifications). Also, the current regulations (the Explosives Act or the Gas Cylinder Rules amendments) are not sufficiently clear about the necessity of a prior permission as a procedure.

### *Reform Agenda*

253. **How can Bangladesh reduce the costs of its bicycles to become more competitive in a more contested market setting?** How can it diversify its markets, and break into markets like the US and Japan, and regional urban clusters in South Asia? Fortunately, most of the answers to these questions involve support at a broader policy level, rather than support that is specific to bicycles. For example, trade facilitation reforms and business facilitation measures will be critical to improve lead time and reduce cost of doing business, strengthening the competitiveness of the industry.

254. **The parts industry will need to invest in modern tools and equipment,** such as semi-automated and, where necessary, automated precision equipment. A modern parts and components industry that progressively produces more and more in-country would help the overall competitiveness of bicycle exports. Producing locally this kind of programmable equipment will allow different kinds of parts to be produced on the same assembly line with low downtimes and high precision. Additional scale economies can be reaped by focusing on standardized parts that are common to different types and makes of bicycles.

255. **Reducing output tariffs and thereby domestic ERPs,** and increasing competition for the domestic market could help provide consumers with a choice of high quality bicycles, and in time potentially narrow the gap between the two markets. Bicycle production for the domestic market is highly protected, and helps to perpetuate keeping the domestic and export market separate. As in other industrial sectors, a growing domestic base of export quality products could help existing and potential manufacturers to export. Of course, lower domestic ERPs also helps reduce the anti-export bias.

256. **Better access to finance will help those producers whose desire to invest in equipment has been hampered by financial access.** One way is for the large OEMs to support such investment by guaranteeing bank borrowings of the suppliers on the basis of their (OEM) orders. This can be complemented by improved financial access for the SME sector as a whole.

257. **Bangladesh could court FDI and also seek to become part of international/regional supply chains in bicycles and parts.** Development and exports of particular components can help achieve scale economies in that product and can create positive externalities for the sector as a whole. Large firms in India and China could potentially invest in Bangladesh and/or be encouraged to make its firms part of their supply chain.

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<sup>68</sup> For example, interviews with OEMs suggest that 'speed money' is quite prevalent as a means to expedite customs procedures. Reported aggregate amounts of unofficial payments at different stages of interaction with customs officials, range from 0.30 percent to 0.75 percent of the value of a finished product (bicycle).

## 4.6 Expanding Services—The Case of Information Technology Enabled Services

### *Background*

258. The Information Technology (IT) industry is one service sector that is considered by the public and private sector to have high growth potential. The industry employs an estimated 30,000 people, generating an estimated US\$250 million in annual revenues. Although the majority of firms in the industry report software development and maintenance to be their core business, the IT-Enabled Services (ITES)/Business Process Outsourcing (BPO) generate more revenues in the industry than software development. The value of exports from the formal software and ITES-BPO sector in 2011 were below US\$50 million, a relatively low amount compared to other countries in the region. Despite high expectations, the sector remains a marginal contributor to Bangladeshi exports. Nevertheless, a number of recent developments have raised the hopes for the sector in the near future: exports are on the rise and multinational corporations are investing in research and development (R&D) centers in the country. In light of these developments, ITES-BPO was selected as one service sector for value chain analysis.

259. In Bangladesh, over 800 software and ITES companies are registered employing about 30,000 people, and generating an estimated US\$250 million in annual revenues in 2011.<sup>69</sup> About two-thirds of firms are small, employing 10-30 people. In addition, there are an estimated few hundred unregistered small companies doing software and ITES-BPO business for both local and international markets. Another 5,000 people are estimated to be working as freelancers. Many firms provide a range of software and ITES-BPO services at the same time (see ITES chapter for more details). Approximately half of officially registered companies provide a range of ITES-BPO services: data and form processing, graphic and web design, content management, and other services.

260. The industry has generated limited exports in the past but a number of recent developments have raised hopes for the sector. Officially reported exports have grown from US\$26 million in 2005-06 to US\$92.5 million in FY13 (July-May). These export figures do not include an estimated US\$20 million - US\$30 million of annual exports generated by the freelancers as well as by informal companies that are not captured by the official records. According to BASIS, the IT and ITES-BPO sector is expected to exceed US\$100 million for the first time in 2013. BASIS estimates that 160 IT and ITES-BPO companies are involved in exports. The industry has also recently gained new multinational members: Samsung opened its R&D center in 2010 employing over 200 engineers; over 30 joint ventures have been established in Dhaka to provide offshore services to clients in international markets.

261. In Bangladesh, the majority of ITES-BPO services providers operate in the lower end of the BPO pyramid from data capturing/transcription to some level of problem solving/basic voice services. Up to 2011, Bangladesh did not export any basic voice services, but according to a recent study, some revenues (US\$2 million) were generated in 2011.<sup>70</sup> The bulk of revenue and exports, however, remain in the areas of basic data capturing and rule-based processing. This report will provide value chain analyses for the typical data capturing and rule-based processing BPO services provided in Bangladesh: 1) Vectorization data processing (image processing); and 2) Accounting rule-based processing of data (invoices and similar data). In addition, a third higher value added value chain of industrial engineering BPO services will be provided.

262. In this context, the industry depends heavily on government's effective implementation of its long-standing plans for improvement of domestic and international connectivity. According to the Digital Bangladesh strategic plan, the government plans to expedite the process of having a second and even third submarine cable connection to ensure minimal redundancy and reliability in nationwide internet

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<sup>69</sup> Source: Bangladesh Association of Software and Information Services (BASIS),

<sup>70</sup> ITC and KPMG, *Bangladesh Beckons: An emerging destination for IT/ITES outsourcing*, January 2012.

Information on how much was exported from the US\$2 million voice-based BPO revenues is not available.

connectivity; and take initiatives to reduce the price of bandwidth.<sup>71</sup> It is anticipated that a rapid and robust implementation of these policy initiatives is needed to bring the country's internet connectivity infrastructure at par with other countries competing in the international BPO market. Sri Lanka, for example, has four international submarine cables, and fairly developed broadband, leased-line, satellite connectivity as well as developed 3G and 4G technologies. India has an even more advanced connectivity network. By comparison, Bangladesh has the least developed network compared to countries with developed ITES-BPO service industries (see table 9).

**Table 9: Benchmarking ICT Network and Overall Infrastructure, 2012**

Country	Network Readiness	Overall Infrastructure
Ireland	5.0	5.3
Malaysia	4.8	5.1
China	4.1	4.5
India	4.0	3.6
Sri Lanka	3.9	4.1
Egypt	3.8	3.6
Philippines	3.6	3.2
<b>Bangladesh</b>	<b>3.2</b>	<b>2.2</b>

*Source:* Compiled by Global Development Solutions, LLC from World Economic Forum Global Competitiveness/Information Technology Reports, 2011-2012. Network Readiness defined as “the degree to which economies across the world leverage ICT for enhanced competitiveness.” (Scale 1=underdeveloped, 7=efficient by international standards).

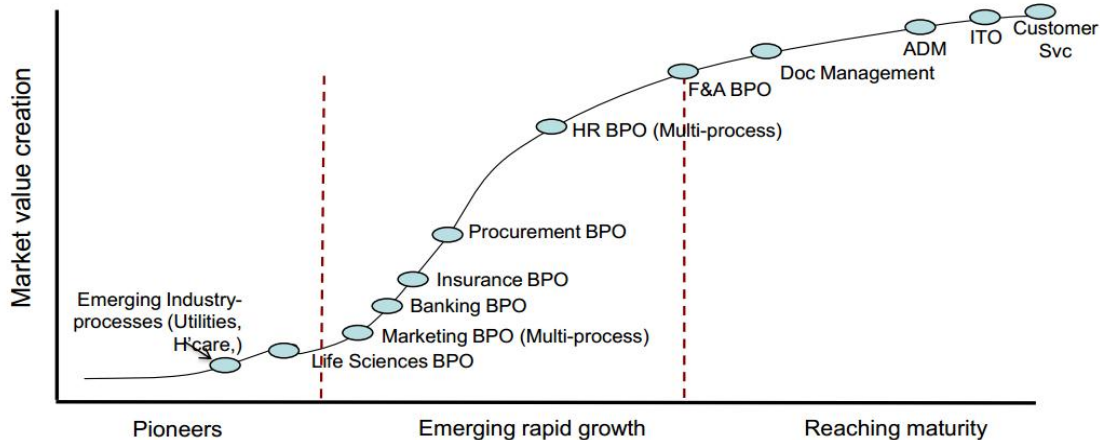
263. **IT and ITES sector benefits from a number of preferential policies.** IT and ITES-BPO firms are exempted from income taxes that are set to expire in 2013, although the industry has called for extension of this relief until 2018. Also, the industry enjoys various value-added tax exemptions for some imported hardware, software and related service purchases. Moreover, an estimated 20 IT and ITES firms have been provided access to Grade-A office space at preferential prices at the government-owned Janata Tower premises in central Dhaka. The industry can also use the Equity Entrepreneurship Fund (EEF), a venture capital fund offering equity support and managed by the Bangladesh Bank, in place since 2001. An estimated 40 to 50 IT/ITES companies have made use of roughly US\$10 million in the last 10 years, but according to the industry, access to this fund has been difficult due to bureaucratic procedures.

### *Prospects*

264. **Worldwide spending for IT and BPO exceeded US\$1.7 trillion in 2011, a growth of 5.4 percent over 2010.** Software products, IT and BPO services continued to lead, accounting for over US\$1 trillion (63 percent) of the total market. In terms of the maturity of different segments of the BPO industry, services such as document management, customer services, and application development and maintenance (ADM) are reaching maturity whereas banking, insurance and procurement BPO are at the phase of rapid growth. Life sciences, healthcare and utilities BPO are the early emerging stage of growth (see figure 22).

<sup>71</sup> *Strategic Priorities of Digital Bangladesh*, Draft, October 2010. PMO Office.



**Figure 22: Outsourcing Maturity Curve, 2011**

Source: Horses for Sources, State of Outsourcing in 2011 as quoted in [www.softec.sk](http://www.softec.sk)

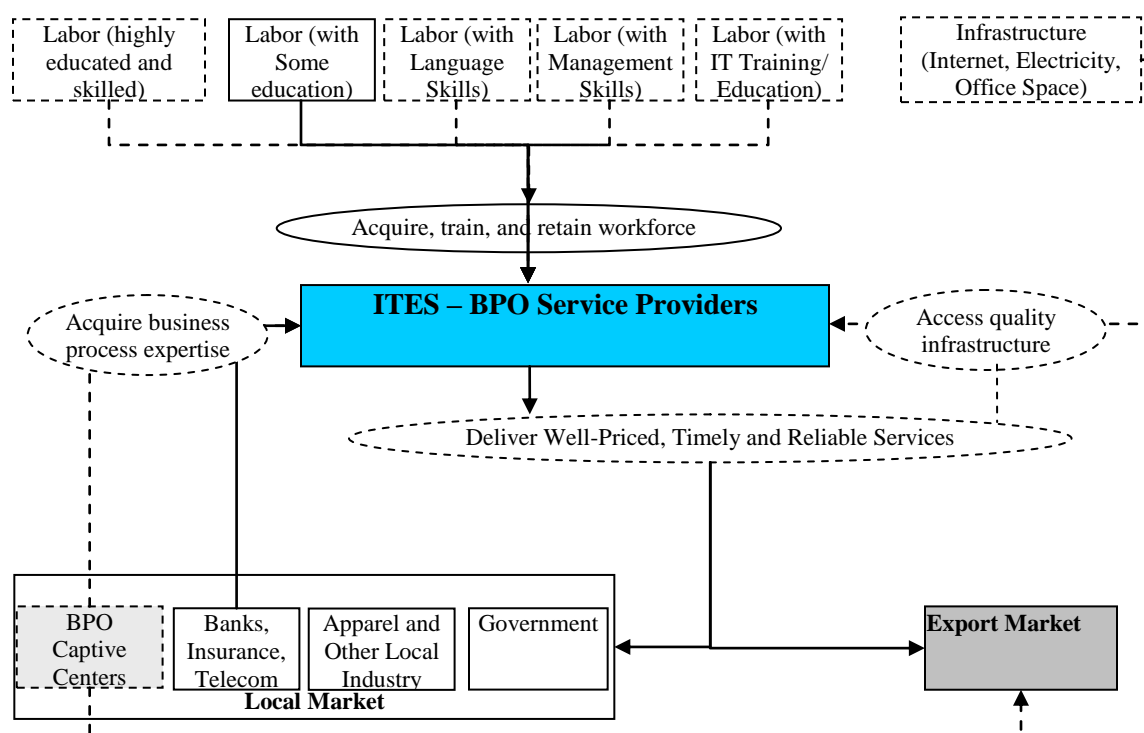
265. **The current state of infrastructure is a key component in the supply chain of ITES-BPO service exporters.** From the perspective of BPO clients, outsourcing a business process to a BPO service provider only makes sense if it delivers services in a timely and reliable manner. Bangladeshi BPO service providers report major difficulties in building quality and reliability reputations with foreign clients because their delivery of services is interrupted by the poor supply of internet connectivity and electricity. Without major improvements in the quality of basic infrastructure, labor or other cost arbitrage will not be enough to make the Bangladeshi ITES-BPO industry attractive internationally. Bangladesh would only be attractive for most basic data entry and similar low-risk business processes.

266. Internet costs are a heavy burden on ITES-BPO SMEs' cash flows and can result in delivery costs that resemble those of manufacturing value chains. The cost of purchasing internet services contributes approximately 50 percent of total cost of delivering services to clients. Since internet connectivity is needed for both data reception and data delivery, when both data reception and delivery stages are included, internet costs contribute 11 percent to the total cost structure of this particular image processing SME. Even though data reception and delivery is by and large automated and done electronically, the value chain structure of ITES-BPO service providers more closely resembles manufacturing value chain structures that involve costly transportation of and delivery of physical goods. This is because internet access in Bangladesh is costly. Notwithstanding the fact that internet service prices are decreasing, BPO SMEs spend US\$10,000-US\$14,000 per year to secure a relatively modest internet connection bandwidth.

267. **In addition to and despite its high price, the quality of internet services is poor.** First, internet network failures are common. At least once and up to three times a month, the internet connection is not available for six to eight hours. Shorter duration failures of a few hours are more frequent. One of the key reasons for internet network failures owes to the existence of only one international submarine cable. For image processing BPOs, internet network failures present a challenge but only to a limited degree: data (images) that could not be received or sent in any given day can generally be received/sent the following day. By contrast, other ITES-BPOs that operate in segments that need real-time and continuous business process support are highly impacted by the poor quality of internet services. Moreover, the limited bandwidth effectively caps the amount of throughput to 7,000-8,000 images per month that can be uploaded to client-dedicated servers. Second, the maximum available bandwidth is 5 Megabits per second (Mbps). For invoice processing and other BPOs, limited bandwidth reduces their ability to offer complementary voice and other helpdesk services to their clients. The current network infrastructure, therefore, is not conducive to ITES-BPO growth.

268. **Bangladeshi ITES-BPO service providers operate in a supply chain without any captive BPO centers** (figure 23). BPO service providers need to have domain-specific knowledge of business processes to provide BPO services in finance, human resources, insurance, procurement or any other outsourcing field. Lessons from successful ITES-BPO supply chains in countries like India and the Philippines suggest that local BPO service providers obtain vital business process knowledge through business relationships with captive BPO centers. Bangladesh has a distinct competitive disadvantage because it is not able to acquire business process knowledge and expertise directly from captive BPO centers. This leaves Bangladeshi ITES-BPO service providers with two choices: acquire business process expertise from local clients in the banking, insurance, telecom and similar service sectors and/or directly from international clients abroad. Acquiring expertise and specialization through these two channels is slow and arduous, as Bangladeshi ITES-BPO firms have discovered.

**Figure 23: ITES-BPO Sector Supply Chain, Bangladesh**



Source: Global Development Solutions, LLC

Note: --- Dashed lines indicate underdeveloped parts of and relationships in the supply chain

269. **Captive BPO centers are a critical source of business process information to local BPO service providers.** Captive BPO centers are BPO centers set up and owned by multinational corporations. American Express, General Electric, British Airways, Citibank, and hundreds of other multinational corporations own BPO centers in India, the Philippines and other countries. Moreover, depending on where they are in the trajectory of the build-operate-transfer business model, foreign-owned captives become deeply embedded in local BPO supply chains: numerous linkages along cross-ownership, sub-contracting, vertical industry specialization, and other lines, emerge between captives and local BPO centers. This way, local BPOs not only gain deep understanding of business processes in a range of industries but also grow together with captive centers through third-party business relationships.

270. **In the absence of captive centers, Bangladeshi BPOs must create market demand on their own, which is extremely difficult.** In India, for example, captive units dominate the ITES-BPO

industry—in 2005, they accounted for over 65 percent of the value of the work offshored to India.<sup>72</sup> Captive centers are also generally involved in developing local managerial and other talent; this option generates considerable cost-savings compared to the parent firms sending over their expatriate managers. Furthermore, with the current technologies, parent companies adopt virtual training methods that generate additional savings and at the same time accelerate manpower development in the countries where they operate their captive centers. Deep familiarity with the parent company's business process is a major advantage in outsourcing, and Bangladesh suffers in this respect.

271. Bangladesh's performance on literacy rates and secondary school enrollment is extremely poor and undermines the development of the sector. Basic data processing BPOs typically need a labor force that comes out of secondary schools and colleges that can then be trained. In this respect, Bangladesh has one of the poorest records of any country competing in the BPO market and major improvements are needed to improve ITES-BPOs' access to an educated workforce. In terms of ICT literacy, the national ICT Policy 2009 goals stipulate, among others, the following objectives in the area of education: (i) Boost ICT tools in all levels of education; (ii) Extend the reach of ICT literacy throughout the country by incorporating ICT courses in secondary, technical and vocational education; (iii) Encourage closer collaboration between academia and industry; and (iv) Ensure that all universities provide education with global ICT standards.

### *Reform Agenda*

272. **GOB gave a new impetus to the ICT industry and introduced its “Digital Bangladesh by 2021” vision in 2009.** Digital Bangladesh is an ambitious policy agenda that envisions utilization of information and communication technologies as pro-poor tools, “to eradicate poverty, establish good governance, ensure social equity through quality education, healthcare and law enforcement for all and prepare the country for climate change.”<sup>73</sup> It also updated the ICT Policy 2009 and ICT Act 2009 that represent the current strategic and policy framework for the ICT sector in the country. The ICT Policy 2009 has a comprehensive list of objectives across a wide range of areas, from social equity, healthcare and environment to employment generation, export growth and support to ICT sector. It includes a specific policy objective related to improving access to finance for software and ITES companies. In late 2011, the Ministry of Information and Communication Technology (MOICT) was established to spearhead ICT policy implementation. Giving the ICT industry priority is a powerful message given by the government, and can lead to positive returns if implemented in a strategic manner.

273. **The ICT policy is wide-ranging, lacks prioritization, and is poorly implemented.** The policy has guidelines for budgetary allocation, which, not surprisingly, do not get implemented.<sup>74</sup> The general perception in the industry is that government ICT policy each year recycles the same initiatives without major action and financial commitment to back them up. Annual budgets have for many years emphasized establishment of high-tech parks, setting up a second submarine telecommunication cable, and many related initiatives that by and large are considered by the industry as paper-based policies only. Finally, according to the industry, there are 306 action items in the ICT Policy 2009 for which various agencies have been designated as key or supporting implementing agencies. While some agencies, most notable Bangladesh Bank, have already implemented or started to implement some action items during last three years (including e-commerce, national payment gateway, etc.), many other initiatives, such as special education loans for ICT graduates, technology parks, etc., remain unaddressed.

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<sup>72</sup> PriceWaterhouseCoopers India, 2005.

<sup>73</sup> *Strategic Priorities of Digital Bangladesh*, Draft, October 2010; Prime Minister's Office.

<sup>74</sup> The ICT 2009 Policy guidelines stipulate that 5 percent of the annual development budget and 2 percent of the revenue budget are to be allocated to the IT sector. These guidelines generally are not followed both in terms of budget allocations and fund distribution and utilization

274. **One priority area for the government would be to provide quality internet services at affordable rates.** Uninterrupted connectivity with latency and high bandwidth are all basic necessities to compete in the global market, particularly at the higher value added end of ITES-BPO service provision. As is stated in the Digital Bangladesh strategic plan, two additional international submarine cables should be installed to ensure minimal redundancy in case of failure of one of the three cables. Tax exemptions do not seem to apply for items that are purchased more frequently by ITES-BPO companies. Most notably, the internet connections sourced from local service providers are taxed at 15 percent. Import tariffs on ICT-related products and accessories are also considered too high by the private sector. Microphones, headphones and related accessories used by BPO providers of voice-related services have a tariff of 25 percent (Optical fiber cable imports face tariffs of 12 percent. UPS/IPS backup devices have a tariff of 5 percent. Modems, routers and similar networking equipment have a tariff of 3 percent). If duties protect a particular sector, and hurt a sector that is potentially large and promising, then such duties need to be looked at carefully (see chapter on trade policy). It appears that the protection for the domestic optical cable manufacturer, for example, may be hurting the rest of the sector.

275. Addressing the skills gap is another priority for the sector, including high school students, dropouts as well as graduate students. BITM could develop a combination of training programs, coaching, workshops, and certification for individuals as well as organizations. International experts can be instrumental in developing curricula and leading courses that will be relevant for multinationals requiring ITES-BPO services. The donor community can help in sourcing appropriate international experts. Additionally, with donor support, curriculums in the traditional school system should be adapted to international trends. Building on students' basic computer skills acquired from primary school, vocational secondary schools could offer courses appropriate to ICT and also focus on the soft skills lacking in the market. Training would also cover management practices, marketing techniques and English language courses.

276. **The industry also particularly suffers from stringent Foreign Exchange (Forex) Regulations and inflexible payment regime.** Several restrictions exist. According to Foreign Exchange Circular No. 15, foreign exchange intermediaries can remit on behalf of IT/ITES firms only up to US\$10,000 in a calendar year for fees related to software registration, domain registration/hosting, server maintenance, and similar fees. Increasing this limit to at least US\$50,000/year, and expanding the list of eligible expenditure to include technical training fees, web advisement/ listing fees, and conference/event registration fees, would help. Also, the maximum allowable forex outward remittances for technical services are 6 percent of previous year's sales,<sup>75</sup> and permission from the Board of Investment is required for each transaction. These rules restrict the scope of business. Finally, IT/ITES companies cannot purchase/renew soft-copy downloadable software licenses through a Letter of Credit (LC). As a result, IT/ITES companies face problems when they want to import software through Internet in legal ways. Allowing LC payment for non-physical software purchases would facilitate doing business, both in terms of ease of transactions and would also help reduce the use of illegal software/licenses.

277. **Access to SME loans is one of the biggest challenges for the ICT sector.** ITES-BPOs, with the exception of large ones, are generally unable to access credit easily. Most of them have limited physical collateral which prevents them from accessing credit. In this context, policy support that improves access to specialized credit facilities such as EEF or other government- and/or donor-based SME financing facilities is anticipated to improve access for finance for ITES-BPOs in Bangladesh. Policy support can help improve access to existing funds (EEF and the JICA-funded SME loan facility). Analysis should be made to determine what intervention is necessary to the EEF program in terms of improving the valuation tools, fund repayment policies, proposal evaluation, fund disbursement, supervision, and monitoring and evaluation.

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<sup>75</sup> According to current forex guidelines (Chapter 10, Volume 1).

278. Finally, a focused and sustained promotion campaign - both country branding and sector branding—and high profile networking events aimed at proactively addressing the main concerns of industry players in target markets would help better position Bangladesh. This should be carefully thought out, in partnership with the private sector and international consultants. Among the goals here could be to bring in an anchor investor in the captive BPO segment, which could have major positive spillovers for the sector as a whole. Demonstrable and long-run commitment by the government also is essential to boost investor confidence. For example, an IT/ITES business portal for the country could help develop a positive reputation for the Bangladesh ITES sector. Presenting the sector as a whole has advantages beyond individual companies attempting to place their URL at the top of the search list. This can also be done in partnership with the industry.

## 4.7 Pharmaceuticals

### *Background*

279. While the industry has been able to meet the bulk of domestic needs, it has not done well on the export front, despite being long held up as a major export prospect. Under the TRIPs (Trade Related aspects of Intellectual Property rights) agreement, signed by all members of WTO in 1995, developing countries agreed to honor product patents for drug manufacturing after 2005. LDCs like Bangladesh were exempted from its obligations until 2016. This gave Bangladesh an edge over countries like India and Brazil between 2005-2015, wherein it could legally reverse-engineer patented pharmaceutical products and sell them in its domestic market as well as export to other countries (mostly LDCs) where the product patents were not recognized.

280. The import regime consists mainly of banned items, restricted items, and freely importable items while tariffs on both input and outputs are low. Importation of final products of medicines and vaccines is based on a list of importable items published in the government gazette by the DGDA. The procedures for importation are facilitated by creating a “block list” of imports for each recognized pharmaceutical company approved by the Director of the DGDA. The block list describes the raw material, packaging material, value, and quantity according to the annual production plans of the pharmaceutical companies. The list is usually prepared as part of product registration. Companies importing raw materials have to present an import invoice and analysis report of the quality, value, and quantity for each import. The analysis report of the raw materials must be certified by the DGDA or be prepared by a government-approved preshipment inspection agent (Ministry of Commerce 2012).

281. **The pharmaceutical sector has been among the highest priority sectors of Bangladesh’s export policy since 2006.** Highest priority sectors are entitled to income tax exemption for export earnings, export credit at reduced rates, assistance in marketing in overseas market through participating in export fairs, and so on. In addition, the government reduced or exempted duties on some capital machinery and raw materials imported for the use of pharmaceutical production.<sup>76</sup> The sector also enjoys a tax holiday and duty drawback scheme. The export policy of 2012–15 doubled the value of samples allowed to be sent by the pharmaceutical industry to overseas buyers to US\$60,000 a year. The World Bank (2012) estimates the ERP for the drugs that are exported to be mildly negative (0 to –0.5 percent).

282. **Exports have been low and stagnant, while countries like India have emerged as major players in the generics market.** By the late 1980s, Bangladesh had become a drug exporting country, but exports have stagnated, and are a small share of production. Bangladeshi pharmaceutical exports totaled US\$48.3 million in FY 2011/12, only 0.2 percent of total export earnings. The bulk of export earnings owe to Novartis/Sandoz. Exports comprise only around 8 percent of the total production of the local

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<sup>76</sup> The FY 2012/13 budget reduced the total tax burden for 46 essential items of pharmaceutical manufacture from 38–59 percent to 3 percent. In the FY 2012/13 and FY2011/12 budgets, duties were withdrawn or reduced on machinery such as air handling units, heating ventilation, cartridge filters, sandwich panels, and leucocyte filters.

pharmaceutical companies who are exporting. Currently, the world generic market is around US\$130 billion, with India holding roughly a one-fifth share. As of 2008, Bangladesh was exporting pharmaceuticals to more than 70 countries, but mostly to the less regulated markets. Bhutan, Kenya, Myanmar, Nepal, and Vietnam are examples of such markets. Bangladeshi pharmaceuticals are also exported to two other types of markets, but to a much lesser extent. One is the semi-regulated or moderately regulated market like Malaysia, the Russian Federation, and Tanzania. However, the biggest market in generics is the United States which is very strictly regulated. Australia and the United Kingdom are also strictly regulated markets in which Bangladeshi exports are minimal. Only a select few firms have the proper accreditation and they export only a few products. The largest barriers for Bangladesh's entry into regulated markets are lack of manufacturing facilities, which cost at least US\$50 million each, and lack of know-how (World Bank 2008).

**283. Bangladesh is almost self-sufficient in manufacturing pharmaceuticals.** In 2011, 97 percent of the country's needs were met by domestic manufacturers (including locally based MNCs) and the rest was imported (Beximco Pharmaceuticals 2011). The imported drugs are mostly specialized pharmaceutical products like vaccines, anti-cancer drugs, and essential lifesaving drugs. Industry insiders believe that this ratio might shift further in favor of the local producers as some of the big domestic firms are preparing to manufacture these drugs in house. The sector emerged in the early post-independence period of Bangladesh when multinational companies (MNCs) dominated the pharmaceutical sector. Eight leading multinational companies enjoyed 75 percent of the total domestic market (Bangladesh Tariff Commission 2010), producing vitamins, enzymes, and cough syrups locally and imported other essential drugs from their sister units located abroad. Then, the National Drug Policies (NDP) of 1982 and 2005 helped the formation and growth of a domestic pharmaceutical sector. Under the NDP, multinational companies could no longer produce vitamins, enzymes and cough syrups. Only local companies were allowed to produce them. MNCs were also restricted to producing injectable vitamins for local supply. Furthermore, contract manufacturing by Bangladeshi companies for multinationals was prohibited.<sup>77</sup> The policy also restricted importation of a pharmaceutical product or a close substitute as long as the pharmaceutical product was being produced in the country. As a result of these restrictions, several multinational corporations sold out their companies to local entrepreneurs. This led to the formation of local pharmaceuticals companies and an increase in domestic production. Bangladesh, which was once a drug-importing country, became a drug-exporting country by the late 1980s.

**284. The domestic pharmaceutical market is highly concentrated and has been growing steadily.** According to the Directorate General of Drug Administration (DGDA), there are currently 267 pharmaceutical companies in Bangladesh. Among these firms, 73 are termed as "non functional" or "suspended." The companies include medium to large Bangladeshi companies with international links, specialized subsidiaries of MNCs, and a number of small companies. However, the top 10 firms (all of whom are locally owned) hold 67.6 percent of market share while the top MNCs hold only 9.1 percent of the total market (IDLC 2011). In the last five years, the domestic pharmaceutical market has experienced robust growth and has almost doubled in value to more than US\$1 billion. This owes to the growth in the market and rising healthcare spending, improving access to health care, and an increase in new types of illnesses.

**285. Pharmaceutical companies employ the highest number of white collar workers in Bangladesh** (Bhuiyan, Maniruzzaman, and Sultana 2011). Pharmaceutical manufacturing is a capital-intensive and technically challenging industry where skilled labor is essential. Around 115,000 workers are employed in this sector, of which 58.6 percent work in management and 41.4 percent work in production. Only 2.1 percent of the total work force in this industry is female (Bangladesh Tariff Commission 2010).

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<sup>77</sup> In 2005, the National Drug Policy was revised and the ban on Bangladeshi companies manufacturing under contract and license for multinationals was lifted.

### *Prospects*

286. **Bangladesh's pharmaceuticals industry does not have any significant capability for research or sophisticated production.** Pharmaceutical manufacturing generally consists of two steps (World Bank 2008). Manufacturing of active pharmaceutical ingredients (APIs), the first step, is a highly sophisticated, technically demanding chemical and biochemical fermentation and synthesis process. Firms can either manufacture their own APIs or purchase them on the open market. Commodity API manufacturing tends to be a high-volume, low-margin business based extensively on scale economies and large dedicated manufacturing lines. Smaller manufacturers therefore have limited opportunities to compete globally. The second step is the drug's final formulation. Unlike the chemical business of API production, final formulations belong to the manufacturing sector. During this process, firms mix APIs and excipients (other nonactive ingredients); press the mixture into pills, tablets, or solutions; and then package the product for the consumer market. Final formulations are as equally complex as API manufacturing but require different skills. Because firms can produce 50 or more products in a single plant with adaptable equipment, economies of scale are less important for final formulations than for API manufacturing.

287. **Exporting pharmaceutical products is challenging.** Each country has its own product regulations, registration requirements, language requirements, cultural preferences, national packaging requirements, and industry protection mechanisms. Sales on the global market are quite competitive with firms from around the world vying for business. Furthermore, initiating exports requires a significant investment in money, time, and paperwork to register the product in the target country. Because generic products are branded in less regulated markets, pharmaceutical firms also need to make significant investments in sales and marketing. Testing and certification investments are also critical. All these investments are made without a guarantee of future sales.

288. **Different factors within the industry have prevented Bangladesh's pharmaceutical exports from growing as hoped.** Perhaps the expectations from the industry were too high.<sup>78</sup> The industry is inherently a capital-intensive one, where quality of production and highly sanitized conditions are at a premium. The share of labor in total production cost is low, and this is even more so when cost of APIs is included in the overall cost of production. Moreover, the incentives created by policy (as opposed to exhortations by policy makers) have led to a private-sector focus on import-substitution. Thus, the industry did not focus on the capacity to reverse engineer to take advantage of the TRIPS waiver.

289. **Other critical export constraints include weak enforcement of quality regulations and strict foreign exchange controls.** The lax enforcement of regulations has allowed local companies to fall below the standards necessary for the more strictly regulated export markets. Strict foreign exchange controls deter firms from undertaking critical activities to increase exports. These include receiving certification from foreign regulatory authorities, using consulting services to advise on best practices in manufacturing, and having drug samples tested. Obtaining permission to transfer large amounts of foreign currency is a lengthy and cumbersome process that is creating a nontax barrier for exports. Lack of an API production facility means that Bangladesh has to rely on imported APIs for formulation and, while not insurmountable, this could create a handicap vis-à-vis companies in countries that have in-house or in-country API production.<sup>79</sup>

290. **Despite extensive rules, the pharmaceutical market remains underregulated due to lack of capacity of the regulatory authority.** The primary responsibility for drug quality control lies with the manufacturers, and the top firms have their own quality control mechanisms. However, DGDA has to ensure the quality, efficacy, and safety of pharmaceutical products through the implementation of relevant legislation, via its monitoring and supervision functions. Though the DGDA was upgraded from "department" to "director general" status after the adoption of the revised NDP 2005, it continues to

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<sup>78</sup> Source: field interviews with the pharmaceutical companies.

<sup>79</sup> Source: field interviews with the local pharmaceutical companies.

suffer from funding, staffing, and technical competence constraints. It is severely understaffed, given the rapidly growing pharmaceutical market, large number of registered products, and large population size<sup>80</sup>, and standards' enforcement suffers. In 2012, there were 370 personnel vacancies at different levels and only 146 people working in the DGDA, 52 of which were at officer level (DGDA 2012). With limited human resources, and staff not sufficiently trained in recent developments in quality control, compliance is difficult to test and enforce. Local inspectors have been found to be less stringent compared to international inspectors, and DGDA has issued some questionable certifications. To overcome this issue, some pharmaceuticals firms are adhering to different manufacturing quality standards like the Therapeutic Goods Administration of Australia, the United Kingdom's Medicines and Healthcare Products Regulatory Agency; others firms are operating below WHO standards. This is preventing the use of a harmonized global standard in drug regulation.

291. **The drug-testing laboratories also have insufficient capacity.** Testing of drugs is required for evaluating preregistration and post marketed drugs and medicines quality. The two laboratories under DGDA have extremely limited capacity with inadequate staffing and equipment. According to the UNCTAD (2011) study, there are three technical staff members in the Chittagong Laboratory and eight in the Dhaka Laboratory. There is neither a central reference laboratory nor any independent contract research organizations in the country. Companies that export to international markets have their products tested and certified in established laboratories in other countries.<sup>81</sup>

### *Reform Agenda*

292. **Improvement in Bangladesh's regulatory functioning is of extreme importance for increasing exports.** Strict regulatory environments are associated with higher-quality drugs. Initiatives should focus on building the DGDA into an effective regulatory body by providing the agency with necessary facilities, a full staff, and authority. Institutional measures should be investigated to increase transparency and provide inspectors with incentives to find, report, and fine low-quality manufacturing. Many governments have satisfactorily appointed a semi-autonomous regulatory authority. The authority's independence promotes a professional discharge of responsibilities. Capacity building of the regulatory body will help harmonize quality standards.

293. In order to ensure quality standards for the export market, Bangladesh needs to modernize its drug testing laboratories and establish bioequivalent testing facilities.<sup>82</sup> There is a need to develop accredited laboratories and clinical setups to conduct bioequivalent tests to ensure that drugs meet globally accepted standards. Domestic bioequivalence testing facilities could help reduce costs and time delays, and potentially help open up regulated markets, even for manufacturers of medium size. As for testing labs, government-approved and internationally accredited independent private testing laboratories could provide drug monitoring and quality services. These private labs could have industry representatives from associations, academics, civil society, and a government representative as their board members.

294. Deregulation in foreign exchange controls and capital investment is also critical for the growth of Bangladesh's pharmaceutical exports. Deregulating the foreign exchange regime would reduce these costs to comply with global standards, to receive certification from regulatory authorities of other countries, to hire consulting services to create best-practice manufacturing and make pharmaceuticals more competitive. In addition, entering regulated or semiregulated markets through registering products and

<sup>80</sup> System for Improved Access to Pharmaceuticals and Services (SIAPS) assessment funded by USAID and FDA, <http://siapsprogram.org/2013/02/11/strengthening-the-pharmacovigilance-system-in-bangladesh/>

<sup>81</sup> Source: interviews with the local firms.

<sup>82</sup> Under the US\$ 350 million Health Sector Development Program, the World Bank along with the World Health Organization is supporting the modernization of the National Drug Testing Laboratory in Dhaka. More detail is available in the Project Appraisal Document, Health Sector Development Program, May 3, 2011 p. 39-40.



acquiring different certifications is a lengthy process. Also, current regulations do not allow domestic companies to invest abroad except on a very lengthy, case-by-case basis. This can be changed (see chapter on Trade Finance).

295. **Gradual introduction of competition may improve the quality of products.** Bangladesh should consider opening up its domestic pharmaceutical market to global competition, allowing FDI through joint ventures to begin with. Similarly, import restrictions also need to be gradually lifted, to benefit the consumer with greater choice of drugs, and induce domestic firms to compete not only on price, but also in quality terms. This could also reduce the market share of spurious drugs which are clearly a major problem in Bangladesh, provided that it is accompanied by a major initiative to improve the drug testing and certification infrastructure. FDI-based tie-ups with Indian/Chinese firms that manufacture API competitively can help Bangladeshi government plans to establish an API park. In order to produce API, ensuring the quality of education and human resources, and a supply of skilled labor in chemistry and engineering fields, would need particular attention.

## Section 5: Conclusions

296. **Bangladesh has a solid development record.** It has posted robust and resilient growth over the last decade, and reduced the number of poor from 63 million to 47 million over 2000-2010. Growth in labor incomes and favorable demographics were key factors behind poverty reduction.

297. It now faces one of its greatest development challenges, to provide 21 million jobs to new entrants to the labor force over the next decade. Moreover, only 51.5 million of its 90 million working age people are employed, reflecting low female participation in the labor force.

298. Fortunately, outward orientation can provide the answer, as recognized in the Sixth Five Year Plan.

299. **Bangladesh's own experience is a testimony to the power of the global market.** In gaining five percent of the global garment market, Bangladesh has provided jobs to four million people, and indirect jobs to about 10 million. Only a fraction of this employment would have been possible in catering to the domestic market.

300. The example of Vietnam shows that accelerated, export-oriented development is possible, even in the context of the current global environment. Vietnam moved from being one of the poorest countries in the world to a lower middle income one in the space of 25 years, with FDI and trade playing a dominant role in the economy: exports and imports each form 90 percent of GDP, and, with 88 million people compared to Bangladesh's 150 million, it exports four times as much as Bangladesh today.

301. **For Bangladesh to sustain and accelerate export growth will require actions centered around four pillars.** These are: (1) breaking into new markets through a) better exploitation of regional trading opportunities; and b) better trade logistics to reduce delivery lags and become more competitive in nearby markets, especially Asia; as world markets become more competitive and newer products demand shorter lead times, to generate new sources of competitiveness and thereby enable market diversification; (2) breaking into new products through a) more neutral and rational trade taxation and bonded warehouse schemes; and b) concerted efforts to attract foreign direct investment, to spur investment and export diversification; (3) improving worker and consumer welfare by a) improving skills and literacy; b) implementing labor and work safety guidelines; c) making safety nets more effective in dealing with trade shocks; and (4) building a supportive environment, including a) sustaining sound macroeconomic fundamentals; b) easing the energy constrain; c) strengthening the institutional capacity for strategic policy making geared to the objective of international competitiveness to help bring focus and coherence to the government's reform efforts.

302. With the implementation of the four pillar agenda, a virtuous circle of export-led growth can be put in place, with multiple sources of strength. Along with skill improvement, this will help improve overall competitiveness of the economy and provide sources of strength other than low wages.

303. A neutral trade policy needs to correct not just the anti-export bias, but also take due account of consumer interests, since those are linked to welfare. Currently, distortions affect critical areas that affect consumer welfare, such as medicines and consumer products, and producer interests have tended to dominate over consumer interests.

304. The ultimate goal of export-led growth would be poverty reduction and enhanced welfare of Bangladesh's citizens. Hence skill development and worker safety need to be part of the goals. Rapidly growing exports and the millions of new jobs accompanying them, along with skill-upgradation, will increase productivity and wages, which over the long term is the only sustainable way to improve living

standards; it will also begin a discourse to move beyond wage-based competitiveness. Improving skills will also allow effective participation of people in growth. Improving labor standards and worker safety is also part of this agenda, and, in the wake of recent tragic incidents in the garment sector, has become a part of the preconditions for garment exports.

305. With a coherent vision centered around international competitiveness, along with strong leadership to ensure implementation of that vision, Bangladesh can see itself as a bigger, more efficient economy, using more labor and yet paying higher wages to its workers. As the share of trade rises from the current 55 percent of GDP towards 100 percent of GDP, the economy will become more efficient and will also use its abundant resource, labor, more intensively. Rising skill levels, complemented by other sources of competitiveness, will help ensure that productivity and wages also increase, enabling higher living standards among the citizens of Bangladesh.

306. **Bangladesh is well placed to take on some its strongest development challenges, with the right leadership.** Its track record on growth and employment is strong. To grow faster and absorb more labor, and continue its pace of poverty reduction, it will need to build on that record and improve upon it. The good news is that a number of reforms are relatively low hanging fruits, may be implemented in the short to medium term, and can bring large pay-offs.

307. **Bangladesh will need strong leadership to support its multi-sector competitiveness agenda.** In many cases, it will require taking on strong domestic interest that may not welcome competition, either through imports or FDI. In other cases, it would require cohesion and coordination between different ministries/departments, such as the National Board of Revenue, the Ministries of Commerce, Finance, and Industry, the Roads Division, and so on. If the Sixth Plan and Vision 2021 goals are to be achieved, this leadership has to be exercised.

## Annex A: Proposed Action Matrix

Draft, August 16 2013

Phase 1: 12-24 months; Phase 2: 24-48 months; Phase 3: 48 months and beyond

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>PILLAR 1: BREAKING INTO NEW MARKETS</b>							
<b>A. Promoting Economic Integration with Asia</b>							
<b>Transloading of trucks across international borders inhibits movement and creates long, avoidable delays</b>	Negotiate either regional or bilateral instruments with neighboring countries especially India to allow the cross-border movement of trucks	Ministry of Communications		Large numbers of people are employed to transload cargo at the border posts so there will be social costs	Faster movement of cargo through border posts. Increased vehicle utilization	Phase 1	World Bank, ADB
<b>Design of new border infrastructure in India is not always in sync with existing facilities in Bangladesh</b>	Establish formal mechanisms for consultations at policy and operational levels on border management	Ministry of Shipping, NBR, Security		New mechanism will disrupt existing mechanisms for cooperation and consultation	Synchronized and more efficient traffic flow patterns through border posts	Phase 1	
<b>Space in Land Customs Stations not suited to traffic flow volumes</b>	Customize design of border infrastructure depending on predominant flow, import or export.	Ministry of Shipping		With through transit of traffic then space requirements in LCS will be reduced	Greater efficiency in use of resources	Phase 2	
<b>Cross-border trade (cross-border radius and unit value)</b>	Redefine cross-border trade regime extending 5 miles to 10 mile radius and increase unit value to US\$100 per transaction (look for Korgas model)	Ministry of Commerce/Customs/National Board of Revenue			Increased cross-border trade		
<b>Road map of mutual recognition of food-related border procedures between India and Bangladesh</b>	Technical assistance to examine legislations, assess border procedures, promote mutual understanding, identify critical elements, hold technical discussions and support necessary reform	BSTI/Ministry of Industry	Substantial costs	May necessitate deep reform of Bangladesh regulation and conformity assessment	Fewer delays of food traded between India and Bangladesh		

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>B. Improving Trade Facilitation</b>							
<b>Weak coordination of transport and logistics strategies across different sectors and modes of transport</b>	Establish a national logistics committee	PMO	\$300,000 per year	Agencies may still prefer to design and their implement their programs without consulting other agencies and the private sector	Better coordination and prioritization of interventions to improve performance of national logistics system	Phase 1	ESCAP
<b>High volumes of containers are stripped in the port or immediate vicinity of the port</b>	Improve performance of Dhaka – Chittagong corridor	Bangladesh Railways, Ministry of Shipping, Ministry of Communications, NBR		Private sector has already invested heavily in systems to strip containers and may resist change. There will also be social costs of not stripping high volumes of containers in the port	Reduce logistics costs for containerized shipments	Phase 2	ADB World Bank
<b>Continuous decline in volume of containers moved by rail on Dhaka-Chittagong Corridor</b>	Dual-track the main line between Dhaka and Chittagong	Bangladesh Railways		Insufficient financing to complete the dual tracking	Increase movement of containerized cargo	On-going, Phase 1	ADB
<b>Limited use of inland water transport system</b>	Modernization of the vessel fleet and investment in handling equipment	Ministry of Shipping Ministry of Finance		It takes time to build vessels, but Bangladesh has a growing ship building industry	Reduce transport costs for containerized lower value shipments moved by IWT	Phase 1	ADB
<b>Air shipments and samples are subjected to the same clearance formalities as all other cargo</b>	Adopt and implement WCO's Immediate Release Guidelines	NBR			Expedite clearance of small air shipments	Phase 1	IFC

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>Poor capacity and inefficient ground handling at airport</b>	Introduce competition in ground handling especially of cargo	Ministry of Aviation		Biman is considered a strategic asset that also plays other social roles	Increase efficiency of ground handling operations especially for key garment industry	Phase 2	IFC
<b>High customs clearance times</b>	Implement an Authorized Economic Operators (AEO) program especially for critical industries such as garments	NBR		Develop clear plan for phased introduction of QEO regime	Speed-up clearance of some goods and, freeing customs and other border management resources to target those consignments that pose the most risk	Phase 1	IFC, World Bank
<b>Long clearance times for goods shipped overland</b>	Automation all land customs stations by rolling out ASYCUDA World software	NBR		Improve reliability of IT connections to all major LCS	Faster clearance of goods, easier collection of statistics	On-going, Phase 1	
	Allow pre-arrival clearance of goods	NBR		Allow electronic submission of documents	Faster clearance of goods	Phase 2	
<b>Costly trade finance hurting competitiveness of exporters and producers</b>	It is proposed that title documents be left “open” and not assigned to a local bank.	Bangladesh Bank (BB)	\$200,000 to design a new automated system with good controls.	Controls need to ensure export proceeds are correctly repatriated.	Significant increase in foreign financing of exports. Lower interest rate costs.	Phase 1-6/12 months	
	All exporters whose suppliers import inputs should be permitted to use back to back L/Cs.	BB	\$30,000 to review procedures and revise the ruling.	Ensure proper controls are in place to avoid leakage from BWH facilities.	More exporters will be able to pass on the benefits to their suppliers.	Phase 1-6 months.	
<b>Outward FDI and international transactions are restricted</b>	To allow internet-based payments	BB			The private sector can function more flexibly and save time and money in its international transactions, as suitable to a more modern, integrated and open economy		WB/IMF
	Current account transactions, such as dividends, interest payments, payments for consultants and samples, etc, could be speeded up with minimal hindrances	BB					
	Review FERA	BB					WB/IMF

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>PILLAR 2: BREAKING INTO NEW PRODUCTS</b>							
<b>A. Rationalizing Trade Policy to Level the Playing Field</b>							
<b>Trade taxes and the trade policy regime create an anti-export bias and discourage diversification</b>	Merge para-tariffs with import tariff to boost transparency; Reduce dispersion of import tariffs	NBR; MoC		Revenue loss/ Industry lobby for protectionism	Lower consumer and intermediate goods prices	Phase 1	
	Reduce overall Nominal Protection rates	NBR; MoC		same	Lower consumer and intermediate goods prices	Phase 2	
	Close tax loopholes	NBR		same	Higher tax revenue	Phase 1	
	All companies exporting more than 70% of production should have access to Bonded Warehouse facilities	NBR	\$30,000 to review procedures and make recommendation	Possible leakages of imports and consequent arguments about maintaining status quo	More exporters will be able to gain from using Bonded Warehouse facilities.	Phase 1	
	Reduce delays for duty-drawback refunds to two months	DEDO		Rent-seekers who gain from the status quo	Reduced import costs for exporters	Phase 1	
<b>Prevalence of non-transparent and unnecessarily trade-restrictive quality standards</b>	Review mandatory standards to adopt more flexible standards	BSTI; MoI; MoAg	Moderate costs	Resistance can be expected as BSTI depends on testing and certification revenues	An import regime and government certification system closer to international best practice		World Bank, EU, UNIDO
	Review the new Plant Protection Act and develop an implementation plan that provides clarity to importers about the prevailing rules.	BSTI; MoI					

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>B. Improving the Environment for Domestic and Foreign Investment</b>							
<b>FDI is managed by a complex set of laws and regulations under various authorities, and subject to discretionary administrative procedures</b>	A more consolidated, transparent and clear law on investment should be adopted by parliament;  More transparent and clear administrative guidelines to reduce scope for rent-seeking	TBD		Lack of a strong understanding about the positive role of FDI		Phase 2	
<b>Asymmetry between foreign investors and local producers</b>	Fair enforcement of standards so that compliant multinational firms are not penalized	MoI; BSTI; Directorate General of Drug Administration etc.		Lobbying by local firms to continue to benefit from favored treatment	More interest from potential foreign investors, and higher investment by existing foreign investors	Phase 3	
<b>Bangladesh is perceived as not welcoming of FDI</b>	BOI should provide up-front administrative support to potential investors and set-up a one-stop shop for all procedures/	BOI		Insufficient Government desire to be pro-active in seeking FDI, and taking on industry lobbies			
	BOI should pro-actively seek FDI through more high-level investment promotion missions to selected emerging economies (e.g., Japan, China and India); and also seek investment in higher-technology sectors such as shipbuilding/bicycles	BOI		As above			



Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>PILLAR 3: IMPROVING WORKER AND CONSUMER WELFARE<sup>83</sup></b>							
<b>A. Improving Skills and Literacy</b>							
<b>Despite the reported shortages of skilled labor, there are few incentives for the private sector to impart training.</b>	Enhance the linkages between the publicly-funded Technical and Vocational Education and Training (TVET) and the private sector	Ministry of education; Ministry of labor and manpower in partnership with private sector			Training more relevant to the private sector		
<b>The low level of literacy and years of schooling of the labor force make skill acquisition more difficult.</b>	Improve the quality of primary and secondary education  Pursue quality early child development	Ministry of education;					
<b>Market supplies inadequate training owing to job-hopping and training externalities</b>	Introduce trainee-targeted and employer-targeted financing of training (World Bank 2012a)				More effectively trained labor coming out of the programs		
<b>B. Implementing Labor and Work Safety Guidelines</b>							
<b>Workplace safety standards are not enforced</b>	Government to provide leadership for implementation of agreements signed with EU and US buyers	Ministry of Labour					
	Sign and implement Better Work Program						

<sup>83</sup> Area C of Pillar 3 is **Making Safety Nets more effective in dealing with Trade Shocks**. This has not been explored in the DTIS.

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>PILLAR 4: BUILDING A SUPPORTIVE ENVIRONMENT<sup>84</sup></b>							
<b>B. Easing the Energy Constraint</b>							
<b>Continued significant energy shortages and reliance on short-term, high cost solutions that have resulted in large and rising budgetary subsidies</b>	Increase generation capacity in low cost base load power plants. Commissioning of the large gas-fired/dual fuel combined cycle power plants awarded to the private sector should be the top priority.	Ministry of Power, Energy and Mineral Resources/Power Division			Increase in power generation and closing of gap between demand and supply of electricity	On going Phase 3	WB, ADB, JICA
	Convert BPDB's simple cycle plants to combined cycle plants	BPDB			More efficient use of natural gas	Phase 3	WB,ADB
	Accelerate moves to import power from Bhutan, Nepal, Myanmar and from India's North Eastern states	Ministry of Power, Energy and Mineral Resources/Power Division/PMO				Phase 3	ADB
<b>C. Building Institutions for Trade Policy Coherence and Implementation</b>							
<b>The lack of cohesive policies to strengthen trade competitiveness</b>	Adopt a visible Trade Competitiveness Vision to make sure all laws and policies contribute towards this Vision	PMO					
	Develop formal joint committee of MoC and NBR with transparent consultation processes in tariff setting	MoC/BTC, NBR		Buy-in by NBR	Clear agreed upon criteria established for tariff setting; reduced opportunities for rent-seeking		

<sup>84</sup> Area A of Pillar 4 is **Sustaining Sound Macroeconomic Fundamentals**. Much of this agenda is covered by the ongoing IMF program.

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>Strong analytical and research and capabilities should underpin the policy formulation process</b>	Mobilize key economists from Bangladesh's existing think tanks and policy institutes more formally to support policy-making throughout the life cycle (Build legal capacity at MoC through secondment for Law Ministry or direct hiring)	MoC					
	Train MoC staff on basics of trade policy, WTO, regional agreements	MoC					
	Reallocate MoC staff from Admin to policy-making Wings/Cells	MoC					
	Provide Training-of-trainers to BFTI	MoC/BFTI					
<b>Lack of robust research and analysis to support trade policy formulation</b>	Deepen linkages with existing research/policy institutes and academia to support ex ante and ex post analysis of trade policies	MoC, BIDS, CPD, PRI and academia		Lack of sufficient capacity within research institutes	More rigorous analytical inputs to policy-making and evaluation		
<b>Structure and effectiveness of EPB</b>	Increase private sector participation in the board	EPB			Improved effectiveness of EPB	Phase 1	
	Increase funding and provide management assistance to EPB	MoC			Improving the targeting of fairs and markets	Phase 1	
	Build statistical capability of EPB to monitor trade flows				Improving market information and branding		ITC?
<b>Strengthen BSTI</b>	Train [200] people in standardization, testing and certification	BSTI/Ministry of Industry	Moderate costs				EU, UNIDO, GIZ

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
<b>Liberalize market for testing and certification</b>	Change in policy to allow private laboratories to certify shrimp and seafood exports General change in policy to allow private service providers to provide services for quality in areas under government regulation	Department of Fisheries, Ministry of Fisheries and Livestock	Moderate costs	Resistance as revenues may be important and government may be adverse to give up control	Easier compliance with EU food safety legislation – avoidance of future costly extra requirements like 20% inspection		World Bank
<b>SECTOR- SPECIFIC MEASURES</b>							
<b>Shipbuilding – Poor quality of ships in the domestic market, with implications for safety as well as exportability, and a shortage of trained manpower</b>	Update and improve the domestic vessel code with stricter technical rules and standards	MoI					
	Enforce the current rules and standards through appropriately educated surveyors employed by the government	MoI					
	Formal training for workers, managers and engineers	Naval Architecture and Marine Engineering Department at the Bangladesh University of Engineering and Technology			productivity gains		
<b>Jute products – lack of sustained demand for jute products, local and foreign; favored treatment to public sector that hurts the more competitive private sector</b>	The jute packing law needs to be enforced				More stable source of demand for the jute industry		
	To phase-out subsidies to public mills				Increased market for private sector		
	To stimulate further R&D in the sector for the development of additional diversified fabrics	Bangladesh Jute Research Institute, Jute Diversification Promotion Center			reducing costs and increasing fabric variety		

Issue to be addressed	Proposed policy measure/project/TA/capacity building	Responsible government unit	Cost estimate	Potential implementation challenges	Expected results	Phase	Potential donor funding
	Joint marketing, research and branding with India and Nepal to create domestic and international jute	BJRI and Government					Jute Study Group
<b>Incentives that discriminate by types of raw material and vertical integration of firms in jute/leather footwear</b>	Phase out cash incentives in jute and leather footwear, and use savings to provide generic support to the sector that does not discourage new entrants	Ministry of Industry, Ministry of Finance			...		
<b>Bicycles -- Lack of finance, especially for domestically-oriented local producers</b>	Large OEMs (manufacturers) support local producers' investment by guaranteeing the borrowings of suppliers on the basis of OEM						
<b>ITES -- Lack of reliable internet connectivity with latency</b>	To install two additional international submarine cables to ensure minimal redundancy in case of failure of one of the three cables				to provide quality internet services at affordable rates		
<b>Significant skill gaps in ITES, including soft skills, and English language and management skills</b>	To develop training programs, coaching, workshops, and certification for individuals and organizations	BITM			To improve skills		World Bank, others
<b>Lack of access to finance is a major handicap, given the lack of physical collateral</b>	Improve access to specialized credit facilities such as EEF and the JICA-funded SME facility				improve access for finance for ITES-BPOs in Bangladesh		
<b>Inadequate branding of Bangladesh</b>	Develop an IT/ITES business portal	BASIS			To develop a positive reputation for the Bangladesh ITES sector		

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