



Policy Analysis Unit (PAU)

Policy Note Series: PN 0702

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and the Supportive Policy Regime**

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September 2006

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Future Prospects of Bangladesh's Ready-Made Garments Industry and the Supportive Policy Regime

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Abstract

Emergence of the global market has heightened the role of trade in world economy and made industrialization as an integral system of global trade and production. Bangladesh economy at present is more globally integrated than at any time in the past. The MFA phase-out will lead to more efficient global realignments of the textile and clothing industry. After the introduction of Agreement on Textile and Clothing (ATC), the RMG industry of Bangladesh is facing new and unique challenges. The paper attempts to identify the prospects of RMG industry in the post-MFA period by analyzing the current scenario along with different policy measures and the available options in order to be more competitive in the new regime. The phase out was expected to have a negative impact on the economy of Bangladesh. But recent data reveals that Bangladesh absorbed the shock successfully and indeed RMG exports grew significantly. Due to a number of steps taken by the industry (e.g., successful in diversifying products and markets, increased backward integration, high level of investment, and supportive policy regime), Bangladesh still remains competitive in RMG exports even in this post phase-out period. But much more needs to be done (e.g., removal of structural impediments, establishment of training and research institute, sharing of knowledge and technology) in order to maintain the competitiveness in the global RMG market.

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Introduction

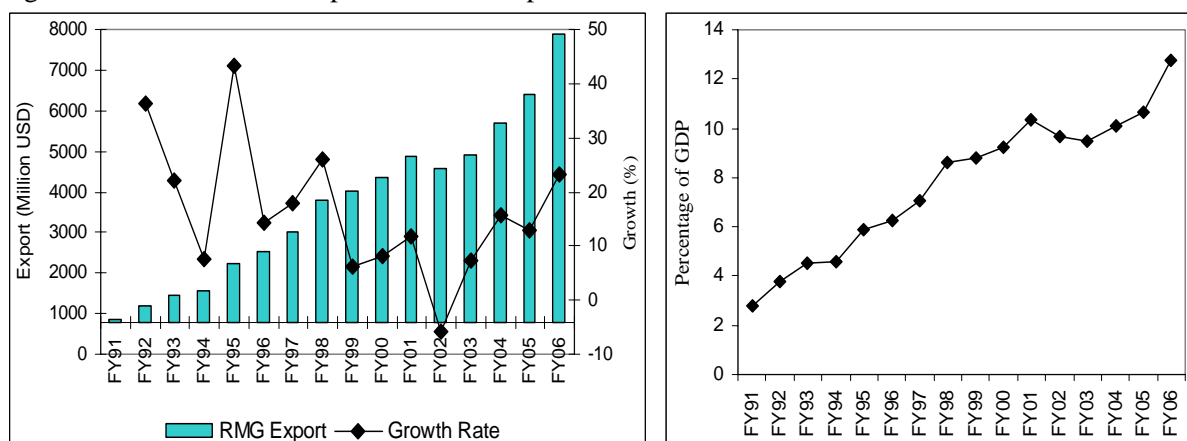
The Ready-Made Garments (RMG) industry occupies a unique position in the Bangladesh economy. It is the largest exporting industry in Bangladesh, which experienced phenomenal growth during the last 20 years. By taking advantage of an insulated market under the provision of Multi Fibre Agreement (MFA) of GATT, it attained a high profile in terms of foreign exchange earnings, exports, industrialization and contribution to GDP within a short span of time. The industry plays a key role in employment generation and in the provision of income to the poor. Nearly two million workers are directly and more than ten million inhabitants are indirectly associated with the industry. Over the past twenty years, the number of manufacturing units has grown from 180 to over 3600. The sector has also played a significant role in the socio-economic development of the country.

The Agreement on Textile and Clothing (ATC) introduced in 1994, aimed at bringing textiles and clothing within the domain of WTO rules by abolishing all quotas by the end of 2004. It provides an adjustment period of 10 years, so that countries affected by the MFA could take the necessary steps to adjust to the new trading environment. Liberalization of trade following the Uruguay Round agreement presents opportunities as well as challenges for a developing country like Bangladesh in RMG sector. In the Post-Uruguay Round period, traditional instruments of trade policy such as tariffs, quotas, and subsidies will become less feasible and less relevant. In a liberalized trade regime, competition among textiles and clothing exporting countries is likely to become intense. The objective of this paper is to identify the prospects of RMG industry after the MFA phase out by analyzing the current scenario along with different policy measures and the available options in order to be more competitive in the new regime.

Contribution of the RMG Industry

RMG business started in the late 70s as a negligible non-traditional sector with a narrow export base and by the year 1983 it emerged as a promising export earning sector; presently it contributes around 75 percent of the total export earnings. Over the past one and half decade, RMG export earnings have increased by more than 8 times with an exceptional growth rate of 16.5 percent per annum. In FY06, earnings reached about 8 billion USD, which was only less than a billion USD in FY91. Excepting FY02, the industry registered significant positive growth throughout this period.¹

Figure 1: Trend of RMG Export Volume, Export Growth and Contribution to GDP



Source: Export Promotion Bureau (EPB) and Economic Trends, Bangladesh Bank

¹ The negative growth in FY02 was most likely the outcome of the worldwide effects of September 11, 2001.

In terms of GDP, RMG's contribution is highly remarkable; it reaches 13 percent of GDP which was only about 3 percent in FY91. This is a clear indication of the industry's contribution to the overall economy. It also plays a pivotal role to promote the development of other key sectors of the economy like banking, insurance, shipping, hotel, tourism, road transportation, railway container services, etc. A 1999 study found the industry supporting approximately USD 2.0 billion worth of economic activities (Bhattacharya and Rahman), when the value of exports stood at a little over USD 4.0 billion.

One of the key advantages of the RMG industry is its cheap labour force, which provides a competitive edge over its competitors. The sector has created jobs for about two million people of which 70 percent are women who mostly come from rural areas. The sector opened up employment opportunities for many more individuals through direct and indirect economic activities, which eventually helps the country's social development, woman empowerment and poverty alleviation.

Prospects of the RMG Industry

Despite many difficulties faced by the RMG industry over the past years, it continued to show its robust performance and competitive strength. The resilience and bold trend in this MFA phase-out period partly reflects the imposition of 'safeguard quotas' by US and similar restrictions by EU administration on China up to 2008, which has been the largest supplier of textiles and apparel to USA. Other factors like price competitiveness, enhanced GSP facility, market and product diversification, cheap labour, increased backward integration, high level of investment, and government support are among the key factors that helped the country to continue the momentum in export earnings in the apparel sector. Some of these elements are reviewed below.

Market Diversification

Bangladeshi RMG products are mainly destined to the US and EU. Back in 1996-97, Bangladesh was the 7th and 5th largest apparel exporter to the USA and European Union respectively. The industry was successful in exploring the opportunities in markets away from EU and US. In FY06, a successful turnaround was observed in exports to third countries, which having a negative growth in FY05 rose three-fold in FY06, which helped to record 23.1 percent overall export growth in the RMG sector. It is anticipated that the trend of market diversification will continue and this will help to maintain the growth momentum of export earnings. At the same time a recent WTO review points out that Bangladesh has not been able to exploit fully the duty free access to EU that it enjoys. While this is pointed out to be due to stringent rules of origin (ROO) criteria, the relative stagnation in exports to EU requires further analysis.

Table 1: Region-wise Share of RMG Export

Year	Export Share to USA	Export Share to European Countries	Combined Share of USA & EU (%)	Export Share of Other Countries (%)
2001-2002	42.67	55.43	98.10	1.90
2002-2003	38.02	57.12	95.14	4.86
2003-2004	28.64	65.42	94.06	5.94
2004-2005	30.64	64.24	94.88	5.12
2005-2006	33.67	49.77	83.43	16.57

Source: Bangladesh Bank Quarterly

Product Diversification

The growth pattern of RMG exports can be categorized into two distinct phases. During the initial phase it was the woven category, which contributed the most. Second phase is the emergence of knitwear products that powered the recent double digit (year-on-year) growth starting in FY04.

Table 2: Growth Pattern of Woven and Knitwear Categories

Year	Woven	Knitwear	Total RMG Export
2002-03	4.28	13.34	7.16
2003-04	8.59	29.88	15.76
2004-05	1.70	31.26	12.87
2005-06	13.50	35.38	23.11

Source: Export Promotion Bureau (EPB)

In the globalized economy and ever-changing fashion world, product diversification is the key to continuous business success. Starting with a few items, the entrepreneurs of the RMG sector have also been able to diversify the product base ranging from ordinary shirts, T-shirts, trousers, shorts, pajamas, ladies and children's wear to sophisticated high value items like quality suits, branded jeans, jackets, sweaters, embroidered wear etc. It is clear that value addition accrues mostly in the designer items, and the sooner local entrepreneurs can catch on to this trend the brighter be the RMG future.

Table 3: Export Performance of Different Apparel Items

(in Million USD)

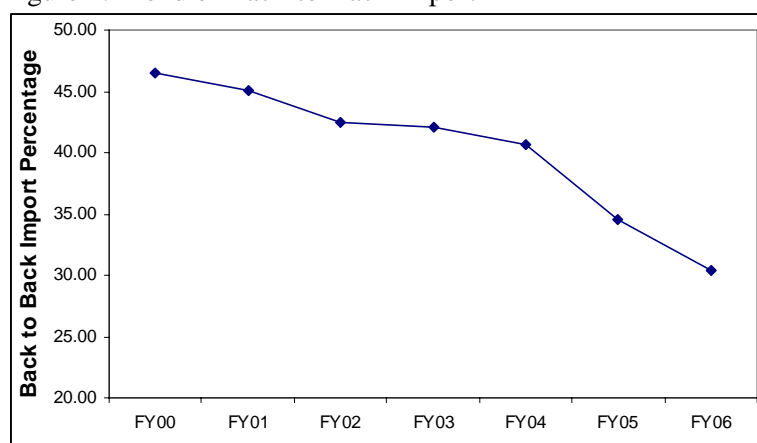
Year	Shirt	Jackets	T-Shirt	Trousers	Sweater
2000-01	1067.22	570.33	593.87	652.44	474.04
2001-02	871.22	412.34	546.28	636.61	517.83
2002-03	1019.88	464.51	642.62	643.66	578.38
2003-04	1116.57	364.78	1062.11	1334.85	616.31
2004-05	1053.34	430.28	1349.71	1667.72	893.12
2005-06	1056.87	408.97	1781.51	2165.25	1042.61

Source: Export Promotion Bureau (EPB)

Backward Integration

RMG industry in Bangladesh has already proved itself to be a resilient industry and can be a catalyst for further industrialization in the country. However, this vital industry still depends heavily on imported fabrics. After the liberalization of the quota regime some of the major textile suppliers Thailand, India, China, Hong Kong, Indonesia and Taiwan increased their own RMG exports.

Figure 2: Trend of Back-to-Back Import



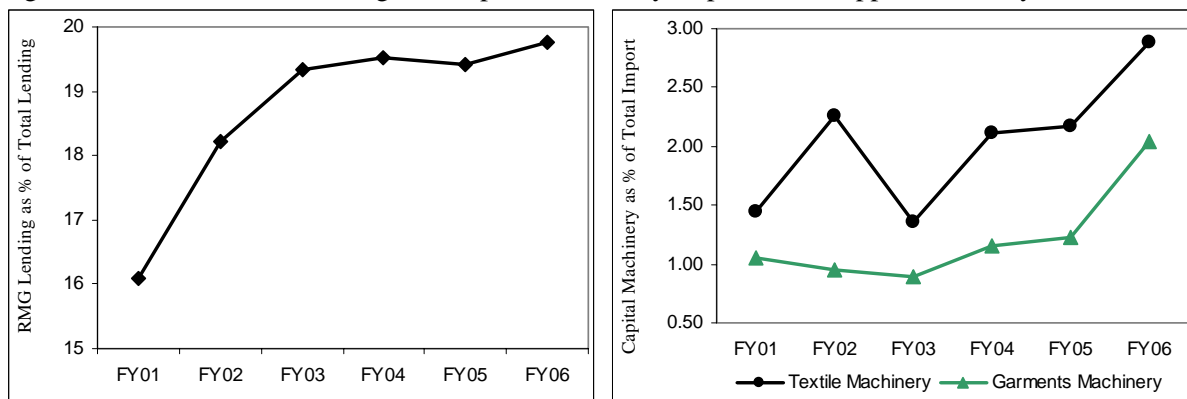
Source: Foreign Exchange Policy Department (FEPD), Bangladesh Bank

If Bangladesh wants to enjoy increased market access created by the global open market economy it has no alternative but to produce textile items competitively at home through the establishment of backward linkage with the RMG industry. To some extent the industry has foreseen the need and has embarked on its own capacity building. The trend of back-to-back import has been declining over the years implying a rising contribution of domestic value addition (Figure 2). This is an optimistic indication that a well equipped and modern backward linkage industry may well prove cost effective and thus helping Bangladesh to meet the challenges in the post-MFA era.

Flow of Investment

It is plausible that domestic entrepreneurs alone may not be able to develop the textile industry by establishing modern mills with adequate capacity to meet the growing RMG demand. It is important to have significant flow of investment both in terms of finance and technology. Figure 3 indicates that the investment outlook in this sector is encouraging, although the uncertainties before the MFA phase-out period caused a sluggish investment scenario. In part the momentum in the post-MFA phase-out period is indicative of the efforts underway towards capacity building through backward integration. This is evident in the pace of lending to the RMG sector and in the rising import share of RMG related machinery. However further progress would be necessary to improve and sustain competitiveness on a global scale.

Figure 3: Trend of Total Lending and Capital Machinery Import in the Apparel Industry



Note: The first figure indicates the total RMG lending as percentage of total lending while the second one represents the import of textile and garments related capital machinery as percentage of total import of the country.

Source: Schedule Bank Statistics (SBS) and Foreign Exchange Policy Department (FEPD), Bangladesh Bank

A Supportive Policy Regime

Government of Bangladesh has played an active role in designing policy support to the RMG sector that includes back-to-back L/C, bonded warehouse, cash incentives, export credit guarantee scheme, tax holiday and related facilities. At present government operates a cash compensation scheme through which domestic suppliers to export-oriented RMG units receive a cash payment equivalent to 5 percent of the net FOB value of exported garments. The FY04 budget also lowered the corporate income tax rate for the RMG industry from 30 to 10 percent for the period up to June 30, 2006. From FY05 the tax regime has been further changed, and a 0.25 percent tax at source will be deducted from the value of the export proceeds of Woven and Knitwear category. At the same time, income tax rate for textile manufacturers were reduced to 15 percent from its earlier level for the period up to June 30, 2008. The reduced tax rates and other facilities are likely to have a positive impact on the RMG sector.

Lead Time

‘Lead time’ is a crucial factor maintaining export competitiveness. Bangladesh happens to feature the longest lead time in the RMG world. The lead time for Bangladesh is 120 days on an average, while the corresponding period for Sri Lanka is about 19-45 days and for India it is only about 12 days. Various factors like the distance from major markets, importation of raw materials, port congestion, strikes, poor roads, etc. are some of the factors responsible for this. At present the fashion seasons are becoming short with a changing trend, it would not be possible to compete if the lead time extends beyond 30-40 days. Therefore, bringing down the ‘lead time’ to about 30-40 days is a major challenge for the country’s RMG sector. Clearly more business can be captured only if the lead time could be improved.

Infrastructural Impediments

The existence of sound infrastructural facilities is a prerequisite for economic development. In Bangladesh, continuing growth of the RMG sector is dependent on the development of a strong backward linkage in order to reduce the lead time. However, other factors constraining competitiveness of Bangladesh’s RMG exports included the absence of adequate physical infrastructure and utilities (e.g., transportation, telecommunication, stable power supply, efficient seaport, political tolerance, quality control and a smoothly functioning bureaucracy). According to a recent World Bank-IFC publication (2006) records that a businessman in Bangladesh needs 35 days to export and incurs USD 902 per container, whereas his counterpart in India requires 27 days and spends USD 864 per container. The comparable figures for Pakistan, Sri Lanka and Vietnam are 24 days and USD 996, 25 days and USD 797, and 35 days and USD 701, respectively.

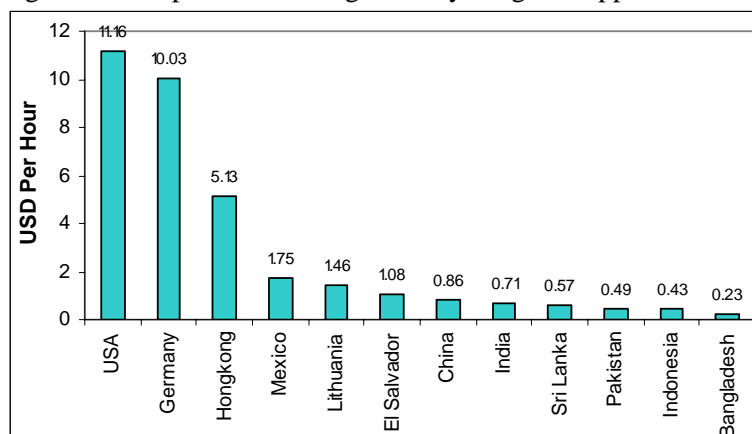
Labour Productivity

The productive efficiency of labour is more important determinant for gaining comparative advantage than the physical abundance of labour. In Bangladesh, the garment workers are mostly women with little education and training. The employment of an uneven number of unskilled labours by the garment factories results in low productivity and comparatively more expensive apparels. Bangladesh labour productivity is known to be lower when compared with that of Sri Lanka, South Korea and Hong Kong SAR. Bangladesh must look for ways to improve the productivity of its labour force if it wants to compete regionally if not globally.

Cheap Labour Force

The strength of a firm depends on its specific comparative advantages, which its competitors do not possess. To date the local industry has flourished in spite of the challenges cited above (e.g., lead time, infrastructure, and bureaucratic red tape) on the back of cheap female labour. The wages paid to RMG workers in Bangladesh are the lowest even by the South Asian regional standard. Figure 4 illustrates the comparative average hourly wages in apparel industry of selected developed and developing countries.

Figure 4: Comparative Average Hourly Wage in Apparel Industry



Source: ILO, 2003 and CPD Occasional Paper Series

Research and Training

The country has no dedicated research institute related to the apparel sector. RMG is highly fashion oriented and constant market research is necessary to become successful in the business. Here India has had a head start and Mumbai and Delhi are on line to become fashion centres on a global scale. At present whatever design work is done in the country, these are mostly carried out with foreign workers and experts. BGMEA has already established an institute which offers bachelor's degree in fashion designing and BKMEA is planning on setting up a research and training institute. These and related initiatives need encouragement possibly intermediated by donor-assisted technology and knowledge transfer. A facilitating public sector role can be very relevant here.

Conclusion and Recommendations

Bangladesh economy at present is more globally integrated than at any time in the past. The MFA phase-out will lead to more efficient global realignments of the textile and clothing industry. The phase out was expected to have negative impact on the economy of Bangladesh. Recent data reveals that Bangladesh absorbed the shock successfully and indeed RMG exports grew significantly both in FY05 and (especially) in FY06. Due to a number of steps taken by the industry, Bangladesh still remains competitive in RMG exports even in this post phase-out period.

Cheap labour is no longer seen to be a mainstay of comparative advantage. The need for establishing strong backward linkage was appropriately realized and accordingly necessary steps were taken by all quarters of the RMG industry, which has been reflected in the decreased pattern of back-to-back import supported by increased domestic value addition. However further progress is in order, and a strong public sector role is necessary to mediate the establishment of textile mills with global standards. An appropriate policy regime is needed to encourage the importation of technology, intermediate and raw materials, so that the local industries get a chance to reduce its average cost to international level and narrow the lead time.

Presently, Bangladesh's apparel sector operates mainly at the lower-end segment of the international market. Although knitwear products achieved tremendous growth but these are low-value products with small profit margins. Bangladesh can enhance its value addition capacity substantially through diversification of apparel products and by moving into more value-added, high-priced, high-fashion products. Woven category can be more attractive via large capital investment. If cost effective investment can increase in the spinning and weaving sub-sectors, as it has been in the past few years, Bangladesh has the possibility of building a competitive export-oriented RMG sector with strong backward linkages in the textiles sector.

Training is always considered as an effective instrument for upgrading skills and raising efficiency of human resource, which eventually ensures increased productivity. Some initiatives have been taken by the entrepreneurs of the relevant sector but much more needs to be done. Necessary steps should be taken both by the public and the private sectors, and development partners to establish appropriate fashion and technology institutes. Improvement in working conditions and organizational environment can also result in increased productivity, which eventually renders these enterprises more competitive.

To remain competitive in the post-MFA phase, Bangladesh needs to remove all the structural impediments in the transportation facilities, telecommunication network, power supply, management of seaport, utility services and in the law and order situation. The government and the RMG sector would have to jointly work together to maintain competitiveness in the global RMG market. Given the remarkable entrepreneurial initiatives and the dedication of its workforce, Bangladesh can look forward to advancing its share of the global RMG market.

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