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Consolidating and Accelerating Exports in Bangladesh

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World Bank Office Dhaka

Plot # E-32, Agargaon
Sher-e-Bangla Nagar,
Dhaka-1207, Bangladesh
Tel: 880-2-8159001-28
Fax : 880-2-8159029-30
www.worldbank.org.bd

World Bank

1818 H Street, N.W.
Washington, D.C.,
20433, USA
Tel: 1-202-473-1000
Fax : 1-202-477-6391
www.worldbank.org

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FOREWORD

Bangladesh's Sixth Five Year Plan underscores the importance of exports for dynamism in the manufacturing sector and provision of high productivity and high income jobs. Indeed, faster export growth will be critical if Bangladesh is to achieve the accelerated growth necessary to reach its goal of becoming a middle income country by 2021.

Bangladesh started to adopt outward-oriented economic policies since the early 1990s, including reduction of tariffs, removal of quantitative restrictions that were related to trade, and managed floating of the exchange rate. This process was accompanied by improved trade and export growth. In turn, trade liberalization and export growth have underpinned Bangladesh's shift to a higher growth trajectory.

Trade and related policies allowed the export-oriented garment industry to exploit the opportunity presented by the imposition of textile and garment quotas in 1974. And despite the phase-out of MFA quotas in 2005, Bangladeshi garment exports have continued to grow and capture an increasing share of world markets. Today, the sector has evolved into a highly competitive, world-class export industry. Within the export basket, the dominance of garments has increased over time. Garments make up over three-fourths of Bangladesh's merchandise exports.

While garments have grown impressively, the rest of the export industry has lagged, at least in terms of volume and value of exports. Is this a concern? This report shows that exports of basic garments, Bangladesh's strength, will continue to be important in the near and medium-term. However, the role of policy makers is to look beyond the immediate future. And accelerating overall exports will require not only consolidating existing strengths in basic garments but diversifying gradually into higher-value garments as well as other exports.

How can Bangladesh make this happen? Available research shows that the infrastructure deficit, especially energy, lack of appropriate skills and the weak regulatory environment continue to deter exports. This report seeks to complement existing research and explore a few critical areas in some depth. It focuses on the role that *trade logistics, skills and compliance with labor standards* can play in consolidating existing strengths in exports and moving to higher value products. In doing so, it uses the garment sector as a lens. The report also examines prospects for diversifying into IT-enabled services, a sector that is growing fast worldwide and can provide high-quality jobs.

This report supports the knowledge agenda of the World Bank, which goes hand in hand with its lending role. Indeed, such knowledge is critical for better and more effective lending approaches, and for supporting the Bank's policy dialogue with Government. The report forms part of the growth and trade work program being undertaken by Bangladesh's Poverty Reduction and Economic Management team.

We are confident that the strategic approach of this report will help stimulate debate about critical policies that can allow the garment industry to continue to prosper as well as encourage the emergence of a vibrant set of new export sectors.

Ernesto May
Sector Director
Poverty Reduction and Economic Management
South Asia Region

Ellen Goldstein
Country Director
The World Bank
Bangladesh and Nepal

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Abbreviations and Acronyms

3PL	Third-party Provider of Logistics	CFS	Container Freight Station
ADB	Asian Development Bank	CIM-UK	Chartered Institute of Marketing, United Kingdom
AEO	Authorized Economic Operator	CPA	Chittagong Port Authority
AGOA	African Growth and Opportunity Act	CPI	Consumer Price Index
ASYCUDA	Automated SYstem for CUstoms DAta	CRF	Clear Report of Findings
ATAB	Association of Travel Agents of Bangladesh	DDP	Delivery Duty Paid
B/L	Bill of lading	DDU	Delivery Duty Unpaid
BASIS	Bangladesh Association of Software and Information Services	DTIS	Diagnostic Trade Integration Study
BB	Bangladesh Bank	EPB	Export Promotion Bureau
BEPZA	Bangladesh Export Processing Zones Authority	EPZ	Export Processing Zone
BGMEA	Bangladesh Garment Manufacturers and Exporters Association	EU	European Union
BIFT	BGMEA Fashion Technology Institute	EXW	Ex-works
BIWTA	Bangladesh Inland Water Transport Authority	FCL	Full Container Load
BKMEA	Bangladesh Knitwear Manufactures and Exporters Association	FDI	Foreign direct investment
BR	Bangladesh Railway	FEU	Forty Equivalent Unit
BRTC	Bangladesh Road Transport Corporation	FoB	Free On Board
BSMTC	BIFT Sweater Manufacturing Training Center	FY	Fiscal Year
BTMEA	Bangladesh Textile Mills Associations	GASSCOM	Ghana Association of Software and IT Services Companies
C&F	Cost and Freight	GATS	General Agreement on Trade in Services
CAD	Cash against Documents	GCB	General Cargo Berths
CCT	Chittagong Container Terminal	GDP	Gross Domestic Product
CD	Customs Duty	GSP	Generalized System of Preference
CEP	Comparative Export Performance	ICA	Investment Climate Assessment

ICD	Inland Container Depot	PIP	Productivity Improvement Program
ICT	Information and Communication Technology	PPP	Public-Private Partnership
IDCO	Orissa Industrial Infrastructure Development Corporation	P-SD	Protective Supplementary Duty
IGM	Inward General Manifest	PSI	Pre-shipment Inspection
IMC	Institute Management Committees	P-VAT	Protective VAT
ISO	Organization for Standardization	R&D	Research and Development
IT	Information technology	RD	Regulatory Duty
ITES	Information Technology Enabled Services	RKCL	Rajasthan Knowledge Corporation Ltd
ITES-BPO	Information Technology Enabled Services-Business Process Outsourcing	RMG	Ready Made Garment
IWT	Inland Water Terminal	SCF	Social Compliance Forum
JAAF	Joint Apparel Association Forum	SEA ME WE 4	South East Asia-Middle East-West Europe-4
L/C	Letters of Credit	SIRV	Special Investor Resident Visa
LCL	Less than container load	SSG	Ship-to-Shore Gantry
LPI	Logistic Performance Index	SWOT	Strengths, Weakness, Opportunities and Threats
MCIT	Ministry of Communication and Information Technology	TEU	Twenty-foot Equivalent Unit
MFA	Multi Fibre Arrangement	TVET	Technical and Vocational Education and Training
MoHE	Ministry of Higher Education	UCEP	Underprivileged Children's Educational Programs
NASSCOM	National Association of Software and Services Companies	UD	Utilization Declaration
NBR	National Board of Revenues	UNCTAD	United Nations Conference on Trade and Development
NCSU	North Carolina State University	UNCTAD- TRAINS	United Nations Conference on Trade and Development- Trade Analysis and Information System
NCT	New Mooring Container Terminal	UNIDO	United Nations Industrial Development Organization
NGO	Non-Governmental Organization	VoIP	Voice over IP
OCAC	Orissa Computer Application Centre	WB	World Bank
ODCY	Off Dock Container Yard	WTI	World Trade Indicators
OMIC	Overseas Merchandise Inspection Co. Ltd.		

Currency Equivalents

2012 US\$ 1=81.97 Bangladesh Takas (Tk.)

Vice President:	Isabel M. Guerrero
Country Director:	Ellen A. Goldstein
Sector Director:	Ernesto May
Sector Manager:	Vinaya Swaroop
Task Team Leader:	Md. Abul Basher

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CONSOLIDATING AND ACCELERATING EXPORTS IN BANGLADESH

Overview

1. For Bangladesh to become a middle-income country, growth in exports needs to accelerate.

Exports of *basic* garments will continue to be important in the near future, but Bangladesh’s competitive advantage in this area could erode over time. As such, looking ahead, accelerating exports will require not only consolidating existing strengths in basic garments but diversifying gradually into other products such as *higher value garment and service exports*. Forward-looking policymaking requires that measures be put in place now to encourage such diversification in future, while building on existing strengths. How can Bangladesh make this happen? Available research shows that the infrastructure deficit, especially energy, as well as lack of appropriate skills and the weak regulatory environment continue to hinder exports from Bangladesh. These weaknesses still persist. To complement work done so far, this report focuses on the role of *trade logistics, skills and compliance with labor standards* in consolidating existing strengths and moving to higher value products, using the garment sector as a lens. In addition, given the growing importance of services in world trade, the report also examines prospects for diversifying into a “reach sector” such as IT-enabled services that can provide high-quality jobs.

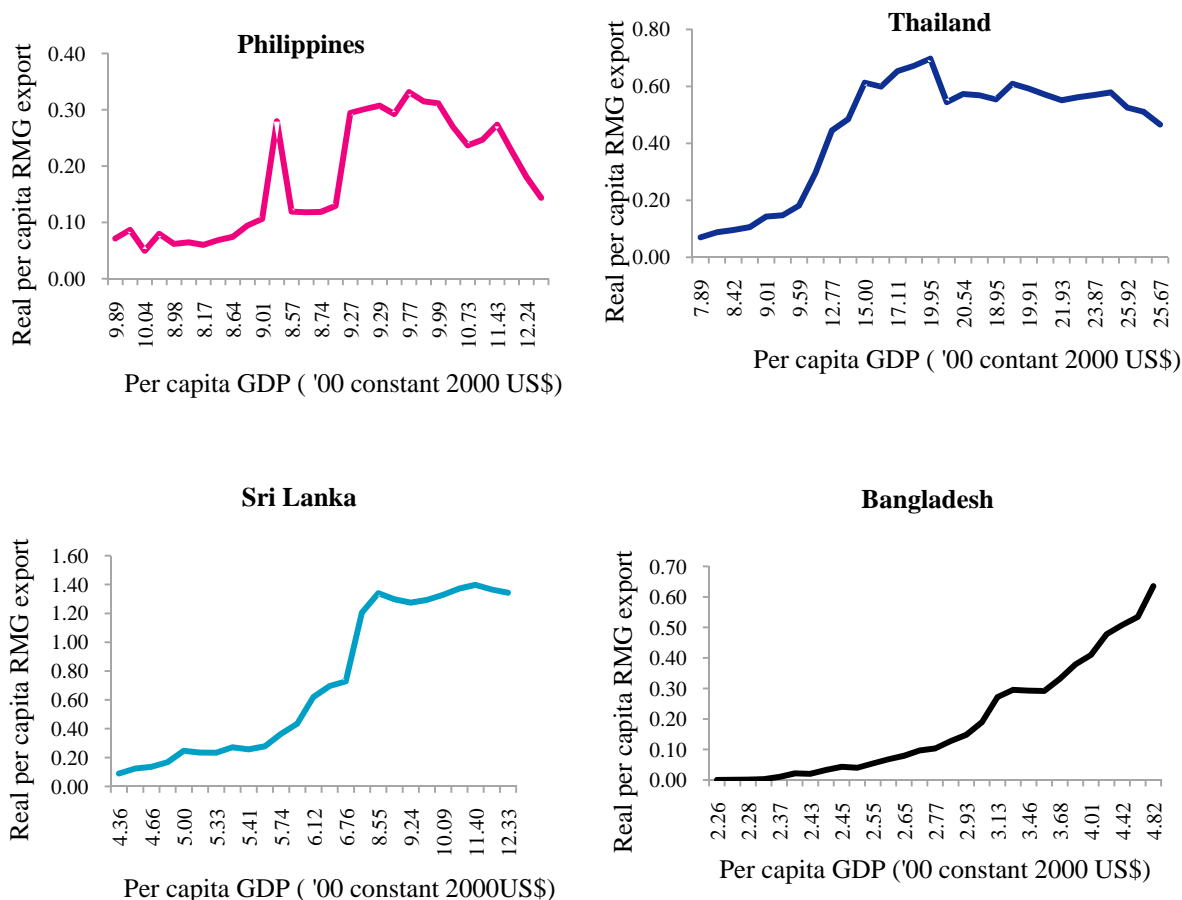
2. Evidence from garment-exporting countries suggests that there is a “threshold” level of per capita GDP, after which per-capita garment exports begin to decline (Figure 0.1). For instance, real per capita exports of garments in Thailand grew until it reached a “threshold” per capita GDP of about US\$2,000 (in constant 2000 US\$), about US\$1,000 in the Philippines, and around US\$1,150 in Sri Lanka. Before reaching

this threshold, a country’s export basket shows a relatively diversified mix of basic-and-higher-value garments. This is because the increasing pressure on wages and benefits erodes competitiveness in basic garments. As such, as shown in Figure 0.2, empirical evidence suggests that growth in per capita garment exports is sustained by moving away from basic garments; as a corollary, the decline in per capita *basic* garments exports (point A) must occur before the overall decline in per capita garment exports (point B).

3. By this reasoning, there is room for the garment sector in Bangladesh to grow and capture an increasing share of the world market.

Exports as a share of GDP were 15 percent on average in the past decade, of which garment exports accounted for around 76 percent. Meanwhile, Bangladesh’s share in world garment exports has edged up, with an increase in market share from 2.6 percent to 4.3 percent over 2000-09. Figure 0.1 shows the steep trajectory of Bangladesh’s success in garments – with its per capita GDP of US\$482 (in constant 2000 US\$) well below the threshold – can be sustained for a while. However, as per capita income grows and reaches closer to the threshold level, Bangladesh will lose its competitive edge to other countries with lower wages, first in basic, and later in higher value garments. Therefore, to ensure continued overall export growth, Bangladesh would need more contributions from other sectors even before reaching the threshold per capita income. But to do this, apart from dealing with the usual constraints to business, Bangladesh needs to focus on improving its trade logistics, skills, and compliance with labor standards.

Figure 0.1: Per Capita Income and Per Capita Garment Exports of Selected Countries



Note: Last two years' garments exports of Bangladesh are estimated from national data.

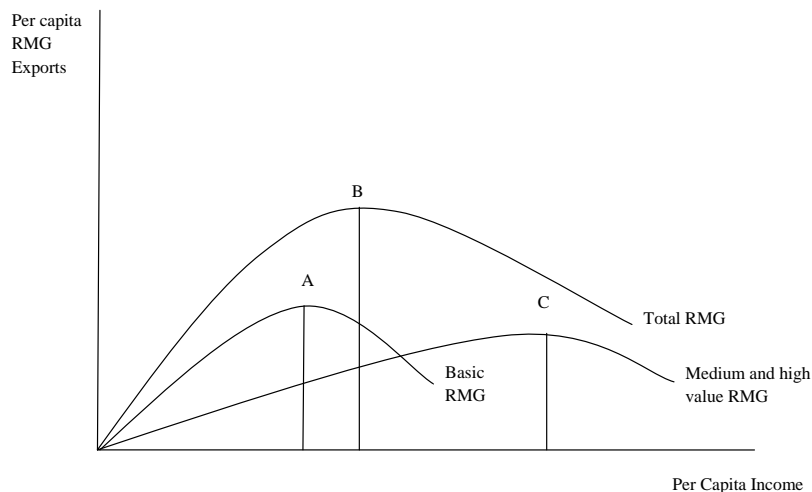
Source: WB staff calculations from UN Comtrade, ITC, and WDI

Trade Logistics

4. Efficient logistics will give Bangladesh a competitive edge in exports of basic-and-medium value garments. So far, low wages in the garment sector have partially compensated for poor logistics. To ensure continued fast growth of basic garments and consolidation of existing strengths and slowly move up the value chain, logistics in Bangladesh would need to improve considerably. Even if wages remain competitive, as Bangladesh moves up the value chain, this low cost advantage may not be enough to compete globally. Thus, Bangladesh needs to improve

logistics to ensure that exports as well as imported inputs are shipped on time, cost effectively and reliably. Strengthening multimodal connections between the Chittagong port and the hinterland, improving customs procedures, enhancing air shipment capacity, and improving rail services by adding new physical capacity and introducing commercial management would be crucial elements of better logistics for the garment sector of the country. Improvements in trade logistics will also increase overall external competitiveness of the country and will have spillover benefits for other existing and potential merchandise export sectors.

Figure 0.2: Graphical Representation of Per Capita Income Threshold for Export of Garments



Skills

5. Lack of skills is becoming a key constraint to growth in exports, and this gap will become more acute as Bangladesh moves into producing higher-value garments. Although there is no recent hard data to point to a skills gap, the available indirect evidence on wages suggests that the gap between the demand and supply of skilled workers in garments is growing. The lack of skilled workers could increase the overall costs of production through the high rates of rejection of final products for defects. Despite the reported unmet demand for skilled labor, firms seem reluctant to incur training costs to raise skill levels because workers change jobs frequently. The publicly-funded Technical and Vocational Education and Training (TVET) is the main vehicle for training workers but it could improve its relevance to better meet the needs of garments and other sectors. Trainee and employer-targeted financing and increased

coordination between academia and industry could help improve overall skills in Bangladesh. More analysis is needed to uncover the quantum and pattern of skill gaps in Bangladesh, through an in-depth skills-gap survey. This will be important for designing specific policy interventions for Bangladesh to ensure that its exports and manufacturing are not hindered by inadequate supply of skilled labor.

Compliance with labor standards

6. Compliance with internationally-acceptable labor standards is becoming increasingly important for consumers in the US and EU – the main markets for garment exports from Bangladesh. Among other reasons, compliance with labor standards is important because it involves externalities – experience in Bangladesh has shown that even if one firm fails to comply with labor standards, the resulting public attention can have negative repercussions for the entire industry.¹ But what is optimal from the industry

¹ The collapse of the Spectrum sweater factory in April 2005 and the death of workers tarnished the image of the country; buyers in the EU and US created pressure on buying firms to not source their supplies from Bangladesh until compliance with labor standards improved.

standpoint may not be a rational economic decision for an individual firm that sees its costs increase with compliance while benefits are captured more generally. Given the externalities involved, there could be a role for the government in ensuring compliance. Responding to this need, the Government of Bangladesh adopted a “unified code of conduct” in 2006 and modernized the existing labor laws, but monitoring remains weak. As Bangladesh moves towards higher value garment exports, it becomes even more important to enforce compliance as the consumers who buy these products can afford to be more discerning about their buying decisions. Accordingly, the government can improve compliance enforcement, work with firms to more proactively adjust wages, and help firms relocate factories from residential to industrial buildings that are better equipped to provide safe working conditions.

Diversifying into non-factor services– the case for IT-enabled service exports

7. One possible avenue for diversification is exports related to IT-enabled services -business process outsourcing (ITES-BPO). The sector helps diversify exports, employs youth, raises incomes while requiring lower investments in human and physical capital compared to the IT sector. The lack of a sizeable ITES-BPO sector in Bangladesh is puzzling, especially when it is flourishing in neighboring India, Sri Lanka and is taking off in Bhutan. Analysis shows that several factors hinder the growth of the sector in Bangladesh: lack of soft skills such as fluency in written and spoken English and general communication; poor infrastructure including the lack of reasonably priced real estate and grade-A buildings, and, until recently, lack of VoiP telephony; a weak business environment; and the lack of clusters. Much needs to be done to promote this industry in Bangladesh by improving skills and the business environment. Creating an apex organization to represent the sector could greatly help improve sector prospects.

CONSOLIDATING AND ACCELERATING EXPORTS IN BANGLADESH

Chapter 1: Introduction and Stage-Setting

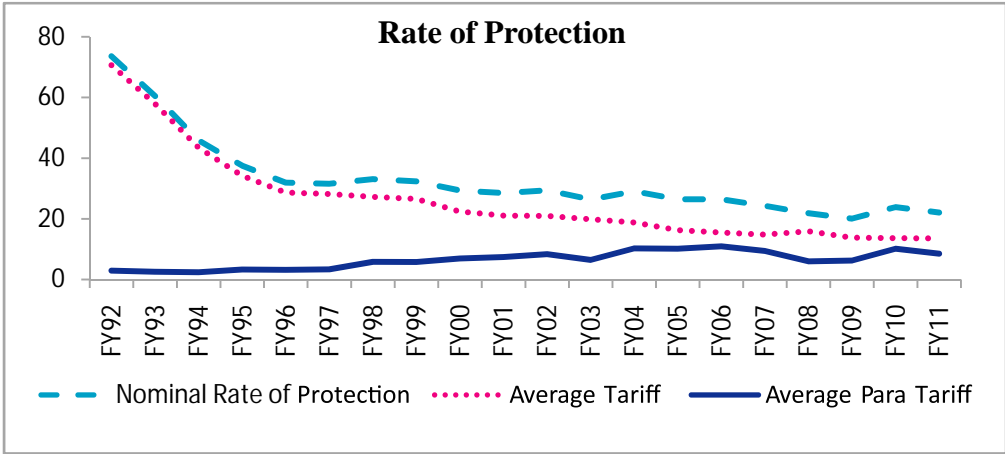
1.1 **Bangladesh’s economy has gradually become more open.** Three distinct regimes can be identified on the basis of the country’s trade policy. The first regime (1972-75) was distinguished by heavy controls on exports and imports, and pervasive price controls. The second regime (1976-1990) was marked by a move towards a market-based economy, beginning of denationalization, modest downward adjustment of tariffs, partial elimination of quantitative restrictions, and policy support to garment exports. The third regime (1990-to date) approached trade liberalization in a more concerted manner. Major progress made so far includes substantial scaling down and rationalization of tariffs, removal of trade-related quantitative restrictions, unification of exchange rates and the adoption of a managed floating exchange rate regime.

1.2 **The trade liberalization coincided with a secular increase in Bangladesh’s growth since the 1990s.** Over the last two decades, GDP growth was underpinned by exports and, more recently, remittances. GDP growth over FY00-10 averaged a robust 5.8 percent (4.8 percent over

FY90-99). Over this period, exports as a share of GDP grew from 14 to an estimated 19.5 percent (up from 6.7 percent of GDP in FY91). The other growth driver was remittances, which grew from 4.1 percent of GDP to 9.8 percent of GDP over FY00-10.

1.3 **Progress was made in reducing tariffs since FY92. However, the pace of decline has slackened since the late 1990s (Figure 1.1) and protection levels remain high in absolute terms and relative to neighboring countries.** For example, average rate of tariffs (without including para tariffs) declined at an annual rate of 10.48 percent during FY92-96, from 70.63 percent to 28.70 percent. Since then it declined only at an annual rate of 1 percent, from 28.70 percent in FY96 to 13.57 percent in FY12. Average tariff in Bangladesh still remains amongst the highest in the region. For example, average applied tariff in Bangladesh was 14.8 percent in 2008, whereas the same in other South Asian countries like India, Pakistan, Sri Lanka, and Nepal was 9.8, 14, 8.9 and 14.6 percents respectively (UNCTAD TRAINS Database).

Figure 1.1: Rates of Protection in Bangladesh (FY92-12)



Source: WB staff calculations from NBR data

1.4 In fact, in the recent past, protection has increased slightly (Figure 1.1 and Table 1.1) and has become more uneven across sectors due to increasing use of non-transparent ‘para tariffs.’ For the last five years, average customs tariffs hovered around 14 percent. In addition to regular tariffs (customs duties), the use of non-transparent para tariffs has expanded in recent years, from an average value of 2.98 percent in FY92 to 3.24 percent in FY96, and 12.94 percent in FY12. This has affected the pace of decline in

the nominal rate of protection, which is a non-linear sum of tariffs.² As can be seen from figure 1.1, the nominal rate of protection declined from 74 percent in FY92 to 32 percent in FY 96, and to 26.5 percent in FY12. Average nominal protection in FY10-12 was higher than in the previous three years. Moreover, the standard deviation of nominal protection, as well as the maximum tariff rate was significantly higher than the previous three years (Table 1.1).

Table 1.1: Nominal Protection and Tariff Dispersion (FY07-12)

Fiscal years	Average (nominal) protection	Standard Deviation	Maximum protection rate³
2011-12	26.5	43.8	680.0
2010-11	23.7	37.1	680.0
2009-10	23.9	36.6	680.0
2008-09	20.1	25.5	462.5
2007-08	21.9	24.0	462.5
2006-07	24.3	22.6	465.9
FY10-12 (avg)	24.7	39.2	680.0
FY07-09 (avg)	22.0	24.0	463.7

Source: WB staff calculations from NBR data

1.5 More than 1000 items are subjected to supplementary duties. For example, government imposed supplementary duties on 1095 items (8-digit level classification in the HS code) in FY12. Out of them, 701 were subject to 30 percent or higher supplementary duty (Table 1.2). The same number was 255 in FY10. All this means that the anti-export bias in trade policy is likely to have increased in recent years, which is detrimental for export growth and diversification, and creates incentives for resources to shift from exports towards import substitution.

1.6 The forthcoming diagnostic trade integration study (DTIS) will analyze trade policy issues in more detail. The DTIS will analyze trade policy and tariffs including a study of the effective rates of protection which may have increased and become more diverse across sectors in recent years.

Bangladesh’s Exports: Dominated by Garments

1.7 The Multi-Fiber Arrangement (MFA) in textiles and clothing gave Bangladesh an opportunity to make up for the decline in jute exports. By the mid-1970s, synthetic substitutes for raw jute had heavily eroded Bangladesh’s jute exports. A cap on textile exports from Korea, Hong Kong SAR, China, and India, imposed through the MFA quotas in 1974, provided Bangladesh an opportunity to enter the global textiles and clothing markets.

1.8 To facilitate this move to garments, Bangladesh introduced special schemes to incentivize garment exports, enabling it to remain relatively immune to the overall high protection levels in the country. Bangladesh

² Nominal rate of protection = (unweighted) average of tariffs (customs duty, CD) + (unweighted) average of para-tariffs, where para tariffs include regulatory duty (RD), protective supplementary duty (P-SD), and protective VAT (P-VAT).

³ The maximum protection rates apply mainly to alcoholic beverages, cigarettes, and luxury cars. In case of 97 percent of items (8-digit classification in the HS code), the protection rate is between 0 to 75 percent.

introduced back-to-back Letters of Credit (L/Cs)⁴ and special bonded warehouse facilities that facilitated credit flows and the availability of inputs at world prices for the garment exports

Table 1.2: Use of Supplementary Duties in FY10-12

Supplementary duty rate	Number of 8-digit HS Code		
	FY10	FY11	FY12
0	5226	5011	5022
20	880	796	394
30	48	48	85
Sub Total	6106	5855	5501
45	33	67	463
60	80	71	75
100	28	27	29
250	14	14	15
350	23	23	26
500	5	5	8
Sub Total	231	207	616
Total	6337	6062	6117

Source: WB staff calculations from NBR data

Table 1.3: Bangladesh Merchandise Exports: Share in Total Exports (percent)

	Garments	Jute	Jute products	Leather	Frozen Food	Pharmaceuticals	Engineering Products	Agricultural Products
FY95	53.0	2.1	9.2	5.8	8.6	..	..	..
FY00	75.3	1.2	4.6	3.4	6.0	..	0.1	0.3
FY05	74.2	1.1	3.6	2.6	4.9	..	1.0	0.9
FY10	77.1	1.2	3.3	1.4	2.7	0.3	1.9	1.5
FY11	78.2 (17915)	1.6 (357)	3.3 (758)	1.3 (298)	2.7 (625)	0.2 (44)	1.4 (310)	1.4 (331)
Average Growth of Exports								
FY96-FY00	19.3	2.7	-3.3	-0.3	3.6	..	-6.0	1.1
FY01-FY05	8.5	7.4	3.8	3.9	5.4	..	279.3	40.1
FY06- FY10	14.5	17.6	18.1	3.3	1.6	12.8	39.3	28.1

* The figures in the parenthesis show the total value of export in (current) million US\$ in FY11.

Source: Export Promotion Bureau

1.9 The garments sector became the main driver of exports and continues to outpace the growth of other exports; other export sectors were not treated as favorably as garments. In FY95, soon after the start of trade policy liberalization, garments formed 53 percent of total exports. This share grew to 75 percent in

FY00 and 79 percent in FY11. This growing dominance of garment exports owes partly to trade policies that gave special dispensation to the sector (see above), which enhanced the natural advantage that Bangladesh has in labor-intensive products. Table 1.3 shows that the shares of frozen food, tea (not included in the

⁴ A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.

table) and leather in total exports have declined over FY95-11. Other fast growing sectors include engineering products, agricultural products, jute and jute products.

Characteristics of Bangladesh's Garment Sector

1.10 The garments sector in Bangladesh has about 5000 factories (with about 4400 reportedly active), including about 2000 in the knitwear segment and 3500 in woven, with about 500 involved in both segments. More than 98 percent of these factories were locally-owned in 2006. The sector employs about 3.5 million workers. Indirect (derived) employment is estimated at around 10 million.

1.11 **Although declining, the import dependence of the sector is still high.** About 65 percent of the fabrics used in woven garments

are imported. This share is about 20 percent in case of knit garments. About 70 percent of the yarn used in knit garments is spun mostly from imported raw cotton in local spinning mills. Although there is some inventorying of imported grey fabric, most orders are placed after receiving an order for the garments, thereby increasing the total production time by several weeks.

1.12 **Growth of garment exports is volume-driven.** Bangladesh exports mostly basic garments, with concentration on T-shirts, trousers, shorts, shirts, jackets, jerseys, pullovers and cardigans. The unit price of Bangladeshi garment products is not only low but also declining over time. On average, the unit prices of knitwear woven garments exported by Bangladesh have decreased by 1.2 and 2.2 percent annually between FY05 and FY09, while their volumes have increased by 26.2 and 13.6 percent respectively over the same period (Table 1.4).

Table 1.4: Growth of Volume, Price and Value of RMG Exports

Year	Knitwear Products					
	FY05	FY06	FY07	FY08	FY09	Average
Growth of volume	31.3	37.7	20.9	21.0	20.4	26.2
Growth of price	0.0	-1.5	-1.6	0.5	-3.7	-1.2
Growth of value	31.3	36.1	19.3	21.5	16.7	25.0
Year	Woven Products					
	FY05	FY06	FY07	FY08	FY09	Average
Growth of volume	2.0	18.0	22.2	10.6	15.2	13.6
Growth of price	-0.3	-3.7	-6.7	0.3	-0.7	-2.2
Growth of value	1.7	14.3	15.5	10.9	14.5	11.4

Source: WB staff calculations from Bangladesh Bank data

1.13 **Bangladesh has several advantages in manufacturing basic garments (See Annex A.1).** First, its labor cost is well below that of its competitors. This is partially offset by lower levels of productivity, and higher costs and time to access major international markets. Second,

favorable trade arrangements give Bangladesh Generalized System of Preferences (GSP) access to the EU markets, enabling it to avoid a 12.5 percent tax that its competitors must pay. Recent liberalization in GSP rules mean that local sourcing is no longer necessary for meeting

⁵ More than 75% of total garment exports are contributed by (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.

value addition norms – this is likely to increase woven exports to the EU.⁶ Arrangements in the US are, however, less favorable, with countries eligible for the African Growth and Opportunity Act (AGOA) receiving more favorable treatment.⁷ Third, many manufacturers have become adept in mass production, which makes them quite competitive in the market segment of large, uniform orders. Finally, there is growing backward integration of inputs such as fabrics, yarn, accessories, etc., which helps in reducing delivery times and increasing flexibility available to the industry.

1.14 Future growth in garment exports will likely see consolidation of existing strengths, requiring an improvement in production efficiency and logistics. Strong growth in garment exports is expected to continue (see next section). Much of this growth is likely to come from increases in orders for the current core knitted and woven products, and from increases in their market share in the two primary markets, the EU and the US. This growth will be driven by an expansion of demand for lower cost garments in these markets, with large retail chains contracting additional production from Bangladesh and Vietnam rather than China. In terms of incremental growth, it is possible that regional markets such as Japan, China and India will play an increasing role, but the EU and the US are likely to continue to be dominant and growing markets for Bangladesh in the foreseeable future. This increase in Bangladesh's market share will require improvements in both production efficiency and logistics. Efforts to achieve the former will initially require improvements in management of production lines but must eventually address the need for greater capital investment per worker. Improvements in logistics will allow manufacturers to offer shorter delivery times and higher levels of order fulfillment. They will also allow manufacturers and freight forwarders to capture more of the value addition

processing of garments, e.g. sorting, labeling, pricing, ironing, and putting on hangers, before placing them on retail shelves.

1.15 Complementing the above growth in basics, Bangladesh is likely to see an expanding demand for medium-value garments, but improving logistics will be critical for this segment. Many of the new buyers over the last few years have come from this segment of the market, e.g. Marks and Spencer and Marshall Fields. These buyers also face downward pressure on prices and have taken advantage of the growing number of Bangladeshi firms able to deliver higher quality products at lower prices. As this production capability is established, this segment of the market is expected to account for an increasing proportion of the value of exports, though not the volume. The primary destination for such medium-value garments will continue to be Europe, but with a growing share of woven goods. There is also potential to supply Japan and South Korea with medium-value garments but this will require developing a relationship with East Asian buyers and designers. Improvements in logistics will be critical for success in this segment of the market because of the smaller order sizes, more frequent style changes and shorter order cycles. It will also be important for capturing the restocking and rapid replenishment components of this market. This requires a variety of supply chains to meet different market requirements.

1.16 Finally, Bangladesh has also begun to move further up the fashion pyramid (Figure 1.2) attracting a growing number of retailers of fashion basics such as H&M, Zara and Mango. These retailers specialize in anticipating trends and increasing product value through frequent design changes (see Box 1.1). They require a new approach to manufacturing which emphasizes flexibility and shorter lead times. Their principal market is Europe in part because of the prominence of European designers and

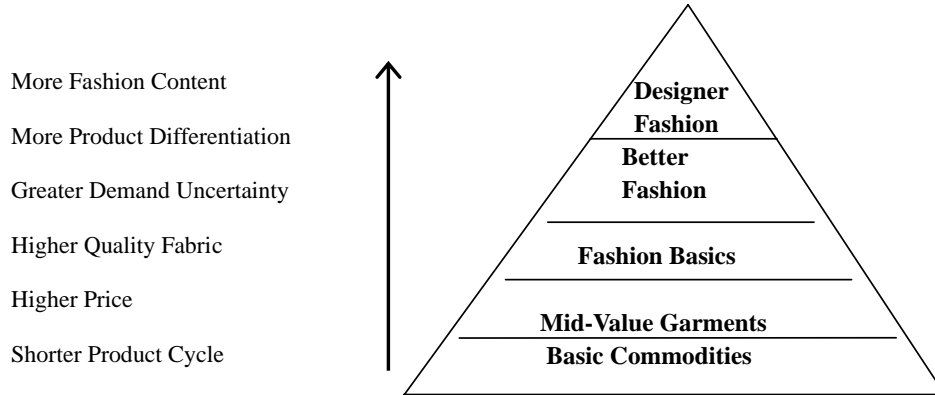
⁶ Earlier, the GSP favored knitwear, which was more likely to meet the required local content. Domestic value addition in knitwear is about 75 percent because of the backward linkage to spinning factories. Local factories supply about 90 percent of the total fabric required. In the immediate past, only about 16 percent of the woven exports to EU qualified for the GSP facility because imported fabric typically accounts for 60 percent of the output price. So far, the EU is the major importer of Bangladesh knitwear accounting for about 75 percent of the total value versus about 16 percent for the US.

⁷ Average tariff rate for the US is 13 percent on woven clothing and 14 percent-18 percent on knitwear.

buyers in this market segment but there is a growing presence in the US market as well. To compete in this market, Bangladesh will have to substantially upgrade its logistics capabilities, providing flexible supply chains and the capacity to handle distribution down to the distribution center and even the store level. Initially this

means that the buyers' nominated forwarders would upgrade their supply chains but would gradually involve local forwarders working together with international forwarders. All these issues relating to the logistics chain are discussed in detail in Chapter 2.

Figure 1.2: Fashion Pyramid



Box 1.1: Industria de Diseno Textil (Zara)

Zara, along with H&M, Benetton and Gap are pioneers in the “fast fashion” business model based on spotting trends rather than creating them. It also requires short development cycles, rapid prototyping and small order sizes and thus a highly responsive supply chain. Originally relying on its manufacturing base in Spain, Zara has gradually expanded its overseas production.

Zara currently orders about 80 million units from Bangladeshi manufacturers. The garments are primarily basic knitwear, which minimizes the order cycle time. At present it does not contract for twill or denim but this may change as local production improves. Zara is more demanding in terms of logistics than other fashion retailers. It relies heavily on airfreight to move goods from its suppliers to its global distribution centers in Spain. In the case of Bangladesh, about half the orders are shipped by air.

Zara multi-sources each style, with initial deliveries being received from factories that have fabric available and can deliver most rapidly. Slower suppliers are blended in as demand for the style increases. Orders are placed in terms of weekly output rather than total orders with production continuing as long as there is sufficient demand. Since styles change frequently—about 12-16 collections per year—suppliers have to be adept at setting up new production.

International Evidence on Prospects for Continued Growth in Garments

1.17 The world market for garments is growing. Overall world exports of garment grew

from \$198 billion in 2000, to \$317 billion in 2009 (see Table 1.5). This represents an increase in real terms, adjusted by the US CPI, to \$254.4 billion in 2009 (at 2000 prices).

1.18 Bangladesh’s market share in garments has grown from 2.6 percent in 2000 to 4.3 percent in 2009. Its share in the EU-15 market grew from 3 percent to 4.7 percent, and in the US

market from 3.4 to 5 percent over 2000-09 (Table 1.5; see also evidence on Revealed Comparative Advantage in Annex 1, which demonstrates a similar rise in competitiveness).

Table 1.5: Market Share of Top Garment Exporters in World, US and EU-15 Markets (percent)

Exporter	2000			2005			2009		
	World	US	EU-15	World	US	EU-15	World	US	EU-15
Total RMG Export, in \$US (2000) billions	198	-	-	277			317		
China	.2	13.3	9.6	26.8	26.4	17.7	31.7	39.1	24
Turkey	3.3	..	6.9	4.3	..	7.6	3.5	..	6.3
Bangladesh	2.6	3.4	3.0	2.5	3.2	3.5	4.3	5.0	4.7
India	3.0	3.2	2.8	3.1	4.2	3.3	3.6	4.3	3.9
Vietnam	..	..	1.0	1.7	3.6	0.7	3.0	7.4	1.1
Indonesia	2.4	3.5	2.0	1.8	4.0	1.2	1.8	5.8	1.1
Mexico	4.4	13.1	..	2.6	8.0	..	1.3	5.0	..
Thailand	1.9	..	1.1	1.5	2.9	0.9	0.9	2.4	0.8
Pakistan	..	..	1.0	1.3	1.8	0.9	0.9	2.0	1
Tunisia	..	..	3.9	1.1	..	3.2	1.0	..	2.7
Cambodia	..	..	..	..	2.3	..	1.1	2.7	..
Sri Lanka	..	2.4	..	..	2.2	..	..	1.8	0.7

Source: UN Comtrade, Eurostat, ITC and WTO

1.19 Even if world garment exports are not growing at the same pace as overall world trade and face a more difficult trading environment, Bangladesh’s garment exports can continue to grow by increasing their market share. Globally, exports of garments are not growing as fast as overall exports. The annual average growth rates of garments and overall world exports were 6.7 and 10.3 percent respectively over 2000-09. Garment-exporting countries also face significantly less favorable market access than countries that rely on other products (WTI, 2008). China is the clear front-runner in the global race for garments exports during the last decade with an increase of its market share from 18.2 percent in 2000 to 31.7 in 2009. Over the same period, Bangladesh became

the second largest garment exporter with an increase in market share from 2.6 to 4.3 percent.

1.20 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.⁸ Exports of the world garment industry grew at an annual average rate of 14.2 percent since 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

⁸ Growth of exports has been analyzed in terms of ‘intensive margins’, i.e., continued growth in existing products, versus ‘extensive margins’, i.e., growth via diversification into new products. Brenton and Newfarmer (2007) found that about 80 percent of export growth of developing countries during 1995-2004 can be explained by intensive margins. Amity and Freund (2008) conclude the same by analyzing growth of Chinese exports during 1992-2007. Helpman, Melitz, and Rubenstein (2008) also found a similar result in their study. Nonetheless, this literature does not seem to be conclusive—for example, Hummels and Klenow (2005), and Kang (2004) found that extensive margins played a more significant role in the growth of exports, the former in a multi-country study, and the latter studying Chinese, Taiwanese and South Korean exports.

to “China plus.” Chinese investors themselves are seeking to source from Bangladesh, given rising wages in China.⁹ Growing diversification away from garments of large countries like India and China also gives Bangladesh an opportunity to not only increase world market share in garments, but also, as shown in Table 1.6, to find markets in these countries. And despite recent increases, wages in Bangladesh remain very competitive.

1.21 In terms of geography, Bangladesh is well located between the world’s fastest growing and potentially largest economies, which are now changing from competitors to markets for Bangladeshi exports. The US and EU will continue as the main destination markets for Bangladeshi exports in the foreseeable future. However, the share of these two markets in Bangladesh’s total exports has declined whereas the share of India and China has increased between FY05 and FY10 (Table 1.6). Bangladeshi exports have risen at an annual rate of 28 percent in the Indian and Chinese markets compared to 14 percent in the US and EU markets over the same period. 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.

1.22 The study posits that 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 rise in Chinese wages and the currency in recent years have made Bangladesh a more favorable investment destination. The other often-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 study focuses on internal constraints to growth, positing that these are the much more serious issues affecting Bangladesh’s garments and overall exports. 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.

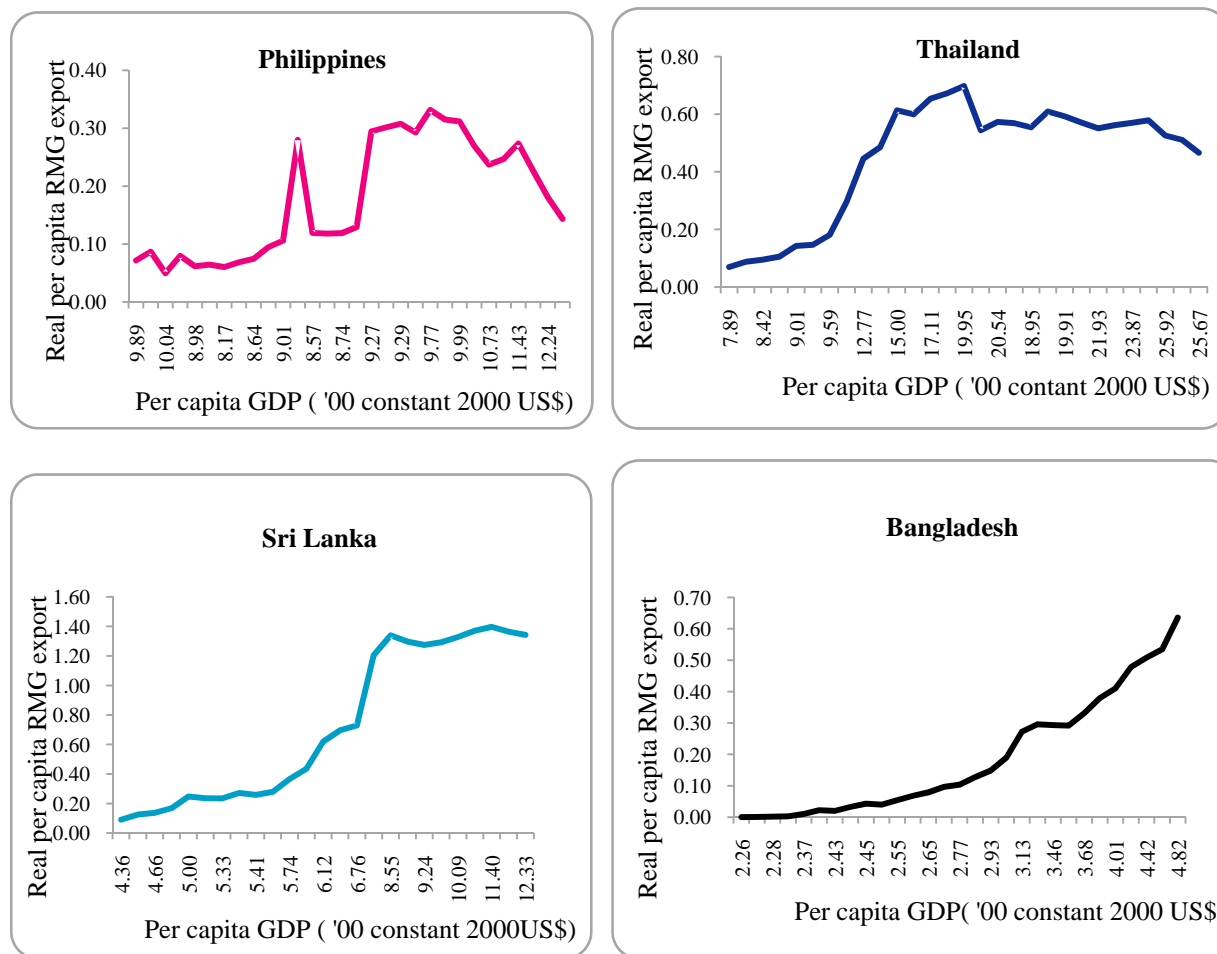
Table 1.6: Country wise Exports of Bangladesh (US\$ million)

	USA		EU*		India		China		Japan		Rest of Asia**	
	Total Export	percent of Total	Total Export	percent of Total	Total Export	percent of Total	Total Export	percent of Total	Total Export	percent of Total	Total Export	percent of Total
FY05	2412.1	27.9	3909.7	45.2	144.19	1.7	57.8	0.7	122.4	1.4	176.0	2.0
FY10	3950.5	24.4	6753.1	41.7	304.6	1.9	178.6	1.1	330.6	2.0	235.2	1.5
FY11	5107.5	22.3	9681.9	42.2	512.5	2.2	319.7	1.4	434.1	1.9	297.4	1.4

Includes Germany, UK, Italy, France, Netherlands and Belgium only; ** Includes Iran, Singapore and Pakistan only, Source: Export Promotion Bureau

⁹ Wages of the internal migrant workers who fuel China’s export industry rose by 40 percent in 2010 and by about 20 to 30 percent in 2011. Apparel companies and retailers are already feeling the pinch from higher wages in China. Britain’s second-biggest retailer is facing an 8 percent increase in prices due to increase in wages in China. Trading group Li & Fung of Hong Kong SAR, China a top apparel supplier to Wal-Mart, predicts a 15 percent increase in price of Chinese garments export this year. Gerry Weber International, Germany’s No. 2 maker of woman’s clothing, is moving production from China. Chico’s too is seeking to diversify its production base away from China. (Source: http://www.businessweek.com/magazine/content/11_11/b4219009844239_page_2.htm)

Figure 1.3: Per Capita Income and Per Capita Garment Exports of Selected Countries (in constant 2000 US\$)



Note: Last two years’ garments exports of Bangladesh are estimated from national data.

Source: WB staff calculations from UN Comtrade, ITC, and WDI

1.23 Evidence from other countries also indicates that Bangladesh’s current level of per capita income should allow continued dynamism in garments exports for the foreseeable future. Figure 1.3 shows that real per capita exports of garments in Thailand grew till it reached a per capita GDP of about US\$2000 (in constant 2000 US\$). The same ‘threshold’ was reached in the Philippines at about \$1000, and in Sri Lanka at about \$1150. On the other hand, India, despite its diversification into many other products (garments formed 6.4 percent of total exports in 2009, versus 13 percent in 2000), continues to see a growth in per capita garment exports. India appears to be below the apparent income threshold indicated by, say, the

Philippines. By this reasoning, Bangladesh’s garments sector should be able to continue to grow and capture world market share. Figure 1.3 indicates the steep trajectory of Bangladesh’s success in 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).

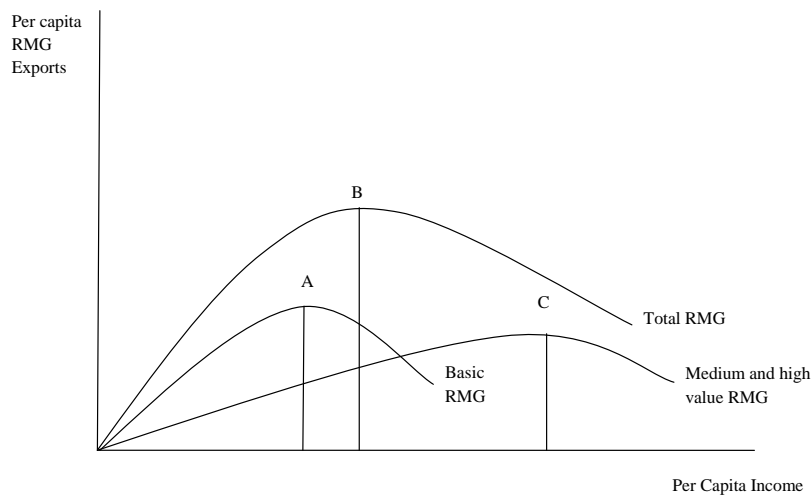
1.24 Over time, a garment producing country is likely to see a slowly increasing share of higher-value garments in its overall export mix. This will arise largely from an increasing level of wages and benefits, which are a major

factor in determining competitiveness in garments. For example, the export mix in Sri Lanka, whose real (in constant 2000 US\$) per capita GDP was US\$1,233 in 2009, largely consists of mid-range garments and above. Recent experience in India suggests that it, too, is moving increasingly into higher-range garments. Thus, before reaching the apparent threshold where per capita garment exports start to decline, a country's export basket has a relatively diversified mix of basic and higher value garments. Figure 1.4 explains this concept in graphical terms: growth in per capita garment exports is increasingly sustained by moving away from basic garments; as a corollary, the decline in per capita basic garment exports (point A) must occur before the overall decline in per capita

garment exports (point B).¹⁰

1.25 Policy makers may wish to anticipate this shift in the composition of garment exports. While overall garment exports should continue to grow, the threshold in basic garments exports will be reached well before the overall turning point. By providing a policy environment that does not discourage individual company initiatives for moving to higher value garments (which should also be more profitable), Bangladesh will ensure that it will be better prepared for the threshold 'A' and 'B'. Moreover, this will also allow point B to be further removed from point A, giving Bangladesh more time to develop other drivers of exports¹¹.

Figure 1.4: Graphical Representation of Per Capita Income Threshold for Export Of Garments



1.26 Further into the future, Bangladesh will also reach the overall threshold (point B). Well before reaching this point, Bangladesh should be encouraging diversification of its export basket.

As its per capita income grows and it reaches closer to point B, other countries with lower wage and per capita income levels will become increasingly competitive in basic and, later, in

¹⁰ In the case of Bangladesh, energy costs are also highly subsidized, which is an additional factor in the competitiveness of the garments industry. On the other hand, the shortage of gas means that most if not all firms have a significant backup of more expensive, own-generated electricity. Thus, possible re-pricing of energy costs (if accompanied by more reliable and adequate grid supply) to reflect actual costs could have a mixed impact on the garments sector.

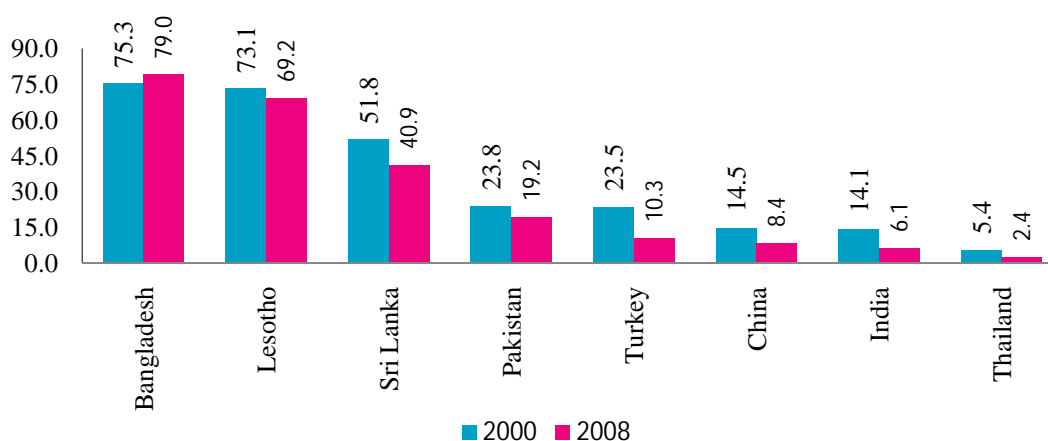
¹¹ Of course, the threshold for Bangladesh can vary depending on the world economic environment, but international experience tells us that the threshold is some time away.

higher value garments. To enable continued overall export growth, Bangladesh would need to see more contributions to exports from other sectors.

1.27 From a risk standpoint as well, diversification is a good strategy. The concentration in a single product category appears to be unique to Bangladesh amongst many peer countries. Figure 1.5 shows that not only is the concentration high, but between 2000 and 2008,

garments as a share of overall exports in Bangladesh have increased from 75 to 79 percent. In other countries such as Pakistan, Sri Lanka and Lesotho, where per capita incomes have grown slower than Bangladesh's over 2000-08, the reliance on garments has declined substantially. In high growth countries like China and India, the relative decline in reliance on garments has been even faster. For Bangladesh, a lower degree of reliance on garments would make it less vulnerable to industry-specific shocks.

Figure 1.5: Share of Garments Exports in Total Merchandise Export (percent)



Source: UN Comtrade

1.28 Diversification into export of non-factor services will help Bangladesh to exploit the emerging export potential in the global market.

Globally, services trade has grown faster than merchandise trade in recent years. Service exports from developing countries almost tripled in the last ten years, growing by 11 percent annually from about US\$240 billion in 1997 to US\$692 billion in 2007. There are several reasons why the export of services will continue growing. First, services account for more than 70 percent of global GDP. Second, the cost difference across countries in the production of services is enormous (Ghani, 2010). The option to narrow such cost differentials through migration is limited as migration has become heavily regulated. However, the scope for exploiting the cost differentials by making use of internet has increased. Third, unlike merchandise exports, it is harder to regulate the export of non-factor

services, especially in the post-GATS liberalized environment.

1.29 Bangladesh has so far failed to make a mark in the export non-factor services. Export of services is driven by three forces- technology, transportability, and tradability- the 3Ts (Ghani, 2010). *Technology*, especially information and communication technology, increases the digital *transportability* of services, making them more *tradable*. Information and communication technology in Bangladesh is still very underdeveloped which affects the export of services, even though services account for over 50 percent of GDP in Bangladesh.

1.30 One possibility for diversification is the ITES-BPO sector. Information technology-based exports, albeit small, are the only significant non-factor service exports from Bangladesh. There are

only about 400 registered IT/ITES firms in Bangladesh (BASIS, 2006). Out of them only 100 are engaged in exports, with exports of about US\$35 million in FY10. There are several reasons why the sector has export potential in Bangladesh. First, Bangladesh's large pool of young and trainable people and its competitive wages are an important strength. Many countries like the Philippines, Kenya, Nigeria, Sri Lanka, and Egypt that have a demographic structure similar to Bangladesh have established themselves as attractive outsourcing destinations. Second, Bangladesh has the potential to attract large volumes of Indian (and other) FDI, given the accelerated wage increases seen in the ITES sector in India.¹² Third, the global market for ITES is big and growing faster than world trade, creating opportunities for new entrants. Even a small share of this market means large volumes of exports from Bangladesh. Fourth, the existence of about 5000 ITES freelancers working for American and European customers points to the potential of the ITES sector which can be enhanced through proper policy and infrastructural support. Finally, development of information technology is a high priority of the government.

1.31 Focus of this Study. Based on the above reasoning, the broader focus of this study is to analyze the constraints to continued rapid growth in overall exports. In answering this question, the garment sector, which comprises about four-fifths of total exports, is used as a lens to capture some of the critical concerns of the merchandize export sector. In addition, the ITES-BPO sector is used as a "case study" to examine possible constraints to non-factor service exports. The traditional service exports, migration of workers, are currently being analyzed in a separate World Bank study on labor-embedded growth. Thus, this study seeks to focus on issues relating to i) continuation of fast growth in the basic garment sector; ii) providing an environment for encouraging export of mid and higher-value garments; iii) possibilities

for diversification into ITES-BPO; and iv) drawing some more general lessons for overall export growth.

Prior Analyses on Constraints to Garments and Overall Exports

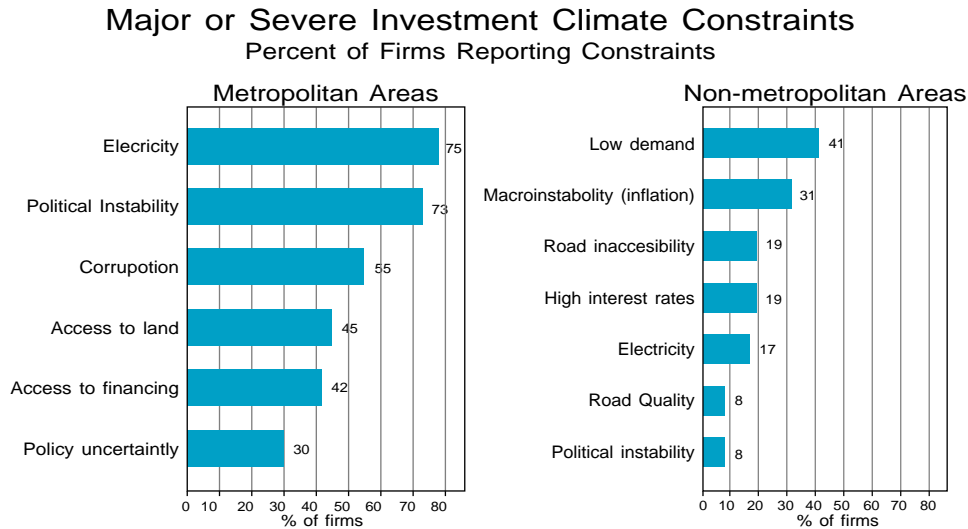
1.32 In the last Investment Climate Assessment (ICA), top concerns of firms were infrastructure, political instability, and access to finance and land. The ICA differentiated between metropolitan and non-metropolitan locations. Figure 1.6 shows the major or severe investment climate constraints.¹³ Responses were more homogeneous for metropolitan firms than for others, with 78 percent reporting major or severe constraints arising from lack of uninterrupted power supply, and 73 percent reporting political instability. For non-metropolitan enterprise, the top constraint, felt by 41 percent of firms, related to low demand; 31 percent pointed to inflation as their key concern.

1.33 For the garment sector, more specific constraints were identified in different studies. Although inexpensive labor is the main engine of growth of the garment sector, Mahumd (2009) examined whether low labor costs of Bangladesh could compensate for its relative disadvantages in marketing skills and infrastructure (including transport, ports, product standards, and certification facilities). A number of other studies, e.g. World Bank (2007a) and Ara and Rahman (2010) also identified poor trade logistics and skill shortages as the main constraints to the growth of the garment sector in Bangladesh. ADB (2007) analyzed the inefficiency of the Dhaka-Chittagong corridor and its impact on country's export including garments. Staritz (2011), World Bank (2005), and Rahman, Bhattacharya and Moazzem (2008) highlighted the importance of compliance with labor standards. Abdin (2008) brings up these and several other concerns such as banking sector issues, and falling competitiveness.

¹² India is the leader with a market share of 37 percent in global outsourcing.

¹³ The 2008 Bangladesh Investment Climate Assessment is based on 2007 survey data for 1,504 firms in metropolitan areas and 2,520 non-farm enterprises in 25 peri-urban areas.

Figure 1.6: Major Constraints to Investment as Reported by Respondents



Source: World Bank (2008)

1.34 **This study focuses on logistics, skills and labor compliance.**¹⁴ Overall investment climate issues are well-analyzed, as seen above, and the solutions are also known. While these issues are important, this report cannot add much value in analyzing and making recommendations relating to say, electricity, access to land, access to finance, political uncertainty and instability, low demand for goods and services, etc. On the other hand, prior conversations with manufacturing firms revealed that logistics and skill constraints were critical for continued growth in garments including the possible shifts to mid-and-higher value garments. Although some studies identified them as main constraints, as seen above, they are less analyzed from a policy perspective and also

deserve more attention in light of the gradually-changing nature of the industry. In the case of logistics, much of the backbone of logistics i.e., infrastructure, is also a critical public good/service. For skills, there is a market failure in the provision of more skilled workers and management, and this could call for a role for government. Finally, in the case of compliance issues, more recent stock-taking is warranted, after the flurry of studies induced by the Harkin Bill of 1993. Here, too, the possible tarnishing of the overall country image by a minority of non-compliant firms means that there is a role for government in trying to ensure that this does not happen.

¹⁴ We did not distinguish between EPZ and non-EPZ environment in our analysis. Exports are mostly driven by non-EPZ firms (more than 80%) in Bangladesh which are more exposed to logistics, skill and compliance constraints. Therefore, our overall policy suggestions remain valid despite some differences between the EPZ and non-EPZ environment. However, while an in-depth comparative analysis of the performance of EPZ and non-EPZ firms will be valuable, it is beyond the scope of this study.

Annex A.1: Revealed Comparative Advantage Indices of 5 top RMG Export Categories of Bangladesh to EU

	China	India	Indonesia	Mexico	Turkey	Vietnam
Year	HS Code 6109: T-shirts, Singlets					
1990	1.44	0.94	1.36	2.78	0.54	1.52
2000	1.65	1.05	1.44	2.43	0.49	1.65
2008	1.59	0.97	1.49	2.45	0.70	1.46
	HS Code 6110: Jersey, Pullovers					
1990	0.95	0.92	0.54	3.28	0.18	0.95
2000	1.21	1.04	0.75	2.94	0.46	1.30
2008	1.09	1.42	1.12	2.90	0.97	1.13
	HS Code 6203: Man/Boys' Suits, Jackets, Blazer					
1990	0.67	1.00	0.94	2.00	0.23	0.58
2000	1.21	1.28	1.09	1.87	0.48	0.88
2008	1.06	1.17	1.04	1.97	0.71	0.77
	HS Code 6204: Woman/Girls' Suits, Jacket, Blazer					
1990	0.12	-0.40	0.25	1.55	-0.41	0.31
2000	0.64	0.38	0.65	2.14	0.12	0.78
2008	0.63	0.48	0.88	1.92	0.33	0.52
	HS Code 6205: Man/Boys' Shirts					
1990	1.74	0.92	1.63	2.98	1.20	0.91
2000	1.75	0.89	1.14	3.26	1.26	0.82
2008	1.19	0.66	0.85	3.29	0.84	0.69

Note: A positive value indicates competitive advantage of Bangladesh for the respective product category

Source: WB staff calculations from UN Comtrade.

Chapter 2: The Role of Logistics in Acceleration of Exports

I. Introduction

2.1 Efficient logistics are critical for competing in a globalized world. Efficient logistics are required for ensuring that exports do not suffer from cost increases or time delays vis-à-vis competing countries; ensuring efficient imports that are needed for exports; and providing competitive imports for consumption and domestic production. High logistic costs can be seen as an implicit export tax that biases the economy away from exports. Logistics are becoming increasingly important for competitive advantage in the wake of increasing globalization, more production-sharing across countries, and shortening product life-cycles, driven by technology. In case of Bangladesh, logistics will play an increasingly important role as the country seeks to diversify into higher-value garment exports as well as other products, such as those with higher import content. Even in a more immediate sense, logistics will need to improve to allow Bangladesh to maintain its competitive edge in current garment exports, not least because many other competing countries are constantly improving their logistics. Beyond garments, merchandize trade in general will benefit from a reduction in the 'export tax,' and thus help longer-term diversification of exports.

2.2 Key messages. Low labor costs will continue to provide Bangladesh a competitive edge in the production of basic garments. Complementing this, the country is also likely to see an expanding demand for medium value garments and fashion basics items.¹⁵ However, taking advantage of these opportunities will require Bangladesh to improve logistics to better integrate its supply chains and ensure adequate infrastructure. Strengthening multimodal¹⁶ connections between Chittagong port and the hinterland, improving customs procedures, enhancing air shipment capacity, and improving rail services by adding new physical capacity and introducing commercial

management would be crucial elements of better logistics for the garment sector of the country.

2.3 Overall trade logistics in Bangladesh is poor. The domestic logistic chain -involving the collection of the products from producers, road haulage to the consolidation center or warehouse, containerization, haulage to the port, and customs at port- is still very underdeveloped. Bangladesh ranks 87 in the Logistic Performance Index (LPI), while its South Asian comparators like India and Pakistan rank 39 and 68 respectively. The performance of Chittagong port remains poor. Increase in the capacity of road and rail infrastructure between Dhaka and Chittagong has been delayed. Air cargo has become an important mode for ensuring reliability of deliveries in the fashion basics market. However, the regulation of airfreight services impedes competition among airfreight companies and causes inefficiencies in the air cargo terminal. During the last five years or so, clearance times have changed little in the airport and land border crossings, and these times continue to be measured in days rather than hours as is typical for most countries.

2.4 It is apparent that logistics will play a key role in Bangladesh's efforts to maintain strong growth in basic garment exports and move up the value chain. Because of the dominance of garments in Bangladesh's exports, overall export growth will also require improvement in logistics, for the foreseeable future. Diversification will also be encouraged by the reduction in the export tax implicit in inefficient logistics. The rest of the chapter will provide a diagnosis as well as recommendations to improve the quality of the trade logistics of the country. Section II focuses on transport; section III focuses on trade transactions. Section IV analyzes the supply chain performance and finally section V provides summary and policy recommendations.

¹⁵ Low, medium, and high value garments are defined on the basis of freight-on-board prices.

¹⁶ Use of different modes of transport – air, road, water, and air.

II. The Transport Network

II.1 Ports

2.5 Chittagong is the country's only seaport capable of dealing with exports and imports.

Bangladesh's major port, Chittagong, is located on the right bank of the river Karnafuli, nine nautical miles from the Bay of Bengal. Vessels calling at the port are limited by the approach channel to a maximum length of 186 meters (153 at night) and by the depth in the port to a draft of 9.2 meters. The maximum capacity for container vessels is 1,200 twenty-foot equivalent units (TEU).¹⁷ There are four locations equipped with the essential equipment to handle containers: (i) Chittagong Container Terminal (CCT), (ii) General Cargo Berths (GCB), (iii) New Mooring Container Terminal (NCT), and (iv) more recently, North Container Yard (NCY). Chittagong port handled nearly 45 million tons of cargo in 2010-11 versus 27 million tons in 2006-07.

2.6 CCT has a 450 meter quay with alongside depth of 9.2 meters. It is equipped with 4 Ship-to-Shore Gantry (SSG) cranes to serve container vessels and has a 150,000 sq. m container storage yard with static capacity of about 8400 TEU. It also has a rail track to serve unit trains carrying containers to the Dhaka ICD. The terminal serves the larger feeder vessels. It currently handles about 40 percent of the containers but this proportion has been increasing. The SSGs are able to handle about 23 moves per net crane hour¹⁸ and the estimated annual terminal capacity is 750 thousand TEU. CCT is operated by a private company under a three-year operating lease.

2.7 GCB has 13 general cargo berths built in the mid-1950s and in varying states of disrepair. Each berth has a maximum length of 193 meters and alongside depth of 8.6 meters. Although meant for

smaller feeder vessels, these berths handled about 45 percent of the containers in FY08. Berth productivity depends on the quality of vessels' equipment, but a typical performance with two cranes is 20-25 moves per vessel hour. Cargo handling services at these berth were provided, until recently, by 12 private stevedoring firms. It has a container storage capacity of 240,271 sq. m. There is a plan to convert three berths to a proper container terminal equipped with SSGs. This would increase its annual capacity to about 750 thousand TEU.

2.8 NCT has a berth length of 1000 meters and alongside depth of 8.8-9.2 meters. It has a container storage capacity of 220,000 sq. m. It lacks SSGs and currently serves only self-sustaining container vessels. Although not officially commissioned, it is operated by the same company that operates CCT and handles about 15 percent of the container traffic. The terminal is not expected to be fully operational until 2012. When fully developed the terminal will be equipped with 10 SSGs and have a capacity in excess of 1.25 million TEU.

2.9 Government has more recently completed the construction of NCY, which has a container storage facility of 62532 square meters.

2.10 **The container traffic at the port has grown rapidly** since the beginning of trade liberalization in the early 1990s at an average rate of 12.9 percent per annum. The primary direction of traffic flow is inbound with 90 percent of the containers loaded, primarily with consumer goods and equipment. Their average weight is 13.3 tons per loaded TEU, and has been rising over the last two decades.¹⁹ In contrast only 62 percent of the outbound containers are loaded. They carry

¹⁷ Vessels up to 1300 TEU can be berthed where these are light loaded because the containers have low density fabric and garments.

¹⁸ Net hour is exclusive of delays. This contrasts with gross hour which includes delays.

¹⁹ The CPA reports weights including the tare weight of the containers. This has been removed for the current discussion

mostly garments and thus have a lower weight over the last two decades. averaging 8.8 tons, with the average declining

Table 2.1: Container Statistics FY08

Import	
Full Container Load (FCL)	90 percent
Less than full Container Load (LCL)	5 percent
Empty	6 percent
Tons per Loaded TEU	13.3
Export	
FCL	62 percent
LCL	0 percent
Empty	38 percent
Tons per Loaded TEU	8.8

Source: Chittagong Port Authority (CPA) Statistics

2.11 Significant improvement was achieved in Chittagong port through administrative reforms but did not sustain. After decades of resisting efforts to introduce private container handling, as had been done in the other major ports in the region, the decision was finally made to grant an operating lease to CCT. At the same time, the inefficient and strike-prone public Dock Labor Board was replaced by private stevedoring companies which function as berth operators. This privatization increased the efficiency of the port. For example, the average turnaround time for vessels decreased from 6.38 days in FY07 to 5.07 days in FY08. The operating lease to private management ended in May 2009. The Chittagong Port Authority (CPA) took back the port handling responsibility as the lease to private management could not be renewed due to some legal complications. The progress made under private management immediately relapsed; the average turnaround time for vessels started climbing back and reached to 6.9 in FY11 (CPA statistics).

2.12 Allowing the operation of private off dock container yards (ODCY) is a welcome step but more policy changes are required to make them more effective. Because of the unsuitability of the Dhaka-Chittagong corridor

for efficient operation of trucks fully loaded with 40 feet long containers, most import containers are unstuffed in the port with the contents transported to their destination as loose cargo in 5-10 ton trucks. This is one of the reasons for growing congestion in the port. In order to solve this problem, the government allowed private off-dock container yards (referred to variously as CFS and ICDs) to be established. Today there are 14 ODCYs located near the port of Chittagong with storage areas up to 18 hectares. They are operated by local companies including manufacturers, traders and 3PLs²⁰. They are used by buyers to consolidate garments shipments delivered from the factory as loose cargo in cartons. However the cartons cannot be opened so it is not possible to do inspection or any modification of the garments. The ODCYs cannot clear import containers containing inputs for manufacture of RMG thereby preventing competition and improvement in the services currently provided by CPA.

2.13 Benapole, the largest land port of the country, needs additional physical capacity. The current traffic in this crossing is 300-500 loaded trucks entering Bangladesh each day and 100-120 loaded trucks exiting. The movement of these trucks is constrained by a prohibition

²⁰ A third-party logistics provider (abbreviated 3PL, or sometimes TPL) is a firm that provides a one stop shop service to its customers of outsourced (or "third party") logistics services for part, or all of their supply chain management functions.

against trucks from one country delivering the goods to a destination in the other country. For imports, Indian trucks cross the border and are cleared at the land port. For exports, Bangladesh trucks cross the border into a No-man's land where the goods are transferred to an Indian truck using a back-to-back operation. This is a cumbersome procedure since the area is very small, about 0.2 hectares only (Figure 2.). When the trucks enter the land port, they are registered and assigned a location for unloading. Perishables

Figure 2.1: No-man's land



2.14 The port lacks loading docks or any design features appropriate for a truck terminal. Furthermore, the port has little cargo handling equipment or systems for managing the cargo stored in the port. The current users of the port identified a number of actions to improve the efficiency of the port. They include: (i) construction of more sheds and a cold storage for the perishables, (ii) procurement of new cranes and forklifts, (iii) expediting completion of the bypass road to reduce the traffic jam, and (iv) construction of a new link road to be used exclusively by the passenger vehicles and passengers entering into and exiting from Bangladesh.

are sent to a separate yard for back-to-back transfer in an unprotected area (Figure 2.). Trucks carrying vehicles are sent to a different yard specifically reserved for this cargo. The remaining cargoes are unloaded at one of 38 small (800 m²) warehouses operated by the land port. The goods are stored in the land port for several days until cleared by the importer or his nominated agents. The minimum time in port for cargoes other than perishables is 1-3 days once documents are available.

Figure 2.2: Perishable Transfer



II.2 Rail and Road Services²¹

2.15 The Bangladesh Railways (BR) network has 2835 route km and 3900 track km²² but is divided between a meter gauge network in East Bangladesh and a broad gauge²³ network in Western Bangladesh, with a dual gauge connection linking the two via the Bangabandhu Bridge over the river Jamuna.

2.16 The amount of overall freight carried on the railway has been declining, limited by lack of capacity and poor quality of service. The amount of freight has been declining not only in terms of percentage share in total container

²¹ Some of the sections that follow are treated in greater depth in the forthcoming Diagnostic Trade Integration Study (DTIS).

²² Route km refers to total distance covered and track km refers to total length of rail tracks which will be always bigger than the former as many sections of the rail network have more than one track.

²³ Metre gauge and Broad gauge refer to railway of 3 ft 3 3/8 inches and 5 ft 6 inches widespread respectively.

movements but also in terms of actual volume. This is due to three interrelated factors: (i) limited supply of aging rolling stock; (ii) congestion on critical links; and (iii) priority given to passenger train services. Currently there are about 34 freight train movements scheduled each day traveling an average distance of only 220 km all over the country. The transit time is longer than for trucks. The delays waiting for locomotives and wagons and the overall deterioration in the quality of service are major concerns. Although the daily schedule has been increased to four train movements in each direction between Dhaka and Chittagong, the actual number is limited by the shortages of locomotives to about two trains in each direction. The trains that do move are generally full, i.e. 60-80 TEU.

2.17 Nonetheless, the transport of containers by rail between Chittagong port and the Kamalapur Inland Container Depot (ICD) in Dhaka has been increasing. The Kamalapur ICD occupies a 13.5 hectare site within Dhaka. Traffic has tripled in volume over the last decade and a half but has fluctuated in recent years due to the increase in delays as a result of lack of locomotives. The principal source of demand for that service is low value imports delivered to the ICD for clearance. Despite the long delays in waiting for wagons, importers are willing to use rail because it is cheaper and the cargo does not have to be cleared until it reaches Dhaka. The flow of containers from the ICD to the port has experienced a similar rate of growth but less than half of them are loaded because exporters have less tolerance for delays in shipments. Access to the container terminal is also controlled during the day to reduce the congestion in Dhaka. The ICD is also badly congested and difficult to access especially for the manufacturers located outside Dhaka city. Efficiency in the operation of the

Kamalapur ICD is questionable. The crane purchased 10 years ago cannot move because it is too close to the fence wall.

2.18 Additional capacity and policy shifts are crucial to enable BR to play a catalytic role in the growth of garment exports. With the growing movement of garment manufacturers out of Dhaka, BR has to play a larger role in carrying freight to Chittagong port. If the operating capacity is increased and a new ICD opened outside Dhaka, then rail's share could increase to 20 percent. This implies at least 5 train movements in each direction with demand increasing to 14 within ten years.²⁴ This will not be possible without a substantial increase in locomotives and rolling stock and providing priority for container trains as well as adopting a commercial approach towards freight transport.

2.19 Upgrading Dhaka-Chittagong corridor is critical for improving logistics. The 233 km Dhaka-Chittagong is the main road network connecting Chittagong port with the hinterland. It is mostly two-lane (84 percent), with some four-lane segments (16 percent), and heavily congested in the vicinity of numerous towns along the route. Congestion is growing with the increase in the country's overall trade. The average transit time was 6-7 hours in 2005-06 implying an average travel speed of only 35-40 kmph. Despite the growing congestion, the road handles about 83 percent of the cargo moving between Dhaka and Chittagong. ADB (2007) recommended a set of comprehensive policy options, based on scenario analyses, to improve the efficiency of this important network.²⁵ Those recommendations are still relevant but yet to be fully implemented. This report did not therefore undertake a fresh analysis of logistics issues relating to the Dhaka-Chittagong corridor.

²⁴ Assuming 12.8 percent growth in container traffic and an average load factor of 95 percent.

²⁵ ADB's recommendations include: i. Completing four-laning of the Dhaka-Chittagong highway (currently under implementation), ii. Planning and implementing six lane connections in the vicinity of Dhaka and Chittagong cities, iii. Planning and implementing a Dhaka bypass (ring road), iv. Planning for the development of an expressway in the Dhaka-Chittagong corridor, and v. Raising the axle load limitations on all bridges to handle a full 40-foot container and installing weigh stations in the corridor to control overloading, especially at the exit from the port.

II.3 Airfreight and air cargo terminal

2.20 Use of airfreight by garment exporters is growing, but is capacity constrained. The principal gateway for airfreight is Dhaka's Shahjalal International Airport. Airfreight is shipped on a combination of scheduled and chartered air freighters as well as in the belly of passenger aircraft. Currently there are 9 scheduled freight services (Table 2.2). The majority of them fly to hubs in the Middle East where cargo is transferred to flights to Europe and the US. Passenger planes accounted for

about 30 percent of airfreight shipments in 2010. In the past, airfreight was used by the garments industry when requested by the buyer or when production delays resulted in a missed shipment date. The buyer's request generally involves higher value garments and has been very significant recently. The use of airfreight for missed shipments is also increasing owing to energy shortages. Lack of physical capacity has already become a major problem. For example, the air cargo terminal has a nominal capacity to handle about 300 tons per day but demand has risen above 500 tons during peak periods.

Table 2.2: Scheduled Airfreight Services

Operator	Weekly Frequency	Aircraft	Capacity (in ton)
Cathay Pacific	2	B747-400	110
Etihad	2	AB340	60
Qatar	2	A300-600	40
Singapore	1	B747	120
Saudi	2	B747	100

Source: DB Schenker

2.21 In addition to inadequate physical capacity, an appropriate policy for airfreight service is also missing. Despite the importance of air courier services for the garments industry, in particular for shipping samples, Bangladesh, unlike its competitors, does not have a policy to encourage this service. Specifically, customs does not have *de minimus* (minimum weight below which there is no duty charged) to allow small packages to clear the airport quickly. The clearing process for packages and airfreight is the same, so that clearance times are 1-2 days for samples and 3-5 days for fabric instead of a few hours for both as in most of the countries in the region.

2.22 The air cargo terminal is poorly constructed and managed. The air cargo terminal is a large, old structure where cargo is scanned, inspected by customs, palletized and loaded on the aircraft. The current layout of the terminal is extremely cumbersome with the cargo flow parallel to the apron parking (ramp) area rather than direct from truck loading bays to the doors leading to the apron. Despite being highly

congested, the number of loading bays where trucks are allowed is limited as are the doors used to access the aircraft. These restrictions were introduced because of security concerns, but there is little control over the people working within the terminal. Instead the working area is congested, poorly lit and generally disorderly. Cargo is supposed to be delivered to the terminal no earlier than 30 hours before the flight time for a charter and 8 hours for scheduled freighters; however, during a site visit, the terminal was observed to be completely congested with cargo spilling out into the truck parking area.

2.23 The monopoly of Civil Aviation is a major constraint. Bangladesh Biman provides the ground handling services through a separate subsidiary that also operates the air cargo terminal. It rents space within the airport to UPS and other courier services. The three scanners owned and operated by Civil Aviation are only about 7 years old but appear to be designed for standard ocean pallets. Since they are not large enough for airfreight pallets, all shipments must be broken

down prior to scanning. Civil Aviation denied the request of Biman to introduce its own scanners. Civil Aviation has tentatively agreed to provide new storage facilities for the cargo, but would still require the use of Biman for ground handling and Civil Aviation for scanning. Bangladesh is yet to adopt an open skies policy that allows airlines to operate freely in the country without licensing restrictions. In the past, open skies policy was adopted for a limited period, enabling airlines to operate additional flights for transporting Bangladeshi workers. The Association of Travel Agents of Bangladesh (ATAB) and the main exporters are pressing for an open skies policy, which is expected to reduce costs and provide more airfreight capacity for the garments sector.

II.4 Inland Water Transport

2.24 Private and public collaborations to build and run inland water terminals are expected to promote multimodal movement of containers.

An inland water terminal near Pagla (Pangaon) to service containers on barges is under construction. It is being built by Bangladesh Inland Water Transport Authority (BIWTA) and financed by the Chittagong Port Authority. This is proposed to be operated by private operators. A private ICD is proposed at Khanpur, Narayanganj. These barge services would bring import containers from Chittagong to the terminal where they would be cleared and transferred to trucks for delivery to their destination. The reverse would apply for export containers. The barges would be self-propelled bay-crossing barges and are expected to carry 100-120 TEU stacked three high. The barges would travel at night requiring about 18 hours from Chittagong but less traveling

downstream. While this multimodal movement would not offer a significant reduction in cost or time relative to movement of loose cargo by truck, it would provide greater reliability and allow containers to be shipped directly to and from the factory.

III. Trade Transactions

III.1 Customs Procedures

2.25 The customs clearing process, albeit changed over the last several years, is still cumbersome. Customs continues to depend on Pre-shipment Inspection (PSI) performed by 4 firms, Bureau Veritas, Intertek Testing, SGS, and OMIC operating in different countries of origin. They confirm the description, quantity, classification and valuation of the goods being exported to Bangladesh and issue a Clear Report of Findings (CRF). While the PSI program continues to make a valuable contribution in terms of improving revenue collection and ensuring accurate reporting on the declarations²⁶, it delays the clearance time by 1-2 days on average by requiring a pre-arrival processing which is not compatible with the ASYCUDA system²⁷. The interaction with customs requires a licensed custom broker. The major improvement has been to allow customs brokers to electronically file the vessel manifest from their office. The ASYCUDA selectivity module is used to determine the level of risk and inspection.²⁸ However, in most cases the ASYCUDA model is disregarded and it is the customs officer that determines the actual inspection rate by reviewing the cargo declaration, the CRF, and other supporting documents and certificates.

²⁶ “Review of pre-shipment inspection in Bangladesh”, Manzur Ahmed:

http://www.thefinancialexpress-bd.com/search_index.php?news_id=17515&page=detail_news

²⁷ The ASYCUDA software is developed in Geneva by UNCTAD. The system handles manifests and customs declarations, accounting procedures, transit and suspense procedures. It takes into account the international codes and standards developed by ISO (International Organisation for Standardisation), WCO (World Customs Organization) and the United Nations.

²⁸ Green-clear without further checks; Yellow-clear subject to the submission of additional supporting documents; Red-physical inspection.

2.26 Garment inputs are given preferential treatment. Customs accommodates the garment sector by: (i) clearing textiles and other inputs to the garment industry within two days where possible, which contrasts with three to seven days for other imports; (ii) allowing manufacturers, buyers and forwarders to establish bonded warehouses;²⁹ (iii) allowing suppliers and logistics service providers to establish a Common Bonded warehouse which can be used to store inputs for garment manufacture, including fabrics, accessories, dyes and chemicals, and yarn, and for manufacturers to purchase these imports duty-free to meet export orders (although so far not a single common bonded warehouse has been established); and (iv) permitting transit movements from the port to EPZs and bonded warehouses. By taking advantage of the above systems, a garment manufacturer can import raw materials duty-free up to 75 percent of the value of the total export. These imports are cleared using the same documents as for other imports plus a utilization declaration (UD)³⁰ issued by the Bangladesh Garments Manufacturing and Export Association (BGMEA). At the time of export of finished products, the manufacturer presents the documents for clearance of export together with the UD.³¹

2.27 Despite these efforts, customs procedures for imported inputs for garments leave much to be desired. For example, an AEO system (authorized economic operator) that would allow expedited clearance has not been introduced yet. The clearance procedures at the airport are similar to the seaports and continue to require paper documentation so that the time to clear

fabrics is 2-3 days rather than 4-6 hours. There is *no de minimus* for samples brought in by courier flights, thus delaying these shipments unnecessarily.

III.2 Terms of Shipment and Payment

2.28 Terms of shipment and payment do not appear to have posed a problem for the garments industry so far. Imports of yarn and fabric are typically shipped by ocean on cost and freight (C&F)³² terms. Free on board (FOB)³³ was used in the past, but as the garments industry has expanded, suppliers have become more comfortable with C&F arrangements. For shipments by land from India, the most common shipment terms are ex-works (EXW).³⁴ C&F terms were rarely used in the past but they are becoming more common with the development of the land port at Benapole. Deliveries to the garment factory under the terms Delivery Duty Paid (DDP) or Unpaid (DDU) are occasionally used for air shipment. Bangladesh Bank discourages DDP since the importer pays the supplier in foreign currency. This is done by requiring permission beforehand as well as various information and documentation.

2.29 Almost all garment exports are shipped by ocean on FOB terms primarily to retail chains. Less than 5 percent move on C&F terms and most of these are destined for traders and small importers. Most exports are transferred to the ODCY rather than the port. The nominated forwarder arranges the movement from the warehouse to the vessel where the goods are loaded on to the vessel.

²⁹ Since the early 1980s, Bangladesh has allowed garments the facilities of bonded warehouses and back-to-back letters of credit to reduce the financial burden of its exporters.

³⁰ UD is used to make sure that the duty free imports of inputs are used only to produce garments for export and not for sale in domestic market.

³¹ Thomas, Ian (2003), Special Bonded Warehousing in Bangladesh. Paper included in Customs Modernization Handbook, Luc De Wulf, World Bank.

³² An arrangement requiring the sellers (exporters) to deliver the goods to their final destination at their own cost and risk.

³³ An arrangement requiring the sellers (exporters) to deliver the goods to the port of departure at their own costs and risks, and the buyers (importers) have to bear all costs and risks from that point.

³⁴ An arrangement requiring the seller (exporters) to deliver goods at his or her own place of business, all other transportation costs and risks are assumed by the buyer.

2.30 L/C is the most common mode of payment and so far has served the RMG sector well. Most of the trade for both imports and exports are done using L/Cs. Cash in Advance is sometimes used for imports of special fabric, but Bangladesh Bank requires the suppliers' bank to provide a guarantee that the product has been shipped as well as other documentation. Some imports are shipped on the basis of Cash against Documents (CAD)³⁵ where the parties have a long-term relationship. The use of sight drafts³⁶ is rare, presumably because of difficulties with clearing foreign drafts in local banks. The Bangladesh Bank (BB) encourages the use of L/Cs as an additional check on the value of the goods to prevent under-declaration on high tariff items and as an additional control on foreign exchange transactions. On the other hand, commercial banks are increasingly willing to offer L/Cs for imported inputs secured by a contract for supply of exports.

2.31 In the future, Bangladesh Bank and the banking sector may need to become more flexible to ensure that the financial system does not constrain garment manufacturers' competitiveness. So far, the focus of BB has been on the control side of the equation rather than on facilitation. As the industry evolves, more flexible supply routes and different options for credit provision will be required. For example, factoring of contracts and bills of lading would be required, and foreign currency credit might become more important.

IV. Supply Chain Improvement

2.32 A typical supply chain for the garment industry is relatively simple (Table 2.3), but not integrated.

Table 2.3: Current Supply Chain Performance

Agree on production design	Buyer-manufacturer	3-13 weeks
Arrange financing	Manufacturer-commercial	3-4 days
Order inputs	Supplier-manufacturer	
	- Domestic	7-10 days
	- Imports	14-35 days
Clear and deliver inputs to bonded warehouse	Customs broker-forwarder	2-3 days
Produce garments	Manufacturer	3-6 weeks
Clear cargo, deliver garments to buyer's	Customs broker-domestic	3-4 days
Deliver garments to port and load on vessel	Nominated buyer	3 days
Transport to foreign port	Shipping line	26-35 days
Clear cargo, deliver to buyer's distribution	Nominated forwarder	3-10 days

Source: WB staff calculations through consultation with garment exporters.

2.33 The supply chain has significant room for improvement. Significant reductions in terms of time and cost were achieved during the period 2007-2008, but much remains to be done. Specifically, the lead time can be reduced by about three weeks (Table 2.4) by:

- Simplifying arrangements for financing
- Maintaining inventory of basic imported materials and accessories and advance ordering from local suppliers and
- Tightening the outbound supply chain through better management and simplified regulation.

³⁵ The exporter's bank sends the export documents to the importer's bank with an instruction to release the documents to the importer only against full payment of the invoice amount.

³⁶ Sight drafts are financial instruments that are payable on demand, in contrast to the time draft, which cannot be honored until a specified date in the future.

2.34 **Columns 2 and 3 in table 2.4 show the existing and improved supply chain for an order size of US\$500k.** It shows that lead time can be reduced to 113 days from the existing level of 134 days through some efficient management

of the supply chain. Air transport (along with local procurement of inputs) can further reduce the overall order cycle to 50 days and the time from start of production to delivery to 26 days (column 4).

Table 2.4: Possible Improvements in Schedule for Production and Delivery of Garments (days, cumulative)

Existing		Improved	High
Most Inputs	imported		Local
Order Size	500k		200k
Principal Transport Mode	water		Air
Initial Contact With Buyers	0	0	0
Receive Buyer's Order	30	23	16
Begin Production	60	44	24
Initial Shipment Loaded On Vessel	79	60	32
Delivery Of Initial Shipment	113	92	49
Delivery Of Final Shipment	134	113	50

Source: WB staff calculations through consultation with garment exporters.

2.35 **Improved supply chains will reduce the lead time but may not affect overall costs to any significant extent.** Table 2.5 shows that for basic garments shipped by water, the logistic costs are estimated to represent only 10 percent of the total cost. This includes the costs for transport and clearance of imported fabric, yarns and accessories as well as the outbound movement from the factory to the buyer's overseas distribution center.³⁷ For high value cargo shipped by air, the logistics costs represent about 40 percent of the total cost as shown in Table 2.6. There is very little scope to save on cost through improved management of the supply chain. The benefits from a savings in delivery time are more substantial. A reduction in delivery times allows buyers to adjust them to meet anticipated market conditions. This will

allow manufacturers to compete for rapid replenishment of medium value garments as well as delivery of fashion basics.

V. Summary and policy recommendations

2.36 **The garment industry has demonstrated strengths that are likely to persist and grow.** There are at least two reasons to be upbeat about growth prospects for garment exports of Bangladesh. It shows continuing strong performance in some categories of basic garments, both woven and knitwear products. The growing market in medium value and basic fashion garments is also expected to create opportunities for both large manufacturers and niche producers of the country. Growing backward integration and a desire to source

³⁷ These estimates are built up from the current average value of exported garments (for a 40 foot equivalent unit load i.e. FEU) of \$7.5 per kilogram, 60 percent of the FOB value of garments accounted for by inputs, the C&F value of imports equal to 35 percent of the FOB value of garment exports, 1/3 of garment exports using imported fabric.

more inputs from neighboring countries will also help reduce lead time and improve the chances of Bangladesh exploiting the medium value and fashion basic markets. Overall, the trends suggest a gradually increasing diversity in the types and value of products that will be exported and an opportunity to expand into new markets that

require smaller order sizes and higher quality products. The low levels of productivity in the industry and the incipient moves to modern factory and supply chain management in the industry suggest that there are considerable opportunities for improvement and growth.

Table 2.5: Estimates of Logistics Costs for Basic Garments

	Per FEU of Garments	
	tons	000\$
Expense		
Domestic fabric, yarn, accessories	11.0	\$30.7
Imported fabric, yarn, accessories	13.8	\$42.0
Ocean transport including port	13.8	\$1.6
PSI and clearance	13.8	\$0.7
Delivery to factory	13.8	\$1.0
Production labor and utilities	16	\$16.0
Transport to Buyers warehouse	16	\$1.1
Outbound transport incl. port	16	\$4.0
Delivery to distribution center	16	\$0.8
Finance costs		\$2.5
Total Cost		\$100.3
Revenues		
Garments revenues	16	\$120.0
Principal logistics costs		10.42
		10.4 percent

Source: WB staff calculations through consultation with garment exporters.

Table 2.6: Estimates of Logistics Costs for Fashion Basic

	Per FEU of Garments	
	tons	000\$
Fabric and accessories	16.8	\$84.0
Production	16	\$20.0
Air Shipments	16	\$65.0
Total Cost		\$169.0
Garments revenues	16	\$200.0
Principal logistics costs		38.5 percent

Source: WB staff calculations through consultation with garment exporters

2.37 However, taking advantage of opportunities would require Bangladesh to improve logistics to better integrate its supply chains, improve work force skills and ensure adequate infrastructure. Countries that compete with Bangladesh have seen rapid improvement in their logistics and supply chain management capabilities. Bangladesh needs to keep up with

these developments. In addition, it needs to improve the skills of its workforce to ensure that efforts for faster growth and to move up the fashion pyramid are not hampered. And it needs to ensure that crucial factors such as energy and land availability do not come in the way of production and investment.

2.38 A focus on multimodal connectivity between Tongi and Chittagong and improvements in customs procedures would be crucial elements of better logistics for the garments industry. The former would help the growing manufacturing cluster around Tongi. The latter would require a step-up in the relatively slow pace of customs reforms seen so far.

2.39 Strengthening multimodal connectivity. In the short term, it is important to improve the capacity and quality of container handling services in Chittagong. The most important initiative is concessioning and equipping of the New Mooring container terminal to further improve port performance. At the same time it is necessary to diversify the corridor logistics by developing and equipping public and private inland water terminals (IWTs) and permitting private container barge operations between Chittagong and these terminals. This will allow containers to move directly between the port and factories (such as those in the cluster around Tongi) which will reduce the congestion in the port. Both initiatives are on going, and quick and transparent completion of these would help reduce delivery timings and enhance reliability of services.

2.40 Customs reforms. There are a variety of improvements in customs procedures that have been recommended but not implemented. Current procedures have not been a major impediment to the garment trade so far, because of the wide spread availability of bonded warehouses. However, many of these procedures prevent integration of supply chains and discourage distributed processing and the incentive for provision of value-added logistic services to Bangladesh. Given the relative slow pace of customs reform, it is important to select the critical reforms to pursue. Five such reforms areas are:

1. Eliminate duty on containers and restrictions on inland movement of containers to allow cheaper and more rapid and reliable delivery of inputs and exports.
2. Modernize regulations for courier services including providing *de minimus* and allowing courier companies to operate

separate facilities within the airport. Despite the presence of foreign buyers in Bangladesh, it is important to provide a rapid exchange of samples and other documents prior to the start of production.

3. Liberalize the role of ODCYs to allow a greater variety of logistics services to be provided by the buyers and third party logistic providers including quality testing and pick and pack for garments, inventory management and distribution of inputs.
4. Reduce the rate of inspection for cargo with a CRF. This is important because inputs in transit to the bonded warehouses are subject to the same level of examination as imports.
5. Restructure Benapole crossing to allow cross-docking (unloading of materials from an incoming carrier directly onto outbound carriers, with little or no storage in between) and electronic processing of declarations at the border. This is an important component of the effort to increase regional sourcing and reduce order cycles by shortening delivery times for inputs from India.

2.41 Strengthen the capacity of Benapole land port. In addition, the construction of more sheds, a cold storage for perishables, and enhancing the ability to handle more cargo through procurement of new cranes and forklifts are essential to ensure better service in this main land port of the country.

2.42 Improvement of rail and road services. The current problem with rail services is a combination of lack of commercial management, poor condition of rolling stock, and a congested ICD. With considerable unmet demand for container traffic by rail and a new ICD in prospect, the service could be concessioned. It is important to develop additional capacity on the Dhaka-Chittagong road corridor by widening all sections of the main road between Narayanganj and Chittagong to four lanes so that articulated trucks with 40 foot containers can move inland freely, and by completing double tracking of the rail line connecting Tongi and Chittagong to provide a significant increase in rail freight capacity.

2.43 Enhancement of air shipment capacity. Increasing use of air shipment is part of the move towards medium value garments and fashion basics. Air freight is constrained by inadequate physical capacity and an inappropriate policy regime. An open skies policy may help to

increase competition and capacity in air cargo. Fabric imported by air also needs to be cleared in a few hours instead of 3-5 days. And the layout, facilities and management of the air cargo terminal could be improved considerably.

Chapter 3: Addressing the Skills Constraint to Garments and Overall Export Growth

3.1 Shortage of skilled workers is one of the oft-cited constraints to industrialization and export growth in Bangladesh. This chapter analyses the skill shortage in Bangladesh, especially in the garment sector, based on available information. Owing to lack of reliable and up-to-date data, the chapter is careful in drawing its conclusions. This gap in data also highlights the urgent need for an in-depth survey-based assessment of Bangladesh's skill gaps.

3.2 Key messages. Despite the reported shortages of skilled labor, there are few incentives for the private sector to impart training. This is because workers change jobs frequently after being trained and therefore it is not in the firms' interest to spend resources on training them. In addition, since the garment workers come from poor households, they are unable to pay for training themselves. Publicly-funded Technical and Vocational Education and Training (TVET) is the main vehicle for imparting training. But TVET needs to enhance its relevance to the needs of garments as well as other sectors. Trainee and employer targeted financing and increased industry-academia coordination at all levels could help improve overall availability of skills in Bangladesh.

Skills gap may be growing over time

3.3 Hard evidence on the skill mix and gap is difficult to come by. There is a 1995 survey of garment workers in Bangladesh, but no hard evidence exists thereafter. The two industry associations do not appear to have systematic data on the skill mix and skills gap either. Thus, this section relies on indirect evidence from multiple sources to make the case that the industry is dominated by basic and low-value exports, has a very large share of unskilled and semi-skilled workers, and that there is a growing shortage of skilled workers and management.

3.4 The skill structure of the industry was bottom-heavy in 1995, consistent with the focus

on basic garments. According to a survey of about 80,000 workers in 242 garment firms in 1995, about 48 percent of the workers were either unskilled or semi-skilled, 44 percent were skilled and only 8 percent were highly skilled. Also, while 34 percent of female workers were unskilled, only 9 percent of male workers were unskilled. Table 3.1 shows 67 percent of the sewing and finishing helpers were unskilled, while 27 percent were semi-skilled. Most workers working as cutting helpers, iron and folding men were semi-skilled while machine operators were skilled. And 49 percent of the cutting masters/cutters, supervisors and quality controllers were skilled while 47 percent were highly skilled.

3.5 No subsequent comparable survey exists, but indirect evidence suggests that the share of unskilled and semi-skilled workers would still be very large. For example, the industry is still dominated by basic and low-value garments. The top five (at 6 digit level of export classification) garment exports of Bangladesh—men's and boys' cotton shirts, knit as well as non-knit; knit t-shirts; pullovers of wool; and men's and boys' cotton trousers, non-knit--appear to be basic categories of exports. Also, average volume growth of woven and knitwear exports between FY05-09 was 26.2 percent and 13.6 percent, respectively. However, the average value growth of exports of these products during the same period was 25 percent and 11.4 percent respectively, implying that their unit price declined by 1.2 percent and 2.2 percent. According to a survey of 84 small, medium, and large enterprises in 2010 (including spinning, weaving and garments units), Bangladesh produces mostly low priced items (UNIDO 2010). As can be seen from Table 3.2, more than two-thirds of the surveyed garment firms receive orders for low, and low to medium priced items; only about 8 percent receive orders for high priced items. Only large firms produce some high priced items, and no firm produces very high priced items. To the extent that quality is reflected in price, it must be that the focus of the industry

has continued to be in the basic segment of the garments market. In turn, this would indicate that

unskilled and semi-skilled workers dominate the sector.³⁸

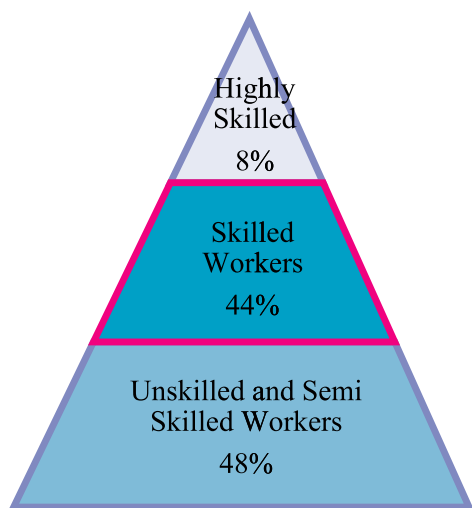


Table 3.1: Distribution of Workers in Various Job by Skill Levels

	Job I	Job II	III	Job IV
Unskilled	67	11	3	1
Semi- skilled	27	41	19	3
Skilled	6	46	76	49
Highly skilled	0	2	2	47

Job I: Sewing and finishing helpers

Job II: Cutting helper, iron and folding man

Job III: Machine Operators

Job IV: Cutting master, supervisor, and quality controller

Source: Zohir and Majumder (2008), based on 1995 survey data

Table 3.2: Percentage Distribution of Surveyed Enterprise by Prices of Items

Prices (FOB) of products (per dozen)	Average	Small	Medium	Large
Woven Garments				
Very high (higher than US \$360)	0	0	0	0
High (between US \$ 24 to 360)	8	0	0	25
Medium (between US \$120 to 240)	17	0	25	25
Low to medium (between US \$42 to 120)	25	25	25	25
Low (less than US\$42)	50	75	50	25
Knit Garments				
Very high (higher than US \$360)	0	0	0	0
High (between US \$ 24 to 360)	8	0	0	25
Medium (between US \$120 to 240)	8	0	0	25
Low to medium (between US \$42 to 120)	17	0	25	25
Low (less than US\$42)	67	100	75	25

Source: UNIDO (2010)

3.6 There is a significant gap between demand and supply of skilled RMG workers. The BGMEA estimates that the garment sector is currently facing a skilled worker shortfall of 25 percent, but this seems to be an intuitive number. Nonetheless, even if not calculated scientifically on the basis of a survey, for example, the figure of a 25 percent shortfall indicates that there must

be a fairly large gap between demand and supply of skilled workers. One of the structural reasons for the shortage of workers arises from the high dropout rate of garment workers, especially from the permanent exit of female workers from the workforce, often at the time of their marriage. The data on minimum wages also provides possible pointers to a growing skills gap-in 2006,

³⁸ Of course, skills are not the only determinant of product quality; as Chapter 2 indicated, a strong logistics infrastructure is essential for moving up the value chain in garments. However, the low-end skills implication of a focus on basic garments is also corroborated by other evidence.

the average wages of the top two grades were 2.55 times the average of the bottom two grades (apart from apprentice); in 2010, this ratio was 2.65. Also, grade 2, just below the highest skills/grade level, received the highest increase of 87.5 percent in minimum wages over the period.

3.7 Other evidence also points to an overall shortages of workers. Average real minimum wages in the garments sector increased by 44 percent over 2006-10, about 17 percent higher than the growth of real GDP over the same period. Prior to 2006, minimum wages were last increased in 1994. Over 1994-2006, real wages were increased by 4 percent but real GDP rose 76 percent. The large differential between growth of real wages and GDP (17 percent over 2006-10 versus -72 percent over 1994-06) would appear to indicate a significant reversal in employer perceptions of skill shortages as well as the employees' own perceptions of their value to firms.

3.8 Relatively high rejection rates in garment manufacture and price reduction arising from defects corroborate the hypothesis of low average skills of garment workers. About 21 percent of the garment firms in the UNIDO study experienced more than 5 percent rejection, while another 17 percent of firms experienced 11-17 percent rejections of final products, mostly due to sizing, sewing, stitching, and finishing (ironing and packing) defects. At the same time, quality claims of the buyers led to about 64 percent of the woven garments and 75 percent of knit garments compromising their agreed price to the extent of 5 to 15 percent, at least once a year (UNIDO, 2010). This affects small and medium enterprises, in particular. A high share of rejects corroborates the earlier evidence on low average skill levels of workers.

3.9 Growing numbers of foreign workers in Bangladesh point to a shortage of supervisory and management skills. According to BEPZA,

the number of foreign workers in EPZs has grown at an annual rate of about 8 percent between FY05-11, reaching to 1575 in March 2011. Since garments account for about 90 percent of total exports from of EPZs, it can be assumed that it employs a growing number of overseas workers, and also accounts for the largest share of overseas workers. According to local businesses, the garments sector as a whole employs about 20000 foreign workers.³⁹ Anecdotal evidence also confirms that there is indeed a growing number of supervisory and management workers from abroad, including from Sri Lanka, India, Pakistan, South Korea, China, etc. According to the statistics of the Board of Investment (BoI), Bangladesh Export Processing Zone Authority (BEPZA) and Ministry of Home Affairs, 6,308 new work permits for foreigners have been issued in FY11, compared with 5,903 in FY10. Out of the total foreign workers, 30.5 percent are Indian, 12.2 percent Chinese, 11.3 percent Sri Lankan, 10.2 percent Pakistani, 6.0 percent South Korean, 6 percent Filipino and the rest from other countries. The Managing director of Khalifka, a leading knitwear group, indicated that he has employed two Sri Lankan experts and one Indian expert, since people with relevant expertise were not available locally. The President of BGMEA is also quoted as saying that “we are facing (an) acute shortage of experts, mainly (on the) production, technical and management sides, which forces us to employ foreign experts”⁴⁰.

What inhibits skill formation in Bangladesh?

3.10 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 (Table 3.3). Moreover, the average years of schooling is also very low compared to countries

³⁹ The Financial Express, August 20, 2011.

⁴⁰ The Financial Express, July 31, 2011.

that are currently competing with Bangladesh's garment sector. The lower time spent in school complicates the process of learning and skill acquisition.⁴¹

3.11 In contrast, Sri Lanka has provided a skills environment that allowed garment firms to quickly move up the value chain. Box 3.1 shows how Sri Lanka's education system provided its firms with a ready source of skilled and trainable labor, and allowed them to either start garment production at the mid-range or move quickly upscale to mid and even higher value

production (see Annex A.3 for other initiatives taken by Sri Lanka).

3.12 The skills gap and shortages should have incentivized the private sector to impart training, but there appears to be a market failure in the provision of adequate skills for the garment industry. There are various reasons why this may have happened, but a major part has to do with the large-scale job-hopping prevalent in the industry combined with private inability to pay for training.

Table 3.3: Literacy Rates and Average Years of Schooling in Some Selected Countries

Country	Literacy Rate	Average Years of Schooling
China	95.9	7.5
Philippines	93.4	8.7
Indonesia	92.0	5.7
Sri Lanka	90.8	8.2
Cambodia	76.3	..
Laos	68.7	..
India	74.04	4.4
Pakistan	58.2	4.9
Nepal	56.5	3.2
Bangladesh	53.5	4.8
Bhutan	52.8	..

Source: UNDP 2009 and 2010

3.13 The potential dissipation of benefits of training from an individual firm viewpoint leads to reluctance of manufacturers to impart in-firm training in Bangladesh. Because of the limited opportunity for upward mobility in the same factory, as well as low wages, job hopping is relatively high in the fast-growing garment sector. Leaving a job after being trained, without even informing the employer, does not cost the worker anything because of the weak enforcement of contracts. One local manufacturer reported that only 25 percent of the operators could be retained

after completion of on-the-job training. This means that manufacturers are very reluctant to impart formal in-firm training, since there is a high probability of losing a just-trained worker. Data for 2006 for the industrial sector as a whole shows that 24 percent of all firms provided either external (13 percent) or internal training (18 percent) to their workers (WB 2007b). A recent survey also finds that a majority of the firms lack in-house training facilities and even what they have is self-rated as poor due to lack of professional trainers and training equipment

⁴¹ A survey of an admittedly limited number of 87 workers from 41 garment factories conducted in 2007 shows that little over half of the workers had completed secondary education and only less than 10 percent had gone beyond grade ten. About one-third of the workers had only studied up to the primary level. The sample was drawn on the basis of proportional distribution of types of factories in the population. See http://www.usaid.gov/our_work/cross-cutting_programs/wid/pubs/Gender_Trade_Liberalization_Bangladesh_03-07.pdf."

(Table 3.4). It seems that in the majority of cases, the only meaningful learning opportunity

arises from learning-by-doing and learning-by-observation.

Table 3.4: Percentage Distribution of Firms by Status of in-Housing Training Facility

Availability of training facility	Woven Garments	Knit Garments
Yes and arrangement is good	8	0
Yes but arrangement is poor	25	17
No	58	75

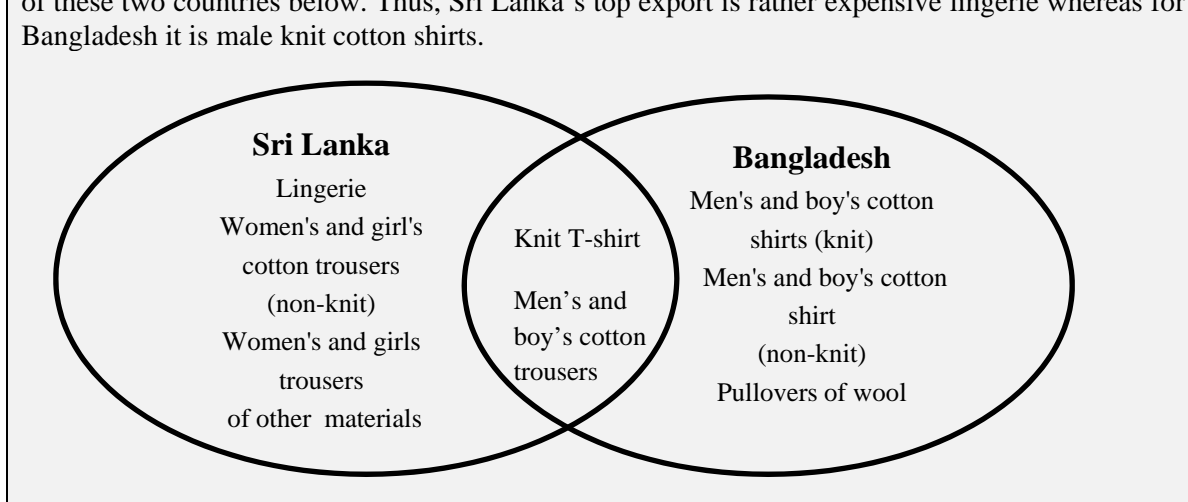
Source: UNIDO (2010)

3.14 Reluctance of firms to sponsor training combined with private inability to pay results in inadequate effective demand for external training. As mentioned above, only 13 percent of firms sponsor their employees for external training. In addition, available research suggests that most students cannot afford to pay for private training before starting employment. The majority of garment workers are young girls coming from a poor socioeconomic and rural

background. These potential trainees have a high rate of time preference, which, combined with their liquidity constraint, translates into a desire to start working as soon as possible. For both these reasons, the actual number of trainees for external training appears to be quite low as a share of the total pool of current and potential workers. This number may also be too low to create adequate incentives for the private sector to provide training.

Box 3.1: Education and Industry Trajectories: Bangladesh and Sri Lanka

Sri Lanka provides free access to education, all the way to tertiary education. This is reflected in its literacy rate of 91 percent in 2009. In Bangladesh, primary education is free, but access was an issue, and quality of education remains a major concern. All this is reflected in Bangladesh's literacy rate of 54 percent. It became clear from interviews with Sri Lankan and Bangladeshi garment firms that while the former could recruit from a pool of high school graduates, the latter's choice was restricted to only primary school graduates and high school dropouts. This difference in initial human capital had major implications for the agility and trainability of the workers in the two countries, which in turn resulted in the industries taking very different paths. Sri Lanka was able to take the high value-low volume path, while Bangladesh was largely competitive in the low value-high volume path. These different trajectories are illustrated in the top five garment exports of these two countries below. Thus, Sri Lanka's top export is rather expensive lingerie whereas for Bangladesh it is male knit cotton shirts.



3.15 Thus, the overall skills picture is one of low trainability of the average worker, reliance on learning on the job, and inadequate external training. While entering the work force does not necessarily require high skills, the inadequate education means that hired workers are not easily trainable compared to, say, workers in Sri Lanka. However, this is an issue for the larger education system and can, at best, only take care of future entrants into the labor force. The question for garment firms is whether adequate number of potential entry level workers in the existing labor force can be given some basic training before entering the factory. For those jobs such as supervisors and machine operators, where higher skills are needed on entry, there are insufficient training opportunities both inside the firms as well as externally.

Initiatives to address market failures

3.16 In absence of a market response to the skill gap, government, manufacturers' associations, NGOs, and private institutions supported by public financing are the main providers of training and skills. Technical and Vocational Education and Training (TVET) is the main stream of education to support training in Bangladesh. A number of public and private (including NGOs) institutions administer three types of skill development courses namely, *basic skills, certificates and diplomas*. The number of these institutions is also growing over time as can be seen from Table 3.5. The number of public institutions increased from 213 in 1998 to 304 in 2005. By taking the advantage of government's salary subvention of up to 90 percent of total salary bill, the number of total private training institutions increased from 520 to 1860 during the same period. A number of policy actions have been identified in the National Education Policy (2010a) to further strengthen and expand this stream of education⁴².

Table 3.5: Number of TVET Institutions in 1998 and 2005

Level of training	Number of institutions					
	Public		Private		Total	
	1998	2005	1998	2005	1998	2005
Basic	64	76	3	414	67	490
Certificate	113	174	510	1303	623	1477
Diploma	36	54	7	143	43	197
Total	213	304	520	1860	733	2164

Source: WB (2007)

3.17 Several NGOs provide basic skills training to target groups such as underprivileged children, with the notable one being the Underprivileged Children's Education Program (UCEP). UCEP has about 44 schools and centers across the country that provide vocational, technical and para-trade training. BGMEA Institute of Fashion Technology (BIFT), established by Bangladesh Garments Manufacturers' and Exporters' Association (BGMEA) in 1999, administers graduate level

courses in disciplines related to garments manufacturing, fashion technology and merchandizing. BIFT also provides 2-6 months long training to the economically disadvantaged population.

3.18 The TVET stream of education lacks the relevance to the needs of the garment as well as other sectors. Several ministries/organizations administer accredited TVET programs.⁴³ Only a

⁴² For details, see National Education Policy 2010a, pages 16-18.

⁴³ They include: i. Ministry of education; ii. Ministry of labor and manpower; iii. Ministry of local government; iv. Ministry of agriculture; v. Ministry of forestry, vi. Ministry of textiles, vii. Ministry of defence; viii. Bureau of Manpower, Employment and Training. However, the National Education Policy 2010 has recommended bringing all technical and vocational education institutes of the country under the control of the Technical Education Directorate to consolidate this education stream.

few courses administered by ministries of textiles and education, and the Bureau of Manpower, Employment and Training have some level of relevance for the garment sector. But the curricula in these courses pay insufficient attention to practical problems and as such have been a bit distant from the needs of the garment sector. Employers in general are not consulted in setting policy, curriculum design or vetting accreditation procedure. This was identified as the main reason for failure of the TVET system to evolve in line with market demand in an employer survey conducted by the World Bank (WB 2007b).⁴⁴ However, employers' participation in the management of training institutions is now increasing, albeit slowly.

3.19 Due to lack of employers' confidence in the TVET system, skill shortages and unemployment amongst TVET graduates coexist. A survey of 2302 TVET graduates found about 47 percent of them unemployed in 2005 (WB, 2007). About 50 percent of those who were employed took more than six months to find a job, 45 percent took more than a year after their graduation. Over 60 percent of the respondents identified the failure of the TVET system to align training materials with local needs and opportunities as the main reason for their difficulty in finding a job. Thus the business community is inadequately served by the TVET system.

Policy recommendations

3.20 Make training relevant to the needs of the garment sector. To make the current TVET stream of education garment sector friendly, employers have to be closely involved in the management of TVET institutions, both public

and private. India's Industrial Training Institutes, which are managed by Institute Management Committees (IMCs) comprising of local industry representatives, could be an example in this regard. UCEP, which has been singled out by the employers for the market relevance of its training programs, can be another example. In both cases, curricula are designed in consultation with the employers. The textile college, institutes, and the private universities which provide bachelor level technical courses should design their curricula in consultation with the BGMEA and BKMEA. However, to allow the employers to play an effective role in making the training more relevant, these institutions would need autonomy.

3.21 Introduce trainee targeted financing. As mentioned before, private inability to pay for training is one of the reasons for market failure. To address this problem, government can think of providing "training vouchers" to interested trainees to finance part of their training cost. Of course, it may create incentives for private training institutions to enroll fake students to redeem their vouchers and share a portion of the money with them, with the students leaving the program incomplete. Addressing this will put the onus on government's monitoring and auditing ability. One way to check the moral hazard problem will be to make the voucher redeemable only after the trainee has found a suitable job.

3.22 Introduce employer-targeted financing. Job hopping of skilled or trained workers is another reason for market failure and may require collective action. Over 30 countries have undertaken a levy scheme,⁴⁵ under which all employers pay a levy of a certain percentage of their wage bills and are eligible to claim a certain

⁴⁴ The survey involved group consultation and structured discussions with three employers' associations, BGMEA, Bangladesh Knitwear Manufacturer's and Exporter's Association (BKMEA) and Bangladesh Textile Manufacturer's and Exporter's Association (BTMEA), and seven employers from garments, textile, electronic and automobiles sectors were also consulted.

⁴⁵ It is similar to the 'comprehensive village development' program once practiced in Bangladesh under "Comilla Model". Under this program, every villager contributed to a common fund which was used to provide loans to finance an agreed action on the basis of some agreed rules and principles. The Comilla Model could not succeed as reimbursement from the common fund became inequitable, skewed in favor of the large farmers.

portion of allowable training cost from this fund. The benefits of the levy scheme in many countries have been inequitable; large employers have benefited more than the small employers. Therefore, it is highly likely that small employers will resist the introduction of the levy scheme. However, considering the importance of skill

development for continued growth of the sector, and the market failure in the supply of training, government could actively seek to make a collective type of scheme workable. This can be topped up with government funding, at least until the time that sufficient funds are collected within the industry for the scheme.

Annex A.3 : Government and industry collaboration to strengthen the apparel sector in Sri Lanka

The Joint Apparel Association Forum (JAAF), formed by the government and the industry association undertook a five-year strategy in 2002 focusing on key areas such as backward integration, human resource and technology advancement, trade, small and medium sized enterprises, finance, logistics and infrastructure, and marketing and image building. The main objectives of this strategy were (i) to transform the industry from a contract manufacturer to a provider of fully integrated services, offering input sourcing and at least an understanding in product development and design, (ii) to increase the share of high value added items in total apparel exports, (iii) to establish an international reputation as a superior manufacturer in four product areas: sportswear, casual wear, children's wear and intimate apparels, and (iv) consolidate and strengthen the industry.

Different initiatives at three levels to accomplish these objectives were taken. First, at the macro level, actions included reduction in the costs of utilities, labor reforms, development of electronic data interchange facilities at ports and customs, infrastructure development and building of strong lobbies in Sri Lanka's main markets. Second, at the industry level, the strategy focused on branding and promotion, R&D, market intelligence, greater market diversification, backward linkages, technological upgrading, building design and product development skills, and reduction of lead times. Third, at the firm level, the focus was on reduction of manufacturing costs, upgrading of technology and human resources, and strong strategic alliances.

JAAF initiated a four year degree course on Fashion Design and Development at the department of Textile & Clothing technology at the University of Moratuwa in collaboration with the London College of Fashion to strengthen the design capabilities of the industry in 2002. Similarly, to strengthen the marketing competencies of the industry, JAAF initiated a postgraduate diploma course on industry specific professional marketing in the same year in collaboration with the Chartered Institute of Marketing (CIM-UK). A Productivity Improvement Program (PIP) was also undertaken in 2004 in selected apparel firms to increase their productivity, reduce their cost, and improve their quality and ability for on-time delivery. JAAF also entered into an agreement with North Carolina State University (NSCU) College of Textile in 2004 to deliver a NSCU affiliated diploma to strengthen the technical capacity of the industry. As an international image building endeavor, JAAF also initiated the "Garments without Guilt" campaign (see box 4.1 in chapter 4).

These efforts enabled the large manufacturers like Brandix and MAS to establish their own design center with in-house designers. The designers work closely with the design teams of brand-owners, interpreting their design, making suggestions and sometimes even giving ideas. MAS has even established design studios in the United Kingdom, the United States and Hong Kong SAR, China to offer design solutions to its main customers, viz., Victoria's Secret, Gap and Speedo. Brandix does not have design centers abroad but has opened marketing offices in New York and London to improve its links with buyers. MAS and Brandix have also developed a range of own brands of intimate wear that caters to the middle income and upper income class and competes with international brands such as Triumph, Etam and La Senza.

Chapter 4: The Growing Importance of Labor Standards

4.1 For buyers worldwide, compliance with internationally-acceptable labor and environmental standards has become important in their sourcing decisions. So far, the problems of labor standards and poor working conditions appear to be more pronounced than the environmental problems in the garment sector of Bangladesh. This is partly due to heavy dependence of the sector on imported raw materials and very limited vertical integration. While not discounting environmental concerns, this chapter focuses on labor compliance in the garments sector.

4.2 Key messages. Consumers, especially in the US and EU, can create pressure on buying firms to avoid sourcing from non-compliant countries. This can affect the growth potential of the sector. As seen in 2005, notable compliance failures in one or more factories⁴⁶ can jeopardize prospects of the entire sector. The Government of Bangladesh has become proactive since 2006 in improving compliance with labor standards in the garment sector by adopting a “unified code of conduct.” However, strengthening the government’s capacity to monitor and enforce this code is important.

Labor standards – how are they defined in Bangladesh?

4.3 A “unified code of conduct” was developed to set the labor standards. Before 2006, there were no uniform set of labor standards in Bangladesh – buyers had different standards based on concerns of their domestic consumers. After 2006, under pressure from the governments of the importing countries, the Government of Bangladesh adopted a “unified code of conduct” pertaining to workers’ rights and safe working conditions. This code was developed by a Social Compliance Forum, consisting of representatives from different ministries, manufacturers, workers,

civil society, buyers, and development partners. The unified code of conduct related to: 1. payment according to minimum wage legislation; 2. issuance of appointment letter; 3. issuance of identity card; 4. timely payment of salary; 5. timely overtime payment; 6. practice of weekly holiday; 7. practice of annual leave; 8. practice of sick leave; 9. practice of festival leave; 10. practice of maternity leave; 11. formation of participation committee; 12. formation of welfare committee; 13. absence of child workers; 14. existence of emergency exit; 15. maintenance of service log books; 16. installation of fire fighting equipments; 17. availability of child room or day care facility; 18. availability of first aid facility; and 19. availability of separate toilet facilities for male and female workers.

4.4 In addition, the government updated and consolidated the old labor laws into one to make them more relevant. The new labor law, enacted in 2006, eliminated inconsistencies in earlier laws and set a clear regulatory framework for the employers.

Compliance with labor standards is becoming more important in the garments sector

4.5 First, the growing penetration of the garments sector of Bangladesh into the global market draws the attention of international social and political activists. Low costs are the main drivers of the fast growth of the garments sector in Bangladesh, which raises a concern among buyers as to whether this low cost is founded on unfair treatment of workers. Organizations like American Federation of Labor and Congress of Industrial Organizations, National Labor Committee, Clean Cloth Campaign, American Center for International Labor Solidarity, American Apparel and Footwear Association, Worker Rights Consortium and their

⁴⁶ The collapse of the Spectrum-Sweater Factory building in April, 2005, was preceded by a string of fire incidents at KTS Textile Industries, Phoenix Building, Imam Group, and Sayem Fashion in February and March of the same year.

country offices became vigilant to ensure that exploitation of workers does not occur to provide an “unfair” competitive edge to Bangladesh in the global market.

4.6 Failure to ensure workers’ rights and a safe working environment has increased the international spotlight on the garment sector of Bangladesh. For example, the collapse of one firm, Spectrum-Sweater Factory, in April 2005, tarnished the overall image of the country. The incident led to the questioning of the integrity of buyers who claimed to have policies and procedures in place to monitor labor practices at their supply facilities in Bangladesh. The country was facing a looming threat of boycott of Bangladeshi garments by concerned consumers. According to the Export Promotion Bureau, overall exports of textiles and clothing were down

1.4 percent, with woven garments declining by 4.7 percent during the first six months of 2005. Realizing the severity of the crisis, government formed the Social Compliance Forum (SCF) in July 2005.

4.7 Second, with the phasing out of the MFA, buyers have more flexibility to move out from a noncompliant country. Until 2004, access to USA and EU garment markets was regulated through use of quotas. Under that environment, many international buyers had to come to Bangladesh after exhausting the quotas allocated to other countries. But in the current environment, Bangladesh will lose buyers if the level of compliance is not acceptable. The emergence of a number of new exporters in the post-MFA environment has provided greater choice to buyers. Thus the importance of compliance has increased.

Box 4.1: Garments Without Guilt: Sri Lanka’s Business Strategy

Following the phasing out of the Multi Fiber Arrangement (MFA), Sri Lanka’s Joint Apparel Association Forum (JAAF) adopted the “Garments without Guilt” initiative as a business strategy to face new global competition. This initiative was expected to give the country a competitive edge as an ethical producer in a crowded international market. The codes of garments without guilt were developed after consultation with different stakeholders and include:

- Free of Child labor
- Free of Forced labor
- Free of Discrimination
- Free of Sweatshop Practices including:
 - Providing limits on working hours within those prescribed in law
 - Guaranteeing workers the right to Freedom of Association
 - Requiring that workers receive all legally required pay and benefits
 - Ensuring that the workplace is safe, with specific requirement for the management of the workplace

The country has signed up an international auditing company SGS to certify that factories comply with these codes. Because of this initiative, Sri Lanka today is identified as a low risk sourcing destination when it comes to ethical trading practices. It has helped Sri Lanka not only to withstand the post-MFA competition but also to carve out and consolidate a niche among high-end clients in casual wear, intimate apparel, active and sportswear, and children’s wear. The country supplies garments to many well-known and prestigious brands such as Gap, Nike, Victoria’s Secret, Next, Liz Claiborne, Tommy Hilfiger, Triumph, Marks & Spencer, and Speedo. It has become the foremost supplier of world renowned intimate apparel to the world, which has made it the Lingerie Capital of the World.

<http://www.garmentswithoutguilt.com/>

4.8 Third, the importance of compliance will also grow as Bangladesh gradually moves up the value chain. In graduating from its current production of basic to medium and high value

garments, Bangladesh will compete with incumbents like Sri Lanka, Turkey, and Vietnam etc., and has to match their compliance levels as well. Retailers of medium and high value products

serve the more compliance-conscious consumers, who tend to avoid the products of a country that has a bad reputation for low wages, long working hours, irregular payments, limited freedom of workers, insecure and hazardous working conditions etc. As a result, the threshold for

compliance of the medium and high value garments retailers is higher than that of basic garments retailers. Better compliance may also help a country to develop a niche market for its products (Box 4.1).

Table 4.1: Financial Information (in million US\$) of Compliant and Noncompliant Factories

Factory name	(A) Initial investment	(B) Initial investment for compliance (B)	(C) Annual running cost (C)	(D) Annual running cost for compliance (D)	(E) Annual Turnover (E)	(F) Annual Profit (=E-C-D)	(G) Profit-to-initial investment ratio (= F/A+B)
Compliant Factories							
Shine fashion	305.31	43.75	173.52	3.36	1000	836.58	2.40
Mascot Knit Ltd.	284.76	9.52	162.34	1.08	1000	716.4	2.44
Zaara Composite	280.88	3.57	199.88	0.72	917	676.76	2.38
Knit Plus Ltd.	274.82	0.71	196.56	1.68	875	789.75	2.87
Knit Asia Ltd.	273.83	0.29	159.41	0.84	950	768.52	2.80
Average	283.92	11.57	178.34	1.54	948.4	757.60	2.58
Noncompliant Factories							
Harun garments Ltd.	92.14		44.3		267	222.70	1.97
Alim Knit Wear Ltd.	113.10		64.43		250	185.57	1.23
Green Knit Wear	151.40		64.28		350	285.72	2.33
Step Two Garments	122.86		63.09		300	236.91	1.66
Texcon Textile Ltd.	142.75		64.68		375	310.32	2.49
Average	124.45		60.16		308.40	248.00	1.94

Source: Baral (2010)

4.9 Fourth, compliance results in economic and social benefits. Compliance with labor standards imposes costs on firms, but is probably outweighed by the sum of private and social benefits. Cases of noncompliance like low wages, irregular payments, safety hazards, and inaccurate payments for overtime lead to frequent labor unrest and disruptions in work. Very often, the anger of the workers culminates in organized damage of capital machinery and factory buildings. Better compliance not only helps to prevent such losses of working hours and capital

equipment, but may also enhance worker productivity (Table 4.1). A comparative study of five compliant and five noncompliant garment firms found that the profit-to-initial investment ratio of the former group was higher than the latter group of firms. The average profit-to-initial investment ratio of the compliant factories was 2.58. The same for the noncompliant factories was 1.94. While this is by no means conclusive, it does indicate that compliance does have positive and tangible payoffs, even for the individual firm. Whether the productivity and overall economic

benefits will override the costs of compliance could be a useful question for further analysis. Also, if the economic and social benefits (such as worker health and safety, the positive externalities for the sector as a whole) of compliance are added up, the case for compliance can become quite strong.

4.10 Finally, noncompliance can potentially increase the non-production costs of a firm. The government has enacted a number of laws and acts like “Bangladesh Labor Law 2006”, “Bangladesh Labor Welfare Foundation Act, 2006” and “Bangladesh Building Code 2006” in recent years. With the enactment of these laws and acts, compliance is no longer an issue of compassion and moral persuasion, but has become a legal obligation for the garment manufacturers of Bangladesh. A firm will be subject to penalty and/or legal action if caught violating these laws.

4.11 In general, EPZs have a better record of compliance. Wages in EPZs are set in US\$ and the gross wage is increased by 10 percent annually. In addition, the factories are located in industrial buildings with adequate fire exits, spacious stairs, lighting, ventilation, toilets etc. Workers’ complaints are quickly arbitrated with the help of around 60 labor counselors⁴⁷ who work only in the EPZs. Regular monitoring has shown an improvement in compliance with labor standards over the years.

4.12 Compliance outside EPZs differs according to government and independent surveys, but both highlight the need for further improvement. The Ministry of Labor and Employment surveyed 295 garment factories during March-May 2010. According to this survey, reasonable progress was made in case of most of the compliance issues (Table 4.2).

How is compliance working in practice?

Table 4.2: Progress on Compliance Reported by Respondents (percentage)

Issues	Percentage of firms reporting compliance
Issue appointment letter	72.9
Issue ID card	77.7
Pay according to pay structure	66.7
Pay for overtime in time	79.7
Follow holiday calendar	74.2
Provide maternity leave	67.1

Source: SCF, Ministry of Commerce, Government of Bangladesh, 2010b

4.13 However, an independent survey (UNIDO 2011) conducted in 2011 does not corroborate the findings of government compliance audits. The findings of a survey of 84 firms shows that although appointment letters are issued for almost 100 percent of officers/executives, the same share is only about 17 percent for woven garment workers and 13 percent for knit garment workers (Table 4.3). The same survey finds that about 30 percent of the firms pay the salaries/wages in

installments throughout the month instead of paying it on a specific date of the month. Similarly, about 42 percent of woven garment firms do not provide workers with the wage sheet containing payment details. The same share for knit garments is about 58 percent. There are several reasons why the compliance situation in the garment sector failed to improve up to a satisfactory level, as indicated below.

⁴⁷ The labor law is not applicable to the EPZs. Around 60 government-employed counselors help monitor and enforce labor standards in the factories located in EPZs. The counselors work in a team of two and are responsible to provide orientation to management on compliance, raise awareness among workers, and arbitrate between workers and management in cases of disputes. The labor counselors also gather data on compliance issues including contracts, wages, overtime and bonus payment and leave provisions, which they submit to BEPZA on a monthly basis for each firm in the EPZ for review and follow up action.

Table 4.3: Percentage Distribution of Worker by Some Selected Compliance Issues

Compliance issue	Woven RMG	Knit RMG
Issuance of appointment letter		
Workers	17	13
Assisting staffs	81	77
Officer/executives	100	100
Providing salary sheet to workers	58	42

Source: UNIDO (2011)

What inhibits compliance with labor standards?

4.14 Infrastructure bottlenecks intensify noncompliance. Because of problems like power and gas shortages, poor connectivity with the port, and inefficient port management, the timely shipment of goods is very often difficult. Delayed shipment delays the payment to the manufacturers, which in turn, delays the payment to their workers. Sometimes delayed shipment also obligates the manufacturers to send the goods either by air instead of sea at their own cost or at a discounted price, which they try to recoup by paying less to the workers. In addition, limited scope for bridge finance through short-term loans from banks increases the severity of these problems.

4.15 Poor enforcement of the law also results in poor compliance. In the early phase of growth of the sector, many garment firms were set up in residential buildings. Unless relocated, they cannot comply with industrial building codes. Moreover, the overall enforcement of the labor law and building code is still very low. The Government has established a compliance monitoring cell within the Export Promotion Bureau (EPB) to increase the enforcement of the law by regularly monitoring factories. But it lacks sufficient numbers of trained inspectors. In absence of any credible threat of consequences for violating the law, the mid-level management of many firms becomes apathetic to compliance.

4.16 Another reason for manufacturers' apathy to compliance is the "unfair" distribution of its premium. Many manufacturers think that they bear the full costs of compliance while the buyers

do not share in this. The price and compliance decisions of buyers are not synchronized. Buyer-nominated audit teams compel manufacturers to improve the overall environment of their factories which involve costs. However, the purchase team makes decisions on the basis of price and quality of the product, not the quality of the factory environment. As a result, manufacturers' incentives are to offer the most competitive price and pay little attention to compliance, if not forced to do otherwise.

4.17 Coordination failure leads to noncompliance as well. Given that some of the most significant competition for Bangladeshi garment firms comes from within the country rather than abroad, firms' incentives dictate delaying compliance until they are assured that all other firms are also complying. This puts the onus on government agencies for ensuring that all firms comply with the law, and that no firm receives an unfair advantage over another.

Policy recommendations

4.18 Increase enforcement of law. Currently, Bangladesh has adequate laws and rules in place for an effective regulatory environment to improve the compliance situation. But because of coordination failure, as well as other reasons cited above, firm incentives may be aligned against compliance, at least in the short run. Therefore, government has to ensure the enforcement of laws. Capacity of the compliance monitoring cell and inspection teams has to be strengthened to monitor and improve the overall enforcement of law in the garment sector.

4.19 About 20 percent of the firms are engaged in subcontracting. Much of the labor unrest initially starts in these firms, due to their poor compliance situation, and then spreads over to other firms, which tarnishes the image of the country. In most cases these firms are not members of any associations like BGMEA or BKMEA, and therefore remain outside the ambit of the associations' inspections. Strengthening of Compliance Monitoring Cell with additional staffing and training is also important to monitor the compliance situation of these factories.

4.20 Reduce the probability of labor unrests by regularizing the adjustment of wages in line with the rise in the cost of living and promoting its implementation. In the past, wages in the garment sector were adjusted intermittently, for example, in the years 1994, 2006 and 2010 after 10, 12 and 4 years respectively. According to the Bangladesh Labor Law 2006, the minimum wage for the workers of a sector has to be reviewed every five years. In many cases, labor unrest is triggered from the poor implementation of the minimum wage. For example, as per the official Gazette notification, the new minimum wage structure was supposed to be implemented from November 2010. In December 2010, ten factories witnessed labor unrest (Islam 2011) as they had failed to implement minimum wages.

4.21 Although the new labor law requires adjustment of minimum wage every five years, an annual adjustment could be better for the garments

sector as a whole for two reasons. First, the five year lag in adjustment of minimum wages may make workers unhappy and lead to strikes and violence. An annual adjustment will reduce the probability of this happening and also help to provide workers with a smoother consumption cycle. Secondly, it may be the case that lack of annual adjustment results in a larger minimum wage award, when that occurs. For example, the last minimum wage adjustment was after four years. Cost of living increased by 36.70 percent during 2006-10, but the average wage was increased by 80.45 percent to meet workers' demand. While an annual adjustment is no guarantee that there will not be a large minimum wage award, it may help to keep this award to a more reasonable level, and so also help cushion the sudden impact on employers' finances.

4.22 Facilitate relocation of factories from residential to industrial buildings. Many small and medium garment factories were set up in the residential buildings without adequate facilities in the early 1980s. These factories have to be relocated in industrially compliant buildings. Government has decided to set up a garment village in Munshiganj, where the noncompliant factories are expected to relocate. Given their financial insolvency, the small and medium garment factories would require access to finance to relocate. Government can also build the factory buildings and lease them out to the manufacturers at agreed terms and conditions following the EPZ model.

Chapter 5: The Potential for Diversifying Exports - The Case of ITES-BPO

5.1 **One possible avenue for export diversification is the ITES-BPO⁴⁸ sector.** The lack of a sizeable information technology enabled services – business process outsourcing (ITES-BPO) sector in Bangladesh is puzzling, especially when the sector is thriving in neighboring India and Sri Lanka. Given the large and growing size of the global ITES-BPO market, even a small share for Bangladesh could result in significant benefits in terms of generating employment, raising incomes and diversifying exports. Despite its large pool of young and trainable people and its competitive wages, why hasn't Bangladesh become an important offshoring destination? Why hasn't Bangladesh attracted foreign direct investment in this sector, especially from Indian firms seeking to lower wage costs that are rising rapidly in India? What does Bangladesh need to do to position itself as the next ITES-BPO destination? These issues are examined in this section.

5.2 **Key messages.** The ITES-BPO sector provides an important avenue for diversifying exports, employing the youth, and raising incomes. But this sector has not taken off in Bangladesh for several reasons: lack of soft skills such as fluency in written and spoken English and professionalism; poor infrastructure including lack of reasonably-priced real estate and grade A⁴⁹ buildings, adequate power supply, fast internet/broadband connectivity, and, until recently, VoiP telephony; weak business

environment; and lack of adequate clusters. Much needs to be done to set the stage for promoting this industry in Bangladesh by improving skills and the business environment. Creating an apex business organization to represent the sector on a global platform could also improve the prospects of this sector.

I. Background

5.3 **Several countries have positioned themselves as attractive ITES-BPO destinations to capture the large and growing global market.** According to the McKinsey Global Institute, the global potential IT/ITES market in 2008 was estimated to be around US\$500 billion and the potential BPO market around US\$150 billion. The demand for these services comes from the Americas, followed by Europe/Middle East/Africa and Asia Pacific regions. While cost savings are the primary reason for outsourcing, other reasons such as access to worldwide talent and potential new markets play an important role as well. On the supply side, several countries in Asia, Latin America and Eastern Europe have established themselves as attractive offshoring destinations using differentiating factors such as time, distance and language skills to make their case.⁵⁰ India is one of the early movers in this area and is a major offshoring destination in Asia, along with the Philippines and Sri Lanka. Countries such as Kenya, Nigeria, and Egypt are also attempting to break into this area.

⁴⁸ *ITES-BPO* refers to all outsourcing needs whether it is customer relationship management, back office operations/revenue accounting/ data entry, data conversion, finance and accounting/human resource services, transcription/translation services, content development/animation/engineering and design/GIS, other services including remote education, data search market research, network management and consultancy services. ITES-BPO industry is distinct from the *IT industry*. ITES-BPO can range from the simple (data entry, scanning etc) to the complex (equity research, knowledge management etc). In contrast, while IT firms service multiple sectors, the range of work is fairly limited and very technical. Some other terms used in this section are: *Outsourcing*, which refers to the contracting out of a business function - one previously performed in-house - to an external provider. BPO that is contracted outside a company's country is called *offshore outsourcing*. BPO that is contracted to a company's neighboring (or nearby) country is called *nearshore outsourcing*.

⁴⁹ Grade A specifications refer to internationally acceptable real estate standards with respect to floor space, construction, etc.

⁵⁰ Language capability and same time zone in case of Africa, nearshoring in the case of Eastern Europe, and all three in the case of Latin America.

5.4 Significant benefits accrue to developing countries positioning themselves as ITES-BPO destinations. By encouraging this sector, developing countries can provide direct and indirect employment to the increasing number of young people entering the job market.⁵¹ Destination ITES-BPO countries have seen an increase in the rate of female participation in the labor force. Moreover, this sector requires low capital investment and skill levels compared to the IT sector. Finally, in addition to bringing in foreign exchange and helping build IT skills in people, the sector also helps reduce spatial inequalities as more of these activities are being

located in Tier 2 and 3 cities as Tier 1 cities⁵² become more expensive.

5.5 Bangladesh has not yet made a mark in this sector. Exports from Bangladesh are dominated by readymade garment exports, with non-factor service exports accounting for a low share of 13.2 in FY10. Of this, the IT/ITES BPO exports in Bangladesh are small, only about \$35 million which accounts for only about 0.2 percent of total export compared to 27.5 percent from India. Many of the existing 400 firms are small (with 10-200 employees), and have been around for a while without growing much.

Table 5.1: Share of Non-Factor Service Exports

	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10
Exports of Goods and Non Factor Services (US\$ million)	7249	6794	7379	8445	9750	11752	13537	16042	17413	18707
Total Non Factor Service Exports (US\$ million)	772	865	887	924	1177	1340	1484	1891	1832	2471
Share of Non Factor Service exports in total exports (%)	10.6	12.7	12.0	10.9	12.1	11.4	11.0	11.8	10.5	13.2
Share of ITES-BPO exports in Non Factor Service exports(%)	..	..	..	..	1.1	2.0	1.8	1.3	1.8	1.4
<u>Memo items</u>										
Share of exports of goods and services in GDP (%)	15.4	14.3	14.2	14.9	16.2	19.0	19.8	20.2	19.5	18.7
Share of Non Factor Service export in GDP(%)	1.6	1.8	1.7	1.6	2.0	2.2	2.2	2.4	2.1	2.5

Source: Bangladesh Bank, BBS and BASIS

II. What explains Bangladesh's lackluster performance in this sector?

5.6 Views expressed by IT and ITES-BPO incumbents firms in an online survey⁵³ provide clues about why this sector has not taken off in a major way in Bangladesh. Respondents said that inadequate power supply, poor internet connectivity, paucity of skills, and lack of supportive government policies were the main constraints to their businesses. Specifically, for the ITES-BPO sector, Bangladeshi respondents pointed to infrastructure as the key constraint, followed by lack of government support and skills. Interestingly, 62 percent of the respondents felt

that a key factor affecting the sector was the global perception that Bangladesh was not a favourable destination for outsourcing of IT or related services (also see Box 5.1, which summarizes views of some Indian companies interviewed for this study, which underscores this point).

5.7 We examine this question in detail along four dimensions: (i) Talent: refers to the cost, quality and availability of human resources who are employable in the sector; (ii) Infrastructure: refers to the cost, quality and availability of support infrastructure including telecom, power, connectivity, etc.; (iii) Policy and business environment: refers to aspects of policy, access to

⁵¹ According to some estimates, every job created in the ITES-BPO sector creates 3-4 jobs in supporting sectors.

⁵² The tier of a city depends on the facilities like infrastructure, hotels, roads, utilities etc.

⁵³ The survey included 26 firms. Around 54 percent of the respondents were from the IT services, 27 percent were IT/ITES, 15 percent were ITES-BPO and the remaining 4 percent were from the hardware sector. Of the surveyed firms, only 15 percent had no revenues from exports. Around 35 percent had export revenues in excess of 75 percent of their total revenues, 31 percent had less than 25 percent, 4 percent had between 26-50 percent, and 15 percent had between 51-75 percent.

finance, fiscal and non-fiscal incentives, social infrastructure etc; and (iv) Clusters: refers to

supporting industries such as training, security, recruitment firms etc.

Box 5.1: What do Indian ITES-BPO Firms Think of Bangladesh as a Potential Offshoring Destination?

Indian companies have considered Kenya, Ghana, Mauritius and Nigeria as potential low-cost options for expansion. Why have they not looked at Bangladesh as a potential offshoring destination? Interviews with some Indian firms shed some light on this:

- **Issues around perception of the country:** The common perception among Indian firms was that the ITES-BPO industry does not really exist in Bangladesh. While the country is known for its excellent textile industry, and its cheap labor, it is not seen as a country with talent suited for 'services' industries.
- **Lack of promotion by Industry:** While some of the local Indian companies had met with BASIS and some of the other industry representatives, most of the larger firms had not interacted with any Bangladesh-based ITES-BPO company, not even at major events such as the International Outsourcing Forum, nor the local events conducted by NASSCOM. This means that they were unaware of the availability of accounting talent, graphics capability, etc. in Bangladesh.
- **Lack of promotion by the Government:** Senior executives from the Indian firms interviewed said governments of countries like Botswana and Kenya had reached out to them and offered different incentives for setting up operations in their countries. However, none of the Indian firms were ever contacted by the Government of Bangladesh or its representatives for attracting investment. This worries Indian firms since they are not sure whether the Government actually supports the growth of the industry.
- **Tedious procedures for talent movement:** One of the key issues that have stopped Indian companies from investing in Bangladesh is the difficulty in obtaining a business visa. Also, repatriation of salaries, capital, dividends, and profits between the countries is not possible, thus reducing the incentive for talent to move across the border.

All the above issues withstanding, the conclusion of most of the interactions was also that while the firms had never evaluated Bangladesh as an option for expansion, they are quite open to carrying out some further interactions with their Bangladesh counterparts. The overall feeling was that if more information was made available regarding the opportunities, and some of the procedural issues ironed out, Bangladesh might be an interesting option to expand into. This is especially true of firms thinking of expanding into the Far East (Philippines, China) or Africa.

(i) **Talent**⁵⁴

5.8 Bangladesh has a sizeable talent pool that can work in the labor-intensive ITES-BPO industry. While the number of graduates in the country is small (number of tertiary enrolments in 2007 is 1.14 million), many students drop out after the secondary level (number of secondary enrolments in 2007 is 10.44 million). These secondary school graduates can be trained to work in the ITES-BPO industry because the skill levels needed are much lower than in the IT industry. Similarly, while some firms mainly recruited

graduates with engineering degrees, an equally large number of graduates from other backgrounds were also hired. In addition, there are around 5000 freelancers in Bangladesh working for European and American individuals/companies. They form a latent pool that can be tapped because they have experience as well as industry-specific knowhow. Finally, Bangladesh has a cost advantage compared to other Asian countries – the average salaries (per year) of people with 2-3 years' work experience is US\$ 2,137 in Bangladesh, compared to US\$8,400 in the Philippines, US\$6,250 in India and US\$2,400 in Nigeria.

⁵⁴ Data on this issue was gathered from primary interactions with the incumbents in Bangladesh and from secondary desk research.

Box 5.2: Egypt: Making the Talent Pool “Industry Ready”

The government of Egypt – via the Ministry of Higher Education (MoHE) and the Ministry of Communication and Information Technology (MCIT) – has launched a program, ‘the Education Development Program for Egyptian Universities’ (EDU Egypt), to increase the employability and industry readiness of the talent pool of the nation. This has been done to provide employment options to the youth – 330,000 of whom are graduating every year in Egypt. Of this roughly 5 percent graduate in engineering and a further 4 percent graduating in other scientific degrees, while 20 percent graduate in commerce.

EDU Egypt has been two pronged in its approach and focus towards upgrading the skills of the talent pool – one area of focus is the BPO industry and the other focuses on IT sector.

The BPO program is aimed at improving the soft skills (language skills, customer service, culture sensitization) and also basic computer and data skills. The IT program focused on the technical know-how that is required by the IT industry and introduces advanced training to graduates to plug the demand-supply gaps for the industry. This endeavor has been implemented with the support of many leading players in the industry – leading global players such as Infosys, IBM and Firstsource – and also domestic firms such as New Horizons. EDU Egypt has grown from the initial phase when it covered just 2 universities, to the current scale where it encompasses 10 universities with 35 faculty and 10,000 students.

5.9 But there are challenges as well, with employability being low. According to industry incumbents, although talent is available, in practice its employability in the ITES-BPO sector is only 10-15 percent. While the quality of basic and technical computing skills is adequate, the problem lies in lack of soft skills such as quality of written and spoken English in particular and written/verbal communication skills in general. This gap in quality is primarily attributed to the fact that the medium of education in most schools is the local language, with English being just one of the subjects. English becomes the medium of instruction only at the tertiary education level.

But, given that the enrolment ratio for tertiary education is amongst the lowest in the South Asia region (at 7 percent, it is only higher than only Pakistan and Bhutan, both at 5 percent), the overall quality of English language diction and grammar is quite low in the potential talent pool. This lack of English language skills creates challenges in terms of low employability levels, low level of IT usage since the primary language of computing is English, and investment of time and money to train students to make them ready for the ITES-BPO industry (see boxes 5.2, 5.3, and 5.4 for different models of training young people to make them ready for the ITES-BPO

Box 5.3: Rajasthan Knowledge Corporation Ltd.: An Online Learning Model

The Rajasthan Knowledge Corporation Ltd. (RKCL) is a joint venture of Government of Rajasthan, Maharashtra Knowledge Corporation Limited (MKCL), Pune, University of Rajasthan, Jaipur, Maharana Pratap University of Agriculture and Technology, Udaipur, Vardhaman Mahaveer Open University, Kota, Rajcomp and centre for e-governance. It runs courses on basic IT skills through ICT-enabled infrastructure without involving instructors. As a result, participation in these courses becomes relatively easy. The participants are tested at the end of the course, and if they show sufficient aptitude to pass the test, are awarded certificates from recognized universities.

In order to carry out this model the RKCL has tied up with many channel partners. To become a partner one needs to have a basic server and a few computers to set up a center known as an ‘IT Gyan Kendra’ (IT Knowledge Center). The courses can be transmitted over low bandwidth internet connections and can be learned by students without the presence of a trainer. This ensures participation even in remote rural areas that may not have high speed internet access and / or highly trained instructors.

industry). Moreover, the alignment between academic/training institutions and the ITES-BPO industry is low. While there are many training institutes operating locally in Dhaka, they mostly provide training on core IT aspects such as programming, networking and not for skills

needed for ITES-BPO sector. Around 90 percent of the respondents in the survey found the training institutes or universities inadequate and felt that the training needs to be further refined to produce talent more in line with sector requirements.

Box 5.4: Nigeria: ITES-BPO Skills Certification and Training

Given its large, young, and educated English speaking population, Nigeria has the potential to develop as an ITES-BPO location. The project is aimed at creating a program that would ensure a steady pipeline of employable talent to the country's BPO industry. The program comprises creation of an internationally benchmarked (but customized) Standard Assessment and Certification Program coupled with a training program using standard training content.

(ii) Infrastructure

5.10 Quality of infrastructure is important for the ITES-BPO industry. Among the major factors influencing this sector are: reasonably-priced real estate and grade A buildings, uninterrupted power supply, and fast internet / broadband connectivity. Bangladesh is yet to develop itself as an attractive destination from each of these perspectives.

5.11 Real estate costs in Bangladesh are relatively competitive when compared to other emerging/established ITES-BPO locations around the world. Rental costs for commercial real estate are relatively low at USD 1.0 per square foot (perhaps comparable to tier 2 cities in South Asia) – although much depends on the quality of space and whether it is inclusive of utilities. Low rents, by themselves, may not be attractive to the ITES-BPO companies because there is a dearth of grade A buildings in the country. The grade A infrastructure currently existing has been developed primarily by garment manufacturers and a few IT firms. Currently there is no grade A

infrastructure that has been developed specifically for ITES-BPO companies. Apart from the proposed Kaliakoir Hi-Tech Park,⁵⁵ no other technology parks or Special Economic Zones have been developed for the ITES-BPO sector. But efforts to set up the Kaliakoir park have also faced resistance due to land litigation, poor road connectivity, and other political/security related issues.

5.12 As with other sectors, lack of reliable power supply continues to constrain the ITES-BPO firms. Due to acute power deficit, there are frequent outages throughout the country. Firms incur additional costs to run expensive generators to keep operating during power cuts, and this adds to overall costs.

5.13 Available capacity needs to be increased to improve internet connectivity. In 2004, Bangladesh was connected with the submarine cable South East Asia-Middle East-West Europe-4 (SEA ME WE 4), which resulted in the internet connection becoming 68 times faster. This submarine cable connected Bangladesh and 12

⁵⁵ This park is envisioned as an integrated, ultramodern, techno-township of 232 acres and will be situated at Gazipur, alongside the Dhaka-Tangail expressway. It has been 11 years since the planning for this park commenced and may still take another 5-6 years to complete. The Bangladesh Computer Council which has the responsibility of developing the Tech Park is now looking at new developers to develop the park through a Public-Private-Partnership (PPP). Another ICT village was initially planned at Mohakali as a PPP, but did not take off owing to political and security issues.

others countries with high speed data communication facilities. However, although the total capacity of SEA-ME-WE-4 is 24,120 Mbps for Bangladesh, only 4,620 Mbps capacity is presently available.⁵⁶ Moreover, in the first two years of landing, the submarine cable was sabotaged around 22 times, affecting business seriously.

5.14 The absence of VoiP telephony until recently constrained the growth of the call center industry but the government is now giving this some attention. The regulatory body, Bangladesh Telecommunication Regulatory Commission (BTRC), is providing call center licenses for a low cost of Tk.5000, with a five year validity. Licenses are renewable for a further duration of 5 years, subject to terms and conditions.

(iii) An enabling policy and business environment

5.15 Apart from the infrastructure deficit described above, other aspects of the business environment are important for the ITES-BPO sector. Most important in this regard is a robust policy environment that encourages growth in this sector and takes measures that are in line with the long-term objectives (see Box 5.5 for an example from Ghana). Bangladesh's National ICT Policy 2006 was updated with the National ICT Policy 2009. The overall focus of the 2009 policy shifted towards viewing the ICT sector as a platform for other key sectors of the economy.

Box 5.5: Developing Ghana as a Destination for ITES-BPO

In 2006, the Government of Ghana undertook the eGhana project to create a five year roadmap for development of the IT and ITES-BPO sector in the country. This project included:

- Creation of a strategy document for the country to increase its competitiveness and capability as an ITES-BPO destination
- Building a roadmap including a skills development plan, policy framework and an investment promotion strategy
- Creation of a monitoring and evaluation framework for the ITES-BPO sector with baselines and targets.

Once the roadmap had been created, the country took a phased approach towards implementing the recommendations. This includes:

- Creation of an Industry body: GASSCOM (Ghana Association of Software and IT Services Companies)
- Investing in usage of ICT in public communications
- Creating a standardized curriculum framework for training for ITES-BPO (Customer Service, Software, Web and Applications, Data Entry, Data Conversion, and Medical Transcription)
- Cascading the curriculum through a 'Train the Trainers' program

The project was expected to create 6000 jobs in the ICT and ITES-BPO sector by 2011, of which 3000 had been created until 2010 through activities undertaken by GASSCOM.

⁵⁶ Out of the total available capacity, 40 percent is allocated for data communication and 60 percent for voice communication.

Box 5.6: Philippines: Attracting Investors Using the Special Investor Resident Visa Program

The Philippines has become one of the leading outsourcing destinations for companies across the world, not only due to its substantial English speaking talent, but also to government's initiatives to attract foreign investment. One such measure taken by the Board of Investments is the Special Investor Resident Visa (SIRV) that allows investors to stay as residents as long as they maintain their investments in the country and pay taxes that are applicable to domestic nationals. The SIRV is granted to any alien who is at least twenty-one (21) years of age and has not been convicted of a crime, provided that he or she:

- Is not afflicted with any dangerous or contagious disease
- Has not been institutionalized for any mental disorder or disability
- Is willing and able to invest the amount of at least US\$75,000.00

These visas are renewable and are also granted to legal spouse and children below the age of 21.

5.16 The National ICT Policy 2009 addresses a few shortcomings of the previous policy. These changes could help increase the attractiveness of the industry both to investors as well as prospective talent, provided at least some of them are implemented. Some comments on the policy:

- a. The 2009 ICT Policy emphasizes IT education to make people "industry ready." To facilitate this, the policy outlines the need for easy loans and planning manpower requirements to bridge the supply-demand gap.
- b. The Policy clearly outlines its intent to safeguard intellectual property and data privacy. Such measures will reassure foreign investors who may have stayed away because of the perception that intellectual property rights were not guarded in Bangladesh. Implementing these measures will require concerted efforts by the government and affiliated bodies.
- c. The Policy also outlines several measures to improve the overall business environment. Among the measures announced are: ensuring that small and medium enterprises have adequate access to capital (through entrepreneurship funds, venture capital funds and easy loans); and providing infrastructural support for the sector (through tax rebates on electricity, better and cheaper connectivity and incubator support for IT and ITES-BPO companies).

5.17 Although the 2009 Policy is a considerable improvement over the previous one, some shortcomings still exist:

- a. Although the Policy emphasizes the importance of a talent pool and also allows for tracking the demand and supply of talent, it focuses primarily on IT/ICT skills. However, the majority of the current talent pool – which lacks these skills – can be trained and employed by the ITES-BPO sector if there was sufficient focus on language (English speaking workforce) and soft skills. Shifting focus towards IT education is good from a medium to long term perspective, but there also needs to be a focus on the current state of talent and current industry needs that are better suited to ITES-BPO sector.
- b. The 2009 Policy seeks to allow online application of work permits and visas to attract foreign investors. But the application process and requirements are still very cumbersome and should be relaxed for foreign nationals who may want to invest or work in Bangladesh including in the ITES-BPO sector (see Box 5.6 for the Philippines example).

(iv) Clusters

5.18 Multiple associations represent the ITES-BPO sector in Bangladesh, leading to weak coordination and duplication of efforts without

necessarily benefiting the industry. There are many industry bodies in Bangladesh for IT/ITES, call centers, Internet Service Providers etc. Each of these industry bodies seeks to improve the existing condition of the IT/ITES-BPO industry in Bangladesh. Although the initiatives being taken by each of these associations are good, there is weak coordination as well as duplication of efforts, with no significant impact on the sector. There is a need for an overarching framework or one central regulatory body that either defines the clear roles for each of these bodies or develops a strong linking mechanism to help share knowledge, data and research. A greater effort also needs to be made to better portray Bangladesh as a destination market for the ITES-BPO sector.

III. What can be done to encourage the ITES-BPO sector in Bangladesh?

5.19 Government can encourage the development of the ITES/BPO sector in three key policy areas, relating to skills, promotion and the business environment:

- a. Address the skills gap among high school students and dropouts as well as graduate students to make them employable in the IT/ITES-BPO sectors, with a focus on soft skills as the specific product skills are typically imparted by the employer.
- b. Demonstrate long-run commitment to the sector, which would boost investor confidence. This commitment can include, for example, partnership with the private sector to undertake a 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.
- c. Tackle the main hurdles to "doing business" in Bangladesh – executing standard legal provisions (Intellectual Property Rights, confidentiality, data security etc); and providing customized infrastructure (such as grade A office space, reliable utilities, IT and physical connectivity) that can be leased to companies in the sector (as in Economic Zones).

5.20 Seven practical interventions can help to address some of the core gaps in the above policy areas (Box 5.7 summarizes the success of Orissa in attracting ITES-BPO investment):

- a. At the highest levels, the government should invite 2-3 top foreign ITES-BPO companies to locate in the new high-tech park in Kaliakor.
- b. Begin a government-sponsored ITES assessment, training and certification program to create a cadre of skilled workers in ITES-BPO in line with internationally-recognized standards.
- c. Create an umbrella industry body to unify the fragmented industry into a powerful coordinating body and lobbying force, capable of promoting and positioning Bangladesh internationally at the highest fora.
- d. Create a network of industry contacts and skills within the "freelance" IT/ITES workers to immediately scale up local capabilities.
- e. The highest levels of government could invite NASSCOM to hold one of its major events/retreats in Dhaka to showcase Bangladesh's potential for foreign direct investment or joint ventures in ITES.
- f. Complement parks like Kaliakor with some other leased buildings, also designated as Economic Zones, to provide high-quality office infrastructure that would allow for possible growth in the short term whilst the Economic Zones are still being built.
- g. Put in place incentives to attract investment of Bangladeshi Diaspora into this sector.

Box 5.7: Orissa: Attracting Investments in the ITES-BPO Sector

The state of Orissa in eastern India has achieved major success in attracting investments in the ITES-BPO sector. The state capital – Bhubaneswar – has become the hub for a few of the leading Indian ITES-BPO companies. Total IT/ITES-BPO exports of the state amounted to USD 275 million in 2008-09. This growth of the ITES-BPO sector was due to a concerted effort including:

- **Creation of an IT park and attracting an anchor client:** One key requirement for any SEZ or IT Park to succeed is the need for an anchor client to set up operations in the area. By attracting an anchor client early in the process, the government has ensured the success of the basic mission of setting up IT parks in Rourkela, Bhubaneswar and the recent one in Bhubaneswar.
- **Setting up a nodal agency for the IT/ITES sector:** The Orissa Computer Application Centre (OCAC) was set up as the nodal agency to carry out various training programs, both long and short term, to cater to the needs of the IT/ITES-BPO sectors. The OCAC has also effectively differentiated between IT and ITES and has helped in promotion of these in international fora. It has also undertaken assessment tests and initiated placement drives in association with some of the leading ITES-BPO players.
- **Infrastructural support:** The Orissa Industrial Infrastructure Development Corporation (IDCO) effectively handled all infrastructure requirements of the sector.

All these factors have enabled Orissa to attract some of the largest IT and ITES-BPO players into the state.

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