

CPD Study

on

Bangladesh's Apparel Sector in Post-MFA Period A Benchmarking Study on the Ongoing Restructuring Process

EXECUTIVE SUMMARY

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EXECUTIVE SUMMARY

1. Background and Objectives of the Study

1.1 Background of the Study: The phase-out of the Multi-Fibre Arrangement (MFA) on 31 December, 2004 has important implications for all agents in the value chain including apparel manufacturers, exporters, importers, retailers and consumers. This has made possible for apparel manufacturing and exporting countries to operate without the restrictions of the quota; has provided importers an opportunity for open sourcing and retailers to take advantage of competitively priced supply; and provided broader choices and lower prices to consumers. As a result global export of textile and apparels has substantially increased in 2005 (US\$275.6 billion with a growth rate of 6.4 per cent) However, the MFA phase out has not been an unmixed blessings for all apparel producing countries of Asia. There are some apparel exporting countries such as China and India which achieved higher level of growth (44 per cent and 32 per cent respectively); at the same time there are countries such as Cambodia, Indonesia which achieved moderate level of growth (11 per cent and 10 per cent respectively) and even countries such as Nepal have negative growth. Bangladesh, surprisingly with all the apprehension of losing its market share to major players, has been able to not only increase its export but also been able to sustain it-- from US\$6.4 billion in FY2005 to US\$7.9 billion in FY2006 and US\$9.2 billion in FY2007. Nevertheless, Bangladesh is still faced with some challenges such as competition with China especially after lifting out safeguard against Chinese apparels in 2008, poor compliance standard etc. The sector has weaknesses in some areas such as lack of diversity in export market, high concentration in few products, and long lead-time etc. Besides, entrepreneurs have to take into account some recent trends in the global apparel market following the MFA phase out, especially in case of buyers' sourcing patterns (concentrated to few sources), consumers' choice (relatively more frequent changes in fashion and compared to earlier periods) and marketing techniques (lean retailing), etc. and make necessary adjustment.

1.2 Objectives of the Study: In spite of some anecdotal information and evidence on the ongoing dynamics of changes in Bangladesh's export-oriented RMG sector, systematic knowledge about the major facets of change and their consequences in terms of performance correlates are largely absent. Most of the available literature has concentrated in three broad areas: projections about likely impact of MFA phase-out,

strengths and weaknesses of the country's RMG sector to address the emerging challenges, and government policies pursued over the years in support of the sector. Present study has been an attempt to improve the understanding on the ongoing dynamics of the sector and to provide appropriate policy suggestions that may address the future challenges and opportunities in the post-MFA period. The study has identified the following specific objectives:

- a) establishment of benchmark and threshold level of information about the state of the current affairs in the apparel sector;
- b) identifying the major features of the restructuring that are currently taking place in the apparel sector to reveal the dynamics of the sector, particularly in terms of employment, productivity, technology, market access, and marketing;
- c) monitoring of the ongoing restructuring of the apparel sector through panel surveys;
- d) recommending policy suggestions based on the outcome of the study to address future challenges and assess the future opportunities emerging in the apparel sector.

2. Methodology of the Study

The study follows a multi-dimensional approach to generate information at macro, sectoral and enterprise levels to examine eight major research questions of the study. It uses primary and secondary information collected from different sources- debriefing of garment factory owners, focus group discussions with entrepreneurs and workers, and base line survey of both entrepreneurs and workers. A thorough and detailed questionnaire with both open-ended and close-ended questions has been prepared for collection of primary data focusing on major research questions particularly on structure, export, product composition, machineries, management, relation with worker, compliances, and prospect of garment export, etc. Most of the questions are designed to get a comparable scenario before and after the quota was lifted out in 2005. A stratified sampling technique has been used for selection of the sample in a manner that ensured an acceptable level of confidence. A total of 190 enterprises with 85 woven units (45 per cent of the total sample), 72 knits (38 per cent) and 33 sweater units (17 per cent) were selected for the survey. Most of the sample units are located in Dhaka city and adjacent areas (80 per cent), while the rest are located in Chittagong. 33 EPZ enterprises are surveyed which covered 17 per cent of the entire survey. A total of 469 workers were surveyed, out of which 31 per cent

belonged to knit units, 47 per cent to woven units and 22 per cent to sweater units. 211 were male (45 per cent) and 258 were female (55 per cent). The survey was initiated in Mid-April, 2006 and was scheduled to be completed in about eight weeks. However, due to the unrest in the garment sector, which began in End-May and continued thereafter for months and consequent difficulties faced, the survey was finally completed in End-November, 2006.

3. Characteristics Features of Sample Enterprises, Entrepreneurs and Workers

3.1 Sample enterprises for the survey are located in Dhaka and Chittagong cities and adjacent areas. A large number of RMG units (29 per cent of the total sample) established in recent years are mostly located outside the Dhaka city, in areas with available land such as in Narayanganj, Savar, Ashulia, Tongi, Gazipur, and Dhaka Export Processing Zone (DEPZ) reflecting the changing location pattern, where new factories are being increasingly established outside of commercial areas. The sample enterprises are established over a wide range of time spanning from the early 1980 to 2005. More than 90 per cent are owned by local entrepreneurs, while the rest 9 per cent are owned by foreign companies. Most of these are private limited company type. The structure of ownership differs with what is observed in other countries like Cambodia, Taiwan etc.

3.2 During 2005, the sample firms, on average, have exported about US\$4.76 million worth of products, which is about 14.4 per cent higher compared to that in 2004. All types of enterprises have had higher exports in 2005 compared to that of 2004. Large enterprises have exported about 23 per cent higher in 2005 compared to 2004, while the figures for medium and small categories are 17 per cent and 6 per cent. Large enterprises export is more than two times higher than that of medium enterprises and about seven times higher than that of small enterprises. Although within the few mass-produced items that were exported by the entrepreneurs (men's/women's trousers, men's and boy's shirts, men's and boy's jacket, women's and girl's shirts), some shifts in composition are discernible over time.

3.3 About 40 per cent sample units have exported their products to two markets, while another 28 per cent enterprises have exported to more than two markets. It reflects enterprise's capacity for market diversification based on their productivity. Majority of large entrepreneurs have exported to two or more markets, which indicates their strength in terms of networking with different buyers from different markets. Market

concentration of sample enterprise is mainly in EU and USA, and to some extent in Canada, Japan and others.

- 3.4 Placement of orders by international buyers and retailers are growing; large firms tended to receive major share of their buying orders (more than 70%) from these sources. International and local buying houses are the major sources of getting orders for small firms. Lack of capacity to supply large volumes, maintain the required factory standards, social and safety compliance standards, etc. were major stumbling blocs for getting orders from big buyers and retailers.
- 3.5 Sample enterprises in the survey, on average, employed 913 workers, which indicate relatively large size of the sample RMG enterprise. In recent years, there has been a trend for RMG units to get larger through mergers and acquisitions which is also reflected in the sample. Survey shows that sweater enterprises employed the higher percentage of male workers; percentage of female workers was higher in woven units.
- 3.6 Average age of a male worker in the sample is 25.4 years, while that of a female worker is 24.4 years. It appears that a female worker ends her working life in the apparel sector in most cases before she reaches 30 years of age possibly because of marriage, stress of work, etc. The majority of the sample workers are found to have at least primary level education. Male workers are found to be relatively better educated compared to female workers. EPZ workers are found to be relatively better educated compared to non-EPZ workers.
- 3.7 Twenty per cent workers in sample enterprises belonged to unskilled category. Skilled workers comprised 44 per cent of total workers. Professional and management level staff comprised 5.7 per cent of the total labour force. Proportion of unskilled workers was relatively low in large enterprises (16 – 18 per cent) while their proportion was higher in medium and small enterprises (18 – 26 per cent). EPZ enterprises were employing more skilled workers compared to non- EPZ enterprises.
- 3.8 The average stock of capital in a factory is about US\$1.78 million. In other words, an entrepreneur has invested about US\$3,396 per machine. Survey data shows that although some categories of machines (such as knitting/weaving cutting machine and sewing machines) are commonly used by all types of factories, sophisticated machines (such as CAD/CAM machine, embroidery machine and boiler machine) are more extensively used by large and medium enterprises resulting in important implications in terms of productivity and capital-output performance.

4. Economic Restructuring of the Apparel Sector of Bangladesh

4.1 According to the survey, fixed capital stock of the sample enterprises has substantially improved following the MFA phase out (0.41 million in 2005, which was 30 per cent higher than 2004). Sample knit units have increased their capacity by 49 per cent, followed by woven units by 21 per cent, and sweater units by 26 per cent. The data has shown that EPZ enterprises have a higher stock of capital compared to that of non-EPZ enterprises. Industrial cost of production in the sample enterprises has increased by 21 per cent in 2005, mainly due to an additional 20 per cent cost for manufacturing in 2005. The rise of industrial cost is relatively higher in knit and sweater units, 26.4 per cent and 23.2 per cent respectively, reflecting higher levels of production in these two sectors following the MFA phase out. Labour cost in the sample enterprises in 2005 is about 13 per cent higher compared to the previous year. This rise in the labour cost reflected the rise in overall production in 2005, although the rise is relatively low compared to that of industrial and non-industrial costs. The share of labour cost is found to be relatively higher in a sweater factory (19.8 per cent) compared to knit and woven enterprises (16.1 per cent). Interestingly incidence of labour unrest, as reported in national dailies during 2006, was relatively high in this sector. It seems that the issue of labour unrest is perhaps related to other non-wage issues as well.

4.2 The rate of profit earned by the sample enterprises is about 7 per cent of gross output. Profit in the sample RMG units has increased by about 16.7 per cent in 2005; growth of profit level is higher in knit units compared to woven and sweater enterprises. According to the estimate, sample enterprises on average earned a profit of US\$896 per worker in 2005. Rate of return of sample enterprises is found to be 18 per cent with sweater units earnings found to be highest. In contrast to the apprehension of a declining rate of profit after the phase out, enterprises were found to earn relatively higher level of profit in 2005 driven perhaps by higher volumes of production. A regression analysis shows that the rate of profit is significantly influenced by ownership, location and year of operation. EPZ enterprises tended to earn higher profit compared to non-EPZ enterprises. It is also found that year of operation has strong negative correlation with rate of profit, since entrepreneurs of older factories did not adequately replace their old, low-productive machineries.

4.3 According to the entrepreneurs of woven and knit units, local value addition of their enterprises would be about 25-30% and about 50-60% respectively. A sensitivity

analysis on sample sweater units shows that if the RoO criteria are set at a level of 45% domestic value addition requirement, about 30% enterprises may not be able to comply with the required criteria.

- 4.4 About 19 percent of sample enterprises are working under subcontracting arrangement with other enterprises. Subcontracting enterprises are about 10 per cent less productive compared to that of non-subcontracting enterprises; compliance standard was found to be poor in these firms as well. On average, sub-contracting firms earned about 8 per cent less profit compared to their counterparts.
- 4.5 Worker's productivity is found to be US\$1,563 in sample enterprises. Labour productivity in sample knit units is relatively higher compared to that in woven and sweater units. Large sample enterprises are 13 percent more productive compared to medium enterprises, and as high as 65 per cent more productive compared to small enterprises. Labour productivity of EPZ enterprises is found to be 9 per cent higher than non-EPZ enterprises, while it is 27 per cent higher in FDI-led enterprises compared to non-FDI enterprises. A higher labour productivity in, large EPZ and FDI-led enterprises is the resultant effect of their strong market linkage, state of technology, scale of operation, use of skilled workforces and possibly for having better compliance standards at the factory level.
- 4.6 There is a wide gap existing between workers' productivity and their wage (US\$896), the gap is much higher in case of enterprises with relatively a higher productivity such as large, FDI-led and EPZ enterprises. A regression analysis has been carried out to examine the impact of various factors on labour productivity which showed that productivity was highly related to wage and in-house facility for research. One unit rise in wage would increase labour productivity by 1.3 units.

5. Major Features of the Ongoing Restructuring in the Apparel Sector

- 5.1 The national data on import of machineries for textile and apparel sector reveals that efforts towards technological up-gradation at enterprise level have been initiated well before 2005 and are continuing. Between FY2002 and FY2005, import of textile and apparel machineries has posted a trend growth of 21 per cent. A large share of these machineries is spinning machineries (40 per cent), followed by apparel making (18 per cent) and knitting (15 per cent). Bangladesh's major sources of import of machineries have changed over time. Countries which were earlier considered as important sources have lost their significance after 2000, most notably Singapore and

Hong Kong. Currently, the three major sources for machinery are Japan, China and Germany. There has been a shift of operational mode from manual to machine-operated automated form, for example, share of circular knitting machines has been increasing over time from 26 per cent in FY 2002 to 40 per cent in FY2006. Besides, use of automatic sewing machines has increased from 23 per cent in 2002 to 78 per cent in 2006, which is expected to ensure higher productivity and better quality of output. On the other hand, the declining share of flat machines over time could potentially squeeze labour demand for this type of operation. Increasing import of making glimpsed yarn, tulle, embroidery, lace, trimmings etc. in recent years indicates that knit enterprises have gradually enhanced their capacity of producing high value, fashionable products. The standard of locally available accessories have improved significantly that matches with imported ones that has resulted in increased local procurement by EPZ and non-EPZ enterprises and even FDI based enterprises.

5.2 Data reveals that Bangladesh is still in the early stage of sophistication level of the production process. No significant change can be observed in the production process which is followed by sample enterprises. About 80-90 per cent of sample enterprises are still operating on CM and CMT basis. Other types of operations, such as OEM, ODM and OBM, are not very common in the sample apparel units. A large part of these forms of operations are found in EPZ units, especially in FDI-led enterprises. It is quite apparent from data that direct contact between buyers and RMG units induces more to adopt a more sophisticated production process. Upgradation of production processes requires technology improvement, development of workers' skill, designing capacity, brand development, marketing at retail level, and networking with international buying houses and buyers. Although R&D investments have increased in 2005, this however is still very small in sample enterprises (only 9 percent enterprises have a separate R&D section). Entrepreneurs opined that substantial improvement in R&D activities needs to be ensured especially in product design, development of fashion, and improvement of workers' efficiency etc.

5.3 Because of increasing use of automated machines in textile and garments sector, demand for skilled labourers has increased which resulted in changes in skill composition in different operations. The change in worker composition is relatively high in the case of woven enterprises, as share of unskilled workers in these enterprises reduced by 7 per cent and that of semi-skilled workers by 4 per cent, especially in medium and small enterprises; share of professional and skilled workers

increased by 5 per cent. Worker composition in the sample EPZ enterprises has shifted towards more skilled component—the share of skilled workers and professionals went up by 3 per cent and 9 per cent respectively and the share of unskilled workers went down by 8 per cent. The incidence of job losses due to technological restructuring is not readily evident from the sample survey of RMG enterprises. About 85 - 90 percent entrepreneurs have informed no incidence of job losses due to technological restructuring. According to sample entrepreneurs, expansion of operation in RMG units through use of new machineries has, directly or indirectly, created new jobs for skilled workers since new machines required skilled workers for their operation. Thus labour displacement, either male or female, was not found to have taken place because of technological restructuring. The data reveals that there is a widespread feeling among entrepreneurs that the government has not placed due importance on technological up-gradation in the apparel sector in view of MFA phase-out when compared to measures taken by neighboring countries.

6. State of Compliance in the Garment Industry

6.1 The data on factory-level ergonomics reveals that large and medium enterprises provided relatively more space for setting up production lines and for workers working in the factory. The worker-machine ratio in large, medium and small enterprises is found to be 1.9, 2.02 and 1.95 respectively. Space-worker ratio or worker-line ratio are relatively better in enterprises which mainly deal with buyers compared to those which mainly deal with buying houses.

6.2 About 80-90 per cent of sample entrepreneurs have mentioned about checking worker's age before appointing them in respective factories. Experienced workers are preferable in all types of factories; however, work experience is not high on the list for entrepreneurs of sample small enterprises. It is found to be relatively difficult to get jobs in EPZ and FDI led enterprises without having a job experience. Reference is relatively less important in the EPZ enterprises compared to non-EPZ ones. 70-80 per cent of sample enterprises do not provide appointment letters to the workers. However, 40-50 per cent of large enterprises provide appointment letters to the workers. About 34 – 51 per cent enterprises paid workers' wages in the first week of the month, while another 47- 49 per cent paid wages in the second week. The practice of payment of workers' wages in the third week of the month is evident not only in small enterprises, but also in medium and large enterprises.

6.3 Normal working hour is relatively high in all categories of sweater units, (about 9 hours); this was followed by knit units (8.30 hours) and woven units (8 hours). Length of overtime working hour is about 13.9 hours per week or more than two hours a day, which has increased by about 3 per cent after the MFA phase out. Thus, effective working hour in sample enterprises has increased by 0.5 per cent in 2005 compared to that in 2004. Longer working hours and high load of work in the factory, especially in sweater and knit factories, have reduced workers' leisure hours. Besides, pressure from the production managers to fulfill high production targets also made their lives very stressful. This often led to deterioration in relationship between workers and management people directly involved in production. However, majority of sample workers wanted to work overtime mainly to sustain their livelihood.

6.4 Most of the enterprises, according to their owners, maintained a weekly holiday. 50 to 80 per cent workers mentioned that maternity leave was provided by their respective factories. Day-care or canteen facility is available in 53 per cent woven factories; the share is very low in the case of sweater and knit factories. Workers take their meal sitting in the stairs or in the corridors or by going back home. In general, the trend is for all types of enterprises to provide such facilities in increasingly greater number in recent years. Analysis shows that monthly wage of a female worker was 28.04 per cent less than that of a male worker with identical characteristics. Monthly wage of a skilled worker was 16.07 per cent more than that of a non-skilled worker. Experience is found to have a positive and significant impact on wage with diminishing marginal effect. In another regression analysis it is found that compliance standard of large enterprises is about six points higher than medium enterprises; while the standard of small enterprises is three points lower than medium enterprises and both are significant at a high level. FDI-led enterprises are more compliant than non-FDI enterprises (by about 6.7 points), while EPZ enterprises are marginally better off compared to non-EPZ enterprises. Woven and knit enterprises are relatively better compliant than sweater enterprises.

6.5 The number of emergency exits is higher in large enterprises (3.2) compared to that in medium (2.0) and small enterprises (1.9). EPZ factories have twice the number of fire extinguishers compared to non-EPZ factories. According to the survey, government inspectors visited a factory 8 times in 2005 in order to check factory level compliance standard and other norms. To compare, the frequency of visit in the case of Cambodia was 16 and in China it was 14. Number of toilets in each floor was relatively higher in

EPZ-factories (23) compared to non-EPZ factories (11) and the number was much higher in the case of FDI-led factories (27). On average, there were 0.8 doctors available in every factory, which indicates a good number of factories have no in-house doctors. According to sample workers, most common diseases from which they suffered were headache, cold fever, etc. since workers worked in a congested place, they were exposed to toxic substance and dust.

6.6 Trade union activities were almost non-existent in the garment sector (2 per cent). The management is strongly against formation of trade union. A large number of respondents opined that management highly discourages any workers' movements and trade unions. Sample entrepreneurs are more or less divided as regards necessity of having a negotiating body to deal with workers demands and other issues. Survey finds that 55 per cent of EPZ factories and 20 per cent of non-EPZ factories have Workers' Welfare Committee (WWC). WWC activity has marginally increased in 2005 from 2004. EPZ enterprises have 7 percent higher number of meetings with workers in WWC in 2005; the increase in the case of FDI-led enterprises is by 20 per cent.

6.7 There is a lack of harmony in the code of conducts followed by the different brands such as Wal-Mart, Reebok, FLA etc. particularly in the cases of minimum age requirements, wages and benefits and overtime payment. Better coordination and cooperation is felt essential to address this confusion and agents of the brand, government regulators and RMG industry should work towards a tripartite understanding.

6.8 The analysis indicates that highly compliant enterprises are 57 per cent more productive compared to less compliant enterprises and 65 per cent more productive compared to moderately compliant enterprises. Sample entrepreneurs were of the opinion that for enhancing labour productivity a number of measures should be taken: organise training for workers, improve compliant situation, diversify production, provide entertainment facility, increase workers' wage and provide other incentives, and ensure good behavior with workers, etc.

7. Livelihood Issues Concerning RMG Workers

7.1 Majority of the sample workers joined the profession mainly because of lack of alternative job opportunities in other sectors. Most male married workers' spouses are house wives— 46 percent in sweater units, 34 percent in knit units and 11 per cent in

woven units. On average spouse's monthly income is about Tk.4,200. Most of the sample workers lived either in tin-roof or pucca houses. During working hours, sample workers had to leave their children at home with some one. In a large number of incidences, when both husband and wife were working and do not have a close relative living nearby, they left their children in rural areas with their parents. Savings propensity is found to be highest among sweater operators (72 per cent) and lowest among helpers of knit units (29 per cent). Sample operators, on average, have incurred debts of about Tk.8,000 with woven operators, Tk.8,670 and sweater operators, Tk.6,300. A major proportion of these debts are on medical treatment either for workers themselves or for their family members.

8. Structural Weaknesses and Future Challenges for the RMG Sector

8.1 Some of the major structural weaknesses identified in this study are high lead-time, interrupted electricity supply, delayed shipment, lengthy and cumbersome procedures in the customs related activities, damage of goods while loading and unloading and lack of vessels stand out among the port problems. Electricity problem is found to be more acute for small and medium enterprises (69 hours and 72 hours respectively). Electricity problem is most acutely felt in sweater factories (73 hours), followed by knit factories (71 hours) and woven factories (49 hours). Regarding laws and regulations, 33 percent entrepreneurs perceived that the laws and regulations should be further improved, especially in the areas such as allowing workers to work during night shift, relaxing the restrictions as regards appointing young workers, and allowing the enterprises to recruit them as necessary, making stricter laws for ensuring worker's health and safety in the workplace. Regarding future challenges, majority of entrepreneurs have mentioned about competition with China after 2008 when the safeguard measures against China will be lifted. Besides, implementation of the new wage structure could be a challenge for the sector, since cost of production will increase (Tk.9,40,000 on average) through implementing the new wage structure. The highest level of burden would be on small knit enterprises, about 6.6 per cent, while the lowest would be on medium sweater enterprises (0.96 per cent) and large enterprises located in EPZ (0.24). Estimates show that with the new wage structure, about 5.3 percent enterprises would earn a negative profit (ranging between -14 per cent and -1 per cent). 7 percent would earn about a 3 per cent profit. During January-August, 2007 Government took a number of initiatives to improve management,

operational system, and worker related issues of the Chittagong port. A number of these reform measures were expected to help improve operational efficiency of the port, particularly in terms of time use; this, in turn, is expected to lead to a reduction of lead time to a certain extent.

9. Policies for Strengthening Competitiveness of the Apparel Sector

The survey reveals there have been significant changes in the post-MFA phase in the RMG sector in terms of technology absorption and innovation, sourcing of inputs, marketing structure and strategy, wage pattern and labour adjustment, rate of return, and state of compliance. At the same time, sector is currently facing new challenges and it has structural weaknesses in some areas. To face these challenges and to translate potential comparative advantage into revealed comparative advantage, necessary policy interventions are immediately required.

9.1 Policy Support for Scaling Up: The study indicates growing consolidation in the country's RMG sector through different ways such as consolidation of different units, acquisition and merger of units under different ownership and establishing new units with acquisition of new technologies. Factories with medium and large sizes have operated under upgraded production processes, used sophisticated technologies, manufactured and exported diversified products, employed more workers etc. The CPD survey revealed that scaling up of operation would enhance, inter alia, profitability, productivity, compliance standard capacity to manufacture high end products. The nature of market dynamics also bears out that buyers increasingly prefer to concentrate on a limited number of countries capable of meeting bulk orders. Thus, even in case of orders for traditional items, there is a growing demand for scaling up production. Analysis shows that transition of a small-scale enterprise to a medium-scale would require an additional capital stock of \$1.16 million and the entrepreneur's profit may meet only 7 per cent of the required capital. Comparable figures for a medium scale enterprise would be \$2.49 million and about 14 per cent respectively. Scaling up efforts of RMG enterprises need to be supported through (a) land acquisition to prepare industrial plots, (b) regulatory facilitation for acquisition and merger of units, (c) continuation of zero-tariff access to RMG machineries and spare parts, and (d) facilitating access to labour through decentralized development in peri-urban areas.

9.2 Policy Support for More Advanced Production Processes and for Manufacturing of High-End Products: The study revealed that majority of the sample enterprises are still involved in basic production processes and dependent on retailers and buying houses for production orders. A significant part of advanced forms of operations are found in the EPZ units, especially in FDI-led enterprises having their own fashion and design units, R & D units and marketing units that are able to establish direct links with international buyers. While it is evident from the survey that short to medium term perspective Bangladesh's comparative advantage will lie in volume-led, lower-end segment of the apparel's demand curve, a gradual movement to medium-end segment of the market is both desirable and inevitable, for at least a significant percentage of enterprises. This graduation should be supported by policies. However, this would require more capacity in such areas as fashion and design, use of IT, R&D, and direct marketing. Targeted policy support for development of fashion and design capacities and strengthening of the related institutions will help more enterprises to explore this segment of the market. Acquisition of sophisticated technologies to manufacture high end products is not widely evident even in large Non-EPZ and EPZ factories. A 'Technology Development Fund' may be put into place to promote and support the process of up-gradation. In addition, policy support in credit facility to encourage technology acquisition, revamping the vocational training system towards acquisition of skills to operate those machineries and initiatives to facilitate more informed choices have been recommended. It seems that instead of fully upgrading the process in large and medium enterprises, it be would better to establish separate sections/units for manufacturing fashionable and high-end products. Initially these units could be operated taking the technical and marketing support of experts/RMG enterprises of neighbouring countries such as China and India. Local fashion-schools need to put more emphasis on fashion-designing courses beside their existing focus on merchandising and commercial issues. In the National budget 2007- 08, an amount of Tk.4.68 crore has been allocated for the development of 10 textile vocational institute; another Tk.3.5 crore has been allocated for strengthening of NITTRAD's and TSMU's capability for development of textile sector. However, appropriate utilisation of these funds should be ensured.

9.3 Policy Support for Acquisition of New Technology: A clear trend favouring acquisition of new technologies by the RMG enterprises is visible from the survey. Import of less sophisticated flat knitting machine has been on the decline, while the

share of the more advanced circular knitting machine of various types has been on the rise. Such technology upgradation has been more prominent for the relatively larger units. Share of automatic sewing machines in sewing operations has increased substantially (from 23 per cent to 78 per cent between 2002 and 2006) as against a significant fall in that of non-automatic sewing machines (from 57 per cent to 15 per cent over the same period). Indeed the government of Bangladesh has facilitated such restructuring of the capital stock through various policies over the recent past: zero-tariff for machineries imported by export-oriented units and zero-duty on import of spare-parts for such machineries. Notwithstanding the support provided so far, the sector needs further support in three areas: (a) credit facility to encourage technology acquisition, (b) revamping the vocational training system towards acquisition of skills to operate those machineries, (c) initiatives to facilitate more informed choices with regard to new technologies. The issue of setting up a dedicated Technological Upgradation Fund to be managed through collaboration of the trade and industry bodies is gaining prominence in this context. Indian government for textile and apparel manufacturers could be a good example for Bangladesh. Indian government has provided various incentives to RMG and textile sector under the “Technology Upgradation Fund Scheme (TUFS)” including credit linked capital subsidy @ 20% for decentralized powerloom sector, increase of ceiling of capital subsidy from Rs.12 lakh to Rs.20 lakh, fixation of benchmarked price of second-hand imported shuttle less looms of vintage exceeding 10 years and up to 15 years with a residual life of 10 years etc. Besides, Indian government has allocated Rs.911 crore for the Fund in 2007-08.

9.4 Promoting Labour Absorption through Technology Upgradation: According to sample entrepreneurs, expansion of operation in RMG units through use of new machineries have, through direct and indirect multiplier effects, created new jobs for skilled workers since new machines required more skilled workers for their operation. In view of the increasing demand for professional and skilled work force, especially in such areas as merchandising, marketing, commercial and engineering, there is a need for revamping both higher and technical education in the country. In this context, partnership between RMG enterprises and public/private institutes could be an effective way to go forward. These programmes should focus on both new entrants and professionals who are already engaged in the sector. In this connection, entrepreneurs mentioned about two types of courses: ‘elementary’ and ‘advanced’

courses in various RMG related areas. In order to ensure supply of skilled labour force, vocational and diploma institutes should expand their existing capacities and go for enhanced enrolment of prospective employees of the RMG sector. The BGMEA, BTMA and BKMEA should be brought into the picture in a more effective way. Regrettably, it is not known how in FY2006-07, the Taka 200 millions allocated by the government for skill development of the RMG sector was actually used. Comparable amount of resources have been allocated in the national budget 2008 for training and enhancing efficiency of the garments workers. It is important to ensure appropriate utilisation of that resource. A national comprehensive plan for effective utilization of various technical, vocational and diploma training institutes for the benefit of the export-oriented RMG sector should be put high on the policy agenda of the government.

9.5 Policy Support for Strengthening R&D Activities: Survey indicates that R&D activities in the sample enterprises were highly limited - only 9 per cent sample enterprises were found to have a separate R&D section. Survey found strong relationship between R&D activities and productivity of labour. R& D activities should be enhanced at enterprise level. Entrepreneurs are interested in certain kinds of R&D activities such as development of new design and fashion, R&D that helped enhance worker level productivity, as well as management level efficiency, etc. EPZ and FDI-led enterprises had put more emphasis on development of new design and new fashion through R&D activities. In this context, establishment of a research institute by the BKMEA namely “Institute of Apparel Research and Technology (iART)” in August 2007 is a welcome initiative. BGMEA and BKMEA should initiate research on development of new products, production techniques, upgradation of skill, motion analysis of workers etc. Collaboration between RMG enterprises and public/private institutes for research on fashion designing, modern technologies etc. could generate good results. Government should develop a “Fund for R&D Development” for textile and apparel sector under which subsidised credit could be disbursed for the establishment of R&D units in RMG enterprises. Enterprises which introduce R & D units should be given tax exemption for a certain period in order to encourage development of new products, production process which could contribute to manufacturing of high-end products.

9.6 Promoting Clusters: The study found cluster-based development largely absent in the RMG industry. There are some concentrations of industries in some areas which are

developing both through relocation and through setting up of new enterprises. Such clusters have created demand for effluent treatment accessories, dyeing, finishing support and skilled labour. Since most of the small and medium size units do not find it cost-effective to go for diverse activities such as dyeing, washing, printing, and embroidery, a number of specialized enterprises have emerged in these areas. The government of Bangladesh should promote and support the development of such clusters which could also be extended to such areas as skill development, R&D and marketing. To this end, government should create a 'Cluster Development Fund' under which entrepreneurs will get financial support to develop specialized service facilities in different RMG-factory zones. A well developed linkages in different services provided in a cluster zone would encourage enterprises to outsource more of different services, which would reduce the overhead cost of production as well as ensure better quality of products and ultimately make the enterprises more competitive. In India, 26 integrated textiles parks have been approved so far out of 30 sanctioned under the Scheme of SITP. Allocation for these parks increased Rs.425 crore in 2007-08 from Rs.189 crore in 2006-07. Indian government also increased allocation for the Technology Upgradation Fund (TUF) to Rs.911 crore in 2007-08.

9.7 Support for Enhancement of Labour Productivity: Labour productivity in Bangladesh is very low compared (US\$1563) to other competing countries such as China, Cambodia, India, Indonesia, and Sri Lanka. Labour productivity in the EPZ enterprises is found to be 9 per cent higher, on average, compared to that of non-EPZ enterprises, while it was 27 per cent higher in FDI-led enterprises compared to non-FDI enterprises. Large non-FDI enterprises located in DTAs are found to be at par in terms of productivity with EPZ-based FDI-led enterprises. However, no significant spill over effect could be found between EPZ/non-EPZ and FDI/non-FDI firms in terms of technology acquisition and adoption and other modern business practices. The study reveals that labour productivity is highly correlated to wage; one unit rise in wage was expected to increase labour productivity by 1.3 units. This signifies the implementation of the new wage structure. The study revealed that for increasing labour productivity at the enterprise level, appropriate training, improvement of compliance situation, diversification of product mix, provision of entertainment facility, performance incentives, and good behaviour towards workers are crucial. Although there is fund allocation for skill development of the RMG workers but the current scenario to a greater extent does not reflect usage of those funds appropriately

and hence an initiative under a public-private partnership is essential. In the national budget for FY2006-07, government allocated about Tk.20 crore for a Skill Development Fund for the RMG workers. Such allocation was also present in the previous budget, but to what extent the allocated sum has been utilised for the intended purpose is not evident. In the national budget 2008, government has allocated Tk.20 crore for training and enhancing efficiency of the garments workers. One needs to pursue this initiative under a public-private sector partnership.

9.8 Better Labour Management in view of Changing Labour Composition in RMG Units :

Bangladesh's export performance is being driven mainly by volume. Consequently there is high degree of pressure on workers to achieve the high target volumes. Under a pressured working situation to fulfill a high target everyday for long period may threaten the relation between workers and mid-level management. The gender comparison of workers is also changing. In knit and sweater sections the proportion of male workers is on the rise. This is likely to have important implications for labour relations in the RMG sector. Some early signals of this is being already seen. In this context, enterprises at first should not take orders from buyers to that amount which could not be managed in usual working hours; at the same time buyers should place orders, which is commensurate to the production capacity of factories and their related subcontracting factories. Secondly, enterprises under such conditions would need to improve labour management practices. With the rise of knit sector including sweater sub-sector, presence of male workers is becoming increasingly visible in the export-oriented RMG sector of Bangladesh. This compositional change is likely to bring forth new sets of demands, which could even be sub-sector specific. There is a need for a continuing dialogue between workers and management, particularly in view of changing employment composition and their new types of demands. Labour relations is likely to become crucially important in near future and RMG enterprises must accord due attention to this. Bangladesh may take lesson from Sri Lankan experience where the government had allocated a special fund (Sri Lankan Rs.80 million) in the budget for 2006-07 to establish an "Academy of Labour Relations" to promote harmonious labour relations in work places.

9.9 Ensure Implementation of the New Wage Structure: Evidently, implementation of the proposed wage structure would increase overall cost of production in the RMG units which are expected to incur an additional annual expense of Tk.9.41 lakhs (equivalent to US\$14,000). This will lead to some reduction in profit in the short term. However,

this should not be a reason for not implementing the new scale immediately and speedily. The new scale has been proposed after twelve years since the earlier scale was put in place. Our estimates indicate that the incremental burden will be manageable from the perspective of the overwhelming majority of the RMG units. Indeed, as the survey results indicate not only the workers, but a significant percentage of entrepreneurs as well felt that wage level has a positive association with performance, and the former needs to be raised. In case of small, informal, sub-contracting based units where enforcement of the new scale could make the enterprise unviable, trade bodies and the government could think together of a package of support following proper identification. Our analysis also bears out a positive association between higher wages and higher productivity. Higher wages are also positively related to better working environment and better compliance. Government is monitoring implementation of new wage structure in the RMG units and requested firms to implement it by the end September, 2007. The government may set up a committee, in collaboration with entrepreneurs and workers, to oversee faithful and appropriate implementation of the new wage structure on a sustained basis.

9.10 Need to Improve Workers' Livelihood: From the country's development perspective, generation of large number of employment through garment sector is no longer regarded sufficient for the development of the poor unless better livelihood conditions can be assured by this employment. Workers' livelihood can be improved firstly by providing them with higher level of wages since their wages are found to be only 43 per cent of their productivity level. With effective support from entrepreneurs and garment associations, NGOs can improve workers' living places by way of providing various services. Government may create a 'Workers' Livelihood Improvement Fund' to support NGOs who are engaged in providing various kinds of health, nutrition, medical and child care support to garment workers.

9.11 Need to Develop 'Compliance' Brand for the RMG Sector: Compliance standard of RMG units varied widely in respect of size of operation and type of compliance. Factory level compliance standard is relatively better than social compliance. Compliance standard is poor in a number of areas including timely payment of wages, canteen facility, childcare facility, availability of doctors, appointment letter etc. In most RMG units workers are not allowed to form organizations at factory level. WWC is present only on a limited scale. In the course of the survey, about 57 per cent sample enterprises were found to be 'less compliant', while another 31 per cent were

‘moderately compliant’ and only 11 per cent enterprises were found to be ‘highly compliant’. The compliance standard of factories was calculated on the basis of sixteen factors in the areas of factory level and social compliance. Survey revealed that maintaining good compliance record with respect to the required standards have positive impact on productivity, indicating that enforcement of compliance at enterprise is likely to yield positive dividends for the RMG sector. Since a number of large and medium enterprises are approaching to enter high-end segment of apparel market, maintenance of a high level of compliance standard at the factory level is being considered as the basic requirement to get those orders. These enterprises thus need to focus on labour-management and labour-relation with highest priority, followed by environmental safety measures in case of disposal of industrial wastes and effluents etc. A common compliance standard need to be established which would take care of domestic legislation as well as buyers’ requirement (code of conduct) which would be enforced through the monitoring agency. The government of Bangladesh could set up a ‘Compliance Upgradation Fund’ in support of developing compliance standard where buyers also could contribute. Enforcement of standards of their own by individual (major) retailers creates a problem in absence of any ‘clearing house’. In view of this, RMG associations could work with major buyers to ensure a common set of standards agreed upon by all buyers. This could place Bangladesh in the global market as a ‘compliant source’.

9.12 Support for Relocation: The concentration of RMG industry in the cities of Dhaka and Chittagong is already revealing a number of disadvantages from the perspective of the need for future expansion of the enterprises and consolidation of the industry. In view of increasing demand in the area of compliance assurance many of these enterprises are looking for opportunities to shift to alternative locations, away from residential and commercial areas in Dhaka and Chittagong. The issue of support for relocation was strongly stressed during the FGDs. The government of Bangladesh has recently announced establishment of a number of garment villages in Adamjee, Munshigonj and other places to facilitate this process. Government may consider creation of a ‘Fund for Relocation of Factories’ to provide concessional loans to the enterprises to stimulate the process. Establishment of new RMG units within the limits of the major cities should also be restricted to the extent possible. It may be noted that the Indian government has approved 26 parks under the Scheme for

Integrated Textiles Parks (SITP) and increased allocation of Rs.425 crore in 2007-08 from Rs.189 crore in 2006-07.

9.13 Support for Improvement of Existing Laws and Regulations: About one third of sample entrepreneurs are of the opinion that laws and regulations guiding the operation of RMG industry should be improved. Bangladesh required more flexible working hours, with provisions for work during the night shift, recruitment of young workers as apprentices etc. Others mentioned about enforcement of more strict laws for improvement of worker's health and safety standards in the workplace, change in the building codes for improving working conditions, and for ensuring compliance with factory laws etc. The issues and concerns as regards various acts of the new Labour Law such as working hours, punishment for failing to provide maternity leave, retirement benefit of workers, timely payment of fired workers etc. need to be reviewed. Thus government may consider setting up a committee to review different Acts of new labour law and also review other rules and regulations relevant to the garment and textile sector with a view of changing these to suit the emerging demands of the industry.

9.14 Need to Focus on Stock Market for Required Capital: The trend of upscaling visible in recent years could in future demand that the RMG industry has access to larger amount of capital for the sort of restructuring taking place at present. The survey found that most of the locally-owned enterprises are private limited companies which are in most cases are operated by board of directors, constituted by family members. In this context, policy support for creating a conducive and enabling environment for the RMG sector to raise funds from the capital market should be given due consideration. Along with this, the RMG enterprises, particularly the large scale ones, should improve their state of corporate governance including standards of auditing, reporting, accounting, management etc. So that they are adequately prepared to offload shares and raise capital in the country's stock market.

9.15 Support for Reduced Lead Time: Lead-time is another crucial factor that puts Bangladesh at a disadvantageous position when compared to China or India. With the change in the consumer market in recent years, retailers tend to spend more time on research on fashion and design, and they are putting more responsibilities on manufacturers under 'lean retailing' arrangement. Strengthening both backward and forward linkage has become crucial, in this context. Ready access to raw materials and inputs and higher capacity at enterprise level to carry out order-specification

related functions are proving to be important. Bonded ware-house facilities for relatively longer period for items for which inputs are not available locally deserves careful consideration in this context (e.g. man-made synthetic grey fabrics). A consensus-based policy needs to be developed on an urgent basis in this respect. Recent initiative to extend the period of bonded warehouse facility is a welcome move. To overcome Chittagong port related weaknesses and bottlenecks and to reduce the overall time of handling goods, the number of containers in the quay area could be drastically reduced by increasing the tariffs for container storage. In addition, reducing the necessary steps to halve is required for customs clearance and set up a system fully in sync with the custom's office for speedy storage, clearance and delivery of goods. With gradual transformation of port operation to an automated one would help overcome the issues.

9.16 Overhaul Port Management: Sample entrepreneurs have pointed out a number of bottlenecks and weaknesses in the management and operation of the Chittagong port. About 35 per cent of entrepreneurs have mentioned about bribe-taking by port officials, 24 per cent mentioned about unnecessary delay caused by port officials in handling export and import consignments, 14 per cent mentioned about container jam in the port which led to delays in shipment, loading and unloading. Lack of vessels for importing raw materials and inputs was another problem that was mentioned by entrepreneurs. Damages of imported or exported goods at the time of unloading or loading were also important concerns of manufacturers. In this backdrop, Caretaker Government's recent initiatives to address management, operation and labour relations issues are expected to contribute to improving efficiency of Chittagong port. These measures include three-shift workday for dockworkers for ensuring round the clock operation at the port; reduction of container handling charges from Tk.4000-5000 to Tk.1200; handing over cargo handling activities of the different jetties in general yards to private companies; shifting handling activities of nine bulk items outside of the port area; allowing delivery of Full Container Load (FCL); reducing the size of the labour groups; setting up sector wise off-dock inland container depot (ICD); cancellation of unreasonable fees and charges by shipping agents and reducing the number of signatures required from customs and port authorities for clearing papers; prescheduled berthing system with effect from August, 2007 etc. To speed up handling activities, government could allow loading of containers at factory premise instead of loading goods at the port premise. Further expansion of port

facilities will be required in the future in order to handle large volume of imported and exported items.

9.17 Need to Develop Backward Linkage Textile Sector: In view of the pressure on lead time, a competitive textile sector would play a critically important role in (a) raising the competitiveness of the forward-end apparels and (b) reducing the lead time. To encourage more investment in the backward linkage textile sector, the government has already taken a number of fiscal measures. In national budget 2008, large allocation was made for the development of textile industries, with a view to promote integration with RMG sector- about Tk 8.48 crore has been allocated for 3 different projects. However, appropriate utilisation of these funds should be ensured. Moreover, access to suitable land and capital needs to be facilitated to establish textile units. Foreign investment particularly for manufacturing woven textile needs to be encouraged. In addition, the proposed “Technology Up-gradation Fund” could also provide support for modernization and technology acquisition initiatives in the textile and RMG enterprises, as is evidenced by the Indian experience.

9.18 Ensuring Uninterrupted Electricity Supply for RMG Units: The study revealed that sample enterprises did not have electricity supply from PDB/REB for about 61 hours each month during 2005. This shortage of electricity was 15 per cent higher compared to that of 2004, testifying to an increasingly aggravating situation. Problem of electricity outage was more acute for small and medium size enterprises (69 hours and 72 hours respectively) as these enterprises could not bridge the gap between demand and supply from their limited captive power generation facility. Besides, the study indicated a negative correlation between lost hours due to outage of electricity and enterprise’s earning of profit (-0.20). In view of rapid expansion and upgradation taking place in the export-oriented RMG sector, use of machineries has increased substantially in recent years. One of the major bottlenecks constraining the expansions of RMG is found to be disruption in the supply of electricity. Government has taken some measures to address the electricity supply problem which include economizing its use, fixing sequential holidays for factories in different industrial/commercial zones etc. However, all these are only temporary measures. Some of the small scale power generation plants getting approval in recent times may not start operation in due time because of lack of supply of gas in the plant. Government may consider exemption of VAT on electricity bill for operating garment factories. Government

may provide subsidy especially to small and medium firms to set up small scale captive power plants. Power generation ought to be given highest priority.

9.19 Vigorously Pursue Various Market Access Initiatives: In view of the heightened competitive pressure following the MFA phase-out, the issue of duty-free, quota free access to the markets of developed countries has acquired added urgency. The analysis carried out in the study bears testimony to falling profit margins and increasing competition. Implementation of the Hong Kong Ministerial decision of the WTO (Annex 36, F of the decision) in a manner that would include (most of) apparels items was thus critical to Bangladesh's RMG industry's competitiveness in the global market. Bangladesh should also lobby for the passing of the TRADE Act by the US Senate. Simulations show that this could potentially increase Bangladesh's apparels export by US\$600-1000million has not yet materialised. Analysis of the data indicates that increasing the local value addition is critical to acquiring the capacity to comply with the rules of origin, both for the EU and the US markets. As is known, the EC rules of origin are being revised at present (from double-jump to value addition criteria). If Bangladesh is to enhance her GSP utilization capacity, this could only be done through enhanced value addition. In view of this, with respect to the issue of market access Bangladesh should focus on several areas: (a) try to ensure that the 97 per cent list for the US market is designed in such a manner that it includes at least some items of apparels; (b) negotiate RoO in EU and USA that enables very high GSP utilization rate (the Canadian GSP, 25 per cent domestic value addition requirement for all LDC exports, should serve as the reference point); (c) enhance and strengthen backward and forward linkage capacities in the RMG sector to raise compliance with RoO and (d) vigorously pursue all market access negotiations in WTO, with EC, USA and in the context of RTAs such as SAFTA and BIMSTEC. In this context it is important to note here that duty free market access for apparels in India (8.0 million pieces per year) under the SAFTA, on a limited scale, is going to be operationalised soon. It needs to be seen that Bangladesh RMG sector is actually able to fulfill the quota. Bangladesh's strategy should be gradual expansion of this tariff rate quota with the objective of taking RMG items out of India's negative list. Bangladesh should also carefully study the recently proposed NAMA draft of the WTO. The lists in the annexes of NAMA draft, identified for slower tariff reductions, need to be carefully scrutinized. It is highly important to ensure that items of

Bangladesh's interest that enjoy preferential treatment are included in the list, and those that do not enjoy such treatment are excluded from the lists.