

Toward New Sources of Competitiveness in Bangladesh

DIRECTIONS IN DEVELOPMENT

Trade

Toward New Sources of Competitiveness in Bangladesh

*Key Findings of the Diagnostic Trade
Integration Study*

Sanjay Kathuria and Mariem Mezghenni Malouche



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Foreword

Bangladesh can be justly proud of its track record in reducing poverty and achieving progress on key human development indicators, such as child mortality, school enrollment, and female empowerment, to name a few. In mid-2015, reflecting a decade of robust growth, the World Bank reclassified Bangladesh from “low income” to “lower-middle-income.”

Over the next decade, the most important development challenge for Bangladesh will be to provide more and better jobs to its workers, as more than 20 million people join the labor force.

Achieving this goal will require Bangladesh to connect more deeply to the world market for garments and other labor-intensive products. Opportunities exist, particularly as wages continue to rise in China, gradually reducing China’s dominance in labor-intensive manufacturing.

To benefit fully from international demand and emerging opportunities for export-based job creation, Bangladesh will need to craft a proactive strategy. This comprehensive report lays out a path for doing so. It covers a lot of ground, including trade policy and institutions, logistics and infrastructure, and finance and foreign direct investment. It also anchors that thematic work in detailed studies of different sectors, such as shipbuilding, non-leather footwear, jute products, garments/polo shirts, bicycles, information technology, services, and pharmaceuticals.

We are confident that the depth and breadth of the report, combined with the high quality of its analysis, will contribute to the development debate in Bangladesh. In addition, policy makers and development partners will find a possible reform agenda, focused on areas critical to Bangladesh’s development, that they can support.

The World Bank Group is already supporting the Government of Bangladesh in a broad range of areas related to private sector development, and, following the guidance of this report, expects to deepen this engagement, centering around job creation and trade and competitiveness.

We are grateful to the Government of Bangladesh for entrusting the World Bank Group to carry out this important diagnostic work, and to the Enhanced

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

The World Bank thanks the Government of Bangladesh for placing its confidence in the World Bank to conduct this study. The main counterpart for the DTIS is the World Trade Organization (WTO) Cell in the Ministry of Commerce of Bangladesh. The European Union is the donor facilitator, which means it is taking the lead in mobilizing resources to fund the identified actions. The Government of Bangladesh has displayed strong ownership of the task, initiating its preparation and forming a national steering committee with concerned ministries, local think tanks, and the private sector to provide guidance to the work. The government's views and comments have been reflected at all stages of the report, from the concept-note stage to the final Action Matrix. The team particularly thanks Mr. Amitava Chakraborty, Director General (Additional Secretary), WTO Cell, and the team in the WTO Cell, Ministry of Commerce, including Mr. Nesar Ahmed (Director, WTO Cell), Md. Hafizur Rahman (Director, WTO Cell), Dr. Md. Moniruzzaman (Director, WTO Cell), Mr. Mohammad Zakir Hossain (Deputy Director, WTO Cell), and Mr. Mohammad Mashooqur Rahman Sikder (Deputy Director, WTO Cell).

Development partners, think tanks, the private sector, and other stakeholders have been consulted regularly at different stages in the preparation of the DTIS. Their views have been solicited through consultative workshops and one-on-one meetings. As an example, the team organized a consultative workshop with business leaders, development partners, members of the government, members of academia, and researchers in June 2010. One-on-one meetings were also held with a number of individuals. The team organized two interim consultative workshops in December 2012. A two-day validation workshop was organized jointly by the WTO Cell, Ministry of Commerce, and the World Bank on October 22–23, 2013, in Dhaka. The prioritized recommendations of

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The report has been prepared by a core World Bank team led by Sanjay Kathuria (Lead Economist) and Mariem Mezghenni Malouche (Senior Economist), including Nadeem Rizwan (Research Analyst). The contributing team included several World Bank Group staff members and consultants, including Charles Kunaka (Senior Trade Specialist, World Bank); Peter Kusek (Senior Investment Policy Officer, IFC); Michael Friss Jensen, Olivier Cadot, Nihal Pitigala, Hugh Baylis, Zaidi Sattar, and PRI Bangladesh; Dr. Selim Raihan (Dhaka University) and Rupa Chanda (Indian Institute of Management, Bangalore); Kay Dausendschoen (FutureShip); Glenn Surabian and Yasuo Konishi (Global Development Solutions); and Atdhe Velu. Support was also received from Martha Denisse Pierola (Economist), Jose Daniel Reyes (Economist), Mohammad Anis (Energy Specialist), Iffath Sharif (Senior Economist), Ayesha Vawda (Senior Education Specialist), Tanya Primiani (Investment Policy Officer, IFC), and Sanjana Zaman (Research Analyst). The team thanks the development partners for their comments and cooperation. The team acknowledges comments received from World Bank Group colleagues, including peer reviewers Ndiame Diop (Lead Economist, MNSD), Philip Schuler (Senior Economist, AFTP1), Vincent Palmade (Lead Economist, SASFP), and Reynaldo Bench (Senior Port Specialist, TWITR); Salman Zaidi (Lead Economist); Zahid Hussain (Lead Economist); Vinaya Swaroop (Sector Manager, SASEP); Gladys Lopez-Acevedo (Lead Economist); Martin Maxwell Norman (Senior Private Sector Development Specialist); Manju Haththotuwa (Senior Private Sector Development Specialist); Arbind Modi (Principal Operations Officer, IFC); Sherif Muhtaseb (Senior Operations Officer, IFC); Hosna Ferdous Sumi (Associate Operations Officer, IFC); Raihana Rabbany (Consultant, IFC); Rodrigo Cubero and Seng Guan Toh (IMF); and Sadiq Ahmad and Zaidi Sattar (PRI). Mariem Mezghenni Malouche, Lalita Moorty, and Md. Abul Basher led the initial preparation of the concept note for the report. The team thanks Mehar Akhtar Khan and Kamrun Nahar Chowdhury for support with desktop publishing, logistics, and organizing the workshops in Dhaka. Rita Soni and Muhammad Shafiq helped with contracting and Sandra Gain and Michael Alwan edited the report. The team also thanks colleagues in the International Finance Corporation (in particular, Masrur Reaz and Paramita Dasgupta) for supporting a number of the sector studies, which greatly helped to increase the coverage of the DTIS, and Christiane Kraus, Chief Coordinator for the Enhanced Integrated Framework at the World Trade Organization. Finally, the team acknowledges the support of the World Bank management team led by Country Director Johannes Zutt (and previous Country Director Ellen Goldstein) throughout the process of preparation.

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Abbreviations

6FYP	Sixth Five-Year Plan
ADB	Asian Development Bank
AEO	Authorized Economic Operator
API	active pharmaceutical ingredients
ASEAN	Association of Southeast Asian Nations
ASYCUDA	Automated SYstem for CUstoms DAta
BASIS	Bangladesh Association of Software and Information Services
BB	Bangladesh Bank
BEZA	Bangladesh Economic Zones Authority
BFTI	Bangladesh Foreign Trade Institute
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
BIDS	Bangladesh Institute of Development Studies
BITM	BASIS Institute of Technology and Management
BIWTA	Bangladesh Inland Water Transport Authority
BJRI	Bangladesh Jute Research Institute
BKMEA	Bangladesh Knitwear Manufacturers and Exporters Association
BOI	Board of Investment
BPDB	Bangladesh Power Development Board
BPO	business process outsourcing
BSTI	Bangladesh Standards and Testing Institution
BTC	Bangladesh Tariff Commission
BTMA	Bangladesh Textile Mills Association
BUILD	Business Initiative Leading Development
BWH	bonded warehouse
CAP	corrective action plan
CPA	Chittagong Port Authority
CPD	Centre for Policy Dialogue
DEDDO	Duty Exemption and Drawback Office
DFID	Department for International Development (United Kingdom)

DGDA	Directorate General of Drug Administration
DTIS	Diagnostic Trade Integration Study
dwt	dead weight tonnes
EEF	Equity Entrepreneurship Fund
EIF	Enhanced Integrated Framework
EPA	Economic Partnership Agreement
EPB	Export Promotion Bureau
EPZ	export processing zone
ERP	effective rate of protection
ESCAP	Economic and Social Commission for Asia and the Pacific (United Nations)
EU	European Union
FDI	foreign direct investment
FERA	Food and Environment Research Agency
FTA	free trade agreement
FY	fiscal year
GDP	gross domestic product
GIZ	Gesellschaft für Internationale Zusammenarbeit, the German Society for International Cooperation
GSP	Generalized System of Preferences
GT	gross tonnes
HS	Harmonized System
ICD	inland container depot
ICT	information and communications technology
IDLC	Industrial Development Leasing Company
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
IPS	Instant Power Supply
IT	information technology
ITC	International Terrestrial Cable
ITES	information technology enabled services
ITES-BPO	Information technology enabled services–business process outsourcing
IWT	inland waterways transport
JICA	Japan International Cooperation Agency
L/C	letter of credit
LCS	Land Customs Station

LDC	least developed country
LPI	Logistics Performance Index
MOAG	Ministry of Agriculture
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOI	Ministry of Industries
MRA	Mutual recognition agreement
MW	megawatts
NBR	National Board of Revenue
NLC	National Logistics Committee
NTB	nontariff barrier
NTM	nontariff measure
OEM	original equipment manufacturer
PMO	Prime Minister's Office
PPP	public-private partnership
PRI	Policy Research Institute
R&D	research and development
RCA	revealed comparative advantage
RMG	ready-made garment
SAFE	Safety Advancement for Employees
SBW	special bonded warehouse
SITC	Standard International Trade Classification
SMEs	small and medium enterprises
SPS	sanitary and phytosanitary
TA	technical assistance
TBT	Technical Barriers to Trade
TEU	20-foot equivalent container unit
TIR	Transports Internationaux Routiers (International Road Transport)
Tk	Taka
TRIPS	Trade Related Aspects of Intellectual Property Rights
TVET	technical and vocational education and training
UNIDO	United Nations Industrial Development Organization
UPS	uninterruptable power supply
US\$	U.S. dollar
USITC	U.S. International Trade Commission
VAT	value-added tax

WB World Bank
WTO World Trade Organization

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US\$1 = Tk 77.8 (March 2015)

Key Messages

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

One of the country's greatest development challenges is to provide gainful employment to the more than two million people who will join the labor force each year over the next decade. Moreover, only 58.1 million of the country's 103.3 million working-age people are employed. Bangladesh needs to use its labor endowment even more intensively to increase growth and, in turn, absorb the additional labor.

The Commission on Growth and Development (2008) suggests that all 13 country cases of sustained high growth over the postwar period were marked by full exploitation of the knowledge, resources, and deep and elastic demand that the global economy offered. Bangladesh will need to do the same and exploit the international market more intensively, building on the pivotal role that exports have already played in providing gainful employment and access to imports.

Bangladesh's exports have exhibited strong growth and doubled their world market share between 1995 and 2012, owing to success in garments, catering largely to the European Union and the United States. Since 2009, Bangladesh has become the world's second largest garment exporter, making it unique among least developed countries (LDCs) in its high share of manufactures in total exports, which reached 90.5 percent in 2013 compared with about 26.2 percent for LDCs.

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

To achieve the above and sustain and accelerate export growth will require actions centered on four pillars. The first pillar is *breaking into new markets* through (a) better trade logistics to reduce delivery lags, as world markets become more competitive and newer products demand shorter lead times, to generate new sources of competitiveness and thereby to enable market diversification and (b) better exploitation of regional trading opportunities in nearby growing and dynamic markets, especially East Asia and South Asia. The second pillar is *breaking into new products* through (a) more neutral and rational trade policy and taxation and bonded warehouse schemes; (b) concerted efforts to spur domestic investment and attract foreign direct investment and to contribute to export promotion and diversification, including by easing the energy and land constraints; and (c) strategic development and promotion of services trade. The third pillar is *improving worker and consumer welfare* by (a) improving skills and literacy, (b) implementing labor and work safety guidelines, and (c) making safety nets more effective in dealing with trade shocks. The fourth pillar is *building a supportive environment*, including (a) sustaining sound macroeconomic fundamentals and (b) strengthening the institutional capacity for strategic policy making aimed at the objective of international competitiveness to help bring focus and coherence to the government's reform efforts.

Detailed studies of a number of growing export sectors confirmed the cross-cutting findings highlighted above and added other, sector-specific issues. In shipbuilding, enforcement of standards for domestic ships would help bring the domestic and export market segments closer and help exporting yards to achieve better scale economies. More credible enforcement of standards in pharmaceuticals would help people's health and reduce the disincentives of firms, including foreign firms that practice self-enforcement. Training to upgrade skills is a critical need in many sectors, including shipbuilding, ITES, and bicycles. Foreign direct investment (FDI) could play a much larger role in many sectors, especially those with technology upgrading needs, such as pharmaceuticals, bicycles, and shipbuilding. Improvements in access to finance and easing of Bangladesh Bank-monitored current account transactions would relieve constraints across all sectors. Additional submarine cables would help the reliability of Internet services for the ITES sector.

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

Trade regime signals are critical for defining domestic production structures and shaping labor and capital usage. Bangladesh needs to increase the share of

labor-intensive manufacturing in its gross domestic product (GDP) and a stronger export orientation will play a critical role here. Increasing basic skills will be critical for Bangladesh to remain competitive in exports, improve worker productivity, and enable sustainable wage increases. For skill flows, development of cognitive and noncognitive skills through a focus on the quality of primary and secondary education, along with industry-specific skills, will bring immense dividends.

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

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

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

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

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

Bangladesh will need strong leadership to support its multisector competitiveness agenda. In many cases, it will require taking on strong domestic interests that may not welcome competition, either through imports or FDI. In other cases, it will require cohesion and coordination between different ministries or departments, such as the National Board of Revenue; the Ministries of Commerce,

Finance, and Industry; the Roads Division, and so on. If the Sixth Plan and Vision 2021 goals are to be achieved, this leadership has to be exercised.

Reference

Commission on Growth and Development. 2008. *Strategies for Sustained Growth and Inclusive Development*. Washington, DC: World Bank.