Manufacturing Sector in Bangladesh:
Is it a Sustained Driver of Economic Growth and Employment Creation?

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Bangladesh economy has witnessedsignificant structural changes over the last fourdecades. The share of agriculturein GDP has declined from over 60 percent to less than 20 percent, while the relative significance of industry(including manufacturing), currently estimated to be 28 percent of GDP, and services sectors (currently estimated to be more than 50 percent of GDP) has increased substantially,.Over the past two decades or so, Bangladesh, has experienced sustained overall economic expansion of more than 5 percent per annum. The growth dynamism in Bangladesh during this periodis largely provided by the industrial and services sectors. However, the economy is yet to have a strong manufacturing base, as the share of manufacturing in GDP reached only to 18 percent by 2010, which was only 3 percentage pointshigher than that in 1980.

The pace of reduction in agriculture's share in overall employment has however been much slower than the pace of reduction in agriculture's share in GDP. This suggests that growths in the overall manufacturing and services sectors have not been strong enough to reallocate surplus labour from agriculture. The share of the manufacturing in overall employment in 2010 was only around 13 percent which was much lower than this sector's share in GDP. This indicates that as far as the overall manufacturing sector is concerned, there remains a challenge for employment creation at a larger scale.

The import substituting trade and industrial policies after the independence in 1971, which continued until the end of 1980s, led to the composition of the manufacturing sector in Bangladesh heavily dominated by the import substituting capital intensive manufacturing industries. However, persuasionof the export-oriented policies during 1990s and 2000s, together with favourable external environment, resulted in the growth of the highly labour intensive readymade garment (RMG) industry. Manufacturing export-orientation is now an overwhelmingly salient feature of the country's export composition, thanks largely to the rapid expansion of the RMG industry. From a small base of only around US$ 32 million in 1984, RMG exports have grown to around US$ 20 billion by 2012, accounting for more than three-quartersof export earnings.RMG has been an important contributor to growth and employment generation in Bangladesh. It provides direct employment to about 4 million people – 80 per cent of whom are women. More than 50 percent of the manufacturing labour force is now employed in this sector, and the sector accounts for 30 per cent of investment in manufacturing. Therefore, the story of the growth of the manufacturing sector in Bangladesh over the past two decades has been the story of the success of the RMG sector. However, question remainswhether the current structure of the manufacturing sector will remain as a sustained driver of economic growth and employment creation in Bangladeshin the future because of two reasons.

Firstly, the composition of the manufacturing during 1990s and 2000s has become increasingly RMG-oriented. Though diversification of the manufacturing sector has been an agenda in the trade and industrial policies, little progress has been achieved during these decades.There is no denying the fact that diversification is a necessary condition for the sustained and long term growth of the manufacturing sector in an economy. However, given the existing heavy reliance on the RMG sector and weak performance of most of the non-RMG manufacturing sectors, the prospects for sustained and long term growth in the manufacturing sector in Bangladesh remainas challenge.

Secondly, it can be argued that the growth in the RMG sector in Bangladesh has also been, to a large extent, driven by some sizeable 'rents' generated in this sector, and there are possibilities of shrinking the sizes of such 'rents' in the future due to both domestic and international factors. There have been five major sources of such 'rents': MFA quota (which no longer exists) and GSPs, different forms of subsidies, tax exemption, labour regime, and compliance. Development of Bangladesh's RMG industry took place under the shield of a restricted global trade in textiles and clothing governed by Multifibre Arrangements (MFA) quotas. Along with providing protection to developed country firms against the most efficient producers in certain developing economies, the MFA regime also created exporting opportunities for a number other countries, including Bangladesh, with no previous experience of textile and clothing production for export markets. In addition to quota-protected export markets, Bangladesh's RMG industry has also been benefited from a generous Generalized Systems of Preference (GSP) facility of the European Union (EU) that allowed duty-free and quota-free market access for products originated in LDCs. The MFA regime phased out by the end of 2004, though the GSP facility of the EU is still on. However, there are concerns with regard to the continuation of such facilities in the future on grounds of lack of compliance, weak labour standards and conflicting political situations in Bangladesh. The RMG industry also enjoys supports from the government in the forms of export subsidies, interest rate subsides and subsidies on cost of utilities. There are budgetary constraints on continuation or enlargement of such subsidies. 'Rent' in this sector is also generated by the tax exemption facilities. It is estimated that the size of the tax forgone in the RMG sector due to the tax exemption facility in recent year could be as high as 6.3 percent of the total tax revenue. However, the size of such 'rent' could be shrunk over time due to the budgetary constraints of the government. The RMG industry over the past three decades has been benefited from a labour regime, supported by the major political parties, which has been able to keep the wages of the labour in this industry very low. However, recent labour unrest over the hike of the minimum wage in this sector and also pressure from the international community has exerted serious challenge over the 'sustainability' of such a labour regime. Similarly, a regime of lack of compliance, especially with regard to working environment and factory standards, in the context of weak regulatory institutions, has generated 'rent' for this sector over the years. However, such 'rent' has become highly unsustainable due to the serious international pressure for enforcing compliance in the wake of recent incidences of fire and building collapses which resulted in a large number of deaths of RMG workers. All these suggest that the RMG sector in Bangladesh will need to undergo some major structural changes in the future for its sustainability which will have important implications for the growth of the manufacturing sector as well as for the overall economy.

Against the backdrop of the aforementioned discussion it is important to highlight that the manufacturing sector, to be a sustained driver of economic growth and employment creation in Bangladesh, needs to put much weight on expanding and diversifying its base. Supporting macroeconomic, trade and industrial policies are needed. The policy-induced and supply-side constraints, that have constricted the growth ofnon-RMG sectors, need to be addressed. Some of these constraints include lack of investment fund and working capital, high interest rate, shortage of skilled workers, lack of entrepreneurial and managerial skills, poor physical infrastructure, inefficient ports along with high transport costs, weak institutions, poor law and order situation, invisible costs of doing business, etc. Therefore, apart from RMG, export response of all other major commodities has been very weak. The RMG sector also appears to be the main beneficiary of the export incentives while for the non-RMG sectors such schemes have been proved to be less effective. The RMG owners are the most powerful and organized business groups in Bangladesh. Its political power is derived from its high contribution to economic growth, close political integration with state (including parliamentary representation) and class basis of the owners (former military, bureaucratic officials and managerial class were pioneers of RMG sector). The political clout and policy capture of RMG sector are also clearly manifested in process whereby the relevant government institutions, such as the National Board of Revenue, and the association of RMG owners-BGMEA jointly decided and enforced a large proportion of the tax privileges the sector enjoy. In fact RMG sector enjoys majority of the tax exemptions and other financial facilities through this joint policy making and management process. Therefore, many of the policy and supply-side constraints haven't constricted the growth of the RMG sectors, whereas, given the existing political-economic environment, the non-RMG sectors haven't been able to overcome those constraints.

This also raises a critical question whether rents are needed for the promotion of the non-RMG sectors. In fact, the current industrial policy highlights the importance of economic diversification and providing incentives to other sectors. These incentives, of course, are meant to generate some rents in the non-RMG sectors. However, it should be kept in mind that the way the RMG sector has been able to generate 'rents' through the suppressed labour regime and weak compliance is not sustainable and can't be replicated in other sectors. For the promotion of the non-RMG sectors, therefore, a well designed and effective industrial policy is needed where monetary and fiscal incentives should be transparent and time-bound. It is worth mentioning that the current industrial policy lacks vision and is also poorly designed.

It is also important to note that the current labour practices in the RMG sectors need to be improved for the sector to sustain in the future. There is a strong international pressure, in the form of threat of cancelling large preferences in the markets of Western countries, if the labour condition is not improved. Improvement of the labour condition is closely linked to the enhancement of the productivity of labour. The RMG owners in Bangladesh have been reluctant to invest on training of the workers as most of them produce low-value added RMG products and also because of the free-riding problem. The BGMEA and the government should collaborate with each other, with the help from relevant international agencies, to effectively work in this area.

One pragmatic way of dealing with such issues is to consider a well-devised integrated approach under a well-designed industrial policy. Under this approach, actions required at different levels can be brought together to make intervention schemes or support systems comprehensive and broad-based. Such intervention schemes should be sector specific as well as economy-wide with a view to ensure effective diversification of the economy of Bangladesh. Relevant government instructions need to be made effective and well functioning for the execution of such integrated approach.