Bangladesh's Cotton Textile Industry

Constraints and Policy Options

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Acknowledgements

The present report is the result of the research done on issues and concerns of Bangladesh's Textile Industry, in particular those of the spinning sub-sector. The study was commissioned by Bangladesh Export Import Company Ltd with the express objective of identifying the problems faced by Bangladesh's Textile Sector and devising an effective support mechanism to enable the local industry overcome its problems and improve its competitive position.

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Ayubur Rahman Bhuyan

Contents

List of Tables

Executive Summary

Introduction

1. Spinning is the most important component of the textile industry that has recently come to occupy a significant position in the country's manufacturing sector. The ability of the textile sector to raise the net foreign exchange earnings from clothing exports through increased value addition hinges essentially upon the growth of the spinning sub-sector, it being the first link in the chain of backward linkage with the RMG industry. The spinning sub-sector, however, suffers from a myriad of problems. This study is intended to examine and suggest solution to these problems, and devise an effective support mechanism to enable the local industry to overcome the disadvantages it currently suffers and improve its competitive position in the local and the world markets.

2. The textile industry did not receive much encouragement from the Government in the decade of the seventies. It was only in the early 1980s when the RMG industry started to make significant contributions to export earnings that efforts were initiated to energize the textile sector.

3. The development of the RMG industry in this country has not been accompanied by the growth of backward linkage facilities such as spinning, weaving, and finishing units. As a result, value addition remains low, and the growth of the RMG industry has failed to create any dynamism in the textile sector as a whole.

4. The growth of RMG exports has been possible because of the secure market access that Bangladesh enjoys in the developed countries under the system of MFA quotas. In the emerging world trading environment in which the MFA quotas will be phased out, Bangladesh will be at a disadvantage because the RMG exporters will confront open competition with the more efficient producers and exporters, for example, of India, Pakistan, China, Indonesia, and Thailand. Appropriate backward linkages will, therefore, have to be built to face the challenges of the emerging environment of the global textiles trade.

5. The various sub-sectors of the textile industry have grown in an unplanned manner and consequently demand supply gaps have arisen in yarn and fabric. In order to achieve self-sufficiency in yarn and fabric, which is the objective of the Government's textile policy, a balanced expansion of all textile sub-sectors will be needed. This will call for huge investment, both domestic and foreign, and an efficient incentive structure.

Yarn Gap

6. In this study, the demand supply gap in yarn for the period upto 2005 is estimated by using three alternative scenarios : (a) self-sufficiency in yarn by 2005, (b) 100% of yarn demand for domestic market, and 50% of RMG demand for yarn to be met locally by 2005, and (c) yarn production to grow at the rate of 15% per annum, i.e., at the rate at which yarn production is expected to increase during the years 1994/95 - 1998/99.

7. For filling the demand gap in yarn, significant additional production capacity over and above the BMR of the existing spinning mills will be needed.

Under Scenario A 185 additional spinning mills, under Scenario B 104 additional mills, and under Scenario C 65 additional mills, all with 25000 spindle capacity, will have to be established between 1995 and 2005 in a phased manner. The amounts of new investment required for that purpose under the three alternative scenarios are Tk. 74.0 billion, Tk. 41.6 billion, and Tk. 26.0 billion, respectively.

International Comparison of Costs

8. International comparison of conversion cost of cotton yarn indicates a clear comparative advantage of Bangladesh over major competitors, viz., India and Pakistan, and, in fact, over all other countries. In comparison with Bangladesh, conversion cost of Yarn is 20 percent higher in India and 8 percent higher in Pakistan.

9. Unit labour cost in spinning is much higher in Bangladesh than in all other countries. The main reason is low labour productivity which neutralizes the advantages of the country's presumed cheap labour. The faster pace of depreciation of Indian and Pakistani currencies relative to that of Bangladesh is another factor that has contributed to keeping the unit labour cost lower in India and Pakistan.

10. In order to remain internationally competitive, all out effort should be made to improve labour productivity by enhancing labour skills and introducing new equipment and modern technology in spinning mills. There is the need for reforming labour market policies for linking wages with productivity. Proper management of the exchange rate is also necessary to prevent any major

appreciation of its currency vis-a-vis the currencies of major competiting countries.

11. The relatively lower conversion cost of yarn notwithstanding, total yarn cost is higher in Bangladesh than in India and Pakistan. This is essentially due to the relatively higher raw material cost in this country.

12. Spinning mills in India and Pakistan have inherent natural advantages of proximity to sources of raw material supplies and lower cost of cotton. Also policies pursued by these countries in the form of export quota for raw cotton and other regulations pertaining to cotton export create a wedge between its international price and the domestic price at which their spinning mills obtain their cotton requirements.

13. Evidence gathered for purpose of this study shows that Bangladesh spinning mills have to procure raw cotton at prices which are on average 30 percent higher than what is paid by the Indian mills and 10 per cent higher than in the case of Pakistani mills. This price differential, including payment of other charges like handling, freight, commission etc., puts Bangladesh spinning mills in a highly disadvantageous situation.

14. The imposition of import duty on textile machinery and a general surcharge on all imports will aggravate the cost disadvantages of Bangladesh mills further.

15. Appropriate policy assistance as recommended in this Report will hopefully enable Bangladesh spinning mills to overcome these disadvantages and enable them to produce quality yarn for meeting both domestic and RMG demand and also for purpose of export.

Textile Sector-related Policies of other Countries

16. An examination of textile sector related policies of different countries reveals that all these countries pursue vigorous support policies for the development of their textile sectors.

India

17. India provides extensive governmental support to promote the development of textile industries. There is a system of providing a minimum price for cotton growers which acts as an incentive to the farmers to allocate their land in favour of cotton crop.

18. The most significant is the imposition of quota restriction on the export of raw cotton which ensures that the Indian mills do have access to raw cotton at a relatively cheaper price. Evidence gathered for purpose of the present study shows that the price of raw cotton in India's domestic market is 20-40 per cent lower than in the international market. This implies a corresponding price disadvantage for Bangladeshi spinning mills which import a large quantity of raw cotton from India.

19. The basic objective of India's textile sector policy is to enhance the value addition of various sub-sectors of the textile industry. As such, it not only

ensures the supply of raw cotton at a lower price to the local mills but also restricts the export of cotton yarn so that the weaving mills can have ready availability of cheap locally produced yarn.

20. In India's textile sector policy maximum emphasis is given on the spinning sub-sector. Besides getting raw cotton at lower price the spinning mills are allowed to import raw cotton duty-free. On the other hand, the duty on yarn historically has been kept at a much higher level. The import tariff on yarn in 1994 was as high as 50 percent. In 1996/97, the basic tariff rate was brought down to 25 percent but a special duty of customs at 2 percent was introduced in addition to a countervailing duty of 7.30 percent. The total import duty on yarn in India today, including countervailing duties, is 34.30 percent.

21. The strong governmental support accorded to cotton spinning has resulted in a huge investment and a significant increase in spinning capacity in India. At present, 82 percent of about 1500 textile mills in India are engaged in spinning. The industry is now strongly demanding of the Government to ease the restrictions on the export of cotton yarn. Of late, the Government have exempted some categories of cotton yarn from export restrictions.

22. There are certain other policies for strengthening India's textile industry. For modernization of textile units the Government introduced a soft loan scheme in 1976 and set up a textile modernization fund in 1985. At present under the Export Promotion Capital Goods (EPCG) scheme the textile sector can import sophisticated machinery at zero or reduced duty basis. Besides, export oriented

units are also allowed to import modern equipment subject to fulfillment of their export obligations.

Pakistan

23. Until recently, Pakistan was practising a dual price policy for raw cotton for protecting the spinning industry. It provided for a lower procurement price of raw cotton for the local spinning mills and a minimum export price (MEP) for raw cotton which used to be higher than the domestic price. There were also quota restrictions on the export of cotton. These policies have now been changed. Raw cotton is now freely importable without duty. The restrictions on the export of cotton have also been lifted. These changes will be in force till the end of 1997-98 fiscal year.

24. The policy of free export and import of cotton is, however, accompanied by some very stringent administrative regulations which are inconsistent with the declared policy of a liberal regime for cotton trade, and which continue to create a differential between the domestic price of raw cotton and its export price (see the discussion on Pakistan in Chapter V).

25. In a bid to remove the various constraints faced by the textile industry the Government of Pakistan have very recently declared three different policy packages in quick succession. The first package was declared in 1995, the second one in November 1996, and the latest one in December 1996, all of them providing some very attractive incentives to the textile sector.

26. In order to give a boost to the spinning industry the Government of Pakistan now allow duty free import of raw cotton, and have reduced the regulatory duties on polyester, viscose, and acrylic fibre. The import of new and old machinery (with a working life of at least 7 years) has also been liberalized. Besides, the import of man-made fibre that is not locally produced is now allowed duty-free.

27. Incentives for textile exports in Pakistan include duty exemption from customs on imports of raw materials, duty free import of plant and equipment by textile clothing firms, exemption of income tax for five years for firms in the EPZs, and concessional freight rates for export to countries of Africa and Latin America. The textile industry also benefits from the Export Finance Scheme that enables exporters to get bank credit at concessional rates not exceeding 13 per cent. The banks providing export finance are entitled to avail of a refinance facility from the central bank, the State Bank of Pakistan.

Indonesia, Thailand, Viet Nam and China

28. In Indonesia, the prevailing textile sector incentives include liberal export financing facilities, zero or low rates of duty on the import of machinery and components, and duty drawback facilities for imported raw materials.

29. Domestic textile industry in Indonesia is protected by an escalated tariff structure. The import duty rates are : fibre 0-10 percent, yarn 10-15 percent, fabric 20-25 percent, and garments 25-30 per cent.

30. Thailand provides a number of fiscal and financial incentives for the textile sector development. These include corporate income tax exemption for 3-8 years for new enterprises, a further reduction of corporate income taxes upto 50 per cent for next five years, and concessionary export finance through the Export-Import Bank.

31. Thailand is committed to a policy of liberal trade regime and has reduced import duty rates significantly over the recent years. The present import duty rates are 0-1 per cent on fibres, 10 per cent on cotton yarn, 20 percent on fabrics, and 30 percent on garments. There is a value added tax of 7 percent at each stage of production.

32. In Viet Nam, there is a duty drawback scheme for materials used in export production. There are a lot of quantitative restrictions(QRs) on imports. Rates of import duty are: zero on raw cotton or other fibres, 20 percent on yarn, 40 percent on fabric, and 45 percent on apparel.

33. China has now become a major exporter of textile items. It is a large cotton producing country and intervenes very strongly in the purchase and sale of raw cotton. Farmers get incentive in the form of a minimum price. The sale to local mills is monopolized by supply and marketing cooperatives at State-set prices which enables local mills to obtain cotton at a relatively lower price. The state is the major investor and is actively involved in supporting all textile units, including spinning. Recently, China has given maximum emphasis on technological upgradation of the textile mills.

Constraints in Bangladesh's Textile Sector

34. The essence of Bangladesh Government's textile sector policy is to increase value addition in RMG exports which is the largest source of the country's foreign exchange earnings. Aiming to achieve self-sufficiency in yarn and fabric by 2005 to meet the local and RMG demand, the Textile Policy 1995 emphasises on the need for establishing backward linkages through a harmonious development of all textile sub-sectors.

35. Major constraints to Bangladesh's textile sector are the results partly of faulty domestic policies and partly of policies and practices pursued by other countries. There are also problems which are structural in nature. Solutions to these problems will require action on a number of fronts.

36. For establishing backward linkages, the spinning sub-sector should receive a high priority. As it is the first link in the chain of linkages with RMG production, its growth would stimulate expansion of other sub-sectors of the industry. Since an increase in value addition is the basic objective of Bangladesh's textile development strategy, in matters of government support spinning should receive priority over other sub-sectors.

37. Determination of priority for the purpose of support policy should be guided essentially by the efficiency criterion. This criterion has not been followed in Bangladesh, however. All available evidence indicates a greater relative efficiency of the spinning sub-sector over weaving, but official policy has always favoured the latter, paying little attention to the problems of the spinning sub-sector.

38. There are glaring anomalies and inconsistencies in the country's tariff structure which have been detrimental to the interest of the spinning sub-sector. This is evident from the drastic reduction in the import duty on yarn over the past decade (from 50 per cent in FY86 to 7.5 per cent in FY95). The tariff on fabric, on the other hand, remained 100 per cent during FY86-93 and then gradually was brought down to 45 per cent in FY96. The level of effective assistance accorded to spinning has been further reduced by the imposition of import duty on raw cotton under the FY98 budget.

39. The rationale behind the drastic cut in nominal and effective protection to cotton yarn is open to question because the spinning mills have to operate at a considerable disadvantage. They have to procure raw material at a very high cost which makes the yarn cost higher than in the competing countries. A rationalization of the tariff structure taking into consideration the problems of the spinning mills is therefore urgently needed. Lessons may be drawn in this regard from the examples of other countries like India, Pakistan, Indonesia, Thailand, and Viet Nam, all of which follow the escalated tariff structure but with a much narrower spread between the tariffs on the successive processing stages of spinning and weaving than in Bangladesh.

40. The recent dispute with EU regarding access facilities of knitwear exports under GSP strengthens the need for promoting the country's spinning sub-sector. Since value addition is of primary concern, adherence to the three-stage transformation as is required under EU rules of origin will be to the best long term interest of the country.

41. Availing of the GSP facility by the knitwear exporters in an allegedly fraudulent manner has in fact been benefiting the countries from which yarn is imported and harming the prospect of forming backward linkage in Bangladesh's textile industry. This practice is also causing a substantial loss of Government revenue, misuse of Export Development Fund (EDF), and most importantly, a setback for the growth of the spinning sub-sector.

42. The two-stage value addition criterion, if agreed upon by the EU on the insistence of Bangladesh's Government, will thwart the growth of spinning industry, stifle the prospect of value addition, and discourage new investments in this sector.

43. A vital point that must be taken into cognizance is that from 2005 onwards when there will be no MFA quota, tariff will remain the only barrier to trade. And also because the tariff cut in the textiles and clothing sector in the Uruguay Round was lower than in other industrial sectors, textile and clothing will remain most heavily protected in the developed countries. But unlike other competing countries, Bangladesh as an LDC is entitled to tariff free access in the EU market if it can satisfy the EU's rules of origin requirement. In order to be able to fully exploit this advantage, therefore, Bangladesh will have to establish backward linkage by giving top priority to its spinning production.

44. The textile mills circle strongly believes that if adequate support is given, the existing capacity of the spinning mills and the planned expansion of capacity under the mills that are currently at different stages of implementation will be able to meet all the demand for yarn in the knitwear industry in the near future.

45. Fast import liberalization is fraught with the danger of adversely affecting the growth of a country's manufacturing sector. Like all other manufacturing activity, Bangladesh's textile sector is at a rudimentary stage of development. It needs sufficient time and adequate policy support for building supply capacity.

46. Trade liberalization is not a necessary condition for the success of industrialization. There are lessons from history that industrialization has been achieved in many countries through high protection. The experience of the Asian NIEs that vigorously intervened in their economies and developed import substituting industries by offering protection in the form of high tariffs, quotas, and exchange control is at variance with the World Bank/IMF thesis that industrialization and economic growth can be faster only in relatively more open economies. Import controls are practised in virtually all industrial countries today. Bangladesh's policy makers should draw lessons from these experiences in formulating the country's trade and industrial assistance policies.

47. The high cost of raw cotton is the most debilitating constraint faced by Bangladesh's spinning mills. The problem will get worse if the FY98 budgetary provision of infrastructure development surcharge on all imports, including raw cotton, is implemented. Already, the cotton price differential with India robs Bangladesh's spinning mills of much of the comparative advantage they enjoy over India. Adoption of an appropriate support mechanism as recommended in this study will ensure a level playing field and help Bangladesh mills achieve competitiveness in yarn production.

48. The prevailing duties on the import of man-made fibres (MMF) constitute a hindrance to spinning. Since these are important raw materials used in yarn spinning, regarding import duties these should be treated as at par with raw cotton.

49. Import duties on textile machinery and spare parts constitute a significant constraint to efforts at undertaking repairs and modernization of the spinning mills.

50. The alleged leakage of yarn from bonded warehouses is a major problem faced by the spinning mills. Imported duty free, the leaked yarns are sold in the open market at below market prices and thus hurt the sale of locally produced yarn.

51. The problem of leaked yarns and their open sale is compounded by the provision of high wastage rate allowed in the knit-RMG sector. The high wastage allowance encourages inefficiency and also enables larger volume of yarn import than required by the knitting factories. The possibility of leakage into the open market is also correspondingly increased.

52. Among structural constraints, there are the problems connected with the use of outdated technology and old machinery for which product quality is poor. Labour productivity is also low as a result, which takes away the major advantage the country often claims to have in the form of an abundant supply of cheap labour.

53. Acute power shortage, poor access to bank credit, lack of qualified and trained manpower and efficient management are other important problems that beset the country's spinning industry.

Policy Recommendations

54. Policy options recommended for removing the constraints to the spinning sub-sector appear in summary form in the final chapter of this Report. To avoid monotonous repetition, these recommendations are very briefly outlined in this concluding part of the Executive Summary.

(i) A major solution of the structural problems lies in introducing the modern technology to keep up with, or even ahead of, the competing countries. Active Government support in the form of easy access to bank credit, fiscal incentives to domestic and foreign investors, and the development of basic physical infrastructure will be needed to encourage and raise the necessary investment for that purpose.

(ii) In order to mitigate the cost disadvantage (because of higher raw cotton prices) suffered by Bangladesh spinning mills vis-a-vis Indian and Pakistani spinning mills, a 30 per cent price support, on an interim basis, towards the procurement of raw material may be extended to the spinning mills.

(iii) Man-made fibre, which is one of the basic raw materials in the production of yarn, should be treated as complementary to raw cotton in yarn production and hence the import duty thereon should also be brought down to zero.

(iv) For purpose of making the spinning mills efficient and competitive, the import of all textile machinery and spare parts should be made duty free. The provision of paying advance income tax at the time of importing raw materials should also be withdrawn.

(v) The yarn manufacturers should be treated as deemed exporters and provided with 25 per cent cash incentive for the supply of yarn to the export oriented knitwear/RMG industries.

(vi) The spinning sub-sector should be given adequate protection by adopting a realistic tariff policy so that it can withstand the competition from the low-priced products of competing countries. Premature exposure of the industry to free external competition may have disastrous consequences for its growth.

(vii) The extent of protection accorded to Bangladesh is well below that in the neighbouring countries. In India, import duty including countervailing duties is 34.3 per cent. It is recommended that a compensatory duty of 11 per cent be levied to supplement the prevailing 7.5 per cent C.D. and 15 per cent VAT (total 23.6 per cent) so that the total of such duties is raised to about the same level as it is in India. This will not in any way violate the WTO rules.

(viii) For preventing, or at least reducing the extent of, smuggling from across the border, strict enforcement of laws and border vigilance is called for.

(ix) Tight monitoring of bonded warehouses is needed to remove possibilities of the leakage of yarn and fabric to the open market.

(x) The current provision of high wastage rate for the knitting industries should be lowered. An appropriate wastage rate may be determined by an expert committee specially constituted for the purpose.

(xi) Steps should be taken to prevent abuse of the scheme of 25 per cent cash incentive provided to woven fabric/knitwear exporters. It is alleged that the cash incentive is now availed of also by the smugglers and suppliers of smuggled products as well as products leaked from bonded warehouses. A provision of obtaining a certificate of origin from the representative association of the mills may be introduced to prevent any abuse of this facility.

(xii) As discussed in paragraphs 40 through 43 above, the recent dispute with EU strengthens the need for promoting the country's spinning sub-sector. Moreover, in order to avail of the duty-free access in the EU market after 2005 when tariff will remain the only barrier to trade, Bangladesh will have to establish backward linkage by giving top priority to its spinning production.

(xiii) Acute power shortage, that results in huge loss of production, is a serious problem for the spinning industry. A long term solution lies in expanding the generation capacity of the country as a whole, through private sector participation including foreign private investment in the energy sector. An immediate solution may be found in encouraging the spinning mills to set up their own generators.

(xiv) Low labour productivity greatly nullifies the advantage of the country's cheap labour. Labour productivity should be enhanced through development of skill and introduction of modern machinery and technology.

(xv) Faster depreciation of Indian and Pakistani currencies in relation to Bangladesh's Taka during the past years is an important factor behind the differences in unit labour cost between Bangladesh and other countries. The exchange rate should be properly managed and allowed to move in line with that of the major competing countries.

Devising an Institutional Support Mechanism

55. The implementation of recommendations made in this Report will require a strong political will as well as an appropriate institutional mechanism encompassing both the private sector and the Governmental organizations.

56. Private sector institutions viz., the BTMA, the chambers of commerce and industry, and the FBCCI will need strengthening in terms of their capacity for research, advocacy and lobbying. Strong lobbying through press briefings, seminars and symposia will be needed to convince the policy makers about the urgency of safeguarding and promoting the interest of the spinning industry.

57. As the private sector becomes more vibrant and dynamic, the government institutions should be made more pro-active. The capability of the Governmental machinery responsible for formulation and implementation of policy should be enhanced. New institution or institutions may be built if the situation so demands.

58. There should be close coordination among the large number of Government organizations that are currently involved in the task of preparation and implementation of policy regarding the industrial sector. This will eliminate duplication of tasks and enable industry grievances to be properly heard and reflected in government policy.

59. Currently, Government institutions responsible for making policy lack the necessary expertise as well as motivation much of which is due to the very short tenure of the officials concerned. Lacking in expertise, they rely necessarily on donor agencies and external technical assistance for policy guidance.

60. Enhancement of institutional capacities will reduce excessive dependence on donor sponsored researches and studies for identifying and finding solutions to the problems of industries.

61. Most relevant for purpose of trade and industrial policies in Bangladesh is the Bangladesh Tariff Commission (BTC) but it has serious disabilities. It lacks in expertise and also has an "image problem" as it is just an appendage of the Ministry of Commerce with no mandatory powers.

62. The BTC should be revamped and renamed as the National Trade Commission (NTC) with an independent status and wide powers, and its recommendations regarding industry problems and policies should be mandatory.

63. The Chairman and the members of the NTC will hold office for a reasonably long tenure. They would be experts in wide areas of trade and industry and

capable of carrying out in-depth study and analysis of problems of local industries, implications of domestic policies, policies of other countries, bilateral, regional and multilateral tariff agreements as well as changes in world trading environment as reflected in decisions adopted in WTO, and developments in various regional trading blocs.

64. The NTC will perform all functions of the present BTC regarding investigations of industry complaints and defending industry interests against injurious and unfair trade practices of other countries.

65. Additionally, the NTC will provide intellectual support to the Government by enhancing its capability to negotiate effectively in international organizations on matters of trade and trade-related issues.

66. The NTC will act as a focal point concerning the country's trade and industrial policies, constantly monitor the problems of the country's industrial sector, formulate policies to enable local industry to acquire efficiency and competitiveness, and recommend measures to give relief to local industry in most practicable ways.

Chapter I

Introduction

Background of the Study

This study examines the constraints faced by Bangladesh's cotton textile spinning industry and recommends measures to overcome them in light of the changing world trading environment in textiles in general and, in particular, against policies pursued by countries that compete with Bangladesh in the production and sale of yarn besides being suppliers of raw materials for its domestic industry.

As is well known, the textiles sector has traditionally played a dynamic role in the process of industrial growth in most developed countries, and also more recently in the NIEs in East/South East Asia. In Bangladesh, the very critical importance of the sector can be easily gauged from the fact that it contributes more than one-third of the total value addition generated by industries and its share is around 5 percent of the national income[1]. The export-oriented ready-made garment (RMG) sub-sector which had a modest beginning in the early eighties, has been a phenomenal success story, and currently contributes about 65 percent of the country's foreign exchange earnings. In particular, the textiles sector directly provides employment to more than 3.5 million people, which accounts for 45 percent of the country's total industrial employment[2]. Further,the growth of the sector has spawned a whole new set of linkage industries and

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[1] Govt. of Bangladesh, Ministry of Textiles, The Textile Policy 1995.

[2] Ibid.

helped expand and strengthen many service sector activities. In particular, with the expansion of the textile industry, a large number of medium and small scale engineering enterprises are being developed to meet the sector's requirements of machinery and spare parts. Finally, the sector, by all reckoning, is also contributing significantly to the social transformation process by providing employment in increasing number to the female work force, and thus mainstreaming them in the development frame.

By now, however, it is widely recognised that the textiles sector in Bangladesh has, in a broad sense, had a lopsided growth: while the final stage RMG flourished, there was little or neglible effective backward linkages for developing the spinning and fabrics sub-sectors. As a result, the RMG industry has had a fragile foundation as it has so far been almost entirely dependent on imported fabrics, accounting for about 95-96 per cent of the fabric needs. Relating to imported accessories - where the situation appears to have vastly improved - the dependence still remains to the tune of about 50 percent of the total requirements. This has meant that the real foreign exchange earnings from RMG exports from Bangladesh is only about 20-25 percent of the total value of exports.

The growth in the RMG sub-sector in Bangladesh can be explained by a combination of favourable factors, including the quota system under the Multifibre Arrangement (MFA), the abundant availability of cheap but easily trainable labour force and the policy incentives, particularly of according bonded warehouse facilities for duty free import of inputs. However, serious apprehensions are currently being expressed about the challenges that RMG exports will have to face in the world market in the post-MFA regime, when the sector will be completely integrated with WTO and governed by WTO rules. The

knitting sub-sector, for example, which has so long been enjoying GSP facilities in the European market, is already facing an acute problem as it cannot effectively meet the three-stage transformation requirement because of its heavy dependence on imported yarn. The European Commission has, over time, become extremely stringent on the condition that unless local yarn is used to produce knitted fabric, the GSP facilities, liberally granted so far, will be withdrawn.

Moreover, as MFA is phased out under the Agreement on Textiles and Clothing (ATC), the other RMG exporting countries which use their own, locally manufactured fabrics will obviously be in a relatively more advantageous position because of assured raw material supply at a reasonable price. In that situation, Bangladesh will have to face stiff competition in the world market from countries like India, Pakistan, China and Thailand from whom she currently meets most of her fabrics requirements. In a quota-free world, all these countries may try to expand their RMG exports using their own locally produced fabrics. This may lead not only to a drastic fall in the supply of fabrics to Bangladesh but also an increase in imported fabric prices, which will erode the country's competitive edge and credibility in the world market. As things stand, the Bangladesh RMG producers are already quite vulnerable to substantial losses because of their inability at times to meet the production targets within the stipulated schedule - usually 90 days - mainly due to the complex and lengthy procedures of fabric imports.

Because of the globalization process, competition will also intensify in future from upcoming competitors like Vietnam, Cambodia, Eastern Europe, Latin America etc. which enjoy a similar abundance of cheap labour supply as Bangladesh. Mexico and Caribbean countries have already made significant inroads in US markets. The GSP scheme, as already pointed out, has taken a more

restrictive form in EU. And, of course, MFA phase-out and tariff reduction under the Uruguay Round will only mean that countries which are currently not enjoying GSP would benefit at the cost of countries like Bangladesh whose margins of preferences will erode in the process. Notice that Bangladesh's garments exports enjoy quota-free entry to EU, whereas garment exports from Bangladesh's major competitors, such as China, India, Indonesia, Pakistan, Sri Lanka and Thailand, are subject to MFA restraints in the EU countries.[3] The implication is that once the Uruguay Round Agreement on Textiles and Clothing is fully implemented and the restrictions facing the above-noted and other countries are gradually withdrawn, Bangladesh's exports will come under increasing competitive pressure, particularly from heavily restricted suppliers like China.

The crisis will naturally deepen for Bangladesh unless appropriate backward linkages can soon be built to face the challenges of the emerging environment in the global textiles trade. There is, therefore, a crying need for creating new capacity in spinning, weaving, knitting, and dyeing and finishing industry with the most modern and appropriate technology in order to ensure quality products at competitive prices. Spinning is the first stage in the chain of linkages in the textiles sector for which its development is vital for achieving the desired goal. Given the country's low labour cost, skill development potentials and other favourable factors, it is quite possible for Bangladesh to turn the challenges of quota-free environment into new windows of opportunities by developing the intra-sectoral backward linkage industries in a planned and expeditious manner. This will help Bangladesh not only to retain its comparative

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[3] UNCTAD, **The Outcome of the Uruguay Round: An Initial Assessment**, Report by the UNCTAD Secretariat, New York, 1994.

advantage in traditional RMG exports, but also to expand her market share, as well as widen the product ranges, including higher value items. In this context, however, it is necessary for the Government to come forward with stimulating policy packages towards backward linkage industries and other supporting activities. Phasing out of MFA and change of *rules of origin* have indeed made it obligatory to develop the various sub-sectors on an emergency basis.

It is noteworthy that considering the importance and prospects of the industry, textiles has already been declared a 'Thrust Sector' by the Government, and a 'Textile Policy' has been formulated for its harmonious development within the framework of an open market economy. The main objectives of the policy are:

a) to attain self-sufficiency in fabrics by ensuring adequate availability of fabrics by the year 2005 to meet the requirement of RMG industry through establishing backward linkage and to ensure direct export of textile goods by expanding production of quality fabrics at competitive price;

b) to help create an enabling environment and to provide the means by which the textile industry can serve as the key mover of industrialization for generating employment, increasing export earnings, and encouraging contribution to national income by enhancing value addition;

c) to establish linkages among the various textiles sub-sectors, both upstream and downstream, by ensuring their healthy and harmonious development; and

d) to create a congenial environment for attracting local and foreign private investment in the expansion of the textile industry by taking all necessary measures through provision of various incentives.

Unfortunately, there are a host of problems, including shortage of raw material, inadequate investment and erratic power which at present are seriously affecting a healthy growth of the sector. However, a more overriding concern for Bangladesh at the moment relates to two serious snags from which the spinning mills - the largest sub-sector of textiles industry, comprising above 2 million spindles and a production capacity of around 183 million kg. per year - are currently suffering.

The first problem is, of course, a fall-out from the trade liberalisation process itself, which the country has been pursuing in recent years covering virtually all fields, including textiles. In fact, the declining customs duty on cotton yarn, reduced from 30 percent to only 7.5 percent in the course of just two years, has made it increasingly difficult for the local spinning mills to compete with cheaper imported yarn from India. The problem was aggravated by an ill-conceived government policy for imposition of import duty on cotton and man-made fibre in 1990-91[4]. Without appropriate remedial measures, including the provision of duty-free import of raw cotton, there is a danger that the spinning industry will virtually collapse and the opportunities of establishing linkages with downstream stages of processing, such as fabrics formation, dyeing and finishing, and RMG, will be lost. A breathing space for the private sector spinners can

[4] The import duty on raw cotton was totally withdrawn beginning from FY95. The problem of the spinning mills will, however, be aggravated by the imposition of a 2.5 percent duty on the import of textile machinery and an infrastructure development surcharge (IDS) at the rate of 2.5 percent on all imports, including raw cotton.

possibly be justified easily, as their financial projections at the time of setting up the mills have undergone basic changes because of unforeseen and unwarranted government policy actions. It is noteworthy that, compared to Bangladesh, import duty on yarn is higher in all other countries (around 10-20 percent). In particular, the import duty on yarn is 55 percent in Pakistan, and about 35 percent in India even under the SAPTA arrangement.

The second problem which needs to be addressed prudently but on an urgent basis relates to the alleged unfair competition that the spinning sector in Bangladesh faces, particularly from cotton yarn imported from India. Since, as will be seen later in this Report, Indian textiles policy effectively allows a lower procurement price of raw cotton for its domestic spinning mills as compared to the price which Bangladeshi importers have to pay for the same, the spinning mills here, overtly dependent as they are on Indian cotton, are put at a serious disadvantage right from the beginning. This is not to deny the natural advantage that India will enjoy as a cotton growing country but if she uses discriminating pricing policy which implicitly subsidizes her cotton yarn exports to Bangladesh, that tantamounts to unfair competition against which compensatory measures can be adopted quite in conformity with WTO rules.

Therefore, it is important at this stage to identify the nature and extent of the unfair practices, if any, adopted by Bangladesh's major competitors so that appropriate remedial actions can be adopted by the country in terms of WTO rules and regulations. At the same time, it is also necessary to devise an effective support mechanism to improve the efficiency and competitive position of the industry in the local and the world market. In order to have such a mechanism on a sound footing, it would be fruitful to draw on other relevant

country experiences in terms of fiscal and financial incentives and also in terms of their institutional frames.

As is well known, in order to neutralize any unfair competition, Bangladesh's spinning industry can legitimately ask for imposing compensatory duties on import of cotton yarn from any country under WTO rules, if it is established that such imports cause or threaten to cause material injury to the domestic industry. Therefore, while identifying the unfair trade practices carried out by the major competing countries, it is also of vital importance to analyse the implications of the WTO rules and regulations in this regard, in order that suitable countervailing measures may be suggested which are logically and practically justified, and which are also acceptable to the local producers and business community. This constitutes the basic object of this study.

It is to be noted that a study was recently conducted by Bangladesh Tariff Commission (BTC) to examine and find solutions to the constraints and disabilities of the different sub-sectors of the textile industry[5]. In that study the consultants' recommendations regarding textile sector-related trade policy measures were expected to be such as would facilitate the Government's task of accelerating the economic reform process and thus were fully in line with the Government's strong commitment to continuing the process of import liberalization. As such, the study refrained from making any recommendation that might be construed as a reversal of the Government's policy of maintaining a liberal trade regime. Most of the BTC's sub-sectoral studies therefore concentrated on basically the structural impediments faced by the respective sub-sectors and their

[5] Reports on the Textile Sector Study Project, Bangladesh Tariff Commission, 1995.

solutions and carefully avoided making recommendations on the policy changes that would conflict with the Government's policy commitments.

However, the BTC study on the spinning sub-sector made some strong observations about the constraints faced by the spinning industry that resulted from policies pursued by countries that are Bangladesh's important trading partners and at the same time major competitors in textile sector production and trade. Moreover, since the completion of the BTC Study there have been significant developments in international trade policy relations, including Bangladesh's conflict with the European Union(EU) regarding GSP facilities, that have caused further problems and complications for the country's textile sector. It is in this backdrop that the present study is conceived.

Objective and Scope of the Study

The objectives of the study are to:

(i) identify the policies and the alleged unfair practices, if any, adopted by Bangladesh's major competitors in the textile sector and indicate if, and the manner in which, these policies and practices contravene the WTO rules and regulations;

(ii) suggest compensatory/countervailing measures which, under WTO rules, can be legitimately undertaken to mitigate the disadvantages of the spinning industry and which will be acceptable and easily understandable to the local producers, business community, and the Government as a whole;

(iii) examine the justification for the continuance of the 25 per cent cash subsidy provided by the Government to the local RMG manufacturers for using locally produced yarn and fabric;

(iv) analyze in detail the fiscal and financial incentives given by the competing countries to the textile sector and suggest adoption of appropriate policy measures for overcoming any disadvantages faced by the producers of Bangladesh;

(v) devise an effective support mechanism to enable the local industry to overcome the disadvantages it currently suffers and acquire efficiency to improve its competitive position in the local and the world market; and

(vi) suggest an effective institutional mechanism to give relief to local industries affected by cheap imports. Such a mechanism should be in keeping with WTO rules, and at the same time it should be simple enough to allow the affected local industry to seek and get speedy redress of its grievances.

Methodology and Data

The report is based essentially on secondary data obtained from various national and international sources but supplemented by information obtained from governments and industry related associations of Bangladesh and other countries. Visits were made to India, Pakistan, Thailand, Vietnam and Indonesia to obtain information and data on the textile sector of the respective countries. Attempts

have been made to gather a comparative picture of textile related policies and problems of these countries from which lessons can be drawn for Bangladesh.

Organization of the Report

The Report is organized as follows. While the present Chapter presents the background, objective, and scope of the study, Chapter II portrays the present structure of the textile industry in Bangladesh. Chapter III discusses the current demand-supply gap of cotton yarn, makes projections up to 2005, and derives the implications for new investment in the spinning sub-sector. Chapter IV presents an international comparison of the cost structure of cotton yarn. Policies pursued by different countries to support the textile sector are discussed in Chapter V. Chapter VI discusses the textile sector related issues and constraints, particularly those related to Bangladesh's spinning sub-sector. Some general policy recommendations for supporting Bangladesh's spinning mills are made in Chapter VII. A framework of an institutional mechanism to provide effective support to the local industry is tentatively suggested in the final chapter.

Chapter II

The Structure of Bangladesh's Cotton Textile Industry

For convenience of analysis, the textile sector of the country can broadly be classified into the following sub-sectors:

1) Public sector(BTMC) textile mills(spinning and weaving)
2) Private sector(BTMA) textile mills(spinning and weaving)
3) Specialized textile units and powerlooms in the private sector
4) Handlooms
5) Hosiery and knitting industries
6) Dyeing, printing & finishing units
7) Export-oriented Readymade Garments(RMG) Industries

The structure of the textile industry and its sub-sectors in terms of the number of units, installed capacity, and capacity utilization is shown in table II.1. The picture that emerges can be elaborated as follows:

Spinning

There are 103 ring spinning mills with 2,068 thousand spindles, and 15 open-end spinning units with 37.2 thousand rotor heads. The dominance of the private mills is clear: while the public sector owns 27 ring spinning mills, 76 ring spinning and all the rotor spinning mills belong to the private sector. The ratio of production capacity between private and public sector is thus around 76:24.

Production capacity of the spinning sub-sector is around 183 million kg per year, of which only 67.3 per cent was realized in 1995/96. Realization of the

production capacity is, however, significantly higher in the private sector(79.0%) than in the public sector (29.5%).

Table II.1: Structure of Textile Industry of Bangladesh
(As of June 1996)

Industry	No of Units	Installed capacity		Actual Production (million)	Capacity Utilization (%)		Employment (000)
		Machine (000 unit)	Production (million)		Machine	Production	
Spinning	118		183 kg	123.2 kg	68.5	67.3	65.1
Ring: Public	27	604 spls	43 kg	12.7 kg	33.4	29.5	19.4
Ring: Private	76	1464 "	132 kg	104.3 kg	83.0	79.0	45.7
Rotor: Private	15	37.2 rtr	8 kg	6.2 kg	75.0	77.5	
Weaving	1126	40.27 lms	777.4 mtr	281.3 mtr	45.8	36.2	60.7
Public	7	2.37 "	31.2 mtr	1.5 mtr	17.2	4.8	3.9
Private:BTMA	13	2.90 "	78.2 mtr	11.3 mtr	28.1	14.4	5.5
Specialized & Powerlooms	1106	35.00 "	668.0 mtr	268.5 mtr	49.2	40.2	51.2
Handloom	212421	514.0 lms	925.0 mtr	595.7 mtr	46.5	64.4	491.5
Dyeing, Printing & Finishing : Mechanized & Semi-mechanized	250	0.25 unit	65.32 mtr	46.4 mtr	83.3	71.4	22.5
Knitting/Hosiery	588	8.79 mach	54.22 kg	40.28 kg		74.3	13.2
Export Oriented	254	1.30 circ 4.36 body	37.18 kg	28.76 kg	97.5	77.3	8.5
Domestic	334	3.13 body	17.04 kg	11.52 kg	45.3	67.6	4.7
Readymade Garments	1830	101 sewing	1510.0 pcs	855.5 pcs	46.5	51.9	1200

Source: Ministry of Textiles, **Quarterly M.I.S. Report**, July-Sep 1995, Oct-Dec 1995, Jan-March 1996 & April-June 1996.

Overall capacity utilization of the machinery in spinning is around 68 per cent. Capacity utilization in the private sector is around 83 per cent as against only 33 per cent in the public sector. Capacity utilization in terms of machinery in both the private and the public sector has decreased over the last year; it was 85 per cent in the private sector and 47 per cent in the public sector.[6] Most of the units in the public sector have become too old to produce quality yarn at competitive prices.

The cotton spinning sub-sector currently employs 65,100 people of which 19,400 are in the BTMC mills and 45,700 in the private sector. Labour productivity (per manhour) in terms of both production and value added in the public sector mills is much lower than in the private sector(Table II.2). In terms of output, labour productivity is only 0.34 kg in BTMC mills as against 0.92 in the private sector, and in terms of value added the respective figures are Tk. 12.27 and Tk. 55.35. This is clearly a very dismal record as a recent World Bank Study indicates that modern spinning technology would enable the same amount of yarn to be produced with less than half the number of spindles with only 10 per cent of the labour employed[7].

Apart from cotton spinning, there are some specialized mills in wool, nylon, viscose, and silk in the public sector. There are also some polyester mills in the private sector where production started in the early nineties[8]. There are currently 7 mills that produce polyester yarn from pre-oriented yarn (POY), and another 2 mills that produce yarn from polyester chips.

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[6] Ministry of Textiles, **M.I.S. Report**, April-June 1996.

[7] World Bank, **Bangladesh: Report on the Textile Industries Restructuring Study - Phase I**, 1992.

[8] Bangladesh Tariff Commission, Textile Sector Studies, 1995.

Table II.2 : Labour Productivity in Spinning and Weaving
(for the 2nd quarter of 1996)

Sub-sector	Volume of Production ('000 kg/ meters)	Manhour (000 unit)	Value Addition (m. tk.)	Labour Productivity	
				In terms of Production (kg)	In terms of Value Addition (Tk)
Spinning	26095 kg	34,155	1490.75	0.76 kg	43.65
BTMC	3124 kg	9,280	113.87	0.34 kg	12.27
Private Sector	22971 kg	24,875	1376.88	0.92 kg	55.35
Weaving	70423 mt	24,473	311.33	2.88 mtr	12.72
BTMC	389 mtr	2,084	(6.23)	0.19 mtr	(2.99)
Private Sector	70034 mt	22,389	317.56	3.13 mtr	14.18
BTMA(mill)	2822 mt	2,657	12.41	1.06 mtr	4.67
Specialized & Powerlooms	67211 mt	19,732	305.14	3.41 mtr	15.46

Source: Ministry of Textiles, **Quarterly M.I.S. Report**, April-June 1996.

There is only one woolen mill in the country, which is in the public sector, and is engaged in both spinning of wool and weaving of woolen fabrics. Installed capacity in wool spinning is 3200 spindles with annual production capacity of 153 thousand kg. Capacity utilization in both machine use and production is less than 50 per cent.

There is also one mill producing nylon yarn in the country. It is in the public sector and produces semidull nylon yarn of 20, 40 and 70 deniers, and sparkling nylon filament yarn. There are 6 spinning machines and 5 draw-twisting machines in the nylon plant having annual production capacity of 0.67 million kg. Approximately, 75 per cent of the installed capacity is currently utilized.

There is one viscose rayon plant(Karnaphuli Rayon and Chemicals Ltd.) with annual production capacity of 1.5 million kg of viscose staple fibre. The plant, however, was beset with many problems and stopped production in June 1994.

There are two silk mills in the public sector having annual production capacity of 0.54 million kg of silk yarn. Both the mills are under Bangladesh Sericulture Board. Silk industry has also been developing in the private sector which now has an annual production capacity of 4.16 million kg.

Weaving

Production of fabrics is carried out by the organized mill sector and the handlooms. The former includes large public sector (BTMC) and private sector (BTMA) mills and smaller specialized units and powerlooms in the private sector which together supply about 32 per cent of the country's domestic production, while the handlooms supply about 68 per cent.

There are 1126 weaving mills in Bangladesh of which 7 are in the public sector managed by BTMC, and the rest (1119) are in the private sector. Among the private sector units, 13 are members of BTMA and 1106 are specialized units and powerlooms.

The public sector mills under BTMC supply as little as 0.5 per cent, the BTMA mills supply 4 per cent, and the specialized units and powerlooms account for the remaining 95.5 per cent of the country's total domestic mill production of grey fabrics.

The total annual production capacity of the weaving sub-sector is 777.4 million meters of fabric with an installed capacity of 40,270 looms. However, the utilization of production capacity in this sub-sector is very low and has also declined in the past one year(July 1995 - June 1996). In terms of production,

only 36.17 per cent of the existing capacity is currently utilized. The rate of capacity utilization is only 4.8 per cent in the BTMC mills, 14.4 per cent in the BTMA mills, and 40.2 per cent in the specialized mills and powerlooms.

The extremely low capacity utilization in the large weaving mills is due to the fact that almost the whole of the existing loomage capacity there uses old and out-dated technology. The large number of small and medium-sized powerloom units that were set up in the 1980s in the private sector have in general narrow width powerlooms without adequate sizing and warping facilities and as such are not suitable for producing quality fabrics. The technology of weaving has greatly developed in recent times and it is now realized that the traditional shuttle looms are no longer technically viable. Modernization of the existing weaving mills with BMRE and setting up new units with state-of-the-art technology will be needed to improve and expand production of quality fabrics for domestic and export oriented RMG sector.

The weaving sub-sector employs around 60,700 manpower of which 3,900 are in the BTMC mills and 56,700 in the private sector. Within the private sector, BTMA mills employ 5,500 manpower while the specialized and powerloom mills employ 51,200 people. Labour productivity (per manhour) in terms of production is 2.88 meters and in terms of value added is Tk. 12.72. Labour productivity in the public sector is much lower than in the private sector.

Handloom

The handloom industry dominates the weaving sub-sector in terms of production of fabrics, supplying about 68 per cent of the local fabric requirements. There are 212,421 handloom units in the country with a total of 514 thousand looms which have a production capacity of around 925 million meters of

fabrics. At present, the capacity utilization in terms of machinery is 47 per cent, and in terms of production 64 per cent. It is worth noting that the utilization of the machinery was nearly 70 per cent in the eighties. The significant decline in capacity utilization in recent years can be attributed to, *inter alia*, shortage of working capital, high price of inputs, and particularly, uneven competition from illegal imports. A significant feature of the handloom industry is its high labour intensity. It currently employs about 0.49 million workers which is about 90 per cent of the employment in the weaving sector.

The handloom products have bright prospects in foreign market as well. On a small scale, it currently exports cotton checkered fabrics called Grameen Check/Dhaka Check through the export-oriented RMG sector, and also a token amount of silk products like Jamdani saree and silk fabrics. It is expected that the demand for such exports will increase significantly in the near future.

Knitting/Hosiery

The hosiery industry produces different types of products such as under garments and stockings which was basically to meet local demand, but recently its products have entered the export market as well. In fact, since about the mid-1980s when along with the growth of domestic demand export of knit garments picked up significantly, the knitting industry has turned into a fast growing textile sub-sector. Notice that in 1991/92 knitwear exports accounted for less than 6 percent of the country's total export earnings, but in 1995/96 the share went up to 15 percent. Also the capacity utilization in the export oriented knitting industry in terms of installed machinery is the highest (98 per cent) compared to all the sub-sectors of the textile industry.

Presently there are 334 hosiery units having 3131 body machines engaged in meeting domestic demand. These units have annual production capacity of 17 million kg. However, the capacity utilization of these units in terms of installed machinery is about 45 per cent. In addition, there are 254 knitting units with 1309 circular knit machines and 4363 hosiery body machines in the export oriented sector having an annual production capacity of 37.2 million kgs. The knitting/hosiery sub-sector employs around 13,200 people. This is a highly promising sub-sector and supplies about 40 per cent of the total requirements of the export oriented knit garment units of the country.

Dyeing, Printing and Finishing Industry

There are 75 mechanized and 175 semi-mechanized dyeing and finishing units with a total annual production capacity of 653 million meters. The capacity utilization in terms of production is 71 per cent. Besides, around 600 million [illegible] of fabrics are said to be dyed and finished manually in the non- [illegible] with the dyeing, printing and finishing [illegible] old and out-dated machinery for which quality of output is very poor. There is therefore a strong need for establishing new units with modern technology to meet the present and future requirements of the domestic and the export-oriented RMG sector.

The mechanized and the semi-mechanized dyeing and finishing units employ around 22,500 people. Information on the employment of the non-mechanized mills, however, is not available.

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Readymade Garments Industry

The export oriented readymade garment industry(RMG) made its first appearance in Bangladesh in 1977/78 with 9 enterprises generating export earnings of only Tk. 1 million. In 1981 there were only 21 export-oriented garment units generating export earnings of Tk. 53 million(US $ 2.9 million). As of June 1996, according to the Textile Ministry's Quarterly M.I.S. Report, there were 1830 export-oriented RMG units, with 101 thousand sewing machines having annual production capacity of 1510 million pieces and employment of about 1.2 million workers, 95 per cent of whom were women. The latest information is that there are now more than 2200 export-oriented RMG units in the country. In 1995/96, the RMG exports generated foreign exchange earnings worth US$ 2.58 billion, a 5-fold increase over 1989/90, depicting an annual compound growth rate of over 30 per cent during these six years (Table II.3).

Table II.3 : Production and Export Earnings of RMG Industry

Year	Production (million pcs.)	Value of Exports (million tk.)	Value of Export (million US$)	Annual Growth Rate of Value of Exports (%)
1977-78	3.15	1.02	0.07	-
1978-79	3.94	1.56	0.10	42.8
1979-80	13.40	10.08	0.68	580.0
1980-81	23.64	52.99	2.93	330.9
1981-82	30.73	140.14	6.34	116.0
1982-83	34.62	255.22	10.42	64.4
1983-84	36.25	774.78	30.74	195.0
1984-85	206.85	1,944.08	69.43	125.9
1985-86	291.56	2,916.93	96.27	38.6
1986-87	255.11	9,650.02	311.29	223.3
1987-88	285.50	10,482.74	332.78	6.9
1988-89	296.46	12,006.66	372.07	11.8
1989-90	316.12	17,910.04	513.18	37.9
1990-91	367.12	23,344.22	652.25	27.1
1991-92	436.43	42,750.00	1,096.15	68.1
1992-93	582.29	57,275.00	1,439.07	31.3
1993-94	789.47	61,997.00	1,540.30	7.03
1994-95	1184.20	89,529.00	2,232.64	44.9
1995-96	1315.80	106,337.00	2,581.00	15.6

Source: Export Promotion Bureau.

The phenomenal growth of the RMG industry can be attributed to a number of factors. The technology and the manufacturing process are relatively simple. The machinery used is inexpensive and easily available. The activity is labour intensive and a very modest capital base is needed to start the business. Long term investment in land and building is not required because the industry can operate on rented premises. Moreover, Bangladesh has the advantage of an

abundant supply of cheap and easily trainable labour force, especially the women folk. On top of everything, there was the emergence of a rising class of well-motivated entrepreneurs in the private sector who were interested in the development of wealth creating activities and ready to build business oriented to production.

These factors coupled with favourable policy incentives such as (a) a liberal trade policy for the RMG industry, (b) preferential tariff on imported machinery, (c) bonded warehouse facilities for duty-free imports of inputs, (d) facility to import under back-to-back L/C, and (e) easy availability of bank credit facilitated the rapid growth of the RMG industry. However, probably the most important factor that propelled the growth of RMG exports of Bangladesh is the benefit of reserved markets that the country has enjoyed in industrial countries under the quota system of Multi Fibre Arrangements (MFA).

The explosive growth in the RMG industry has not, however, been supported by the growth of backward linkage facilities such as spinning, weaving, and dyeing and finishing units. Since local fabrics are of poor quality, of non-competitive prices, and inadequate in supply, the industry has remained almost totally dependent on imported fabrics. At present, the RMG industry meets about 95-96 per cent of its fabric needs and about 50 per cent of the required accessories by import, for which reason the net value addition in RMG production is negligible. In fact, the net foreign exchange earning from Bangladesh's RMG export is only about 25-30 per cent of the total value of exports. Obviously, value addition in RMG production could be substantially enhanced if the industry could be fed by locally produced fabrics and accessories. However, more important is the fact that in the absence of backward linkages the growth of RMG sub-sector has failed to create any dynamism in the textile industry as a whole.

As mentioned earlier, a major factor behind the fast growth in RMG exports is the security of market access that Bangladesh has enjoyed in the developed country markets (US and Canada) under the system of MFA quotas. With the emergence of World Trade Organization(WTO), the integration of textiles and clothing trade into WTO, and the phasing out of the MFA by year 2005, the garments export from Bangladesh will face open competition in the world market, in particular from Pakistan, India, China, and Thailand. These are the countries from which Bangladesh currently imports most of its fabric requirements and which, in a quota free world, may consider expanding their own RMG exports by using locally produced fabrics. This will definitely put Bangladesh at a disadvantage because of the adverse impact it is likely to have on the cost and availability of fabrics the country will need to feed its RMG industries[9].

Appropriate backward linkages will therefore have to be built to face the challenges posed by the impending phase-out of the quota in the industrial country markets. This will necessitate creation of new capacity in spinning, weaving, knitting, and dyeing and finishing industry with appropriate technology. Given the country's low labour cost and maintenance of a favourable policy environment to which the Government is committed, the RMG industry in Bangladesh will be able to face the challenges of open competition and retain its comparative advantage even in a quota free world if only backward linkage industries are developed in a planned manner. All this will call for active Government support with appropriate policy packages for the promotion and

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[9] Bangladesh imports fabrics also from Hong Kong and South Korea but these countries have of late concentrated on the production of high-value garment products and are unlikely to be Bangladesh's competitors in RMG exports in the future when such trade will be liberalized.

development of backward linkage industries in order to sustain the momentum of RMG growth.

There is also a general consensus that value addition, which is now dismally low, needs to be augmented if net export earning from RMG is to be increased. To achieve this, steps must be taken to establish backward linkage from the RMG industry to spinning, weaving, and dyeing and finishing sub-sectors so that the local textile industry can supply the required fabric to the export oriented RMG industry. It is of course true that export earnings can be increased also by export volume growth, but a two-pronged approach which will ensure smooth supply of fabrics to the export oriented RMG industry and at the same time increase its domestic value addition is likely to be more effective.

The textile industry in this country has grown in an unplanned manner and consequently demand supply gaps have arisen in the case of yarn and fabric. The Government, however, appears to be highly committed to the textile industry, and in the recently announced Textile Policy textiles has been declared as the *thrust sector*. The main objective of the textile policy is to achieve self-sufficiency in yarn and fabrics to meet the needs of the RMG industry through backward linkages and by encouraging investment particularly by private investors, both local and foreign. The textile policy, however, lacks in effective strategies for a balanced development of all textile sub-sectors. Devising appropriate strategies to promote a balanced expansion of the textile sector is, however, a difficult task, particularly because the interests of sub-sectors like spinning and weaving are conflicting in nature. For this reason, it is necessary to formulate an incentive structure that will facilitate a harmonious development of different textile sub-sectors and not impede the growth of any particular sub-sector.

Chapter III

Current and Projected Yarn Gap in Bangladesh

Demand for yarn is a derived demand generated by weavers and knitters that supply fabric to meet the demand for local consumption as well as for export-oriented RMG production. About 85 per cent of the demand is generated by the weavers - mills, powerlooms and handlooms, and the rest by the knitters. The prevailing demand supply gap in yarn in Bangladesh and the gaps projected for successive years upto 2005 are estimated here from the requirements of fabrics for the domestic market as well as for the export-oriented RMG industry.

Fabric Gap

In 1994/95, the country's total fabric requirement was 3270 million meters of which 1820 million meters was needed by the export oriented RMG industries and the rest was needed for local consumption(Table III.1). Total domestic fabric production was, however, only 1042 million meters which could meet approximately 32 per cent of the country's total fabric requirement. At present, only 4-5 per cent of the woven fabric requirement of the export oriented RMG industries is met with local supplies. However, there has been a considerable progress in the production of knitted fabrics. Local knitting mills are now able to supply around 40 per cent of the requirement of the knitted fabrics of the export oriented RMG industries.

Table III.1 : Fabric Requirement 1994/95 – 2004/05

(million meters)

Year	Demand for Local Consumption	Demand by Export Oriented RMG	Total Demand for Fabric	Total Fabric Production	Fabric Gap
1994/1995[a]	1450	1820	3270	1042	2229
1995/1996	1519	2002	3521	1094	2427
1996/1997	1591	2202	3794	1148	2645
1997/1998	1673	2422	4096	1206	2890
1998/1999	1760	2665	4424	1266	3158
1999/2000	1860	2931	4791	1329	3462
2000/2001	1963	3078	5041	1396	3645
2001/2002	2079	3232	5311	1465	3845
2002/2003	2202	3393	5595	1539	4057
2003/2004	2333	3563	5895	1616	4280
2004/2005	2370	3741	6111	1696	4414

Note : [a] Textile Ministry's estimates. See Textile Policy 1995.

(1) RMG demand to grow @10% annually upto 2000, and then @5% upto 2005.

(2) Local market demand is projected by using the following formula:

$D_t = D_0(1 + N.G)^t.P_t$

where, D_t = Demand for fabric at time t

D_0 = Per capita effective demand for fabric at the base year 1994/95 (i.e., apparent consumption of 12.14 meters)

N = Income elasticity of demand for fabrics (assumed at 0.8)

G = Annual growth rate of per capita income; 2.9% in 1995/96, 3.7% during 1996/97 & 1997/98, 4.2% till 1999/2000, and 5.4% thereafter.

P = 119.4 million in mid-1995, 130.5 m. in mid-2000, and 140.8m. in mid-2005 (taken from World Bank 1995 CEM). Annual population growth is 1.8% between 1995-2000 and1.6% between 2000-2005.

(3) Domestic production of fabrics to grow annually @5%.

Table III.1 presents projections for Bangladesh's total fabric demand, domestic production of fabrics, and the overall fabric gap for the period upto 2004/05. The assumptions and the formula used for purpose of making projections are described in the Note to the Table. The projections show that the gap between demand and supply will be widening over time. In fact, total demand gap nearly doubles to 4414 million meters in year 2004/05 from 2229 million meters in 1994/95.

Yarn Gap

Table III.2 provides the projected demand for yarn corresponding to the fabric requirement generated by local consumption as well as by the export oriented RMG industries. The average annual rate of growth of yarn demand is expected to be 8.27 per cent during the period 1995/96 to 1999/2000 and 5 per cent per year between the period 2000/01 and 2004/05. The yarn demand for domestic requirement will increase from 161 million kg in 1994/95 to 207 million kg in 1999/2000, and to 263 million kg in 2004/05. For export oriented RMG industry the yarn requirement will increase from 270 million kg in 1994/95 to 434 million kg in 1999/2000, and to 554 million kg in 2004/05. The total yarn requirement will nearly double, rising from 431 million kg to 818 million kg, between the period 1994/95 - 2004/05.

Table III.2: Requirement of Cotton Yarn, 1994/95 - 2004/05

(million kg)

Year	Demand for Producing Fabric for Domestic Consumption	Yarn Demand for Export Oriented RMG Industry	Total Demand for Yarn	Projected Growth of Yarn Demand (%)
1994/1995	161	270	431	-
1995/1996	169	297	465	8.04
1996/1997	177	326	503	8.10
1997/1998	186	359	545	8.30
1998/1999	196	395	590	8.35
1999/2000	207	434	641	8.58
2000/2001	218	456	674	5.17
2001/2002	231	479	710	5.30
2002/2003	245	503	747	5.30
2003/2004	259	528	787	5.30
2004/2005	263	554	818	3.88

Notes: Estimated on the basis of fabric demand presented in Table III.1, and assuming that:
(1) 1 kg of yarn produces 9 meters of fabrics for local consumption;
(2) 1 kg of yarn produces 6.75 meters of fabrics for export oriented RMG production.

Currently (1995/96), local sources supply only 24 per cent of the country's yarn requirement. In 1994/95, 97 million kg of yarn was produced by the local mills(Table III.3). The demand for yarn was 431 million kg of which demand for domestic fabric production and export oriented RMG industry was 161 and 270 million kg, respectively (Table III.3). However, in 1995/96 yarn production increased to 113 million kg as 8 new mills commenced production. In addition, 17 more mills with a total annual production capacity of 69.96 million kg are at

different stages of implementation. It is expected that these mills will start production in the next 3 years which will raise yarn production to around 172 million kg in 1998/99, when the local mills will be able to supply around 29 per cent of the country's total yarn requirement (Table III.3).

In this study we present three alternative scenarios of yarn production for purpose of the projection exercise. Scenario A portrays a situation of self-sufficiency in yarn production in 2005 and provides an estimate of the number of spinning mills that will be required to be established each year to meet all the yarn requirement locally. The projections under Scenario B are based on the assumption that 100 per cent of the yarn requirement for domestic consumption and 50 per cent of the export-oriented RMG requirement will be produced locally in 2004/05. Under scenario C, it is assumed that yarn production will continue to increase at the rate of 15 per cent each year in the period between 1999/2000-2004/05, i.e., at the rate at which yarn production is expected to increase during the early years of 1994/95- 1998/99.

Implication for New Investment

Scenario A

Given the present level of yarn production and the projected demand for yarn, local production of yarn on average will have to grow by about 24 per cent per annum over the period 1994/95 to 2004/2005. However, taking into account the mills currently under implementation, it is expected that yarn production will grow by an average of only 15 per cent per annum between 1994/95 and 1998/99. It implies that in the period between 1999/2000 and 2004/05, yarn production will have to grow by approximately 30 per cent per year to meet the yarn demand locally by 2005(Table III.3).

Table III.3: Self-Sufficiency in Yarn by 2005 : Scenario A

Year[a]	Desired Yarn Production (m.kg)	Desired Growth Rate (%)	Spinning Mills Required[b]	Additional Mills Required each Year	Required Spindle Capacity (in 000)	Fulfilment of Demand out of Local Production (%)
1994/1995	97	-	110		2016.0	23
1995/1996	113	16.5	118	8	2105.2	24
1996/1997	133	17.4	124	6	2245.5	26
1997/1998	152	14.8	129	5	2385.7	28
1998/1999	172	13.3	135	6	2530.2	29
1999/2000	224	29.6	150	15	2895.0	35
2000/2001	290	29.6	169	19	3367.7	43
2001/2002	375	29.6	194	25	3980.4	53
2002/2003	487	29.6	226	32	4774.6	65
2003/2004	631	29.6	267	41	5803.9	80
2004/2005	818	29.6	320	53	7137.9	100

Note: [a] Actual For 1994/95 - 1998/99, and Projected for 1999/2000 - 2004/05.
[b] Annual production capacity of a spinning mill of 25,000 spindles is assumed to be 3.5 million kg (6 oz./spindle/shift X 3 X 330 X 25,000 X 0.85= 3.5 million kg of yarn of 32^s count).

The estimated increase in yarn production under Scenario A will require an increase in the number of spindles from 2016.0 thousand(based on capacity utilization) in 1994/95 to over 7,000 thousand by 2005. In addition to the 17 mills under implementation that will be completed by 1999 raising the total number of mills to 135 and the spindle capacity to 2530.2 thousand, 185 new mills with 25,000 spindles each will be required to be established by 2005. These additional mills may be set up in a planned manner as shown in column 5 of table III.3. This will require investment of Tk. 74.0 billion spread over the period 1999/2000- 2004/05.

Scenario B

Under scenario B, local production of yarn will have to be increased to 540 million kg by year 2005 which will meet 66 per cent of the total yarn demand of the country. This is achievable if yarn production grows at an annual average rate of 18.7 per cent per year over the entire period of 1995/96 - 2004/05 (Table III.4). Given that the yarn production in the coming 3 years (1996/97 - 1998/99) will grow by 15 per cent on average, yarn production in the subsequent years upto 2005 will have to grow at a higher rate of 21.0 per cent. In order to achieve the desired expansion of yarn production, 104 additional mills will have to be commissioned starting from 1999/2000, in addition to the 17 projects already under implementation. The required new investment for that purpose over the period 1999/2000 to 2004/05 is Tk. 41.6 billion which is about 56 per cent of the investment requirement under scenario A.

Table III.4: 100% of Local Requirement & 50% of RMG Requirement to be met out of Local Production by 2005: Scenario B

Year[a]	Desired Yarn Prod. for RMG (m.kg)	Desired Yarn Prod. for Local Consumpt. (m.kg)	Desired Total Yarn Prod. (m.kg)	Desired Growth of Yarn Prod. (%)	Required Spinning Mills[b]	Required Additional Mills	Required Spindle Capacity ('000)	Fulfilment of Demand out of Local Prod. (%)
1994/1995	-	-	97	-	110	-	2016.0	-
1995/1996	30	83	113	16.5	118	8	2105.2	24
1996/1997	49	83	133	17.4	124	6	2245.5	26
1997/1998	69	83	152	14.8	129	5	2385.7	28
1998/1999	89	83	172	13.3	135	6	2530.2	29
1999/2000	108	101	209	21.0	145	10	2788.5	33
2000/2001	130	122	252	21.0	157	12	3101.0	37
2001/2002	157	148	305	21.0	172	15	3479.0	43
2002/2003	190	179	369	21.0	190	18	3936.3	49
2003/2004	229	217	447	21.0	212	22	4489.4	57
2004/2005	277	263	540	21.0	239	27	5158.6	66

Note : [a] and [b] As for table III.3.

Scenario C

If the yarn production is to grow by 15 per cent per year over the entire period upto 2005 as is anticipated for the initial four years, i.e., upto 1998/99, then total domestic production of yarn will increase from 113 million kg in 1995/96 to 399 million kg in 2004/05. This will require establishment of 65 additional mills between 1999/2000 - 2004/2005, i.e., on average 11 mills per year. The required investment for that purpose will be Tk 26.0 billion by 2005, when it will be possible to meet 57 per cent of the demand generated by the RMG sector and 32 per cent of the demand generated by local fabric needs. Overall, the spinning mills under Scenario-C will meet 49 per cent of the country's total yarn demand in 2005 as against only 24 per cent in 1995/96 (Table III.5).

Table III.5: Maintaining Constant Growth Rate: Scenario C

Year[a]	Total Yarn Prod. (m.kg)	Growth of Yarn Prod. (%)	Required Spinning Mills[b]	Additional Mills Required	Required Spindle Capacity ('000)	Fulfil. of Demand out of Local Prod. (%)
1994/1995	97	-	110	-	2016.0	23
1995/1996	113	16.5	118	8	2105.2	24
1996/1997	133	17.4	124	6	2245.5	26
1997/1998	152	14.8	129	5	2385.7	28
1998/1999	172	13.3	135	6	2530.2	29
1999/2000	198	15.0	142	7	2715.0	31
2000/2001	228	15.0	151	9	2927.5	34
2001/2002	262	15.0	161	10	3171.9	37
2002/2003	302	15.0	172	11	3452.9	40
2003/2004	347	15.0	185	13	3776.1	44
2004/2005	399	15.0	200	15	4147.8	49

Note : [a] and [b] As for table III.3.

It is worth mentioning here that the number of mills currently under implementation shows that entrepreneurs have already started to set up backward linkage textile industries in Bangladesh. Moreover, project proposals for 390 textile mills (75 spinning, 130 weaving, 89 knitting & Hosiery, 44 dyeing & finishing, and 32 other textile processing units) are now under active consideration of different financial institutions of the country.

Chapter IV

International Competitiveness of Cotton Yarn

A comparative picture of the manufacturing (conversion) cost as well as the total yarn cost of some selected countries by cost elements is provided in tables IV.1 and IV.2. This will enable an understanding of Bangladesh's competitive position in yarn production vis-a-vis other countries. For purpose of inter-country comparison we will use the cost structure of Bangladesh's private sector mills only, in preference to that of the public sector mills. The reason is that the conversion cost of cotton yarn in Bangladesh's public sector mills does not depict a correct picture because of the use of excessive manpower (and hence high labour cost) and low capacity utilization in these mills. Notice that the conversion cost of yarn in the public sector mills is 1.73 times the cost in the private sector mills, and the labour cost embodied in conversion cost in the public sector mills is more than twice that in the private sector mills.

Conversion Cost

The comparison of conversion cost of cotton yarn as shown in table IV.1 clearly demonstrates that Bangladesh's spinning mills have a competitive edge over all the comparator countries. Of particular interest to Bangladesh is the conversion cost differential in its spinning operation with that in India and Pakistan which are large producers and suppliers of raw cotton and cotton yarn in the world market. These two countries are important sources of supply of raw cotton used in Bangladesh's spinning mills. Bangladesh is also a large importer of cotton yarn from India which competes with the locally produced yarns.

Table IV.1: International Comparison of Conversion (Manufacturing) Cost of Yarn, 1995 (US $ per kg of yarn)

Cost Element	Japan	Korea	Thailand	India	Pakistan	Bangladesh	
						Public Sector	Private Sector
Waste	0.33 (14)	0.32 (18)	0.33 (19)	0.27 (15)	0.33 (21)	0.12 (05)	0.17 (11)
Labour	0.45 (19)	0.08 (05)	0.05 (03)	0.02 (01)	0.20 (12)	1.20 (47)	0.54 (36)
Power	0.50 (21)	0.17 (10)	0.19 (11)	0.28 (16)	0.28 (17)	0.23 (09)	0.15 (10)
Auxiliary Material	0.16 (07)	0.14 (08)	0.17 (10)	0.13 (07)	0.12 (07)	0.24 (09)	0.20 (14)
Depreciation	0.70 (29)	0.60 (35)	0.50 (29)	0.52 (30)	0.24 (15)	0.30 (12)	0.11 (07)
Interest	0.24 (10)	0.42 (24)	0.50 (28)	0.56 (31)	0.45 (28)	0.47 (18)	0.31 (21)
Total	2.38 (100)	1.73 (100)	2.74 (100)	1.78 (100)	1.60 (100)	2.56 (100)	1.48 (100)
Index	161	117	118	120	108	173	100

Memo Items: Cost Factors

Labour Cost/hr (US $)	24.31	5.65	1.56	0.56	0.43	0.44	0.44
Energy Cost/KWH (US $)	0.17	0.06	0.07	0.10	0.08	0.07	0.07
KWH Used/kg	2.9	2.8	2.7	2.8	2.7	3.6	2.4
Interest Rate (%)	4.5	12	15	16	18	13	13

Note :(1) Conversion Cost in Bangladesh public sector mills is high because of low utilization of spinning capacity. Cost factors in the Memorandum items are taken from ITMF and relevant national sources.
(2) Figures in parentheses denote percentages of the total.
Sources: For Japan, Korea, Thailand and India: ITMF, International Production Cost Comparisons, 1995; For Pakistan: All Pakistan Textile Mills Association (APTMA); For Bangladesh: Ministry of Textiles, Quarterly MIS Report, June 1995.

Table IV.2: International Comparison of Total Yarn Cost, 1995 (US $ per kg of yarn)

Cost Element	Japan	Korea	Thailand	India	Pakistan	Bangladesh	
						Public	Private
Waste	0.33 (07)	0.32 (08)	0.33 (0.88)	0.27 (07)	0.33 (09)	0.12 (03)	0.17 (05)
Labour	0.45 (10)	0.08 (02)	0.05 (01)	0.02 (01)	0.20 (06)	1.20 (30)	0.54 (14)
Power	0.50 (11)	0.17 (04)	0.19 (05)	0.28 (08)	0.28 (08)	0.23 (06)	0.15 (04)
Auxiliary Material	0.16 (03)	0.14 (03)	0.17 (04)	0.13 (04)	0.12 (03)	0.24 (06)	0.20 (05)
Depreciation	0.70 (15)	0.60 (15)	0.50 (12)	0.52 (14)	0.24 (07)	0.30 (07)	0.11 (03)
Interest	0.24 (05)	0.42 (10)	0.50 (12)	0.56 (16)	0.45 (13)	0.47 (12)	0.31 (08)
Conversion Cost	**2.38 (51)**	**1.73 (43)**	**1.74 (43)**	**1.78 (50)**	**1.60 (45)**	**2.56 (63)**	**1.48 (40)**
Raw Material	2.32 (49)	2.30 (57)	2.31 (57)	1.80 (50)	1.92 (55)	1.50 (37)	2.26 (60)
Total Yarn Cost	**4.70 (100)**	**4.03 (100)**	**4.05 (100)**	**3.58 (100)**	**3.52 (100)**	**4.06 (100)**	**3.74 (100)**
Index	126	108	108	96	94	109	100

Sources: As for Table IV.1 Raw material cost for India is calculated by taking the average E.I.C.A. spot values of Shankar-6A and F-414 (*Ref.: Cotton Outlook, 8 December 1995*) increased by 10 percent to account for additional charges for reaching the mill gate. Raw material cost for Pakistan is calculated by taking export quotations for MNH-93 price (*Ref.: Cotton Outlook, 8 December 1995*).
Note: Figures in parentheses denote percentages of the total.

Table IV.1 shows that in comparison with Bangladesh, the conversion cost of yarn is 20 percent higher in India, and 8 percent higher in Pakistan. It is noteworthy that in respect of conversion cost of yarn, Bangladesh has a

comparative advantage over India and Pakistan, even though labour cost per kg of yarn in Bangladesh is much higher than in these countries.

While Bangladesh has a clear competitive edge over other countries in respect of overall conversion costs, there are, however, wide differences among these countries in respect of various individual cost components. A look at the magnitude of such differences should be instructive for policy purposes.

Labour

Labour cost is the single most important component of conversion cost of yarn in Bangladesh. It is, however, much higher than in all other countries including Japan where hourly wage rate is the highest, and in fact many times higher than the wage rates in all comparator countries. Wage rate is, however, only one determinant of unit labour cost, and the wage rate in Bangladesh is not very dissimilar with that in India and Pakistan. Yet, mainly because of low labour productivity, unit labour cost of yarn is much higher in Bangladesh than in other countries. This is confirmed by a recent World Bank study which compares the labour competitiveness in the textile production of India, Pakistan, Sri Lanka and Bangladesh and observes that while average dollar wages in Bangladesh are lower than in all comparators, productivity of labour in Bangladesh is much lower than in all these countries.[10] This is also reflected in our table IV.1 which shows that although labour wage in India in U.S. dollars is 27 per cent higher than in Bangladesh, unit labour cost of yarn in India is less than 4 per cent of the labour cost in Bangladesh. In Pakistan unit labour cost in yarn is only 37 per

[10] World Bank, *Bangladesh: Labour Market Policies for Higher Employment*, Report No. 13799-BD, 1995.

cent of that in Bangladesh although hourly wage costs in these two countries are about the same. In Japan, labour wage is 55 times higher than in Bangladesh, but the unit labour cost in yarn manufacturing is 17 percent lower than in Bangladesh.

Apart from relative wage rates and labour productivity, variation in exchange rates also plays an important part in influencing unit labour costs. With exchange rate depreciation, the dollar value of wages denominated in domestic currency is reduced and hence unit labour costs fall. In table IV.3 in which changing labour costs in the 1990s in spinning and weaving in some developing countries are shown, it can be observed that the difference in hourly labour cost in dollar terms has decreased substantially between Bangladesh on the one hand and India and Pakistan on the other. In 1990, hourly labour cost in US dollar in India and Pakistan was, respectively, 200 per cent and 62 per cent higher than in Bangladesh, but in 1996 it was only 27 per cent higher in India, and at par with Pakistan. Notice that between 1990 and 1996, the currencies of India, Pakistan and Bangladesh have depreciated at rates of 101, 61, and 25 per cent respectively. The significant narrowing down in labour cost differences between Bangladesh and these two countries over the past six years can only be explained by the faster pace of depreciation of Indian and Pakistani currencies relative to Bangladesh.

Table IV.3: Labour Cost in Spinning and Weaving Industries in Some Developing Countries

Country	1990			1996		
	Total Labour Cost Per Hour (local currency)	Exchange Rate (Tk/US$)	Total labour cost per hour (US $)	Total labour cost per hour (local currency)	Exchange Rate (Tk/US$)	Total labour cost per hour (US$)
Sri Lanka	9.57	39.32	0.24	24.57	54.94	0.45
Indonesia	451	1833	0.25	1205	2330	0.52
China	1.75	4.72	0.37	4.85	8.33	0.58
Pakistan	8.31	21.55	0.39	15.00	34.72	0.43
India	12.40	17.28	0.72	19.64	34.85	0.56
Thailand	20.05	25.34	0.92	39.32	25.28	1.56
Bangladesh*	7.75	32.92	0.24	18.05	41.25	0.44

Source: Werner International Inc. *Spinning and Weaving Labour Cost Comparisons*, Summer 1990 and Spring 1996.
* Data for 1990 obtained from Bangladesh Bureau of Statistics.

The lesson that can be drawn for Bangladesh from the foregoing discussion is that in order to remain internationally competitive, wage rates should be linked to productivity, labour productivity should be made to improve though imparting new skills and technological improvements, and the exchange rate should be judiciously managed so as to avoid any major appreciation of the home currency in terms of the currencies of major competing countries.

Power

Power is a significant component of manufacturing cost. In fact in all the comparator countries except Bangladesh, the share of power in the manufacturing cost of yarn is higher than the labour cost. The amount of power

consumed per unit of production does not vary widely among the comparator countries; it is within the range of 2.4 to 2.8 kwh per kg, the lowest being in Bangladesh at 2.4 KWH/kg. The rate is higher in countries where industries are more automated. The cost of energy is lower in Bangladesh compared to India and Pakistan, and the power cost per kg of yarn in Bangladesh is only 53 percent of the cost in these two countries. This partly offsets the disadvantage of lower labour productivity in Bangladesh's textiles sector.

Capital Cost

As in power, the cost of capital (depreciation and interest) is substantially lower in Bangladesh's private sector mills than in all comparator countries, including India and Pakistan. The depreciation period is known to be similar (8-10 years) in all these countries, but, compared to Bangladesh, the interest on capital is the lowest in Japan, somewhat lower in Korea, but higher in Thailand, India, and Pakistan. The prevailing interest rate differential between Bangladesh and other countries does not adequately explain the relatively much higher interest cost per Kg of yarn in these countries. A reasonable explanation may be that the higher capital costs in Thailand, India, and Pakistan are due to the introduction of new capital equipment and modern technology in their mills. As a result of automation, labour productivity in these countries has also increased substantially, as is reflected in their lower relative unit labour cost. All this implies that technology upgradation is an inescapable necessity for the spinning mills, if the objectives of raising productive efficiency, improving product quality, and boosting labour productivity are to be achieved.

Total Yarn Cost

Raw Material

It has been seen in the foregoing that in respect of conversion cost of cotton yarn Bangladesh does have a comparative advantage over all comparator countries, including India and Pakistan which are Bangladesh's closest neighbours as well as important trading partners and competitors as far as trade in textile raw materials and products is concerned.

Regarding total yarn cost, however, Bangladesh's comparative advantage over India and Pakistan disappears, even though it retains its competitiveness with the other comparator countries. The higher yarn cost in Bangladesh relative to India and Pakistan is essentially due to the higher raw material cost which is the most important element of cost in the production of cotton yarn.

Bangladesh imports most of its requirement of raw cotton from the neighbouring countries of India and Pakistan, in particular from India. Here Bangladesh is clearly at a disadvantage because these two countries have natural advantages of close proximity to their raw material supplies and hence lower costs. Policies pursued by these countries in the form of export quota for raw cotton also create a wedge between the domestic prices of raw cotton at which the local spinning mills obtain their supplies and their international prices. These tantamount to maintaining a system of dual prices, viz., (i) a low procurement price of raw cotton for the local spinning mills; and (ii) a higher relative export price of raw cotton at which other yarn-producing countries import cotton from India and Pakistan. This has in fact been an important policy tool designed to benefit the spinning industry of these two countries.

Pakistan since 1995 has somewhat liberalized her cotton trade. The dual price policy has been abandoned. Export restriction on cotton has been

withdrawn, the policy to remain in force till June 1998. However, the imposition of certain stringent conditions on the export of cotton regarding registration of buyers' export contract with the Pakistan Export Promotion Bureau, opening of L/C by the buyer within a given time, penalty for delayed shipment, etc., prevent a free functioning of the market forces. In effect, thus, export control remains pervasive which continues to create a differential between the local market price and the price in the export market.

The implication of such price differentials for the Bangladeshi spinning mills is that they have to obtain raw cotton of the same grade at prices about 30 per cent higher than the Indian mills and 10 per cent higher than the Pakistani mills[11]. On top of it, another 6-7 per cent are added by way of bank charges, handling, freight, commission charges etc. which put Bangladesh in a disadvantageous situation.

The adverse impact of such a policy pursued by the raw material supplying countries on Bangladesh's production cost of cotton yarn is easily understood. Although the conversion cost of yarn in the private sector mills in Bangladesh is lower than that in the Indian mills, the total cost of producing yarn is higher. As can be seen from Table IV.2, while the conversion cost in a Bangladeshi spinning mill is 17 per cent lower than in Indian mills and 7.5 per cent lower than in Pakistani mills, the total yarn cost in Bangladesh is 4.5 and 6.2 per cent higher than in India and Pakistan, respectively. The reason is that raw cotton, the most important input in yarn production, costs about 25.5 per cent more in Bangladeshi mills than in the Indian mills, and 17.7 per cent more than in Pakistani mills.

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[11] See Chapter V for greater details.

The implementation of new fiscal measures introduced by the 1997/98 budget will further raise the raw material cost, and hence the yarn cost, of Bangladeshi mills. Thus the imposition of a 2.5 per cent infrastructure development surcharge (IDS) on all imports, including the import of raw cotton, will raise the cotton cost by a further 2.5 per cent[12].

The conclusions of this chapter may be summed up thus:

1) The conversion cost of yarn in Bangladesh is lower than in other countries which clearly demonstrates Bangladesh's competitive advantage with India and Pakistan that are the major competitors of Bangladesh in textiles and clothing. High labour cost, a consequence of low labour productivity, is a negative factor in Bangladesh's textile industry. Unit labour costs also depend upon exchange rate. The policy imperative for the Government is to enhance labour skill, upgrade technology in the spinning mills, and reform labour market policies to establish link between wages and productivity, and ensure a judicious management of the exchange rate.

2) The competitive advantage of Bangladesh's textile mills is lost when unit production cost of yarn is compared with India and Pakistan. The cost disadvantage will get worse after the new provision of IDS which is applicable to the import of raw cotton as well will be implemented. Additionally, the imposition of import duty @ 2.5 per cent on textile machinery coupled with 2.5 per cent surcharge will aggravate the problems of the spinning mills[13].

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[12] Given the price differential that already exists between Bangladesh and other countries, the imposition of IDS will constitute an additional burden to the local spinning mills.

[13] Import duty and surcharge on the import of textile machinery will together amount to (1.025)(1.025)-(1.0) or 5.06 per cent.

3) With appropriate policy assistance made available to the country's spinning mills to match the natural advantages enjoyed by the Indian and Pakistani mills in the form of lower costs of raw cotton and close proximity to their sources of supply, the mills in Bangladesh would definitely be able to produce and supply yarn at competitive prices. This will also encourage them to produce quality yarn both for feeding the domestic weaving and knitting industries as well as for export.

Chapter V

Textile Sector Related Policies of Some Selected Countries

This chapter discusses the textile sector related policies of selected countries, viz., India, Pakistan, Indonesia, Thailand, Viet Nam, and China. This will hopefully provide the perspectives against which Bangladesh's policies can be properly assessed in the next chapter.

India

The textile industry is India's largest single industry. It accounts for 20 percent of the country's industrial production and 7.5 percent of GDP. With over 1500 mill units, about 40 lakh handlooms, 17 lakh powerlooms, and thousands of garment, hosiery and processing units, the textile industry occupies a pivotal place in the country's economy. Among textile mills, over 82 percent are exclusively spinning units, and the others composite mills. The mill sector meets most of the yarn requirement of the country but contributes to as low as 8 percent of the country's total fabric production. Seventy percent of total fabrics are produced by the powerlooms whilst handlooms account for the remaining 22 percent.

India's policy regarding cotton and yarn are crucial for Bangladesh, as Bangladesh imports both the items in huge quantity. India is one of the large cotton producing countries in the world. Based on its cotton crop, and strongly supported by various government policies, a well diversified textile industry has grown up since the very early stage of her industrial development.

The Government policy in India on cotton and yarn is very complicated in nature but its goal is very simple, which is to protect its textile industry. To that end, the Government actively intervenes in various ways in regulating the domestic price of cotton which in turn contributes very significantly to keeping the domestic price to the user mills at a much lower level than the comparable world price. First of all, the Government guarantees a minimum price of cotton for its growers. This policy actually acts as an incentive for farmers to allocate their land in favour of cotton crop. In the second stage, once the crop is produced, adequate measures are taken to ensure that the crop can be used in the textile mills at a relatively cheaper price. To meet this goal, the policy restricts the export of raw cotton. In fact, one major element of the policy measures in the textile sector is to increase value addition at every stage of production. The restrictions on the export of raw cotton are justified on the following grounds :

(1) Quota free export of cotton might increase the price of cotton in the domestic market and thereby make the Indian textile industry uncompetitive in the world market.

(2) Free export of cotton would jeopardize the national objective of enhancing value added in the textile sector.

(3) The social objective of supplying yarn to handlooms, powerlooms, and hosiery units at a fairly low price would be hampered if cotton is exported freely.

(4) It is contended that export of cotton involves shipment of better ginned choice cotton, the availability of which is limited, a view particularly upheld by the Indian Cotton Mills Federation (ICMF).

(5) Finally and most importantly, the policy makers believe that unrestricted cotton export will indirectly help the competing countries in the world textile market by making available to them raw materials at cheaper prices.

There is a strong recognition in Government and the business community in India that the basic strength of their cotton textile exports emanates from relatively low cotton prices. It is feared that the advantage of lower cost of cotton (which is euphemistically termed as natural advantage) will be eroded by free export of cotton because that would raise the cotton price in the domestic market and make India's cotton textile products further uncompetitive in the world market as there is already sufficient evidence that the conversion cost of textile products in India is higher than in the competing countries[14].

The exact impact of Indian cotton policy and export restrictions on the relative cotton prices in domestic and export markets is difficult to assess, but there is plenty of evidence to show that the domestic price of raw cotton to the Indian yarn manufacturer has been historically lower than its international price. A comparison of domestic prices of specific Indian cotton varieties with quotations in international markets as presented in Table V.1 reveals that the international prices of raw cotton are about 20-49 percent higher than the domestic prices in India. This is also borne out by the evidence obtained from industry sources in India, and discussed in the following two paragraphs about the comparative cotton cost in Indian and international markets.

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[14] ITMF, 1995 *International Production Cost Comparison*, Zurich, August 1995.

Table - V.1: Bombay Spot and International Prices of Cotton Crop
(US cents per lb.)

Date quoted	Cotton Specification	Bombay Spot Price	Int'l Price*	Ratio of Int'l to Domestic Price
July 4, 1995	H-4	80.65	97.98	1.2149
Feb 8, 1996	J-34SG	54.43	78.00	1.4330
April 11, 1996	J-34SG	56.85	77.50	1.3632
June 13, 1996	J-34SG	60.02	73.50	1.2246
July 4, 1996	J-34SG	55.10	69.50	1.2613
Dec 19, 1996	J-34SG	52.50	76.00	1.4476
Jan 9, 1997	J-34	50.62	75.50	1.4915
Jan 9, 1997	Shankar-6	65.73	80.00	1.2171
Jan 23, 1997	J-34	51.37	74.50	1.4502
Jan 23, 1997	Shankar-6	66.17	79.50	1.2015
Jan 30, 1997	J-34SG	51.95	74.00	1.4244
Jan 30, 1997	Shankar-6	65.11	80.00	1.2287
April 17, 1997	J-34SG	53.37	71.00	1.3303
April 17, 1997	Shankar-6	69.35	78.50	1.3119

Note : * CIF North Europe quotation.
Source : Various Issues of Cotton Outlook.

In the production of 30s count yarn, an Indian spinning mill uses F-414 and Shankar-6 Grade A cotton in the ratio of 50:50. The market prices per kg of these two varieties prevailing in January 1997 were Rs. 47.42 and Rs. 50.62 respectively. The average price of cotton is thus Rs. 49.02/kg. The user mill has to incur additional costs, such as, 4.4% tax and other charges for selection, inspection, transportation, insurance, etc. which come to about 10% of the cotton price. The mill gate price of cotton is thus raised to Tk. 53.92/kg, i.e., US cents 68 per lb. The international price for similar staple length cotton in January 1997 was US Cents 86/lb, which is 26.47% higher than the cotton cost for the Indian mill.

As illustrated in the aforesaid example, the availability of raw cotton to the Indian spinning mill at a lower price confers on it a definite competitive advantage over the spinning mills in other countries which have to import cotton from the world market, including from India, at international prices that are 20-49 percent higher than the Indian mill gate price. The consequent disadvantage

suffered by yarn producing countries that base their production largely on imported cotton is thus alarming because it tends to erode whatever other advantages these latter countries might have in yarn production.

As mentioned earlier, the most striking feature of the policies that India pursues is the emphasis on the increase in domestic value addition. This is easily discernible if one looks at the Indian tariff structure. Thus, the duty on the import of cotton is currently zero, but historically the tariff rate on yarn has been kept at a high level. Since 1994, the customs duty on yarn import was 50 percent advalorem. In 1996/97, the basic rate was brought down to 25 percent but a special duty of customs at 2 percent was introduced that will remain effective upto March 31, 1999. There is also a countervailing duty on the import of cotton yarn and other textile related imports. At present, total import duty including countervailing duty on cotton yarn (85% or more of cotton) is 34.30 percent. The prevailing rates of import duty in India on items of interest to the textile industry are shown in Table V.2.

It is worth mentioning here that India has been in the practice of imposing countervailing duties (CVDs) not merely on the import of textile products but on virtually all major importables, ostensively with the objective of protecting their domestically produced substitutes from import competition. The economic justification for CVDs is difficult to find, because the Government of India never established or even tried to establish through the normal process of investigation if the industry or industries so defended were ever threatened by unfair competition or suffered any injury or threat of injury from the imported products. It transpired from enquiries made in connection with the present study that the Government of India have been accustomed to imposing CVDs on imports since 1947 along with statutory customs duties intending to give additional

protection to India's local industries so as to keep their products competitive against imported products at all cost.[15]

Apart from the import duties on yarn, there are quota restrictions on the export of yarn. This ensures that the local yarn is used in the domestic weaving industry. Again, nowadays superior long staple cotton is being increasingly used in India for blending with polyester for manufacture of blended yarn. But the rate of excise duty on such blended yarn is high. There are indications that in order to increase the intake of the superior long staple cotton the rate of excise duty on blended yarn might be lowered to augment the value addition in this sector.

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[15] It may not be out of context to mention here that many of Bangladesh's exports to India are subjected to CVDs in addition to high import duties which effectively keep Bangladesh's exports out of the Indian market. Bilateral negotiations have failed to remedy the situation. See GOB, Ministry of Commerce's Memo. No. MOC/ITO/AEA/1(8)/96/564 of 26 August 1996 to Bangladesh National Board of Revenue and related communications between the Metropolitan Chamber of Commerce and Industry, Dhaka and the Ministry of Commerce, Government of Bangladesh.

Table – V.2 : Import duty on the Textile Items in India, 1997-98

Custom Tariff Heading No.	Item	Basic Customs duty (% advalorem)	Special duty of Customs (% advalorem)	Total import duty including Countervailing duty (% ad valorem)
5201.00	Raw cotton	Nil	Nil	Nil
5504.10	Viscose Staple Fibre	25	2	56.21
5504.90	Other Artificial Staple Fibre	30	2	62.36
5503.20	Polyester Staple Fibre	30	2	62.36
5503.30	Acrylic Staple Fibre	30	2	92.72
54.02	Polyester Filament Yarn/POY	30	2	77.54
54.02	Nylon Filament Yarn/POY	30	2	62.36
54.03	a) Viscose Filament Yarn b)Cuprammonium Filament Yarn	30 30	2 2	62.36
5204.11 52.05 5207.10	Cotton Yarn (85 percent or more of cotton)	25	2	34.30
55.09 55.10 55.11	Man-made Fibre Spun Yarn	50	2	86.96
5802.11 5802.19	Cotton Terry Towel Fabrics	25	2	27 + Appropriate Excise duty
63.02 5802.19	Terry Towels	25	2	27 + Appropriate Excise duty
52.08 52.09 52.10 52.11 52.12	Other Cotton Fabrics	50	2	52 + Appropriate basic and additional excise duty
54.07 54.08 55.12 51.13 55.14 55.15 55.16	Man-made Filament Fabrics Man-made Spun Fabrics	50	2	52 + Appropriate basic and additional excise duty
28.36	Soda Ash	30	2	58.4
2815.11 2815.12	Caustic Soda	30	2	58.4
84.45 84.46 84.47 84.48 84.49 84.50	Textile Machinery (a) Specified Machinery (b) Other than above under EPCG (c) With export obligation of 4 times CIF value of machinery to be fulfilled in 5 years (d) With export obligation of 6 times CIF value to be fulfilled in 8 years (Provided CIF value is 20 crore or above)	 10 25 15 Nil	 2 2 2 Nil	 23.2 39.7 17 Nil

Source : The Indian Cotton Mills Federation, *Report for the Year 1995-96*, and Ministry of Finance, Government of India, Budget Documents of 1996-97 and 1997-98.

In recent times the ICMF has been demanding withdrawal of restrictions on the export of cotton yarn with a view to encouraging higher cotton consumption and larger production of yarn by the local mills. They also argue that since spinning capacity and thus production of yarn has of late increased manyfold, the Government should raise the ceiling for export of cotton yarn to 125 million kg. However, the export policy for cotton yarn in 1996 allowed only 80 million kg of yarn for export, and at the same time exempted the following categories of cotton yarn from export restriction:

(1) export by 100 percent export oriented industries

(2) export by Export Promotion Capital Goods units to the extent of meeting their export obligation

(3) all export against bilateral quota

(4) all export of 41 counts and above

(5) export of processed yarn

(6) export against import of cotton under Advance Licensing Scheme

(7) export of cotton yarn against import of cotton under Open General Licence (OGL)

For modernization of textile mills the textile policy of 1985 provided for setting up a textile modernization fund. Under this scheme, funds for modernization were made available by financial institutions on soft terms. This was not, however, the only such scheme in a bid to modernize the sector. In fact, in 1976 the Government of India had introduced a soft loan scheme for the same purpose. This soft loan scheme was replaced by the Textile Modernization Fund in 1985 and an amount of Rs. 750 crore was earmarked for this purpose. There was a very enthusiastic response from mills to this scheme and the earmarked

amount was fully utilized. The scheme proved to be of great help in giving a boost to the modernization effort of the sector. Another important policy support to modernize the textile sector relates to facilities provided under the Export Promotion Capital Goods (EPCG) scheme, under which the textile sector can import sophisticated machinery at a zero duty basis if the machines are worth Rs. 20 crore or more. At present the textile industry is pressing hard to lower the minimum stipulation at Rs. 5 crores. An estimate given by the ICMF shows that presently the textile sector is annually investing Rs. 1500 crore in modernization. Since the amount kept for the textile modernization fund has already been used up there is also a demand that such scheme should be reintroduced immediately.

It has been indicated earlier that the basic incentive structure of Indian textile policy is to promote value addition in the sector. There exist some specific regulatory mechanisms which augment this process. Firstly, in India, the mills designated as Export Oriented Units (EOUs) are allowed to import machinery and raw materials duty-free provided that 75 percent of their total production is exported. Secondly, the Export Promotion Capital Goods Scheme (EPCG) allows other mills reduced duty on imports of machinery against export obligations. These mechanisms of generating value added are further strengthened by the provisions of duty free import of raw cotton, high customs duty and surcharge on the import of value added cotton, and special import licensing requirements for the import of cotton fabric and apparel. Yet another important policy intervention is that the EOUs and firms that are required to import yarn and fabric to meet their export obligations are given duty discounts on these two value-added cotton imports.

Finally, the Indian textile sector has targeted to achieve at least 5 percent share in the global trade in textiles and clothing by the turn of the century. In

order to fulfill this goal the industry is now putting forward the following demands :

(1) Liberalization of yarn export policy

(2) Interest rate which is now at 20-24 per cent level be reduced at 8 percent

(3) Import of sophisticated textile machinery against export obligation should be allowed on a duty free basis

(4) Power tariff to be brought down significantly

(5) Textile modernization fund should be reintroduced

(6) Technology Mission for cotton to be set up so that productivity growth in cotton production and quality of cotton could be improved.

Pakistan

The textile sector in Pakistan is vitally important as it alone contributes more than 60 percent of the country's total export earnings. Pakistan is also a large cotton producing country. In 1995, Pakistan produced 1361 thousand metric tons of cotton which was about 7.3 percent of the total world production. It is estimated that Pakistan's share in the world production in 1996 and 1997 would be 8.7 percent and 7.9 percent respectively. Based on this natural fibre a diversified textile sector has grown up in Pakistan.

Until recently Pakistan had been practising a dual price policy for raw cotton for protecting their local spinning industry. The policy provided for (a) a lower procurement price for raw cotton at which the domestic spinning mills could procure raw cotton from the local market and (b) a minimum export price (MEP) of raw cotton imposed by the Government which was much higher than the domestic price. In addition, Pakistan had a 5 per cent tariff on imported cotton.

However, there has been some radical change in Pakistan's cotton policy since 1995. The system of MEP has been abandoned. There is now no formal restriction on cotton export which has of late been opened to the private sector. The policy of free export of cotton would continue until 1997/98. The policy of minimum support price of seed cotton as incentive to the grower also remains effective. The import of cotton is now allowed free of any duty or restrictions.

With the policy of free export and import of cotton without any duty and restrictions, the market would be expected to determine its own price and also the level of exportable surplus of cotton. There are, however, important snags in policies regarding cotton exports that take away the beneficial effects of export liberalization. There are regulations requiring registration of export contracts with the Export Promotion Bureau within a stipulated time, opening of L/Cs by foreign buyers, again within a stipulated time, penalty for delayed shipment, etc., all of which create a price differential for the cotton crop between the local and the foreign markets.

In a bid to remove the various constraints faced by the local textile industry the Government of Pakistan in October 1995 announced a 17-point textile package, important features of which are the following:

i) Payment of all duty drawback claims would also be made by banks, in addition to collectorate of customs.

ii) Duty draw back rates were raised on yarn, grey cloth, bleached, dyed and printed fabrics, textile made-ups and garments.

iii) Existing exemption from payment of Export Development Fund (EDF) surcharge allowed on export of fabrics, made-ups and garments was extended upto 30th June, 1996.

iv) Freight concession @ 25 percent was allowed from EDF on the export of non quota woollen and silk products.

v) Re-finance borrowings were either exempted from the payment of excise duty or if not legally possible, the tax would be included in the tax rebate.

vi) Banks were authorized to reschedule loans, reduce interest rates or freeze interest payments for viable spinning and weaving mills.

vii) Pakistan Banking Council was allowed out-of-court settlement in cases where courts have granted decrees against textile mills on their merit of each case.

The Pakistan Government declared a further package to revitalize the textile spinning sector in November 1996. The objective was to (i) enhance the availability of cotton and polyester fibre, (ii) to improve value addition in the textile sector, (iii) to provide cheap and assured working capital, and (iv) to improve the existing duty drawback scheme. Some of the measures taken to achieve these objectives are as follows:

a) 5 per cent custom duty on cotton import was removed.

b) The regulatory duty of 15 per cent on polyester and 10 per cent regulatory duty on viscose fibre and acrylic fibre were reduced to 5 percent.

c) The 5 per cent excise duty on polyester fibre was removed.

d) State Bank of Pakistan would ensure adequate availability of credit to this sector.

e) Duty drawbacks would be automatically adjusted whenever there was an exchange rate movement. This would be effective 90 days after the exchange rate change.

f) Man-made fibres which are not produced locally would be allowed under the existing no duty no draw back scheme.

g) Export rebate would be paid for duties paid on all inputs of the domestically produced pollster fibre.

Apart from this, the Government in December 1996 declared another policy package to revitalize the value added of the textile sector. Some important measures taken under this package are :

i) Regulatory duty on polyester chips, used in the manufacture of filament yarn was reduced from 10 to 5 per cent.

ii) Import of processing machinery for the textile processing industry was liberalized. The machinery whether old or new would be allowed import without limit. However, old machinery would be allowed only if it had a working life of 7 years and it was so certified by some internationally recognised surveyor or inspection agency.

iii) Regulatory duty was waived on some of the industrial sewing machines, knitting machines and their spares.

iv) Unused inputs imported by the exporters in their manufacturing bonds would be allowed re-export freely, if these cannot be consumed within the time frame allowed under some regulations.

v) Duty drawbacks on packing materials to the garment and hosiery exports were allowed.

vi) Except thread, wadding for jackets, and zipper for garments, the rate of sales tax on textiles and some other exports was reduced from 18 to 10 per cent.

Pakistan also practises several other measures to promote export of textiles and other related items. For a long time the export-oriented firms were granted a complete duty exemption from customs on import of raw materials. The textile and clothing firms also enjoyed duty free import of plant and equipment. At present, firms in the export-processing zones are exempt from income taxes for at least five years and there are other provisions to reimburse the duties and indirect taxes in accordance with standard rates. Concessional freight rates are provided for a number of items including textile goods and this facility has been extended to all goods destined for Africa and Latin America.

The textile industry also benefits from the Export Finance Scheme. This scheme was first introduced as early as 1971 when it was known as "Refinance Scheme for Non-Traditional and Newly Emerging Exports" and its objective was to provide adequate bank credit for exports of non traditional and newly emerging commodities on favourable terms. Later, from 1976 it was decided to include all manufactured goods in the scheme and consequently all exports other than raw cotton, rice, wool, and hides and skins were made eligible for concessionary finance and the scheme was renamed as *Refinance Scheme for Exports*. Subsequently, the scope of the scheme was enlarged further and currently it is called *Export Finance Scheme*. The scheme covers all items of exports other than rice, raw cotton, cotton yarn, fish and fish preparations, petroleum products, leather, raw wool, vegetables and some other small miscellaneous items. However, in the export policy of 1995/96 synthetic and blended yarn were made eligible to get the facilities provided under the Export Finance Scheme. This scheme envisages the provision of financing facility to the exporters by the commercial banks for export for eligible commodities at concessional rates not exceeding 13 per cent. Where refinance is obtained from

the State Bank, the Bank participates in the overall profit and loss of the bank concerned subject to a maximum of 10 per cent. The banks providing export finance to the exporters become entitled to avail refinance facility from the State Bank of Pakistan.

Indonesia[16]

The beginning of Indonesia's textile industry dates back to early 1950s when weaving and knitting industries developed, which in turn spawned the growth of yarn spinning and fibre raw material manufacturing industries. The textile industry in Indonesia, in fact, began with the import substitution of consumer goods such as fabrics and knitwear, and this led to the gradual growth of upstream sectors like spinning and synthetic fibres. Moreover, the expansion of the domestic market for readymade garments enhanced the development of midstream (weaving and dyeing and finishing) and upstream sectors. The Indonesian textile industry has over years experienced an unprecedented boom generally supported by a rapid surge in exports till the early 1990s. As a result, the sector has become the country's largest export industry after the petroleum and natural gas sector. The factors that contributed to the tremendous growth of Indonesian textile sector can be identified as (i) rising wages in Asian NIEs which gave Indonesia a comparative advantage in terms of lower labour cost, (ii) the devaluation of Rupiah in 1983 which provided incentives to the textile

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[16] Information on Indonesian Textile Policy collected from *Department Perindustrian Direktorat Jenderal Industri Aneka*, Jakarta through the Embassy of Bangladesh in Jakarta.

exporters, (iii) improved product quality, and finally (iv) a huge foreign capital inflow which was mainly concentrated in the textile sector.

With the establishment of capital investment law in 1967, foreign investors began to invest in Indonesia as a means of maintaining their market share. Particularly the spinning sector developed with Japanese investment into this area. At present, Japan, China, Korea and Taiwan are the major investors in Indonesian textile sector. Such investments are mainly in garment manufacturing and other garment related operations, such as woven fabrics, knitwear, dyeing, and button manufacturing. Besides foreign investment, a number of government policies have been conducive to the growth of Indonesian textile sector. The Government of Indonesia provided the following export incentive schemes :

a) Export financing facilities were granted to the exporters under which relatively low cost financing with an upper limit of 85 percent of manufacturing cost for export was provided,

b) Import duties on machinery and components were either reduced or eliminated,

c) Import duties and surcharges on raw materials destined for re-export as finished goods were either reduced or abolished.

Apart from the aforementioned incentives, the Government also took necessary measures to train the people associated with this sector. In Indonesia support for export promotion activities had been extensive which included, *inter alia*, (i) aid for participation in international trade fairs, (ii) financial aid for business trips to develop foreign markets, (iii) assistance in the preparation of sales promotion aids such as leaflets, pamphlets and catalogs, (iv) consulting services related to overseas market development, and (v) sponsoring for export promotion seminars.

In addition, opportunities are open for establishing any kind of new textile industries or expanding the existing ones, and such industries can be located in any region throughout the country. New or relocated industries are directed to be set up in industrial areas.

The only protection for domestic textile industry in Indonesia is in the form of import duty. Currently the import duties are:

- Fibre : 0-10 percent
- Yarn : 10-15 percent
- Fabrics : 20-25 percent
- Garments : 25-30 percent

There is no restriction on export of textile products and all types of textile product are freely importable subject to the payment of aforementioned duties. Exporting industries using imported raw materials are entitled to duty drawback facilities.

The main constraints facing the Indonesian textile industry is the shortage of raw materials, particularly raw cotton. It has to import a huge amount of raw cotton every year. In fact, it is at present the second largest cotton importer behind China and it is projected that by the end of the present fiscal year it would be the largest cotton importing country.

While Indonesia is greatly dependent on the import of cotton for use in yarn production, it has access to an abundant domestic supply of synthetic short and long fibres such as polyester, rayon, and acrylic. A wide variety of woven and knit fabrics and linings are also produced locally for use in the garment sector. However, most garment manufacturers rely on foreign sources for 25 percent to 30 percent of their materials.

Since 1974 Indonesia has been subject to restrictions under the MFA quotas on exports to the USA, Canada, the EU, Sweden and Norway. The annual increase

in MFA quota was set at 3 to 7 percent. Despite this quota restriction Indonesia's garments export rose rapidly mainly due to (i) diversification of exportable items, (ii) the development of non-quota items, (iii) increased exports of non-quota items, (iv) increased export to non-quota countries, and (v) increased unit prices due to higher quality.

At present, however, Indonesia's textile sector is faced with two major problems: (i) soaring spun yarn prices and (ii) imposition of anti-dumping duties by the EU. Although some sign of recovery in yarn prices has been noticed since October 1996, the EU decision of imposing anti-dumping duties is still a cause of serious concern for the Indonesian spinning mills which consist of 8 million spindles on an approval basis, 7.4 million on an installation basis, and 7 million on an actual basis. In a move to resolve the problem of anti-dumping duties the Indonesian Ministry of Industry and Trade filed a protest against the process of determination of anti-dumping duties by the EU on the ground that the calculation method of manufacturing costs does not comply with the WTO.

Indonesian textile and apparel exports recorded a spectacular growth of above 45 percent in the early years of the 1990s but in the face of changed international business environment the country refixed its target of textile export for the Sixth Five Year Development Plan (April 1994 - March 1999) downward. Initially the target was set at US$ 12,000 million whilst the new target is US$ 10,000 million. This type of downward revised export targets was unprecedented under the past Five Year Plans. Due to the crisis in the EU markets there are some apprehensions that even the revised target for textile and apparel exports might be quite high. In the backdrop of these developments the textile and clothing industry is demanding governmental supports such as tax reductions,

financial aid, the removal of the hassels of bureaucracy, and a general improvement of investment environment.

Meanwhile Indonesia is also putting emphasis on meeting the domestic requirement as there is growing expectation that the domestic consumption would increase tremendously with the increase in national income. Indonesian Textile Association feels that they need more spindles as the middle class are getting older and demand more and more clothing. At present the country has a population of 200 million which provides a huge consuming potential. To feed the middle class market the country would need more fine count fabrics. Consequentiy, spinning and weaving sectors have been identified as the prime sectors. Particularly in the spinning sector it is expected that investment would grow rapidly over the next few years.

Thailand

Although textile and clothing industry began to develop in the 1960s, Thailand has only recently become an important source of textile items in the world market, and also an attractive location for foreign investment. The flow of foreign investment and strong links with overseas buyers have helped Thailand achieve a rapid and robust growth in the production and export of textile and apparel products.

Thailand provides various measures to enhance the export of textile products which has been the country's prime source of foreign exchange earnings for several consecutive years. Particularly, in the last five year plan (i.e., 7th National and Social Development Plan, 1992-96) extensive efforts were made to promote value added in the textile and clothing sector. At least six major

organizations were involved in the process of developing mechanisms which could contribute to this sector's performance. These organizations were Ministry of Industries, Ministry of Finance, Ministry of Commerce, Ministry of Science, Technology and Environment, Ministry of Education, and Ministry of University Affairs. The responsibilities of these ministries related with the textile sector are outlined in Table V.3.

Table – 5.3: Various Responsibilities of the Concerned Ministries in Thailand under the 7th Five Year Plan (1992–1996)

Name of the Ministry	Responsibilities
Ministry of Industries	To provide technological services to the textile industry which included training and seminar, advisory services, testing and inspection, carrying out research and development and techno-economic study.
Ministry of Finance	To reform the tax and tariff structure.
Ministry of Commerce	To provide information on potential markets and new buyers, manage and negotiate textile export in the quota and non-quota market. To arrange fairs to promote direct business between potential clients and Thai exporters.
Ministry of Science and Technology and Environment	To provide funds for textile research and development to both the public and private sector.
Ministry of Education	To ensure the supply of textile personnel to meet the industrial requirement.
Ministry of University Affairs	To provide textile education in various universities in order to provide skilled manpower in the management level.

Source : Information supplied by the Textile Division, Department of Foreign Trade, Ministry of Commerce, Royal Thai Government through the Embassy of Bangladesh in Bangkok.

Thus it is apparent that Thailand could correctly identify the whole package of textile requirements and having done so the country took appropriate measures to provide the industry not only with the fiscal and monetary

incentives but also such supports as research and development, skilled managers, information regarding market opportunities, etc. There is no denying the fact that such a comprehensive package can only function if sound coordination and cooperation among the concerned agencies could be guaranteed. The available evidence also suggests that the country did this particular job adroitly and as a result the whole array of activities was conducive to the growth of textile industry and export as well.

Apart from the aforementioned ministries, the Board of Investment (BOI) and the Export-Import Bank played a crucial role in promoting and supporting exports and investment in the textile sector for export purposes. In order to promote investment the BOI offered a number of incentives which included exemption of corporate income taxes for 3 to 8 years, a further reduction of corporate income tax upto 50 percent for five years after the initial exemption period for the enterprises located in the investment promotion zones, and exemption and reduction of import duties on raw materials. Besides, the BOI also guarantees against nationalization and price controls and permits to employ foreign technicians and experts to work in the industry. Furthermore, there is no stipulation on the amount of foreign currency remitted or taken abroad. The Thai Government has also taken necessary measures to provide financial support for the exporters. With this view in mind, the Export-Import Bank was established in 1993. The Bank is responsible for providing credit to exporters through a concessionary rediscount facility.

Particularly under the Seventh Five Year Plan, Thailand has undergone a series of reforms some of which have greatly benefited the textile and related industries. For example, the restriction on establishing new textile industry and expanding the existing ones was removed and as a result it opened a great

opportunity of investment in the various sub-sectors of the textile industry including the spinning sub-sector. However, investment in the large factories which could be a threat to environmental degradation is controlled under the prevailing laws. Another important reform measure which greatly benefited the textile sector was the introduction of the value-added tax system. It effectively mitigated the problem of double taxation to which the textile sector was earlier exposed. At present VAT is levied on the value added at each stage of production and distributed at the rate of 7 percent.

Under the tariff reforms the number of tariff rates has been reduced to 6 (0, 1, 5, 10, 20 and 30) from the previous 39. The new tariff structure is based on the escalated value added system which is given below.

- 0 percent tariff on goods for which the government has a policy to exempt import duty
- 1 percent on raw materials
- 5 percent on primary products and capital goods
- 10 percent on intermediate and semi-finished goods
- 20 percent on finished goods
- 30 percent on products needing special protection

Given the above tariff structure, the import duty on some items has been reduced in order to provide further incentives to some of the textile sub-sectors. For example, (i) duty on imported dye is reduced from 30 percent to 10 percent, (ii) duty on chemical used in bleaching, dyeing, printing, and finishing has been reduced to 20, 10, or even 5 percent subject to items, (iii) tariffs on wool have been brought down to 10 percent from the level of 30 percent, (iv) duty on synthetic and cotton yarn has been reduced from 30 percent to 10 percent, (v) tariffs on woven and knitted fabrics have been brought down to 20 percent from 40 percent, and finally (vi) tariff on garments has been cut from 45 percent to 30 percent. Besides, to support export activities Thai Government now offers tax rebate. Under this scheme, textile enterprises can obtain tax rebate from the

Customs Department for customs duties and excise taxes paid on imported raw materials within 60 days from the date of exports. Furthermore, the Government grants tax coupons to exporters that comply with prescribed rules and procedures. The value of coupons is based on the invoiced value of the exported goods at the rates determined according to the type of goods. A claim for tax coupons must be made within a year after the date of exports.

Above all, the Government of Thailand patronizes effective cooperation between public and private sectors to enable a deeper private sector involvement in all textile industrial development activities, including provision of suggestions about manufacture and export policy, trade negotiations, and participation in overseas export promotion.

Viet Nam

Viet Nam is a new comer in the export market of ready-made garments. The first textile factory was set up in 1989 while by 1996 the number increased to 100. Various trade policy reforms introduced by the Vietnamese Government have contributed to the growth of textile sector and export of RMG as well.

Until 1988, Viet Nam followed a state trading system when export and import targets were achieved through interaction between local and central governments, and trade was executed by state trading companies. However, with the beginning of 1990s, a lot of reforms have been undertaken to liberalize export and import trade. To that end, three important policy interventions were introduction of i) a unified exchange rate system, ii) a market oriented exchange rate regime, and iii) a duty drawback scheme for materials used in the production of export items. These initiatives have actually helped the production

and export of RMG products despite the fact that still there exist a lot of restrictions in terms of direct export controls and quantitative restrictions on import.

Presently, most of the garment factories are owned by the Government. In fact, the figure is as high as 95 percent. The rest of the factories belong to the private sector and joint venture companies including 100 percent foreign owned ones. Recently, Viet Nam has been able to attract a huge foreign investment, a big share of which is going to the export-oriented RMG sector. Viet Nam has a very disciplined labour force and there is no power shortage to meet the industrial sector's demand for power. These two features have made Viet Nam an attractive location for foreign investment.

Like the other countries the Vietnamese Government have also followed an escalated tariff structure. The duty structure on various textile items can be seen below[17]:

- 0 percent on raw cotton and man-made fibre
- 20 percent on yarn
- 40 percent on fabric
- 45 percent on apparel

Since Viet Nam is not a cotton producing country, in order to ensure adequate supplies of raw material, it does not have any duty on importable raw cotton. Most of the raw cotton is imported from CIS countries (mainly Uzbekistan) and West Africa. The local mills supply virtually all the yarn needed by the downstream factories. However, often a little quantity of quality yarn is imported from India.

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[17] Information supplied by Viet Nam Chamber of Commerce and Industry (VCCI).

China[18]

Very recently China has become a major exporter of textile items. Being a traditional industry in China, the cotton manufacturing leads China's textile industry and occupies a decisive position in the country's overall textile industry. It is, however, only after 1979 when the economy witnessed various reforms and open policies, that China's cotton manufacturing industry began to develop rapidly. In fact, during the period 1988-1991 the number of spindles in the spinning sector increased at an annual average of 12.7 percent, and by 1991 the production far exceeded domestic demand thus making China a huge exporter of cotton manufactures.

China is a very large cotton producing country, and there is enormous governmental intervention in terms of selling and buying raw cotton in the country. The trading in cotton is monopolized by supply and marketing cooperatives and there are State-set prices both to provide incentive to the farmers to expand the production of cotton and to ensure supply of cotton to the local mills at relatively lower price.

The policy reforms undertaken in China over years have provided at least two major incentives to the exporters. Firstly, the reform of foreign exchange administration system has resulted in the unification of the previously operating dual-track exchange rate. Under the new system all exporters get more Yuan (the Chinese currency) per dollar than what they used to get previously. Again, under the reforms of tax administration the duty drawback facilities have been expanded further which have greatly benefited the textile exporters as a group.

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[18] Based on information contained in the *Asian Cotton Textile Outlook*, 1995-96.

Apart from the aforementioned activities the State is actively involved in supporting the domestic textile and spinning sector as well. The Government took several measures for this purpose, of which the important ones are mentioned below:

i) Under the *grant preferential tax policy* to support the State-run large and medium cotton textile enterprises, the state first collected taxes and then returned them to some of the enterprises. This policy continued upto 1995.

ii) The Government have decided that the loans allocated to various enterprises for technical upgradation which are not expected to be repaid would be regarded as investment by the state.

iii) When cotton prices are unusually high the Government intervenes directly so that the mills can purchase cotton easily. In this regard, the State usually makes provision for *bonuses* and reallocate the supply of cotton among provinces.

Presently, China has given maximum emphasis on technological upgradation, and measures are being adopted in order that advanced equipment including autowinders, chute-feed systems and modern combing and rotor spinning machines can be introduced in the existing mills. Besides, under the 9th Five Year Plan (1996-2000) the State is vigorously attempting to promote the production of synthetic fibres. China has targeted textile export of US$ 50 billion by the year 2000. To realize this goal the country is trying to supply more technology intensive and competitive products in the world market.

Chapter VI

Bangladesh's Textile Sector Policy and Constraints

Evolution of Textile Policy

Although Bangladesh has a long and rich heritage of textile industry, no serious effort was made in the immediate post-independence years to develop the sector. The successive development plans did not take into cognizance the potential of the different sub-sectors of the industry. It was only in the 1980s when ready-made garments started to make significant contribution to export earnings that efforts were initiated to energize the country's textile and clothing sector. This attempt was further strengthened by a policy shift from import substitution to outward-looking strategy and from a restrictive trade policy regime to a more liberal one. In fact, from the mid-1980s the RMG sector began to be treated as the engine of growth for Bangladesh. From then on, the share of primary and traditional exports in total export earnings was declining very fast whilst that of RMG was increasing.

In order to exploit the potential of the garment sector to the maximum the Government adopted the *Textile Policy - 1989*. The objective of this policy was to provide guidelines for a harmonious development of the industry and to expand export market further. The policy also attempted to augment the process of generation of value addition in RMG export as the local contribution of value added in this sector was as low as 20-25 percent. However, the 1989 textile policy failed to create significant backward linkages and could not accomplish its goal of achieving self-sufficiency in textiles to meet the demand for local consumption as well as the need for export-oriented RMG industry.

In this backdrop the Ministry of Textiles in 1994 launched a *sixteen point programme* to promote the development of textile industry in the country. The programme highlighted some of the critical issues pertaining to this sector, suggested certain measures and actions, and also laid emphasis on increasing the value addition in the RMG sector. In the meantime, the Government identified the textile sector as the *Thrust Sector,* and the 16-point programme was quickly followed by the announcement of *Textile Policy - 1995.*

The main objective of this latest policy is to attain self-sufficiency in textiles for meeting the local as well as the RMG demand for fabrics. To that end, the policy seeks to achieve a harmonious development of all textile sub-sectors and increase value addition by establishing necessary backward linkages through encouraging private investment, both domestic and foreign.

On the basis of the projected demand supply gaps for products of various sub-sectors, attempts were made in the Policy to work out the required domestic physical capacity in the industry to attain self-suffiency, and the amount of investment needed for that purpose. The estimated demand gaps in various sub-sectors in 1995 and 2005 and the amount of new investment needed to create additional capacity in these sub-sectors are shown in Tables VI.1 and VI.2.

Table - VI.1 : Demand Gap in Spinning, Weaving and Dyeing and Finishing Sub-sectors in 1995 and 2005

Indicators	Spinning (Yarn) (in Crore kg)	Weaving (Grey Fabric) (in Crore Metres)	Dyeing & Finishing (in Crore Metres)
Total demand in 1995	46.70	327.00	327.00
Local demand in 1995	20.70	145.00	-
Export demand in 1995	26.00	182.00	-
Local Production	9.65	104.00	104.00
Demand Gap	37.05	223.0	223.0
Demand Gap in 2005	77.10	475.00	475.00

Source : Textile Policy 1995, Government of Bangladesh.

Table - VI.2 : Investment Requirements to Meet the Local and Export Demand of Textile Products

Sub-Sectors	To meet the present demand		To meet the demand in 2005	
	No. of mills to be set up	Estimated investment (Crore Tk.)	No. of mills to be set up	Estimated investment (Crore Tk.)
Spinning	123 (each with a capacity of 25000 spindles)	4640	(123+126) = 249	9680
Weaving	223 (each with a capacity of 1.0 crore metres	4460	(223+252) = 475	9500
Dyeing, Printing and Finishing	223 (each with a capacity of 1.0 crore metres	2230	(223+252) = 475	4750
Total Investment Required =		11330	-	23930

Source : Textile Policy 1995, Government of Bangladesh.

The investment requirement in the textile sector as estimated in the Textile Policy is very large and ambitious. Doubts have been expressed in different quarters about whether it is at all feasible to generate such huge

amount of resources for this sector alone. An attempt has been made in this study to make alternative estimates of investment requirements in the spinning sub-sector under different scenarios[19]. These estimates, although somewhat lower than those in the textile policy, are still large, but with appropriate incentives it may not be difficult to achieve the investment targets in a phased manner. The various types of incentives currently available to the textile sector and their instruments are listed in Table VI.3.

Table - VI.3 : Instruments Used Under Various Incentive Packages

Types of incentives	Instruments
Fiscal	i) duty drawback facilities ii) tax holiday iii) income tax rebate facilities iv) waiving of import license facilities v) concessional tariff rates on the import of inputs vi) rebates on freight and power charges
Financial	i) cash assistance to promote backward linkages ii) credit at concessional rates iii) retention of foreign exchange earned by the exporters iv) export credit guarantee schemes v) provision of import under back to back L/C vi) provision for inland back to back L/C vii) bonded warehouse facilities viii) availability of credit lines in foreign exchange
Institutional	i) setting up of Export Promotion Bureau (EPB) ii)setting up of Duty Drawback and Duty Exemption Office (DEDO)

Source : Sadrel Reza *et al. The Emerging Global Trading Environment and Developing Asia*: Bangladesh Country Paper, Asian Development Bank, 1996.

[19] See Chapter III of this report.

Incentive Structure for the Textile Sector

The package of textile sector incentives has been designed primarily to benefit the exporters. Allowing them access to imported inputs at international prices through the temporary admission scheme and refund of duties and taxes paid on both imported and domestic inputs through various schemes operated by the DEDO is now the most important incentive. Bonded warehouse facility is allowed for some exporting sectors, including the garments manufacturers and producers of specialized textiles as well. Exporters are permitted to import inputs worth upto 70 percent of the value of L/Cs under this facility. However, any export-oriented unit not enjoying the bonded warehouse facilities can avail of duty drawbacks. The exporters of RMG, specialized textiles, household linens, and hosiery products are allowed to open L/Cs for the required import of raw materials against their export L/Cs. Currently, under inland back to back L/Cs, suppliers of locally produced fabrics linked to export industries are also eligible to enjoy this facility of advantageous financing.

The incentive measures have also attempted to augment the domestic value addition of RMG and knitwear exports. These two items presently cover two-thirds of Bangladesh's export earnings but in terms of value added their contribution is very modest. The local value addition in the RMG sector is about 25 percent, while for the knitwear export it is 50 percent. In order to stimulate the domestic value addition, a provision for minimum value addition was introduced under which the exporters are required to add a certain percentage of the total export earnings locally in order to be eligible for back-to-back L/C facilities. At present these minimum requirements for RMG vary from 15 to 25 percent.

The local value addition is also encouraged through a cash compensatory scheme which is administered by the Bangladesh Bank. Introduced in 1989, this

scheme initially provided a cash subsidy equivalent to 10 percent of gross value added of exports for non-quota items of garments and 10-20 percent of net value added of local sales to exporters of garments for sales of locally produced yarn, hosiery and handloom fabrics. Later on, these incentives were withdrawn and a scheme of 15 percent cash compensation was introduced. Since 1994, the amount of cash compensation has been increased to 25 percent and is available to RMG, hosiery and specialized textile units which are either not covered, or refrained from using the facilities provided under the bonded warehouse and duty drawback facilities. Since the overall tariff rates in the country have come down substantially over a few years, the 25 percent cash subsidy is now regarded as a very powerful incentive.

Another incentive is given to the exporters to provide post-shipment financing for imported inputs from the Export Development fund (EDF) which was formed in 1989 with the help of IDA assistance. The exporters are also given rebates on income tax attributable to export receipts. Recently, the advance income tax deduction has been reduced from 0.50 to 0.25 percent on the export earning textile sector, and the EPZ units are exempted from paying this tax for a period of ten years.

Very recently a few more decisions have been taken to provide further incentives. For example, all exporters are now allowed to retain 40 percent of their foreign exchange earnings instead of the previous rate of 20 percent. However, for low value added items such as RMG the rate of retention has been raised from 5 to 7.5 percent.

Major Constraints of Spinning Sub-sector

The Textile Policy 1995 has identified some of the major problems pertaining to various sub-sectors of the textile industry. These problems are highlighted in Table VI.4. There are yet other problems which are the results of inappropriate domestic policies, and still others that emanate from policies and practices pursued by other countries. Appropriate solution of these problems is to be found if the professed objective of achieving self-sufficiency in the textile sector is to be achieved. In what follows, the major problems will be discussed and their solutions suggested. Some of the weaknesses of the textile policy will also be highlighted from which lessons may be drawn for policy.

Table - VI.4 : Major Problems of Textile Sub-sectors as Identified in the Textile Policy 1995

Textile Sub-sector	Major Problems Identified
Spinning	1) obsolete technology 2) frequent interruption of electricity 3) scarcity of raw materials 4) high import duty on raw materials and spares 5) high percentage of wastage 6) lack of proper maintenance of machinery 7) slow progress of privatization of public textile mills
Weaving	1) obsolete technology 2) inferior quality product 3) low capacity utilization 4) high prices of yarn 5) high tariff and taxes on imported yarn 6) electricity failures 7) lack of working capital 8) non-availability of funds for BMRE of some industries
Handlooms	1) high prices and irregular supply of yarn and raw materials 2) non-availability of working capital 3) lack of trained manpower 4) problems of marketing as the industry is unorganized in character
Dyeing, Printing and Finishing	1) lack of modern facilities 2) shortage of quality yarn and fabric from domestic sources
Knitting and Hosiery	1) technological handicaps in knitting an fabric processing 2) non-availability of quality raw materials 3) shortage of working capital
Sericulture and Silk Industry	1) shortage of cultivable land 2) lack of research 3) traditional technology 4) excessive operational cost in the public sector 5) dearth of skilled workers

Source : Government of Bangladesh, Textile Policy 1995.

First, there is the lack of a well-defined strategy for the development of the textile sector. The textile policy emphasizes the need for achieving self-sufficiency in textiles through a harmonious development of all textile sub-

sectors. The thrust is for establishing backward linkages so that value addition can be increased. There is, however, little indication as to how this objective will be achieved.

For a resource poor country like Bangladesh, it is very difficult to find adequate resources for investment to be self- sufficient within such a short time span of 10 years. It would probably be wise to assign priority to a particular sub-sector over the others so that the growth of the prioritized sub-sector could stimulate expansion of the other sub-sectors in future. Obviously, this type of strategy was not considered in the textile policy. In Bangladesh, the spinning sub-sector could be considered as the priority sector, the development of which would propel the expansion and growth of the other sub-sectors. The importance of the spinning sub-sector, however, appears to have been insufficiently appreciated in the textile policy.

Secondly, a serious problem that besets the textile sector is that of a very low domestic value addition in RMG exports. A proper recognition of this problem would make the task of identifying the priority sub-sector easier. If value addition in this sector is to be enhanced, then some of the intermediate products which are currently imported to produce the finished goods should be substituted by domestic production. Bangladesh not being a cotton growing country, the process of generation of value addition in the textile industry should start with spinning. In fact, all the countries where value addition is significant have a very strong spinning sector. For example, in India out of 1500 mill units, 82 percent are in spinning. Indonesia which is a large cotton importing country has a very strong spinning sector and its value addition is also significantly higher. Once yarn production is started and import of yarn is substituted by domestic production it will eventually augment the value addition.

Thus if value addition is to be a basic objective of Bangladesh's textile development strategy, there is no denying the fact that the process should start from the spinning sub-sector. Strategically, therefore, the spinning sub-sector should be given priority over other sub-sectors.

Thirdly, in Bangladesh there is a clash of interest between various sub-sectors of the textile industry (for example, between spinning and weaving) which makes the task of prioritization, and for that matter, the formulation of policy difficult. A certain policy incentive to one particular sub-sector may often negatively affect some other sub-sectors. Yet, the need for differential policy treatment across various sub-sectors remains, and in such a situation, the policy makers will have to judge as to which of the sub-sectors should get priority in matters of support policy.

In the case of Bangladesh's textile industry, determination of priority for purpose of support policy should be guided essentially by the efficiency criterion. Evidently, this efficiency criterion has not been applied in extending assistance to Bangladesh's textile industry. Available empirical evidence, including the MIS data of the Ministry of Textiles on productivity and capacity utilization, indicates a greater relative efficiency of the spinning sub-sector over weaving, but official policy has always been unambiguously in favour of weaving, giving little attention to the opportunities and problems of the spinning sub-sector.

A fourth problem of the textile industry is that of glaring anomalies and inconsistencies in the structure of tariff and other types of protection accorded to this sector. The Textile Policy admits that import tariffs related to textile products have not been able to provide adequate support to the country's textile industry. It stresses the need for removing the anomalies that exist in the tariff structure through tariff rationalization, but the revision of tariff structure

actually carried out in recent times appears to have been far from realistic and failed to correct the anomalies. This becomes evident if one looks at Table VI.5 which depicts a comparative picture of how the import duties on woven fabric (H.S. Code 53.09) and cotton yarn (H.S. Code 52.04-52.07) have been adjusted downward during the period 1985-1997.

From table VI.5 it becomes clear that the process of tariff reduction has resulted in a drastic cut in the nominal rate of protection for the spinning and weaving sub-sectors. However, throughout much of the last decade the weaving sub-sector remained heavily protected, and some reduction in the level of protection to fabrics was started only from FY 1993/94. On the other hand, the cut in nominal protection in the spinning sub-sector has been more drastic than in weaving, the extent of reduction in the level of nominal protection having been as high as 85 percent for yarn, and only 55 percent for fabric.

Table VI.5 : Tariff Rate on Imported Woven Fabric vis-a-vis Cotton Yarn, 1985-1996

Year	Rate of Import Duty on Woven Fabric (% ad valorem)	Rate of Import Duty on Cotton Yarn (%)
1985/86	100	50
1986/87	100	20
1987/88	100	20
1988/89	100	20
1989/90	100	20
1990/91	100	20
1991/92	100	30
1992/93	100	15
1993/94	75	15
1994/95	60	7.5
1995/96	45	7.5
1996/97	45	7.5

Source : Supplied by Bangladesh Textile Mills Association (BTMA) from NBR data.

The rationale behind such a drastic cut in the level of nominal protection accorded to spinning is open to question because there is an overwhelming evidence to show that the domestic spinning sector has to operate at a great disadvantage because its textile mills do not have easy access to raw materials, i.e., raw cotton, unlike the mills in India and Pakistan. As has been seen in Chapter IV of the present study, the higher yarn cost in Bangladesh relative to India and Pakistan is essentially due to the higher raw material cost, even though in terms of the conversion cost of yarn the Bangladesh mills have a clear competitive edge over India and Pakistan, and also, such other countries as Korea, Thailand, and Japan. Yet, the country's trade and industrial policy has not extended any meaningful assistance to mitigate the observed disadvantages of the spinning sub-sector. On the contrary, as is evidenced in the BTC study referred to earlier, the effective rate of protection to the spinning sub-sector has always been negative which implies that cotton spinning activity in this country is taxed rather than protected. The recent imposition of IDS, which is applicable to the import of raw cotton as well, will further reduce the extent of nominal protection enjoyed by spinning mills, indicating that the country's trade and industrial policies have served to penalize an efficient sub-sector.

The BTC Textile Sector Study on Weaving, on the other hand, reveals that the weaving sub-sector has long been enjoying a very high level of effective protection and yet its performance remains extremely poor. The present study fully recognizes the need for having an efficient weaving sub-sector and to that end acknowledges the necessity for extending adequate assistance to that activity to enable it overcome its current problems. However, given the conflicting nature of interest between weaving and spinning, it is desirable that the Government's

policy in support of weaving does not harm the interest of the relatively more efficient spinning sub-sector.

As can be seen in Table VI.6, all the countries that are actual or potential competitors of Bangladesh have followed an escalated tariff structure under which the level of protection is usually higher for the weaving sector[20]. Bangladesh, follows a similar tariff structure, but unlike in the comparator countries the spread between the tariff rates on the successive stages of spinning and weaving has been kept wider with the consequence that the effective rate of protection for weaving in this country is much higher than that for spinning. However, the case for raising the level of effective assistance to spinning through according greater tariff protection remains strong because that will to some extent mitigate the disadvantages currently suffered by the spinning sub-sector. The absolute level of assistance to the weaving sub-sector would thereby be somewhat reduced but it would still remain substantially higher than that accorded to the spinning sub-sector, particularly because the former currently enjoys significant protection in the form of quantitative restrictions (QRs) on fabric imports[21].

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[20] Table VI.6 shows the prevailing custom duty rates on raw cotton, yarn and fabric in India, Pakistan, Viet Nam, Indonesia, Thailand, and Bangladesh.

[21] Devising a support mechanism for weaving does not fall within the scope of the study. Yet, as is indicated in Chapter II above, the major problems of the weaving sub-sector are believed to be those of out-dated technology and old machinery. The remedy for this sub-sector may, therefore, be sought more in removing its structural problems than in trade policy measures alone.

Table VI.6 : Comparable Import Duty Rates of Different Countries, 1997/98

H.S. Code	Item	India		Pakistan		Indonesia		Thailand		Viet Nam	Bangladesh	
		CD	CV	CD	ST	CD	VAT	CD	VAT	CD	CD	VAT
5201.00	Raw Cotton	0	0	0	18	0	0	0	7	0	0	0
5204.11	Cotton Yarn	27	7.3	55	18	10	10	10	7	20	7.5	15
5208	Cotton Fabrics	52	+Ex.duty	65	18	20	10	20	7	40	45	15
5402.1	Polyester Filament Yarn (POY)	32	60.72	35	18	5	10	-	-	-	30	15
5402.2	Nylon Filament Yarn	32	45.72	35	18	5	10	-	-	-	30	15
5403	Viscose Filament Yarn	32	30.36	35	18	5	10	-	-	-	30	15
5503.20	Polyester Staple Fibre	32	30.36	20	18	10	10	-	-	-	2.5	15
5503.90	Acrylic Staple Fibre	32	30.36	Rs18/kg+25%	18	5	10	-	-	-	2.5	15
5504.10	Viscose Staple Fibre	27	29.21	10	18	10	10	-	-	-	2.5	15
5504.90	Other Artificial Fibre	32	30.36	Rs18/kg+25%	18	5	10	-	-	-	2.5	15
5509	MMF Spun Yarn	52	34.96	35	18	10	10	-	-	-	15	15

Sources : National Sources.

Fifth, a serious cause of concern for Bangladesh's textile sector which has arisen very recently out of the dispute with the EU regarding the tariff-free access to EU market strengthens the argument for promoting the spinning sub-sector. A little digression will clarify the matter.

Bangladesh's export of textile and clothing items can be broadly grouped into two components, RMG and knitwear. Knitwear is also a readymade garment but the only difference is that RMGs are made of finished fabrics whilst the knitwear weaves yarn directly into a readymade garment. In 1996 RMG accounted for 50 percent of gross export of Bangladesh while the corresponding share of knitwear was 15 percent. However, one important point is that the local value addition from the knitwear is two times higher than from the RMG. If

Bangladesh's total exports on the basis of net value addition were computed, the contribution of RMG and knitwear taken together would account for 39.8 percent of Bangladesh's total export earnings instead of 65 percent[22]. Within this export share of garment items the net exports of RMG accounted for 26.3 percent of total exports whilst the knitwear sector accounted for 13.5 percent. This indicates the growing importance of knitwear in the net export earnings of the clothing sector.

To come back to the issue in question, the most significant feature of the knitwear export is that the product has the largest market in the EU[23], where Bangladesh enjoys duty-free access under the GSP scheme. This preferential treatment is granted without any reciprocal obligation on the part of Bangladesh, provided the rules of origin and competitive need provision of the respective EU countries are fulfilled. The EU textile policy varies its treatment on textile and clothing imports for different groups of countries, as shown in Table VI.7.

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[22] See Ismail Hossain and others, "Growth or Stagnation? A Review of Bangladesh's Development 1996", CPD (1996).

[23] In 1995, 66.3 percent of the total export earning from knitwear generated from the EU market as against only 24.9 percent from the US market.

Table - VI.7: EU Treatment on Imported Textile and Related Products from Various Groups of Countries

Countries/Groups	Tariff (%)	Quota	Surveillance[7]	Certificate of origin
Preferential countries[1]	0	No	Yes	EUR1
Lome countries[2]	0	No	No	EUR1
LDC (Bangladesh)	0	No	Yes	GSP form A
EFTA countries[3]	0	No	No	EUR1
OECD countries[4]	0-25	No	No	EUR1
Autonomous regime countries[5]	0-25	Yes	Yes(only UAE)	Yes
Central and Eastern Europe[6]	0-25	Yes	No	Yes
WTO/GATT registered countries under MFA		Yes	n/a	Yes

Note : [1] Tunisia and Morocco; [2] Mauritius; [3] Switzerland, Norway, Liechtenstein; [4] USA, Japan, Canada, Australia, Mexico, New Zealand; [5] North Korea, Bosnia-Hercegovina, Croatia, Former Yugoslavia, UAE; [6] Poland, Romania, Czech Republic, Hungary, Russia, Slovak; [7] Many suppliers are subject to surveillance which means that imports are monitored to identify sudden surges which may require action.

Source : Madhavi Majmudar (1996), "The MFA Phase-Out and EU Clothing Sourcing: Forecasts to 2005", *Textile Outlook International*, March 1996.

From Table VI.7 it becomes clear that Bangladesh stands to gain significantly from the EUGSP scheme vis-a-vis its main competitors such as India, Pakistan, China etc., since Bangladesh enjoys both quota-free and tariff-free access to the EU market. However, it is to be noted that in order to access GSP, the EU Rules of Origin requires a three stage value addition in case of knit-RMG, while for woven RMG two-stage value addition is enough. So under this process criterion Bangladesh is unable to get preferential access in the case of woven-RMG as most of the fabrics for woven products are imported from abroad under back to back L/C and hence two-stage value addition requirement is not fulfilled.

On the other hand, for three stage conversion as required in the case of export of knit-RMG, Bangladesh has managed to get GSP facilities. The three

stage conversion in effect means that the yarn is produced domestically and then the domestic yarn is used in knitwear production. Very recently, however, a serious uncertainty has appeared in accessing the GSP facilities in the export of knitwear as it has been alleged that most of the yarn used in knitwear production in Bangladesh is imported and hence the process of production of knitwear does not comply with the requirement of three stage value addition.

The allegation brought against Bangladesh that it has violated the EU rules of origin is very unfortunate, indeed. The Export Promotion Bureau (EPB) of Bangladesh has the responsibility to issue certificates of origin (COO) confirming that the yarn used to produce knitwear for the EU market is of Bangladesh origin. But EPB has allegedly been issuing COO without proper verification as to whether the yarn used in the export-oriented knit and hosiery industry was domestically produced or imported[24]. The EU Commission has taken the issue seriously and launched an investigation to verify the allegations[25]. After the investigation has been launched against Bangladesh, many EU importers have stopped taking orders from Bangladesh which has already caused a huge loss to Bangladesh[26].

In such a situation, the Government of Bangladesh have requested the EU to favourably consider the case of Bangladesh as a least developed country (LDC) and to apply a two-stage process criterion on the knit-RMG instead of the

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[24] Bangladesh Textile Mills Association Annual Report 1995-96, *Chairman's Report*, p.20.

[25] Similar investigations against Maldives, Nepal, Cambodia, and Laos have resulted in the withdrawal of GSP facilities from these countries.

[26] For Example, export earnings from knit-RMG has declined from $81.9 million in the month of January 1997 to $48.6 million in the month of February 1997, a reduction of about 40 percent.

existing three stage formula. The EU is yet to decide the issue but has only informed Bangladesh that her demand has been under active consideration.

In any case, the manner in which Bangladesh has responded to the facilities provided under the EUGSP scheme leaves much to be desired. The basic attractiveness of EUGSP scheme is that it facilitates the building up of manufacturing capacity and encourages the promotion of backward and forward linkages in the LDCs so that they can gradually switch over from production and export of primary goods to that of high value added products. But the GSP facilities provided to Bangladesh have actually benefited other yarn producing countries and served to promote the backward linkage of these other countries rather than of Bangladesh. There are also allegations that taking the benefits of loans at a subsidized rate of 6.5 percent from the Export Development Fund (EDF) yarn has been imported and sold at the domestic market and finally these yarns have been shown to have been purchased from domestic spinning mills in order to qualify for the three-stage of value addition in the knit-RMG. All this has caused a substantial loss of government revenue, misuse of EDF and, most importantly, a setback for the promotion of the spinning sub-sector.

In the above context, it goes without saying that if the EU considers Bangladesh Government's request and allows a two-stage value addition, the country will be able to benefit from it only marginally because the prospect of promoting backward linkage will thereby be blocked. Thus for Bangladesh the pragmatic policy option would be to ensure backward linkage in the textile sector which would increase value addition and thereby contribute to higher export earnings. This strategy acquires an added significance because in the near future, especially after 2005, trade in textile and clothing will be completely free, and Bangladesh will have to face severe competition from its competitors.

Yet, if the EU at all approves a two-stage value addition process in the knit-RMG, in the country's own interest it must be time bound and for a short period only, say for three years, by which time the short run difficulties can be overcome. This will keep open the prospect of building backward linkages in the country.

One vital point that must be taken into cognizance while designing any policy related to textile sector is that after the dismantling of the MFA quota in 2005 the only major obstacle to the export of textile products will be the tariff barriers in the developed country markets. In fact, since the Uruguay Round tariff reductions in the textiles and clothing sector have been lower than the average tariff cuts for industrial products, this sector now remains most heavily protected in the developed countries[17]. Yet, since Bangladesh enjoys a tariff-free access in the EU market while none of its competitor does have such facility, Bangladesh will have a clear competitive advantage in the EU market over its competitors. In order to fully exploit this advantage Bangladesh will need to establish adequate backward linkage in this sector.

The foregoing discussion clearly leads to the conclusion that in the process of creating backward linkages the spinning sub-sector should be given the topmost priority. In fact, with the dispute over EUGSP scheme which has come to light recently, the spinning sub-sector should be treated as the heart of backward linkage activities. At present, the total investment in the spinning sub-sector is around Tk. 4000 crore, which is the highest among all the sub-sectors of the textile industry. According to official estimates, the present demand for yarn by the export-oriented knit industry is 63 million Kgs. The BTMA claims that

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[17] In industrial products the average tariff reduction by the developed countries was 38 percent, whereas in the textile and clothing sector it was only 22 percent.

against the total demand for 63 million Kgs, existing capacity of the spinning mills is capable of supplying 34.98 million Kgs. In addition, the under implementation units that are expected to start operation by June 1997 will have the capacity to supply a total of 69.96 million Kgs of export quality yarn to the knit industries[28]. Besides, a good number of mills with additional supply capacity of 20 million Kgs are now at different stages of implementation with various banks[29]. Thus there are reasons to believe that if adequate support is given, the domestic spinning mills will be able to meet all the demand for yarn in the knit-wear industries in the near future.

Sixth, the possible adverse effects of import liberalization should be given due consideration. Since the mid-1980s the Government of Bangladesh have been liberalizing the economy very fast, as is reflected in the sharp downward revision of the tariff structure in the textile sector. Policy makers should, however, realize that the basic objective of import liberalization is to expedite the process of industrialization. Trade policy should be development oriented, aimed, on a selective basis, at building supply capacity and thus form an integral part of industrial and development strategy. Competition from imports may no doubt have significant efficiency improving effects, but it may also drive entrepreneurs out of industry into intermediation for imports[30]. Depending on the country concerned, therefore, trade policy may comprise liberalization of import in some goods, and at the same time include strengthening the degree of protection accorded to others.

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[28] See BTMA Annual Report 1995-96, p. 112-113.

[29] Ibid.

[30] C.f. Rehman Sobhan, *Rethinking the Role of State in Development: Asian Perspectives* (Dhaka : University Press Limited, 1993).

For a country like Bangladesh with a very fragile manufacturing base, the main requirement is to develop supply capacity and lay the foundation of a competitive export sector. In areas where the country has some production capacity, say textile spinning, it should aim at product upgrading and development to make the products internationally competitive and capable of exploiting new opportunities in the international markets. A reassessment and revision of the tariff structure keeping in view the interest and problems of the country's textile sector thus becomes necessary.

This is not, however, to advocate assistance to the spinning activity for an indefinite period, but to allow it sufficient time to overcome the present difficulties. It should be noted here that Bangladesh started the process of import liberalization at the behest of the World Bank and IMF whose ideology runs in terms of the growing submission to the so-called rules of the market, with emphasis on competition, removal of the anti-export bias, and improvement of allocative efficiency.

However, the lesson from economic history is that industrialization has been achieved through controlling access of foreign goods to domestic markets. In general, the experience of Japan and East Asian NIEs is at variance with the World Bank/IMF thesis that the more open the economy, the faster is its economic growth. Governments of some of these countries had intervened vigorously in their economies and offered selective protection using high import tariffs, quotas, and exchange controls for developing their import substituting industries. In fact, import control still remains the most practised policy even in the highly developed countries today, which is also evident through the operation of MFA quotas which is nothing but protection under the aegis of quantitative restrictions provided to the textile industry of the developed countries. Our

policy makers should draw lessons from this experience in formulating trade and sectoral policies. Sudden or rapid liberalization of domestic and external markets could have disastrous consequences for the economy as a whole.

Even a country like India which has a large manufacturing base and a well diversified textile sector has increased its tariffs and countervailing duties on yarn from 32.19 percent in 1995/96 to 34.30 in 1996/97. Similarly, Turkey has imposed a 20 percent import duty on Pakistani fabrics in order to save her domestic textile industry. The EU has recently imposed anti-dumping duties on yarn and fabric exports of Pakistan, India and Indonesia. Bangladesh's policy makers should take cognizance of such trade restrictive measures around the world and make the donors understand that in the name of drastic liberalization Bangladesh cannot afford to lose the potential for strengthening and expanding its industrial base.

Seventh, the most debilitating constraint faced by Bangladesh's spinning industry is the high cost of raw cotton. There is an unimpeachable evidence that the domestic spinning mills have to procure the basic raw material, i.e., raw cotton, at a relatively higher price than its competitors, in particular, India and Pakistan[31]. This price differential in raw cotton contributes significantly to eroding the competitive advantage of Bangladesh's spinning sector. The implication of the budgetary proposal for introducing a general infrastructure development surcharge on all imports will aggravate the spinning mills' problems further.

In order to relieve the industry from the disadvantages it suffers in competition with the neighbouring countries, all types of duty and taxes on raw material imports should be withdrawn, and an appropriate support mechanism, say

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[31] See Chapters IV and V above for greater detail.

a provision of cash subsidy to the spinning mills, should be immediately introduced. Such subsidies would ensure Bangladeshi mills a level playing field and help achieve competitiveness in the production of yarn in relation to other countries.

Eighth, the prevailing restrictions on the import of man-made fibres constitute a hindrance to spinning activity. Man-made fibre is an important raw material used in yarn spinning, including production of mixed yarn. There is no domestic production of man-made fibre but yet its import is subjected to a duty of 2.5 percent. Man-made fibre (MMF) should be treated at par with raw cotton and its import should be allowed duty-free. The duty on MMF reduces the extent of effective protection enjoyed by this sector and acts as a hindrance to the process of value addition. Its withdrawal will greatly contribute to raising the competitiveness of the local spinning industry.

Ninth, Machinery and spare parts imports related with the spinning mills are still subject to high import duties. At present, spare parts worth 10 percent of value of capital machinery are allowed duty free, but there are some items on which import duty is quite high. Moreover, in the budget for FY 98 a fresh import duty of 2.5 per cent on textile machinery has been proposed. In order to enable rapid development of the textile sector, the import of all machinery and spare parts should be allowed duty-free.

Tenth, a major problem facing the spinning sub-sector is the leakage from the bonded warehouses. At present the RMG sector can import duty-free yarn and fabric by using the bonded warehouse facilities. But there are allegations that the yarn and fabric imported under this scheme are sold in the open market through leakage from bonded warehouses. The leakage of duty-free yarn hurts the sale of locally produced yarn because the leaked products are sold in the

local market at prices below the duty-paid price as well as the ex-factory price of locally produced yarn. Table VI.8 which presents the findings of a price survey shows that the price of Indian yarn of 30s count in the Narayanganj market is 10-11 percent lower than the duty-paid price and about 12-13 percent lower than the ex-factory price of similar counts of Bangladesh yarn. There is a resentment among the industrial circle that the leakage of duty-free yarn imported by knitting and hosiery mills accounts for a substantial portion of supply of yarn in the local market, resulting in unsold stocks and loss to the local mills.

Table VI.8 :Prices of Locally Produced Yarn Vs Indian Yarn, May 1997

Count	Ex-Factory (Tk/Lb)	C & F Benapole		Duty Paid price* Tk/lb	Narayanganj Market Price Tk./lb
		US$/Kg	Tk./lb (average)		
100% Cotton					
30s Carded	82.00	3.05-3.20	60.44	78.95	69.00-72.00
30s Combed	86.00	3.25-3.40	64.31	84.00	75.00-76.00
40s Combed	99.00	3.15-3.80	67.21	87.79	81.00-88.00
82s Combed	145.00	4.80-5.10	95.74	125.06	129.00-158.50
Blended					
30s PC(65%+35%)	78.00	2.90-3.00	57.06	74.54	70.50-73.00

Note : * including 7.5% CD, 15% VAT, and 7% to cover all other charges.
Source : Market Survey.

The afore-mentioned problem is compounded by the provision of high wastage rate - above 26 percent- allowed for the knit-RMG sector. This high wastage allowance aggravates the situation as it is possible to reduce the rate of wastage, and the difference between the permitted wastage and actual wastage can be sold in the market. Supporting the high wastage rate would contribute to encouraging inefficiency in this era of superior technology and stiff

competition. Furthermore, such irrational support measure is provided at the cost of the efficient spinning sector. Thus it is imperative that the bonded warehouse facilities are strictly monitored and the wastage rate reduced to a reasonable level. The rate may be determined in consultation with industry representatives, experts, and the Mills Association. A committee may be constituted for that purpose.

Structural Constraints in the Spinning Sub-sector

There are a few structural constraints to which due attention should be given so that the Spinning sub-sector can grow and act as the focal point of an integrated textile industry structure. First is the problem of technology. In most cotton mills, technology used is very old. Some mills use machinery which are 40 years old with little or no investment made for renovation and modernization. Some units have new equipment but with very conventional technology. Only a few mills have the modern machinery and the latest technology. It is these mills that produce quality yarn.

Because of the use of old machinery and antiquated technology yarn quality is poor and unsuitable for producing the fabric demanded by the RMG industry. Labour productivity is low because of the poor condition of the machines and nullifies the comparative advantage the country claims to possess on account of its low labour cost. This disability of the spinning industry is indeed the major constraint to development of the linkage between the spinning and the other mid-stream sub-sectors. There is, therefore, no alternative to getting the latest technology if the spinning industry is to develop and effectively compete with other yarn producing countries.

Secondly, power shortage has been a chronic problem in Bangladesh and in recent times it has deteriorated to the extreme. This problem affects production of every sector including the textile sector and is a major reason for low capacity utilization. According to one estimate[32], the total energy requirement for full capacity utilization in the textile sub-sectors (spinning, weaving, dyeing, printing and finishing) in 1994/95 was 476 million MW, and if the planned capacity expansion as envisaged in the Textile Policy 1995 is to be achieved 529 MW would be needed by the year 2005. While Government should sincerely try to attract foreign investment in the power sector, initiatives should also be taken to allow the textile units to produce their own electricity. For that purpose, provision may be made for bank credit at concessionary interest rate for importing generators by industries. Import of generators and spares should also be made duty free, and the Government should supply gas to these power generating units at the same rate as is allowed to PDB for power generation.

Third, lack of access to cheap credit is a serious constraint faced by the textile industry. Because of weak competition in the banking sector and the oligopolistic structure of the banking system led by the large Nationalised Commercial Banks (NCBs), the interest cost of loans is high. Besides, the policies of fixing rates and charges followed by the NCBs seem to be driven by their compulsion to recoup their past losses which is not at all in conformity with the profit maximizing behaviour[33]. These practices penalize the new borrowers who have to shoulder high interest charges due to the bad performance of their predecessors. It is widely believed that appropriate reforms of the banking

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[32] G.A. Matin, "Textile policy 1995 : Some Constraints", *BTMA Annual Report 1995-96*, p.50.

[33] Kabir Hassan, "Financial Sector Reforms", *Growth or Stagnation? A Review of Bangladesh's Development 1996*, CPD, 1997.

sector would generate a fair competition in the banking sector, and the cost of borrowing would also be lower. This would make the bank credit attractive and help the textile sector in getting funds at a reasonable cost. Until such time, the Government might think of providing loans to textile sector at lower rates of interest in view of the fact that the textile sector has been identified as the *thrust sector*, and, furthermore that the efforts to achieve the Textile Policy objective of self-sufficiency by the year 2005 will need a huge amount of investment. The Government should also consider creating a textile modernization fund which will ensure loans at a subsidized rate to modernize the existing spinning units. India introduced a similar type of fund which contributed significantly to boosting efforts made by spinners to upgrade their technology.

Another problem pertaining to the spinning industry is the lack of trained and qualified manpower. With the installation of sophisticated units it is felt that demand for qualified textile engineers, managers and operators will go up. At present, the country does not have adequate facilities to produce the required number of qualified and skilled personnel.

Finally, and most importantly, a huge investment would be needed in the spinning and other textile sub-sectors. Given the poor physical and socio-economic infrastructure it is very difficult to attract foreign investment in this sector. An all out effort must be made to mobilize domestic resources as well as external funds to meet the investment demand.

Chapter VII

Policy Recommendations

The spinning industry in Bangladesh is beset with many problems. Some of them are due to inappropriate, often faulty, trade and industrial policies that have failed to provide the necessary incentives and encouragement for its growth. Some of the problems are the results of textile sector related policies and practices pursued by the neighbouring countries which supply the much needed raw materials to Bangladesh's textile spinning industry and whose products also compete with those of Bangladesh in the latter's own domestic market. There are yet other problems which are basically structural in nature and related to obsolete and inappropriate technology, poor management and labour skill, high wastage, frequent interruptions in power supply etc. Solution to these problems will require action on a number of fronts. Some tentative policy options designed to remedy these problems can be discerned in the earlier chapters. These are summarized and pieced together in this chapter.

1. A major solution of the structural problems of the spinning industry lies essentially in introducing modern technology and replacing old and worn out machinery that will improve product quality and raise competitiveness. The industry will require huge amount of new investment to accomplish this objective, for which active Government support will be needed. Easy access to bank credit with provision of low interest rates, setting up a textile modernization fund for providing soft loans as has been done in India, and the provision of duty free import of sophisticated machinery (also as in India) will contribute to the

promotion of spinning industry. Foreign direct investment and joint ventures that will bring in new capital and modern technology should also be welcome. To attract FDI, significant doses of domestic public investment will also be needed for the development of the country's physical infrastructure. Unless the structural impediments are removed by the injection of new investment, introduction of modern technology, and development of basic infrastructure, trade policy incentives that are recommended later in this chapter are unlikely to be effective in improving the competitive position of the spinning sub-sector.

2(i). Bangladesh's main competitor in cotton yarn is India. In respect of the conversion cost of cotton yarn, Bangladesh private sector mills demonstrate a clear competitive edge over India and also Pakistan, not to speak of other high cost comparator countries such as Japan, Korea and Thailand. However, the advantage in the form of lower conversion cost of cotton yarn is lost as Bangladesh mills have to obtain raw cotton at a higher price compared to the Indian and Pakistani mills. This is due partly to the natural advantages of lower costs and close proximity to raw material supplies, and partly to the policies undertaken by these countries that enable their spinning mills to obtain cotton (the main raw material) at a price lower than in the world market. Yarn cost in these countries thus becomes lower than in Bangladesh as a result of which the domestically produced cotton yarn in Bangladesh suffers a price disadvantage in competition with the yarn imported from these countries, in particular from India. In order to ensure a level playing field for Bangladesh's domestic spinning mills so that they can compete on relatively equal terms with those of India and Pakistan, appropriate policy assistance will be necessary. If such assistance enables the country's spinning mills to match the cost advantage enjoyed by

their competitors in India and Pakistan in the form of cheaper availability of raw cotton and other inputs, these mills will be able to produce and supply yarn at competitive prices. In this regard, the following policy options may be considered:

2(ii). Bangladesh's spinning mills have to procure raw material (cotton) at about a 30 per cent higher price than those in India. In order to mitigate this cost disadvantage suffered by the Bangladeshi mills, a strong case can be made, on an interim basis, for extending a 30 per cent price support towards the procurement of raw materials by the spinning mills. This deserves the highest consideration by the Government.

2(iii). The recent decision to impose a 2.5 percent infrastructural development surcharge which is applicable to all imports, including raw cotton, has been absolutely ill-conceived. If implemented, this budgetary measure will aggravate the problems of the spinning mills further. The BTMA and all chamber bodies in the country have in one voice raised strong protests against implementation of the proposal. In the interest of future growth of the spinning industry and hence of the textile sector as a whole, the Government should not hesitate to withdraw all tariffs and taxes on the import of raw cotton, the basic raw material for the industry.

3(i). The Government currently provides 25 per cent cash incentive on export of local woven fabrics/knitwear. Since the export-oriented knitwear industry is using local yarn to claim the 25 per cent cash incentive, it would be fair to treat the spinning mills as deemed exporters and provide them cash incentive of 25 per cent of the value of the yarn they supply to producers of such knitwear/woven

fabrics. This incentive will make the locally produced export-quality yarn competitive and cheaper than the imported yarn. Moreover, the local yarn will also be easily available and at a much shorter lead time than the imported yarn.

3(ii). The provision of 25 percent cash incentive is definitely a laudable step which is expected to significantly contribute to promoting backward linkages in the industry. The Government should therefore continue with the scheme and ensure that the exporters using locally produced yarn and fabric in export production can avail of the facility without difficulty. According to WTO rules, Bangladesh as a least developed country(LDC) is entitled to provide the cash subsidy upto year 2002.[34] Table VII.1 shows that this scheme renders the locally produced yarn cheaper to the domestic knitwear industry as compared to the yarn imported from India under back-to-back L/C. The cost per kg of yarn to the knitting industry is US$ 3.10 if they use locally produced yarn, while the cost is US$ 3.37 per kg if they import under back-to-back L/C. If the prevailing subsidy is withdrawn, the cost per kg of yarn will be US$ 4.13 per kg, which is 22.5 per cent higher than the duty free imported yarn. Therefore, the Government should not have any hesitation to allow continued operation of the scheme.

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[34] WTO Agreement on Subsidies and Countervailing Measures, Article 27(3).

Table VII.1: Comparison of the Cost of Imported and Locally Produced Yarn (30 Carded) to the Knitting Industry

Prices	Locally Produced Yarn (2)	Imported Yarn under Back-to - Back L/C (3)	Yarn Leaked out from Bonded Warehouses (4)	Imported Yarn with Import Duty Paid (5)
Procurement Price Per LB (Tk)	80.00	n.a	n.a	n.a
Procurement Price Per Kg (Tk)	176.37	n.a	n.a	n.a
Procurement Price Per Kg (US $)	4.13	3.15	3.15	3.15
Transportation, Insurance & Others @7% (US $)	n.a	0.22	0.22	0.22
Import Duty Paid CD:7.5% & VAT:15% (US $)	n.a	n.a	n.a	0.74
Less Cash Incentive @ 25% (US $)	1.03	n.a	1.03[a]	n.a
Net Price Per Kg (US $)	3.10	3.37	2.34	4.11
Index	100.0	108.7	75.5	132.6

[a] Estimated on the basis of the price of locally produced yarn.
Note: n.a indicates 'not applicable'

3(iii). It is, however, alleged that the scheme of providing 25 per cent cash incentive on the export of woven fabric/knitwear is being greatly abused. The exporters of readymade garments/knitwear not availing of the duty draw-back facility are entitled to this scheme. The industry people, however, complain that the incentive so given often benefits the smugglers rather than the actual producers. Yarns/knitted fabrics/woven fabrics of foreign origin are available in the local market which are either leaked out from the bonded warehouses or smuggled in from the neighbouring country. Many exporters buy these products from the local market where they are cheaper(see table VI.8, Chapter VI), and thus take advantage of the cash incentive rather than avail of the duty draw

back facility. Because of the abuse of the scheme, the desired objective of the subsidy - to promote backward linkage industries - is not achieved.

3(iv). A mechanism should be devised to prevent abuse of the cash incentive facility. For example, the firm intending to avail of the cash subsidy may be required to produce a certificate of origin of the product. Thus, knitwear exporters will have to obtain from BTMA/BTMC a certificate of origin(COO) of the yarn they use to get the cash incentive. In the same way, COO will have to be obtained from BTMA/BTMC, if the RMG industry exports garments made of locally produced woven fabric. It implies that the RMG exporter will have to obtain certificates of origin from the association whose members supply them the raw material. A strict enforcement of this type of regulation will ensure that the subsidy is received by the genuine exporters and not given against smuggled goods or products leaked from bonded warehouses.

4(i). Considerable trade liberalization has occurred in the textile spinning sub-sector where the tariff on cotton yarn has been significantly lowered - from 30 per cent in 1991 to 7.5 per cent in 1995. This drastic reduction in tariff has made Bangladesh yarn uncompetitive with the Indian cotton yarn which, with its advantage of low yarn cost, is outcompeting Bangladesh's yarn in its own domestic market. In order to protect Bangladesh's yarn industry from the onslaught of Indian yarn, adoption of a realistic tariff policy becomes an inescapable necessity. True, Bangladesh is committed to a policy of pursuing a liberal trade regime, but when its textile industry is yet to build a sound base, a sudden exposure of the industry to free competition with the established and far more efficient suppliers may have disastrous consequences for its growth.

The need for according adequate protection to the spinning industry, therefore, hardly requires any emphasis.

4(ii). There is a scope for rethinking about the Government's policy of trade liberalization, not just in the textile sector, but encompassing all other sectors of the economy. The policy makers must realize that the basic objective of trade liberalization is to facilitate the process of the country's industrial development. It should aim at building supply capacity first and allow the industries sufficient time to stand on their own feet and become competitive in world terms. Blanket liberalization of the market without any consideration of the stage of development of the industries concerned may have disastrous consequences for their continued existence. In Bangladesh, the process of import liberalization started primarily at the insistence of the donor agencies (World Bank/IMF), whose ideology runs in terms of submission to the rules of the market and a liberal trade regime for accelerating the process of growth. Historically, however, the industrialization experience of many countries comprehensively contradicts the World Bank/IMF thesis that openness of the economy is essential for economic growth. The East Asian countries like Japan, Korea and Taiwan intervened vigorously in their economies offering wide ranging protection to their import substitution industries. Strict import control remains in vogue even in many developed countries today. Our policy makers should draw lessons from such experiences in formulating Bangladesh's trade and development polices.

4(iii). Notice that import duty on cotton yarn in all neighbouring countries is much higher than in Bangladesh (see table VI.6, Chapter VI). Most relevant for purpose of comparison is India where, despite a well developed textile sector,

total import duty on yarn including countervailing duties is currently 34.30 per cent. Examples of trade restrictive measures like anti-dumping duties are rampant in the developed countries as well. Bangladesh is also within its rights to safeguard its nascent industrial sector from unreasonable external competition which causes or threatens to cause injury to its industries. Bangladesh is, however, deeply committed to accelerating the process of trade liberalization, and since tariff on cotton yarn has remained at a low level of 7.5 per cent for the past three years, we do not recommend any upward revision of the import duty, for that might be misunderstood by our trading partners as a reversal of policy. Instead, we recommend that a compensatory duty of 11 per cent be imposed along with the prevailing 7.5 percent import duty and 15 percent VAT (23.6% overall) so that the total of all such duties is raised to about the same level of import and countervailing duties (34.3 per cent) prevailing in India. Bangladesh is entitled to take such action and it will not contravene the WTO rules. It is desirable that the proposed compensatory duty is kept in force for a period of atleast 5 years within which time the industry can be expected to overcome its existing disabilities and become internationally competitive.

4(iv). It is suggested in certain quarters that any increase in the rate of import duties on yarn will hurt domestic fabric producers, because higher import duties may increase the cost of yarn and impede the ability of weaving mills to expand production and meet the fabric demand of the local market as well as of export oriented RMG industry. This contention is not, however, borne out by historical evidence. A strongly held view of the industry circle is that reductions in import duties on yarn in the past were not accompanied by corresponding declines in their prices, resulting in a lower relative increase in the benefits to the user

mills. The benefits of reduced duty were pocketed mainly by the middle men and traders. There is therefore little guarantee that a reduction of import duty on yarn will benefit the general weaver.

4(v). Observations made in the foregoing paragraph strengthen the argument for increasing the level of assistance to the spinning industry. Notice that the weaving sub-sector has historically been receiving a very high degree of protection in the form of tariffs and quantitative restrictions(QR), but its efficiency in terms of quality, costs, and capacity utilization has consistently deteriorated. As is evident from the Bangladesh Tariff Commission Study on Weaving referred to in this report, improvement in the efficiency of the weaving sub-sector will call for greater efforts on structural and technological improvements, rather than perpetual and continuously increasing trade policy support to this sub-sector.

5. Smuggling of yarn from India is widespread. The cost of smuggling from India, is believed to be within the range of 10 - 15 per cent. It implies that as long as the protective duty is higher than 15 per cent, smuggling of yarn will remain cheaper than legal imports. Stricter law enforcement and vigilance at the borders may keep the incidence of smuggling to a minimum.

6(i). The export oriented garments industry(Hosiery) imports yarn from India on duty free basis for export of knitted garments. It is alleged that a significant quantity of this duty-free yarn finds its way into the open market through leakage from bonded warehouses. This illegal practice hurts the sale of locally produced yarn in the domestic market, because the yarn imported under back-to-

back L/C is sold at a much lower price in the local market than the locally produced yarn(see table VI.8, Chapter VI).

6(ii). Note that the cost of imported yarn under back-to-back L/C is US$ 3.37/kg (see table VII.1). These yarns are therefore very attractive to knitting/hosiery/weaving mills who produce for the local market and who otherwise would have been required to procure locally produced yarn at US$ 4.13/kg or import yarn at US$ 4.11/kg after paying 7.5 per cent CD and 15 per cent VAT. The hosiery units can thus obtain(illegally) the yarn at a 22 per cent cheaper price than if they were required to procure it from normal sources(see table VII.1, cols. 2 and 5). These illegal yarns are also attractive to the export oriented knitting industries who can ask for 25 per cent cash subsidy. This enables them to obtain yarn at a 24.5 per cent lower price than if they were required to procure yarn from the local source (see cols. 2 and 4, table VII.1). For preventing the possibilities of illegal leakages, therefore, tight monitoring of Special Bonded Warehouse (SBW) facilities will be needed.

7. The knitting industries are allowed to import excess yarn in the name of wastage allowance which raises the extent of the leakage from bonded warehouses. Currently, knitting industries are allowed to import yarn with 26.33 per cent wastage which is far above the required quantity. Such a high wastage allowance enables these firms to off-load the surplus yarn into the local market. BTMA argues that the rate of wastage fixed by the Government is very high and cannot be justified because of constant improvement of technology. In fact, the knitting industry would not be able to compete in the international market with such a high wastage. BTMA recommended for allowing a total wastage of 8 per cent in different stages of knitting, that is, wastage before and during knitting:

2.0 per cent; wastage during dyeing and processing: 3.5 per cent; and wastage in cutting and sewing 2.5 per cent.[35] Moreover, it is alleged that many companies who perform only one stage or two stages in knitting, or knitting and dyeing, are taking advantage of the 26.33 per cent wastage and importing huge quantities of duty free yarn and illegally dumping the surplus in the local market. Therefore, it is suggested that a Committee be formed immediately to determine the maximum wastage that can be allowed to the knitting industry. For mills doing a part of the conversion, the wastage level should be limited to their respective figures as allowed.

8(i). 'Three Stage Transformation' is required for knit garments to qualify for the GSP Facility accorded by the EU. It implies that Bangladesh exporters will have to use locally produced yarn in order to avail of the GSP facilities in exporting knitwear sweater and terry towel. Violation of the EU rules of origin by Bangladesh exporters has been taken very seriously by the EU which threatens the export of a promising item like knit RMG. The Government of Bangladesh is now lobbying to EU to provide them the GSP facility by applying the two stage transformation criterion instead of the three stage formula. This policy may at best be a short-run, temporary relief measure as it will be extremely harmful for the overall long term development of Bangladesh's textile sector. It will disintegrate the spinning sector from the dynamics of readymade garments export and slow down the investment in the spinning sector in Bangladesh. On the other hand, it will mainly benefit the yarn producers from which Bangladesh exporters import the required yarn, rather than increase value addition in the knit industry. It is worth mentioning here that the spinning

[35] BTMA Memorandum to the Government.

sector has made good progress and currently has the capacity to meet around 40 per cent of the yarn demand of the export oriented readymade garments industry. It is therefore suggested that Bangladesh stick to Three Stage Transformation criterion that should be important for the long term development of the country's spinning industry.

8(ii). In the wake of the dispute with EU over GSP facilities in the export of knit-RMG, the Government have decided to provide a 12.5 per cent cash subsidy to the knit-RMG industry until such time as the demand for two stage transformation is accepted by EU. There may be some justification to this Governmental support as it may help the knit-RMG industry to find markets in non-EU countries. But it goes without saying that while taking such a policy measure the Government have apparently failed to get into the essence of the problem.

8(iii). The basic attraction of EUGSP scheme, as described in chapter VI, is its contribution to promote backward linkage. In order to be able to benefit from this scheme, the pragmatic policy option would be to promote the domestic production of yarn. This is more so because if EU does not consider Bangladesh's request for two-stage conversion to qualify for the GSP scheme, it would imply that Bangladesh will not be able to get such facilities until and unless locally produced yarns are used in the knit sector. On the other hand, even if EU does accept the two-stage conversion criterion as asked for, it will not be to Bangladesh's long term interest, because it will almost inevitably obstruct the growth of the spinning sub-sector and thus hurt the prospect of increasing value addition in the textile industry. Thus the dispute over EUGSP actually

strengthens the justification for extending all necessary support to the spinning sub-sector as recommended in paragraph 2(i) above. It is to be noted that the promotion of spinning activity would ensure Bangladesh's right to claim GSP, which in turn will give the country's knit producers a competitive edge over other countries, particularly after 2005 when tariff will be the only important barrier to textile export. This process will also enrich the value added content of our knit export.

9. Prior to the announcement of the FY 98 budget, textile machinery was imported duty free. The FY 98 budget has proposed an import duty of 2.5 per cent on textile machinery, and retains the pre-existing 30 per cent import duty with 15 per cent VAT on all spare parts. To make the spinning mills efficient and competitive, all such duties and taxes should be withdrawn. It is worth mentioning in this connection that most textile mills currently in operation are 20/30 years old, and these need immediate BMR for raising production and quality of the products. For BMR purposes, Card Conversion Machines and Ring Frame Drafting Zone Machines are indispensable. However, for duty purposes these machines are treated as spare parts which attract 30 per cent customs duty and 15 per cent VAT, even though prior to 1990 these were considered as capital machinery and could be imported at concessional rates of duty. All the same, for purpose of facilitating BMR of the spinning mills it is desirable that the required machines and spares are all made importable at zero rate of duty and taxes.

10. Power is an essential input in textile production. Most mills do not have their own generator and hence depend on electricity supply by the PDB. These mills have a high loss of production through power failures. Given the existing

generation capacity of Bangladesh, the problem of power shortage will remain for atleast next 3-4 years. An immediate solution may be found in encouraging the spinning mills, through adequate incentives, to set up their own generators. The required incentives are the provisions of duty free import of generators, interest free and easily accessible loans to set up generators, and supply of gas at the same rate as is allowed to PDB for power generation. Most of the mills that have their own gas based power generators, suffer from low gas pressure which makes the generator inoperative. To remedy this problem, one solution may be to provide express gas lines to places where group of textile mills are located or, alternatively, incorporating booster pumps in the existing gas lines. A long term solution, however, lies in expanding generation capacity of the country as a whole, through private sector participation, including foreign private investment in the energy sector.

11. Man-made fibre is one of the basic raw materials in the production of yarn. Import duty on man-made fibre(MMF) increases the production cost of yarn. Recognizing its importance, the Government have recently brought down the import duty on MMF to 2.5 per cent from the previous 7.5 per cent. Man-made fibre should however be treated as complementary to raw cotton in yarn production and hence the import duty thereon should also be brought down to zero.

12. Unit labour cost in Bangladesh's spinning is much higher than in all other comparator countries, including Japan where hourly wage rate is the highest. Low labour productivity is the main reason which nullifies the advantage of low wage cost in Bangladesh. Faster depreciation of Indian and Pakistani currencies in

relation to Bangladesh Taka over the past years is also an important factor behind the differences in unit labour cost between Bangladesh and other countries. The lesson for Bangladesh is that in order to remain internationally competitive, labour productivity should be enhanced through development of skill and introduction of modern machinery and technology. Wages should be linked to productivity, and the exchange rate should be properly managed and allowed to move in line with that of the major competing countries.

13. The BTMA has long been complaining about the provision of paying advance income taxes at the time of importing raw materials and spares. This provision greatly inconveniences the textile mills as most of these are plagued with acute paucity of working capital. Moreover, payment of taxes with each and every transaction creates administrative problems for the mills. The provision is also unnecessary because income taxes can be conveniently assessed annually. In the interest of smooth functioning of textile mills and to facilitate unhindered availability of inputs, they should be exempted from payment of advance income taxes.

Chapter VIII

Devising An Institutional Support Mechanism

The Need for an Institutional Support Mechanism

The overwhelming importance of the textiles sector in the Bangladesh economy in terms of employment generation as well as foreign exchange earnings is now generally recognized. Moreover, the sector is expected to play a catalytic role in the country's industrialization process. The Bangladesh Textiles Policy 1995 recognizes this and has also declared it as a thrust sector. Yet, the biggest sub-sector in the industry viz., cotton spinning is currently beset with multifarious problems, what with faulty government policies and partly due to an element of unfairness in competition it faces from some neighbouring countries.

It is urgent, therefore, that some remedial actions are taken for the harmonious development of the industry and its sustained growth. This is crucial in order to achieve the targets set by the Government for 2005 to competitively meet the post-MFA challenges. This report has endeavoured to come out with some concrete policy suggestions towards that end. The recommendations are all based on identified problems and also draw on the wisdom of other country experiences. Such an exercise is of course vital to drive home the rationale of our arguments. However, this is relatively the easier part of the task. The more difficult phase - which is also the really effective one - relates to the implementation stage. It requires as much a strong political will for inter- and intra-sectoral conflict resolution as an appropriate institutional mechanism to successfully put the remedial actions in practice. Such an institutional mechanism

can be viewed in the context of different time frames and can belong to both the private sector and the public authorities.

Private Sector Institutions

In the short-run, in order to motivate the political leaders and the bureaucracy, it is the private sector institutions which need immediate strengthening in terms of their capacity for research, advocacy, and lobbying. The findings of this report should be immediately publicized in different relevant fora. Steps may be taken to publish the full report. However, to begin with, press briefings may be arranged by the Bangladesh Textiles Mills Association (BTMA) so that the general public as well as the policy makers can be made aware of the legitimate demands of the industry. BTMA should also take up its case with the various chambers, including the FBCCI, in order that they can also exert influence on the Government to promote cotton spinning and safeguard its interests by timely implementation of the recommendations. Seminars and conferences should be organized to have free exchange of ideas with participation from business/industry, the relevant public officials, and researchers and academics. At the same time, BTMA should engage in strong lobbying to convince the policy makers in the various Ministries about the urgency of protecting and promoting the interests of the spinning industry. If necessary, professional lobbyists can also be hired for the purpose.

However, to carry out these tasks effectively, BTMA itself needs to strengthen its position which may be possible over a medium-term period. Studies have shown that most business/industrial chambers/ Associations in Bangladesh currently suffer from organizational problems and weak financial base. Moreover, in spite of their legally autonomous status, the Government retains significant

power to take over their administration if it is deemed necessary on grounds of restoring discipline. Therefore, in order to turn these bodies strong and more vibrant, the Government itself has a role to play as also technical assistance from donors. But the main initiative must come from the private sector itself by taking a drive to increase membership and introducing other internal reforms. The Chambers/Associations should then be increasingly vocal and assertive to get their viewpoints effectively reflected in Government's policy decisions. This should also be welcome by the Government as it fits the presently accepted coalitional development strategy in which the public and private sectors interact with each other to generate synergies for growth.

Government Institutions

As the private sector becomes more dynamic, the government institutions should also be more pro-active. And this has to be a continuous process covering all time frames. While existing institutions need to be revamped, there is no reason why the Government should shy away from building new institutions if the exigencies of the circumstances so demand.

To start with, all out efforts should be made to improve the capability of the governmental machinery responsible for formulating and implementing industry-related policy. At the moment, the policy making apparatus in Government is highly fragmented. There are a number of government ministries, divisions, and autonomous bodies under different ministries that are directly or indirectly involved in the preparation and implementation of policies pertaining to the textile sector.[36] For purpose of ready reference, the core functions and

[36] These are the Ministries of Commerce, Industries, Textiles, and Finance; organizations and constitutional bodies attached to various Ministries,

responsibilities of these governmental bodies are briefly described in the following.

(A) The Ministry of Commerce (MOC) is responsible for formulation and review of export and import policies and deals with all matters relating to tariff setting, tariff valuation, general and international agreements on tariff, and relationships with international organizations like WTO, UNCTAD, and ITC, and major regional trading blocs.

(B) The Ministry of Industries is responsible for administration of industrial policy, formulation of import policy relating to industry, and consideration of tariff as a measure of safeguard to local industry.

(C) The Ministry of Textiles prepares industrial policy for the development of textile industries, advises the Government for protection of local industries through imposition of duties and taxes, collects and compiles market reports on both local and foreign textile products, and recommends remedial measures as and when required.

(D) The National Board of Revenue (NBR) under the Internal Resources Division of the Ministry of Finance deals with matters relating to all taxes, duties, fees etc. (other than land revenue) and the administration of all Excise, Customs, and Taxation Services.

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such as the Tariff Commission, the Export Promotion Bureau, and the Office of the Chief Controller of Imports and Exports under the Ministry of Commerce; and National Board of Revenue, the Collectorate of Customs and Excise, and the Directorate of Customs Intelligence and Investigation under the Internal Resources Division of the Ministry of Finance.

(E) The Chief Controller of Imports and Exports (under the Ministry of Commerce) is responsible for the preparation and formulation of import policy and its implications, and also coordinates the activities with customs authorities and the Ministry of Industries.

(F) The Collectorate of Customs (under NBR, IRD, Ministry of Finance) administers, among others, the Customs Act 1969, the Excise and Salt Act 1944, the Import and Export Control Act 1950, and the Foreign Exchange Regulation Act 1947, and is also responsible for prevention of smuggling.

(G) The Directorate of Customs Intelligence and Investigation (under NBR, IRD, Ministry of Finance) collects and disseminates information on smuggling and links up with the Departments of C.I.D., S.B., N.S.I., B.D.R., and other Border forces for the exchange of information.

(H) The Export Promotion Bureau (under Ministry of Commerce) formulates an integrated export development strategy, makes continuous review and advice on the adequacies of policies in light of changing international market conditions and acts as a Secretariat of the Government in formulating export policy of the country.

Shortcomings of Governmental Institutions

There is a lack of proper coordination among the various governmental entities and, as is apparent from the foregoing paragraphs, it results in duplication of work and waste of time and resources. Policies and practices of different organizations are often found to work at cross purposes. Because of the

fragmentation of responsibilities and duplication of tasks, local industries that require immediate solution of their problems fail to have their grievances properly heard and obtain speedy resolution of their problems.

The different institutions and organs of the government lack expertise to deal with the problems of industrial enterprises. They are run by bureaucrats who are either not adequately informed about and conversant with trade and industry related problems or do not have the commitment or motivation since, in the bureaucratic tradition, their assignments are purely temporary and they hold a particular office for a very short length of time. Their services being frequently transferable, the accumulated experience of an official in a particular assignment cannot be used to any advantage by the organization concerned.

These institutions have to depend very greatly on the studies undertaken by the donor agencies for policy making purposes. This is essentially because they do not have the necessary expertise to deal with the problems of the industries, a consequence of which is that they increasingly rely on donor agencies for policy guidance that is bound to be in line with donors policies.

All this calls for bringing in improvements in the Government's administrative machinery. Enhancement of institutional capabilities and skill of the personnel will reduce excessive dependence on donor sponsored researches and studies for identifying and finding solutions of problems of the economy and its various sectors. The influence of donors in matters of formulating domestic policies will thus be correspondingly reduced.

Bangladesh Tariff Commission (BTC)

Most relevant, and also most important, for purpose of trade and industrial assistance policies pertaining to the country's textile sector is the Bangladesh

Tariff Commission (BTC), a constitutional body attached to the Ministry of Commerce. It has a wide range of statutory duties and functions, but the important ones are summarized below.

The BTC carries out enquiries under sections 2 and 3 of the Protective Duties Act 1950, and considers and recommends what protective tariffs or other forms of assistance are necessary for the protection of an industry.

It investigates into allegations of dumping and other methods adopted in the import and sale of foreign goods in so far as they affect the interest of domestic industry.

It also investigates into the export potential of industries applying for protection and recommends measures which would, along with affording protection into the home market, improve the export prospects of such industries.

It examines the rates of import duty as between raw materials and finished goods with a view to recommending adjustments in rates so as to improve the competitive position of domestic industry.

It also investigates into the administration of customs, tariff, and excise duties with a view to determining their effects on domestic industries.

As is well known, however, currently the Bangladesh Tariff Commission which deals with issues relating to industrial assistance is seriously handicapped by tradition, status, and lack of adequate expertise. It has an "image" problem as it is treated only as an appendage of the Commerce Ministry for all practical purposes. From the legal point of view, too, its recommendations are not mandatory. Although some attempts were made in the past to strengthen the Commission, apparently they did not yield the desired results in terms of long-term institutional growth.

However, under the circumstances and in the immediate context, the spinning industry has little option but to explore all possible avenues including the Tariff Commission to get the recommendations implemented. Over the medium- and long-run though either the Tariff Commission will have to be remodelled and recast with additional legal authority or an alternative Commission should be set up to exclusively deal with trade matters with adequate powers to settle issues on its own.

Formation of a National Trade Commission

For purpose of convenience, however, and also in order to take advantage of the institution that already exists, we recommend that the Bangladesh Tariff Commission be revamped and renamed as National Trade Commission (NTC). It shall be a high-powered body, and its recommendations regarding industry related problems and policies will be mandatory. In order to ensure its independence, free of any untoward influence in policy making matters, its Chairman and the members shall be appointed for a reasonably longer tenure of office, say six to nine years. They will be experts in wide areas of trade and industry with strong academic and professional background, and competent to carry out in-depth study and analysis of problems of local industries. They should be able to assess the implications for domestic industry of internal policies, policy changes in major trading partners, bilateral, sub-regional, regional and multilateral tariff agreements, as well as changes in international trading environment as reflected in decisions adopted in WTO, UNCTAD, etc., and developments in major trading blocs like EU, NAFTA, and the ASEAN.

The NTC will be expected to perform the following functions:

1) It will be required to engage in extensive research, conduct specialized studies, and maintain a high degree of expertise in all matters relating to Bangladesh's international trade policies.

2) It will defend local industry against injurious and unfair trade practices of other countries in a manner consistent with Bangladesh's international trade obligations under the WTO rules.

3) It will conduct investigation upon petition on behalf of an industry, a firm or a business association, business chamber, or other entity representative of an industry to determine whether an article is being imported in such increased quantities as to be a substantial cause of serious injury or threat thereof to the domestic industry producing a like article which is directly competitive with the imported product. If the NTC's finding is affirmative, it would recommend such action (e.g., imposition of anti-dumping or countervailing duty) as would address such injury and effectively facilitate positive adjustment by the industry to import competition.

4) The NTC will conduct investigations to determine whether there is reasonable indication of material injury to, threat of material injury to, or material retardation of an industry in Bangladesh by reason of imports of foreign merchandise allegedly being subsidized or sold at less than fair value. If the NTC's finding is affirmative, it will recommend remedial action within the purview of the country's international trade obligations.

5) It will conduct investigations to determine whether, as a result of the reduction or elimination of a duty provided under bilateral and regional trade agreements (e.g., SAPTA), import of an article increases to such quantity that it causes serious injury to the domestic industry producing an article that is like or directly competitive with the imported article.

6) It will investigate into any disadvantageous position of an industry due to domestic or external policies upon complaints from the industry, or independently of any complaints.

7) It will have the obligation on a continuing basis to assess implications of all international treaties and agreements pertaining to trade for the growth and development of Bangladesh's trade and industry.

8) It will provide intellectual support to the Government by enhancing its negotiating skill and capability in meetings of international organizations like WTO and UNCTAD, and in conducting tariff negotiations with regional arrangements like SAARC and other sub-regional forums within and outside SAARC.

9) The NTC will gather detailed information about all industry related problems, which may be structural in nature, or due to faulty domestic policies or unfair external policies, and take remdial actions irrespective of whether complaints have been lodged by an industry or not.

10) It will gather and make available to concerned government agencies all information about policies of Bangladesh's major trading partner countries, major economic powers, international organizations like WTO, UNCTAD and ITC, and various regional trading blocs like EU, NAFTA, ASEAN, etc.

11) The NTC will be the focal point concerning the country's trade and industrial policies and facilitate coordination of different Ministries, Divisions and Agencies, and ensure that the policies undertaken by various Governmental bodies do not work at cross purposes.

12) In short, the National Trade Commission will be responsible for constantly monitoring the problems of the country's industrial sector, formulate policies and programmes to enable local industry to acquire efficiency and competitiveness, recommend measures to give relief to local industries affected by cheap imports, and provide intellectual support to the Government to enhance its capability to effectively negotiate on trade matters with bilateral trade partners and in regional and international forums.

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