

Comments on the paper titled “Foreign Ownership and Firm Productivity in Bangladesh Garment Sector” presented by Ms. Hiau Looi Kee at a Seminar on “FDI and Productivity in the Garment Industry” organized jointly by the World Bank, DFID and CIDA in the Conference of the World Bank Office Dhaka on August 22, 2005.

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The Chief Guest Mr. Mahmudur Rahman, the excellencies, the Key note speaker Ms Kee, my co-discussant Dr. Musa, distinguished participants and guests.

Assalamu Alaikum and good morning

I would like to begin by thanking the organizers of this Seminar, particularly Dr. Zaidi Sattar for giving me this opportunity to comment on the paper presented by a distinguished researcher of Development Research Group of the World Bank. Because I have developed a personal academic interest in RMG industry, I consider it a great privilege and honour for me.

I want to congratulate Ms. Kee for presenting a highly informative and academically valuable paper based on empirical research. The research model she has used is not new. As the author has rightly said, “Conventional wisdoms have it that firm with foreign equity tend to be more productive. This could be due to the firm specific tangible assets such as exclusive technology and product designs or the intangible know-how embodied in foreign equity such as marketing, networking and sourcing. ...” If an MNC from a developed country makes direct investment in a developing country and operates a firm that is owned 100% by itself, it is likely to be more productive than domestic forms.

Many researches have proved this. The productivity advantage of FDI is an established fact. The positive spillover effect of FDI through technology transfer, including management technology is widely recognized. The same should be true of garment industry of Bangladesh. In fact the rapid development of RMG industry in Bangladesh in the early 1980s was to a great extent caused by two joint-ventures with South Korean firms. For example, (1) the joint-ventures between Dosh Garments and Daewoo Corporation of South Korea and (2) the then Treximp Ltd (the predecessor of currently operating Stylecraft- a Bangladeshi RMG firm) and Youngones Corporation of South Korea proved the validity of this thesis. The second of these two cases was the first joint-venture with foreign equity. (For further detail, see *The Readymade Garment Industry of Bangladesh* authored by Hafiz G.A. Siddiqi, UPL, 2004). In both cases marketing and production technology were provided by the foreign MNCs.

The author herself quotes a number of studies in the non-garment sector. She has applied the set of well-recognized methodologies to test the validity of the “Conventional wisdom” using data of Bangladesh garment industry. Her findings simply corroborate the earlier research findings undertaken in other countries in non-garment sector. Very few people will contest the general hypothesis she has tested. This is good contribution. She deserves congratulation.

In the post-MFA era, Bangladesh is facing new challenges including tougher competition. To remain competitive in the global market, Bangladesh is already active in using new ways and means of increasing productivity of the RMG industry. Bangladesh is already pursuing a very generous and open policy to attract FDI. However, among other strategies

it must implement the strategy of improving its productive efficiency to retain its highly visible position as exporter in the global apparel markets. In this context, the findings about the productivity advantage and spillover of FDI firms presented by Ms. Kee undoubtedly provide some useful insights. It should be acceptable to the policy makers of Bangladesh.

A discerning reader will feel disappointed when s/he finds that the author has chosen not to deal with other major components of the supply chain without which full advantage of the increased productivity due to the presence of FDI cannot be taken. For example, increased productivity may not automatically lead to increased export at profitable prices if there is restricted market access. The author does not attempt to analyze the relationship between the FDI firms and market access or the role of FDI firms in market diversification. To conclude that more efficient FDI firms export to a larger number of markets does not necessarily mean that the FDI firms meet the requirement of having access to new markets.

As I go through the paper, I feel tempted to make some observations on both (1) “technical aspects and (2) implied Policy implications.

(1) Technical Aspects:

I am unable to find a clear cut definition the total factor productivity (TFP) except as it is “the level of output not explained by the level of inputs”. It is true that “output” has been mentioned as the measure of productivity, but to me it is inadequate. The author concludes, “the firms with foreign capital are the most productive of all firms” ... and “knitwear firms are most productive. An average knitwear firm has 10% higher productivity than a woven firm and 17% more productive than a

sweater firm”. (See Para just above Figure10). In the absence of a comprehensive definition or an unambiguous example of “productivity” or TFP, the reader has to struggle hard to see what she really means. There is a scope for more than one interpretation. Which one is relevant for us? Is it in terms of volume of knitwear output/ sweater / woven wear of some specific category? Or is it the FOB value of export volume or export earning? Or cost / price per unit of export? Or a combination of them that are used to determine the TFP? At least I need some more clarification.

The conclusion that the FDI firms “produce more output given the same level of inputs, and thus a higher level of total factor productivity (TFP) than the solely domestic firms” has to be qualified. It may be true that in case of large established MNCs i.e. 100% large FDI firms. But the joint-venture between a domestic firm and a relatively small and less known foreign firm having relatively weak marketing and sourcing network, the conclusion may be different. A large 100% domestically owned firm having large marketing network and good image among the large buyers like Wal-Mart, JCPenny, etc. may have equally high total factor productivity. It is not clear if the author studied the production function of a cluster of firms that fall in this category.

From the study presented, it is not clear if the cost of production, a determinant of TFP is consistently lower in case of FDI-JV firms.

The validity of this conclusion may vary with the stage of development. If a separate sample of Bangladeshi large firms (100% domestically owned) that have acquired high level of direct marketing skills and can operate without the help of buying houses, and have developed very

sustaining business relations with large retailers of USA and EU are studied, one may get a different result.

The conclusion that “FDI firms are more productive than otherwise identical domestic firms operating in Bangladesh” seems to be illusive. There are hardly any 100% domestic firms that are identical to FDI firm. I have gone through the list of the firms published in the BGMEA membership Directory, and identified the firms employing 1000 or more workers (that I call large firms). The number came to be around 128 including FDI firms. There are not even 10 firms that one can call identical. They do not have **identical** capacity, employing the same number of workers, using the same number of machines, producing the same product categories, etc. It is not clear to me what the author means by “identical”.

There are two conclusions that seem to be contradictory: These are:

(1) “On average, FDI firms are larger, they hire **more workers given the same number of machine**”... and...(2) FDI firms are more capital intensive, **they use less workers per machine** given the same number of plant capacity”.(p-4) What is the definition of plant capacity—is it the number of machine, or number of workers, volume of production?

Incidentally, I have studied 128 large firms both domestic and FDI firms including Youngone and KDS that employ 1000 or more workers. The range of employment –number of workers per machine-- in case of domestic firms spreads approximately between 1.5 – 3.3 whereas that range for FDI firms spreads between 1.2 –2.2. This contradicts the conclusion # 01 above. I will be happy if I am wrong.

(2) Policy Implications

Unfortunately, the author does not elaborate the policy options that her study has generated for Bangladesh. She has only reemphasized what we already know, namely, the benefits of encouraging FDI firms as I have discussed at the beginning. The author concludes that low level of FDI in the garment sector (only 15% of the Bangladeshi garment firms have foreign equity) is partly due to unfriendly government policy or the present investment Act that adversely affects RMG sector. This conclusion can be contested. Any how my strong recommendation will be that the policy be made to create more FDI friendly environment in the management of RMG sector. But to maximize the benefits of FDI, certain conditions as implied in the study need to be applied. If “the number of markets a firm supplies reflects the productivity and competitiveness of the firm in the world market” (p-10, below Figure 5) then special condition for **MARKET DIVERSIFICATION** and perhaps **PRODUCT DIVERSIFICATION** should be imposed. The FDI firms may be provided special incentives if they agree to access new and large markets. For example, the FDI firms having a good promise to have access to such markets as India, Japan and China should be encouraged with special incentives to invest in Bangladesh. Given the uncertainty in the US market, in spite of some encouraging turnaround (see the Annexure-1 attached to this note), Bangladesh desperately needs market diversification. Selective FDI firms may be helpful in this context.

I can think of two other implications for the policy makers.

- a) One policy may be to encourage **Capacity Building** through spillover effects. “On average, garment firms are 3% more productive in 2003 than in 1999. The improvement is especially clear for the sample of domestic firms. .. Such an increase in productivity within a firm suggests that there are exogenous factors pushing firms to be more productive over time”. The author interprets this as a spillover effect of FDI firms. If the spillover theory is right, then it has a clear-cut policy implication. For domestic capacity building, more FDI may be encouraged in the RMG sector. The Foreign FDI firms must try to transfer effectively all kinds of technologies, namely, production, designing, marketing, sourcing and image-building. Otherwise, encouraging FDI will only produce much larger benefits for the foreign MNCs. This will keep the local firms permanently dependent on the FDI firms.
- b) Looking at Figure 2, it seems that Bangladesh (2.8%) is losing ground in the US market to China (16%), Mexico (10%) and even to Vietnam (3.7%) which was a much smaller supplier than Bangladesh until 2000. What are explanatory variables? Recently, FDI in Vietnam has shot up. In spite of the fact that many large garment factories are still owned and managed by the State, its RMG export to US has increased substantially. Is it due to the FDI firms? Bangladesh can gain new insights by analyzing the causes of success of Vietnam.

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ANNEXURE--1

RMG Export of Bangladesh

Knitwear

			(In Million US\$)
Period	Total Export	Export to USA	Export to EU
July 04	279.98	Not Available	Not Available
Aug 04	274.22	Not Available	Not Available
Sep 04	224.95	Not Available	Not Available
Oct 04	198.30	Not Available	Not Available
Nov 04	193.04	Not Available	Not Available
Dec 04	232.14	Not Available	Not Available
Jan 05	221.74	33.90	172.97
Feb 05	196.06	29.51	151.60
Mar 05	231.41	29.78	185.60
April 05	215.08	29.37	173.97
May 05	272.33	35.49	218.26
June 05	283.75		
Total	2823.00	158.05	902.4

Woven Garments

			(In Million US\$)
Period	Total Export	Export to USA	Export to EU
July 04	401.96	Not Available	Not Available
Aug 04	370.17	Not Available	Not Available
Sep 04	280.24	Not Available	Not Available
Oct 04	231.49	Not Available	Not Available
			Not Available
Nov 04	232.02	Not Available	Not Available
Dec 04	308.09	Not Available	Not Available
Jan 05	296.07	141.76	136.93
Feb 05	292.92	131.76	137.61
Mar 05	264.55	115.86	128.13
April 05	236.57	125.75	99.20
May 05	313.24	155.36	136.33
June 05	378.60		
Total	3605.92	670.49	638.2

Source: BKMEA August 2005