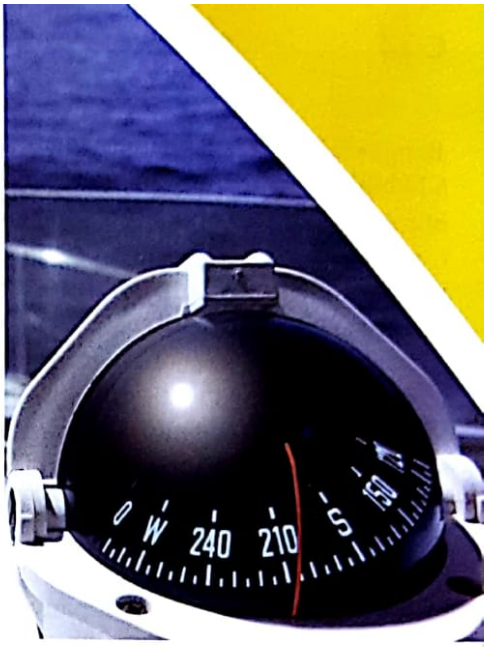
CASE 9

DISASTER IN BANGLADESH



On the morning of Wednesday April 24, 2013, an eight-story industrial and commercial building in Bangladesh collapsed, killing over 1,100 people, most of them workers in one of the five garment factories that occupied six floors of the building. This was not the first high-profile accident in the Bangladesh garment industry. The prior November, a factory fire had killed 112 garment workers. Just days after the building collapse, a fire in another garment factory killed eight people. The spate of accidents led to calls for Western clothing retailers to do more to improve working conditions and safety in Bangladesh and other poor nations from which they source production. Some interest groups went further, arguing that Western companies should refuse to source production from countries where working conditions were so bad. One prominent Western company, Walt Disney, had already made this decision. In March 2013, Disney removed Bangladesh from the list of countries where it authorized partners to produce clothing and other merchandise. Politicians in Bangladesh responded to the Disney announcement with dismay. They argued that the economy of Bangladesh was very dependent upon the garment industry, and that "the whole nation should not be made to suffer" because of these accidents.

THE GARMENT INDUSTRY IN BANGLADESH

Bangladesh, one of the world's poorest countries, has long depended heavily upon exports of textile products to generate income, employment, and economic growth. Most of these exports are low-cost, finished garments sold to a wide range of retailers in the West such as Wal-Mart, The Gap, H&M, and Zara. For decades, Bangladesh was able to take advantage of a quota system for textile exports that gave it, and other poor countries, preferential access to rich markets such as the United States and the European Union. On January 1, 2005, that system was scrapped in favor of one based on free-trade principles. From 2005 on, exporters in Bangladesh would have to compete for business against producers from other nations such as China and Indonesia. Many analysts foresaw the quick collapse of Bangladesh's textile industry. They predicted a sharp jump in unemployment, a decline in the country's balance of payments accounts, and a negative impact on economic growth.

The collapse didn't happen. Bangladesh's exports of textiles continued to grow, even as the rest of the world plunged into an economic crisis in 2008.

Bangladesh's exports of garments rose to around \$20 billion in 2012, up from \$8.9 billion in 2006, making it the largest export industry in the country and a primary driver of economic growth. By 2012, the textile industry in Bangladesh comprised some 5,000 factories, which were the source of employment for 3 million people, 85% of whom were women with few alternative employment opportunities.

As a deep economic recession took hold in developed nations during 2008–2009, major importers such as Wal-Mart increased their purchases of low-cost garments from Bangladesh to better serve their customers, who were looking for low prices. Li & Fung, a Hong Kong company that handles sourcing and apparel manufacturing, saw its production in Bangladesh jump 25% in 2009, while production in China, its biggest supplier, slid 5%.

Bangladesh's advantage is based on a number of factors. First, labor costs are low, in part due to low hourly wage rates and in part due to investments by textile manufacturers in productivity-boosting technology during the past decade. The minimum wage rate in Bangladesh is currently \$38 a month, compared to a minimum wage in China of \$138 a month. Wage rates in the textile industry are about \$50 to \$60 a month, less than a fifth of the going rate in China. Textile workers may have to work 12-hour shifts and can work 7 days a week during busy periods. While the pay rate is dismally low by Western standards, in a country where the gross national income per capita is only \$850 a year the pay is better than that available in many other unskilled and low-skilled occupations.

Second, there are few regulations in Bangladesh, and as one foreign buyer says, "there are no rules whatsoever that cannot be bent." The lack of effective regulations keeps costs down. Another advantage for Bangladesh is that it has an established network of supporting industries that supply inputs to its garment manufacturers. Some three-quarters of all inputs are made locally. This saves garment manufacturers transport and storage costs, import duties, and the long lead times that come with the imported woven fabrics used to make shirts and trousers.

Bangladesh also has the advantage of being an alternative to China. Many importers in the West have grown cautious about becoming too dependent upon China for imports of specific goods, fearing that if there was a disruption, economic or otherwise, their supply chains would be decimated unless they had an alternative source of supply. Thus, Bangladesh has benefited from the trend by Western importers to diversify their supply sources. Although China remains the world's largest exporter of garments, Bangladesh is now second. Moreover, Chinese wages are now rising fast, suggesting that the trend to shift textile production away from China may continue.

Bangladesh, however, does have disadvantages; most notable are constant disruptions in electricity because the government has underinvested in power generation and distribution infrastructure. Roads and ports are also inferior to those found in China.

The demand for garments from low-cost sources such as Bangladesh has been driven by intense competition among Western clothing retailers. U.S. consumers, for example, have become accustomed to spending relatively little on clothing. In 2012, U.S. consumers devoted just 3% of their annual spending to clothing and footwear, compared to around 7% in 1970. One reason Americans now spend so little on clothing is that real prices have fallen significantly over the last two decades. Since 1990, clothing prices in the United States have risen by just 10% in nominal terms, compared to an 82% jump in nominal food prices during the same period. Adjusted for price inflation, clothing prices have fallen. The sluggish U.S. economy and stagnant wage growth have increased pressure on clothing retailers by capping consumers' disposable income. At the same time, the desire to shop for fashionable new outfits remains strong. The result has been strong price competition among retail apparel chains.

FACTORY COLLAPSE

The building that collapsed on April 24 was an eight-story complex, the Rana Plaza, named after its owner, Sohel Rana, a local politician and member of the ruling political party. The builders of the Rana Plaza only had approval for the construction of a five-story structure, but in Bangladesh rules can be bent, so the builders added three extra floors. Five garment factories occupied six floors in the building. At the time of the collapse, it is estimated that they were making clothes for some 30 Western apparel brands.

In retrospect, the building collapse should not have been a total surprise. Parts of the complex had been built on a pond filled with sand, making for an unstable foundation. The entire building vibrated whenever its diesel generator was working. The day before the collapse, visible cracks had appeared in the building, promoting some workers to run out. Both the local police and the Bangladesh Garment Manufacturers and Exporters Association warned Sohel Rana that the building was unsafe. Rana disagreed, and the complex stayed open for business. Two inspectors were in the building when it collapsed. Both died. Some survivors stated that their employees had pressured them to turn up for work as usual on Wednesday, the day of the incident. After the collapse Sohel Rana fled. He was arrested four days later on the border with India and charged with criminal negligence.

The death toll from the factory collapse was initially pegged at 250, but over the following days and weeks it kept increasing. By mid-May it was clear that over 1,100 people had died in the collapse, making it the second-worst industrial disaster in the history of South Asia, after the infamous Bhopal disaster in 1984. The Bangladesh government stated that it would pay $250 in compensation to each family that lost a member in the building collapse.

AFTERMATH

The building collapse prompted soul searching on the part of Western retailers who sourced production from Bangladesh. Critics were quick to point out that desires to drive prices down may have contributed to the situation in Bangladesh. Factory owners might bid low to get business from Western companies. While these factories might meet the standards required by Western companies, such as they are, it is commonplace for them to outsource production to a shadow economy of subcontractors where regulations are routinely ignored and workers are paid less than the legal minimum wage. Indeed, this is how they make a profit. That being said, all of the factories operating in the Rana Plaza seem to have been among the country's 1,500 or so regular exporters.

Some Western companies had already taken steps to improve working conditions in Bangladesh prior to the collapse of the Rana Plaza building. In October 2012, The Gap announced a $22-million fire and building safety plan with its suppliers in Bangladesh, without identifying which factories it was using there or how many factories would be improved under the plan. In early April, in response to the factory fire the prior November that had killed 112, Wal-Mart pledged $1.8 million to train 2,000 Bangladesh factory managers about fire safety. Critics noted that these commitments represented a drop in the bucket. Some nongovernmental organizations estimated that it would cost some $3 billion to make the needed fire safety and building improvements to ensure that Bangladesh's 5,000 garment factories were safe.

Three weeks after the building collapse, several of the world's largest apparel companies–including the retailer H&M, Inditex, the owner of the Zara chain, and Tesco–signed a legally binding agreement designed to improve safety conditions in Bangladesh's garment factories. Under the 5-year agreement, the signatories agreed not to hire manufacturers whose factories fail to meet safety standards and committed to help pay for necessary repairs and renovations. Signatories will form a governing board to oversee safety inspections of up to 5,000 factories over 2 years, with results being made public. The governing board will include three representatives from retailers, three labor representatives, and a chairman chosen by the UN International Labor Organization. Participation will cost each company a maximum of $2.5 million over the 5-year period of the agreement.

Several major U.S. retailers, including Wal-Mart, Gap Inc., Sears, and JC Penny, did not initially sign the pact. Gap Inc. stated that it would not sign the pact because the language makes it legally binding in U.S. courts. Instead it put forward an amendment calling for retailers to be publically expelled from the group if they fail to comply with arbitration. Wal-Mart declined to comment on why it did not sign, but stated that it will continue to work with industry groups, suppliers, and the Bangladesh government "to come up with an appropriate resolution for this matter and develop broad based solutions." Wal-Mart, which has had a sourcing office in Bangladesh for at least a decade and is one of the largest garment importers from the country, has long resisted legally binding agreements. For its part, the government of

Bangladesh stated that it would raise the minimum wage for garment workers in the country and tighten building and fire regulations.

Sources: S. Banjo, "Promises in Bangladesh," *The Wall Street Journal*, May 14, 2013; K. Bradsher, "Jobs Vanish as Exports Fall in Asia," *New York Times,* January 22, 2009, p. B1; "Knitting Pretty," *The Economist,* July 18, 2008, p. 54; "The New Collapsing Building," *The Economist*, April 25, 2013; "Rags in the Ruins," *The Economist*, May 4, 2013; K. Bradsher, "Competition Means Learning to Offer More Than Just Low Wages," *New York Times,* December 14, 2004, p. C1; V. Bajaj, "As Labor Costs Rise in China, Textile Jobs Shift Elsewhere," New *York Times,* July 17, 2010, pp. 1, 3; S. Greenhouse, "Bangladesh Fears Exodus of Apparel Firms," *New York Times*, May 2, 2013; S. Greenhouse, "Major Retailers Join Bangladesh Safety Plan," *New York Times*, May 13, 2013; A. Zimmerman and N. Shah, "American Tastes Fuel Boom in Bangladesh," *Wall Street Journal*, May 13, 2013.

CASE DISCUSSION QUESTIONS

1. From an economic perspective, was the shift to a free-trade regime in the textile industry good for Bangladesh?
2. Economically who benefits when retailers in Europe and the United States source textiles from low-wage countries such as Bangladesh? Who might lose? Do the gains outweigh the losses?
3. What are the causes of the weak safety record of the Bangladesh garment industry? Do Western companies that import garments from Bangladesh bear any responsibility for what happened at the Rana Plaza and other workplace accidents?
4. Do you think the legally binding agreement signed by H&M, Zara, Tesco and others will make a difference? Does it go far enough? What else might be done?
5. What do you think about Walt Disney's decision not to purchase merchandise from Bangladesh? Is this an appropriate way of dealing with the problem?
6. What do you think of Wal-Mart's approach to this problem? Is the company doing enough? What else could it do?